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PLR-131462-16

Date:

April 07, 2017

Legend

Issuer:

Entity X:

Date 1:

Date 2:

Date 3:

Year 1:

Year 2:

Year 3:

Bonds:

PLR-131462-16

D:

E:

Project A:

Project B:

Project C:

Utilities:

Region:

Sales Agreement:

Buyer:

Contracts:

Share:

Prior Resolutions:

New Resolutions:

Dear _____ :

This responds to Issuer's request for rulings (described below) regarding its proposed issuance of the Bonds and the implications under §§ 103(b)(2)(B)(ii) of the Internal Revenue Code of 1954 (the "1954 Code"), 141(b)(6) of the Internal Revenue Code of 1986 (the "1986 Code")¹, 1.141-7(h) of the Income Tax Regulations, 148, and 1.148-9(h)(4)(v)(D).

FACTS

Generally

Issuer is authorized to acquire, construct, and operate plants, works, and other facilities for the generation and transmission of electric power. Issuer is further authorized to issue revenue notes, bonds, or warrants for these purposes. Entity X, a governmental person, blends the electric power from Project B with other electric power that Entity X has available to market and provides that power on an undifferentiated basis to meet Entity X's power sales and related obligations. Project B was synchronized to the transmission grid, all critical tests were completed, and Project B was able to operate at its rated capacity on Date 1. Construction on Project A was suspended in Year 1, and Project A was terminated in Year 3. Construction on Project C was suspended in Year 2, and Project C was terminated in Year 3.

The Bonds

Issuer first issued tax-exempt obligations under § 103(a) of the 1954 Code to finance the costs of acquiring, and constructing Project A, Project B, and Project C (the "Projects"). Issuer also has issued tax-exempt obligations subject to the 1986 Code to finance capital expenditures for Project B. In addition, Issuer has issued tax-exempt obligations under both the 1954 Code and 1986 Code to refund those new money obligations (collectively, the "Refunding Bonds"). Issuer now proposes to issue the Bonds to refund certain of its outstanding obligations and to finance capital expenditures for Project B.

¹ If no reference is made to either the 1954 Code or the 1986 Code, assume the Code cite is referencing the 1986 Code.

The Sale Agreements

D Law requires Entity X to offer to sell electric power to meet the Utilities' net requirement loads in the Region, and Entity X does so pursuant to the Sale Agreements. D Law also requires Entity X to give preference to Utilities in the sale of its available power. This means that Entity X must meet the requests of Utilities in the Region for available power from Entity X before meeting a competing request from an entity that is not a Utility for the same power. The current Sale Agreements cover the period commencing on Date 2 (or such later date when a Buyer's Sale Agreement commenced) and terminate on Date 3.

The Contracts

Prior to the commencement of construction on each Project, Issuer, and Entity X entered into separate but materially identical Contracts with certain Utilities, including Utilities with Sale Agreements. Each of the Contracts relates to a single Project; under a Contract the Utility is required to make payments with respect to the costs only of the Project to which the Contract relates. Certain Utilities have entered into Contracts for more than one Project.

Under each Contract, Issuer sold a designated Share of the related Project to a Utility. In return, the Utility agreed to pay Issuer a proportionate share of Issuer's annual net costs for operation, maintenance, repairs, renewals, and replacements of the related Project, including debt service on notes and bonds to be issued for that Project. The proportionate share of costs of the Project for which the Utility is obligated to make payments is equal to the Utility's Share of that Project.

Simultaneously with its purchase of its Share from the Issuer, the Utility assigned its Share to Entity X. In return for that assignment of Project generating capability, Entity X agreed to provide the Utility a dollar amount of credits (Credits) and/or cash payments up to the dollar amount which the Utility is required to pay Issuer for purchases of power and transmission services from Entity X. The Credits reduce the cash payments the Utilities would otherwise make to Entity X for such purchases.

Under the Contracts, it is possible that the dollar amount of Credits received, or to be received, by a Utility under its Contract(s) may be greater than the cost of the power needs of the Utility (an "Insufficiency"). The Insufficiency may be eliminated in two different ways: (1) subject to some restrictions, the assignment of all or a part of that Utility's excess Share to one or more other Utility customers of Entity X; or (2) subject to the availability of money from appropriations or otherwise for such purpose, cash payments by Entity X to the Utility. If neither option is feasible, the Utility may direct

Issuer to deliver all or a portion of the energy associated with its Share of the Project to a point of delivery specified by the Utility.

Throughout the many decades during which the Contracts have been in effect, the participating Utilities' conditional right to take energy from a Project directly from Issuer as described above has never been exercised and conditions which would have given rise to the exercise of such rights never occurred. Issuer does not expect that any Utility will ever make such a request under the Contracts and represents that the chance of any nongovernmental Utility ever taking delivery of energy from Issuer pursuant to the Utility's Contract is contingent and remote.

Financing Allocations

The Prior Resolutions were adopted prior to July 1, 1993. As required by the Contracts and the Prior Resolutions, separate series of tax-exempt obligations were issued for each of the Projects. After July 1, 1993, the Prior Resolutions were replaced by the New Resolutions, and tax-exempt Refunding Bonds were issued pursuant to each of the New Resolutions. In addition, tax-exempt new money obligations have been issued pursuant to the New Resolution for Project B. Like the Prior Resolutions, the New Resolutions require that separate series of obligations be issued for each of the Projects. As of the proposed issue date of the Bonds, obligations issued under only one of the Prior Resolutions will remain outstanding. The Bonds will not directly refund any obligations issued under a Prior Resolution.

Issuer represents that for E Law and Contract purposes, it cannot allocate the Bonds between the Projects pursuant to the methods outlined in paragraph (B) or paragraph (C) of § 1.148-9(h)(4)(v). An allocation of the proceeds of each substantially identical Bond pro rata, as provided in paragraph (A) of § 1.148-9(h)(4)(v), among each of the purposes of the issue of Bonds would require a portion of proceeds of Bonds issued for each Project to be treated as used to finance or refinance costs of one or both of the other Projects. Although Issuer could apply a pro rata cross-Project allocation method for tax purposes, but apply a Project-specific allocation method for purposes of documenting compliance with E Law and the Contracts, this would require Issuer to maintain a separate set of books resulting in additional complexity and burdens. Issuer represents that allowing it to allocate the Bonds pursuant to § 1.148-9(h)(4)(v)(D) will not result in a greater burden on the market for tax-exempt obligations than would occur using the pro rata method set forth in § 1.148-9(h)(4)(v)(A).

Rulings Requested

1. The Contracts among Issuer, Entity X, and Utilities that are nongovernmental persons do not give rise to private business use within the meaning of

§ 141(b)(6) the 1986 Code or cause proceeds of the Bonds to be treated as used in a trade or business of a nonexempt person within the meaning of § 103(b)(2)(B)(ii) of the 1954 Code.

2. Section 1.141-7(h) and corresponding principles of prior law do not require output of Project A, Project B, and Project C in amounts corresponding to a Utility's Share to be allocated to such Utility that purchases electric power from Entity X pursuant to a Sale Agreement.
3. Issuer may apply § 1.148-9(h)(4)(v)(D) to treat the Bonds, which comprise a single multipurpose issue, as separate issues of bonds: (a) for all purposes of § 148 of the 1986 Code except those purposes specified in § 1.148-9(h)(1), (b) for all purposes of § 141 of the 1986 Code except §§ 141(c)(1) and 141(d)(1) of the 1986 Code, and (c) for all purposes of § 103(b) of the 1954 Code.

LAW AND ANALYSIS

Requested Ruling 1

Prior to enactment of the Tax Reform Act of 1986, § 103(b)(2) of the 1954 Code defined the term "industrial development bond" to mean any obligation (A) which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person within the meaning of § 103(b)(3) of the 1954 Code (the "trade or business test"), and (B) the payment of the principal or interest on which (under the terms of such obligation or any underlying arrangement) is, in whole or in major part -- (i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or (ii) to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business (the "security interest test").

Subparagraph (5)(i) of § 1.103-7(b) clarifies the trade or business test and the security interest test with respect to certain output contracts, and provides that the use by one or more nonexempt persons of a major portion of the output of facilities constructed, reconstructed, or acquired with the proceeds of an issue satisfies the trade or business test and the security interest test:

[I]f such use has the effect of transferring to nonexempt persons the benefits of ownership of such facilities, and the burdens of paying the debt service on governmental obligations used directly or indirectly to finance such facilities, so as to constitute the indirect use by them of a major portion of such proceeds. Such benefits and burdens are transferred and

a major portion of the proceeds of an issue is used indirectly by the users of the subparagraph (5) output of such a facility which is owned and operated by an exempt person where --

(a) (1) . . . or (2) two or more nonexempt persons, each of which pays annually a guaranteed minimum payment exceeding 3 percent of the average annual debt service with respect to the obligations in question, agree, pursuant to contracts, to take, or to take or pay for a major portion (more than 25 percent) of the subparagraph (5) output of such a facility (whether or not conditioned upon the production of such output), and

(b) Payment made or to be made with respect to such contract or contracts by such nonexempt person or persons exceeds a major part (more than 25 percent) of the total debt service with respect to such issue of obligations.

Except as provided in § 103(b) of the 1986 Code, § 103(a) provides that gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of § 141(e)).

Section 141(a) provides that the term “private activity bond” means any bond issued as part of an issue which meets (1) the private business use test of § 141(b)(1) and the private security or payments test of § 141(b)(2), or (2) the private loan financing test of § 141(c).

Section 141(b)(1) provides that an issue generally meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(6) states:

(A) In general. For purposes of this subsection, the term “private business use” means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For purposes of the preceding sentence, use as a member of the general public shall not be taken into account.

(B) Clarification of trade or business. For purposes of the 1st sentence of subparagraph (A), any activity carried on by a person other than a natural person shall be treated as a trade or business.

If 5 percent or more of proceeds is used to finance or refinance costs of output facilities, § 141(b)(4) provides the issue may be private activity bonds if the nonqualified amount with respect to the issue, together with the nonqualified amounts with respect to

all other outstanding issues that finance or refinance the same project, exceeds \$15 million. Section 141(b)(8) defines “nonqualified amount” to be the lesser of (A) proceeds used for a private business use, or (B) proceeds in respect of which there are private payments.

Section 1.141-7 sets forth rules to determine whether arrangements for purchases of output from an output facility cause an issue of obligations to meet the private business use test. An output facility is defined by § 1.141-1(b) to include electric generation, transmission, distribution, and related facilities. Section 1.141-7(c)(1) provides that a nongovernmental person’s purchase of available output of an output facility financed with the proceeds of an issue is taken into account under the private business use test if the purchase has the effect of transferring to the nongovernmental person the benefits of owning the facility and the burdens of paying the debt service on the obligations used (directly or indirectly) to finance the facility (the “benefits and burdens test”).

Section 1.141-7(c)(2) provides that the benefits and burdens test generally is met if a nongovernmental person agrees pursuant to a take contract or a take or pay contract to purchase available output of a facility. Section 1.141-7(b)(4) provides the following definition of a take contract or a take or pay contract:

A take contract is an output contract under which a purchaser agrees to pay for the output under the contract if the output facility is capable of providing the output. A take or pay contract is an output contract under which a purchaser agrees to pay for the output under the contract, whether or not the output facility is capable of providing the output.

Section 1.141-7(c)(3)(iv) provides that retail requirements contracts generally do not meet the benefits and burdens test. Section 1.141-7(c)(3)(iv) provides safe harbors pursuant to which wholesale requirements contracts do not meet the benefits and burdens test, including a safe harbor if the amount of output to be purchased under the contract (and any other requirements contract with the same purchaser or a related party with respect to the facility) does not exceed 5 percent of the available output of the facility.

The Contracts provide a number of available methods of remediating Insufficiencies other than providing a Utility with any energy associated with its Share. Throughout the decades during which the Contracts have been in effect, the participating Utilities’ conditional right to take energy from a Project directly from Issuer as described above has never been exercised, and during that time period conditions which would have given rise to the exercise of such rights never occurred. Issuer does not expect that any Utility will ever make such a request under the Contracts and

represents that the chance of any nongovernmental Utility ever taking delivery of energy from Issuer pursuant to the Utility's Contract is contingent and remote.

Accordingly during the measurement period(s) for the Bonds, the Contracts have not provided and are not expected to provide nongovernmental Utilities, that are parties to the Contracts, any rights transferring the benefits of owning the facility, and the burdens of paying the debt service with respect to output of the Projects that give rise to private business use under either §§ 103(b) of the 1954 Code and 1.103-7(b)(5) promulgated thereunder, or §§ 141(b) of the 1986 Code and 1.141-7 promulgated thereunder.

Requested Ruling 2

Section 1.141-7(h)(1) provides that the determination of whether output sold under an output contract should be allocated to a particular facility (for example, a generating unit), to the entire system of the seller of that output (net of any uses of that system output allocated to a particular facility), or to a portion of a facility is to be based on all the facts and circumstances. Significant factors to be considered in determining the allocation of output from a financed output facility among the various uses of output available to the owner of that output are the following:

- i. The extent to which it is physically possible to deliver that output to or from a particular facility or system.
- ii. The terms of a contract relating to the delivery of that output (such as delivery limitations and options or obligations to deliver power from additional sources).
- iii. Whether a contract is entered into as part of a common plan of financing for a facility.
- iv. The method of pricing output under the contract, such as the use of market rates rather than rates designed to pay debt service of tax-exempt bonds used to finance a particular facility.

Throughout the measurement period(s) of the Bonds, the rights of nongovernmental Utilities to take delivery of energy from Issuer pursuant to their Contracts have been and are expected to continue to be contingent and remote. In addition, allocating all of the output of Project B solely among those Utilities that have Shares in Project B would fail to take into account the use by Buyers who take some portion of Project B output through their Sale Agreements.

Requested Ruling 3

For purposes of § 103, § 148(a) provides that the term “arbitrage bond” means any obligation issued as part of an issue any portion of the proceeds of which is reasonably expected (at the time of issuance of the obligation) to be used directly or indirectly to acquire higher yielding investments, or to replace funds which were used directly or indirectly to acquire higher yielding investments. For purposes of § 148(a), an obligation is treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such obligation is a part in a manner described above.

Section 1.148-9(h)(1) provides that the portion of the obligations of a multipurpose issue reasonably allocated to any separate purpose under paragraph (h) is treated as a separate issue for all purposes of § 148, except for certain arbitrage purposes listed therein. A multipurpose issue is an issue the proceeds of which are used for two or more separate purposes determined in accordance with § 1.148-9(h).

Section 1.148-1(b) defines the term “multipurpose issue” to mean an issue the proceeds of which are used for two or more separate purposes, determined in accordance with § 1.148-9(h). Section 1.148-9(h)(3)(i) provides, in part, that separate purposes of a multipurpose issue include refunding a separate prior issue, financing a separate purpose investment, financing a construction issue (as defined in § 1.148-7(f)), and any clearly discrete governmental purpose reasonably expected to be financed by the issue.

Section 1.148-9(h)(2)(i) provides that § 1.148-9(h) applies to allocations of multipurpose issues, including allocations involving the refunding purposes of the issue. Except as otherwise provided in § 1.148-9(h), proceeds, investments, and bonds of a multipurpose issue may be allocated among the various separate purposes of the issue using any reasonable, consistently applied allocation method. An allocation is not reasonable if it achieves more favorable results under §§ 148 or 149(d) than could be achieved with actual separate issues. Allocations under § 1.148-9(h) may be made at any time, but once made, may not be changed.

For each multipurpose issue that is used in whole or in part to refund a separate prior issue, § 1.148-9(h)(4)(v) provides that an allocation of obligations is reasonable only if the allocation:

- (A) Results from a pro rata allocation under paragraph (h)(4)(ii) of this section;

(B) Reflects aggregate principal and interest payable in each bond year that is less than, equal to, or proportionate to, the aggregate principal and interest payable on the prior issue in each bond year;

(C) Results from an allocation of all the bonds of the entire multipurpose issue in proportion to the remaining weighted average economic life of the capital projects financed or refinanced by the issue, determined in the same manner as under § 147(b); or

(D) Results from another reasonable allocation method, but only to the extent that the application of the allocation methods provided in this paragraph (h)(4)(v) is not permitted under state law restrictions applicable to the bonds, reasonable terms of bonds issued before, or subject to a master indenture that became effective prior to, July 1, 1993, or other similar restrictions or circumstances. This paragraph (h)(4)(v)(D) shall be strictly construed and is available only if it does not result in a greater burden on the market for tax-exempt bonds than would occur using one of the other allocation methods provided in this paragraph (h)(4)(v). (See also §1.148-11(c)(2)).

Except for purposes of §§ 141(c)(1) and 141(d)(1), § 1.141-13(d) provides that allocations of multipurpose issues (as defined in § 1.148-1(b)), including allocations involving the refunding purposes of the issue, must be consistent with allocations made for arbitrage purposes under § 1.148-9(h). Pursuant to § 1.141-15(j), § 1.141-13 applies to bonds that are sold on or after February 17, 2006, and that are subject to the 1997 Treasury Regulations.

Section 1.150-1(c)(3)(i) provides for bonds of a multipurpose issue to be treated as separate issues if certain requirements are met and the allocation of such bonds is made in writing on or before the issue date. Pursuant to § 1.150-1(a)(2)(i), § 1.150-1(c)(3) applies to bonds that are issued after June 30, 1993, to which §§ 1.148-1 through 1.148-11 apply. If any such separate issue consists of refunding bonds, § 1.150-1(c)(3) further requires that the allocation rules in § 1.148-9(h) must be satisfied. Section 1.150-1(c)(3)(ii) provides § 1.150-1(c)(3)(i) does not apply for purposes of §§ 141, 144(a), 148, 149(d) and 149(g). For multipurpose issues that meet these requirements but are not subject to the 1997 Treasury Regulations, §1.150-1(c)(3)(ii) provides that § 1.150-1(c)(3)(i) does not apply for purposes of §§ 141(b)(5), 141(c)(1), 141(d)(1), 144(a), 148, 149(d) and 149(g).

The Issuer represents that E Law and the Contracts prohibit it from allocating the Bonds pursuant to the methods outlined in paragraph (B) or paragraph (C) of § 1.148-9(h)(4)(v). The Issuer also represents that limitations placed upon the use of proceeds

of the Bonds pursuant to E Law and the Contracts do not allow a pro rata allocation, as outlined in paragraph (A) of § 1.148-9(h)(4)(v), of substantially all identical Bonds to each purpose of the Bond. Nevertheless, Issuer concedes that it could meet one or more of the allocation methods described in § 1.148-9(h)(4)(v) for federal tax law purposes and adopt an allocation that meets the requirements of E Law and the Contracts; however, to do so would impose undue complexity and burdens. Under the facts and circumstances of this case, we conclude that these additional burdens are unnecessary. Issuer represents that the use of another reasonable allocation method as outlined in paragraph (D) of § 1.148-9(h)(4)(v) will not result in a greater burden on the market for tax-exempt bonds than would occur using one of the other allocation methods.

CONCLUSIONS

Accordingly, we conclude that the Contracts among Issuer, Entity X, and Utilities that are nongovernmental persons do not give rise to private business use within the meaning of § 141(b)(6) of the 1986 Code or cause proceeds of the Bonds to be treated as used in a trade or business of a nonexempt person within the meaning of § 103(b)(2)(B)(ii) of the 1954 Code. Further, amounts corresponding to a Utility's Share need not be allocated to such Utility that purchases electric power from Entity X pursuant to a Sale Agreement. Finally, Issuer may apply § 1.148-9(h)(4)(v)(D) to treat the Bonds, which comprise a single multipurpose issue, as separate issues of bonds (a) for all purposes the 1986 Code except those purposes specified in § 1.148-9(h)(1), (b) for all purposes of § 141 except §§ 141(c)(1) and 141(d)(1), and (c) for all purposes of § 103(b) of the 1954 Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied as to whether the Issuer's method of allocation under § 1.148-9(h)(4)(v)(D) is a reasonable method of allocation.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

PLR-131462-16

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Associate Chief Counsel
(Financial Institutions & Products)

/S/

By: _____
Timothy L. Jones
Senior Counsel, Branch 5
(Financial Institutions & Products)

cc: