Private Letter Ruling 9831003

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

PLR 9831003; 1998 PLR LEXIS 777

April 7, 1998

[*1]

SUBJECT MATTER: Code Sec. 150

REFERENCE: Symbol: CC:DOM:FI&P:5-TAM-118821-97

UI LIST:

UI No. 0150.00-00; Definitions and special rules

TEXT:

ISSUE:

Whether the Bonds are either reimbursement bonds within the meaning of §1.150-2(c) or refunding bonds within the meaning of §1.150-1(d)(1).

CONCLUSION:

The Bonds are a refunding issue within the meaning of §1.150-1(d)(1).

FACTS:

The Authority issued the Bonds as qualified *§501(c)(3)* bonds on Date 1, and loaned the proceeds to the University, a *§501(c)(3)* organization. The University used $a of the proceeds of the Bonds to retire the Loan, one of a series of refundings of taxable debt incurred by the University in Year 1 and later years (collectively, the "Capital Loans"). There were no unspent proceeds of the Capital Loans (including the Loan) at the time the Bonds were issued. Proceeds of the original Capital Loans were spent to finance various acquisition and renovation projects undertaken between Year 2 and Year 3 (a period of ten years) involving capital assets of the University (the "Projects"), and proceeds of the refunding Capital Loans were spent to discharge the prior Capital Loans.

Capital Loans $\xleftarrow{\text{refunded}}$ Capital Loans $\xleftarrow{\text{refinance}}$ Bonds

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Capex

The Projects had been paid for from current operating funds of the University (the "Current Fund"), [*2] but the expenditures were recorded as liabilities against the University's Plant Fund because they were long-term expenditures. Being unable to borrow funds on a long-term basis for the Projects, and without an identifiable source of funding, the University took out shortterm taxable loans (the original Capital Loans) to finance the Projects.

Although the short-term loans (including the Loan) were recorded as liabilities of the Current Fund (because the loans were short-term), proceeds of the short-term loans were transferred to the Plant Fund and their expenditure on the Projects were recorded as liabilities of the Plant Fund. As a result of this accounting treatment, a deficit was created in the Current Fund that had to be "reimbursed" when the Loan was retired using proceeds of the Bonds. The accounting treatment changed neither the fact that the Projects were financed with short-term loans (including the Loan), nor the fact that the Loan was retired with Bond proceeds.

Pursuant to §1.148-11(b)(1) of the 1993 Income Tax Regulations, the Authority has elected to retroactively apply the provisions of §1.148-1 through §1.148-11 to the Bonds.

ANALYSIS:

Section 103(a) of the Internal Revenue Code [*3] provides that, except as provided in *§103(b)*, gross income does not include interest on any state or local bond.

Section 1.148-11(b)(1) provides in part that an issuer may retroactively elect to apply in whole, but not in part, the provisions of §1.148-1 through §1.148-11. Section 1.150-1(a)(2) provides in part that §1.150-1 applies to any issue to which the election described in §1.148-11(b)(1) is made.

Section 1.150-1(d)(1) generally defines "refunding issue" as an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on a "prior issue", including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue. Section 1.150-1(d)(5) defines "prior issue" as an issue of obligations all or a portion of the principal, interest, or call premium on which is paid or provided for with proceeds of a refunding issue. Section 1.150-1(b) defines "obligation" as any valid evidence of indebtedness under general Federal income tax principles.

The Authority has elected to retroactively apply the provisions of §1.148-1 through §1.148-11 [*4] to the Bonds. Therefore, pursuant to §1.150-1(a)(2), §1.150-1 applies to the Bonds.

The Loan, a taxable obligation, was retired with $a of the proceeds of the Bonds. The Loan is a valid evidence of indebtedness and thus does constitute an "obligation" within the meaning of §1.150-1(b). The Loan is therefore a "prior issue" for purposes of §1.150-1(d)(5). Because proceeds of the Bonds were used to redeem the Loan, the Bonds are a refunding issue within the meaning of §1.150-1(d)(1).

There were no unspent proceeds of the Loan at the time the Bonds were issued. Therefore, no unspent proceeds of the prior issue became transferred proceeds of the Bonds.

The conclusions reached in this technical advice memorandum apply to the issuer and any holder of the obligation, unless the holder initiates a request for technical advice on the same issue addressed in this memorandum and the national office issues a technical advice memorandum involving that issue and that holder. Section 16.02 of *Revenue Procedure 98-2, 1998-1 I.R.B. 74,94.*

A copy of this technical advice memorandum is to be given to the taxpayer(s). *Section 6110(j)(3)* provides that it may not be used or cited as precedent.