and are allocable to the 1990 escrow. The proceeds of the 1990 issue are treated as used to refund the 1984 issue and are allocable to the investments in the new 1984 escrow. The proceeds of the 1990 issue allocable to the nonpurpose investments in the new 1984 escrow become transferred proceeds of the 1994 issue as principal is paid on the 1990 issue from amounts on deposit in the 1990 escrow. As a result, the yield on nonpurpose investments allocable to the 1994 issue is materially higher than the yield on the 1994 issue, causing the bonds of the 1994 issue to be arbitrage bonds. In addition, the transaction employs a device under section 149(d)(4) to obtain a material financial advantage based on arbitrage, other than savings attributable to lower interest rates.

(ii) The following changes in the facts do not affect the conclusion that the 1994 issue consists of arbitrage bonds—

(1) The 1990 issue is a taxable issue;

(2) The original 1984 escrow is used to pay the 1994 issue (rather than the 1990 issue); or

(3) The 1994 issue is used to retire the 1984 issue within 90 days of January 1, 1994.

(e) *Authority of the Commissioner to clearly reflect the economic substance of a transaction.* If an issuer enters into a transaction for a principal purpose of obtaining a material financial advantage based on the difference between tax-exempt and taxable interest rates in a manner that is inconsistent with the purposes of section 148, the Commissioner may exercise the Commissioner's discretion to depart from the rules of §1.148–1 through §1.148–11 as necessary to clearly reflect the economic substance of the transaction. For this purpose, the Commissioner may recompute yield on an issue or on investments, reallocate payments and receipts on investments, recompute the rebate amount on an issue, treat a hedge as either a qualified hedge or not a qualified hedge, or otherwise adjust any item whatsoever bearing upon the investments and expenditures of gross proceeds of an issue. For example, if the amount paid for a hedge is specifically based on the amount of arbitrage earned or expected to be earned on the hedged bonds, a principal purpose of entering into the contract is to obtain a material financial advantage based on the difference between tax-exempt and taxable interest rates in a manner that is inconsistent with the purposes of section 148.

(f) *Authority of the Commissioner to require an earlier date for payment of rebate.* If the Commissioner determines that an issue is likely to fail to meet the requirements of §1.148–3 and that a failure to serve a notice of demand for payment on the issuer will jeopardize the assessment or collection of tax on interest paid or to be paid on the issue, the date that the Commissioner serves notice on the issuer is treated as a required computation date for payment of rebate for that issue.

(g) *Authority of the Commissioner to waive regulatory limitations.* Notwithstanding any specific provision in §§1.148–1 through 1.148–11, the Commissioner may prescribe extensions of temporary periods, larger reasonably required reserve or replacement funds, or consequences of failures or remedial action under section 148 in lieu of or in addition to other consequences of those failures, or take other action, if the Commissioner finds that good faith or other similar circumstances so warrant, consistent with the purposes of section 148.

[T.D. 8476, 58 FR 33544, June 18, 1993; 58 FR 44453, Aug. 23, 1993, as amended by T.D. 8538, 59 FR 24046, May 10, 1994; T.D. 8476, 59 FR 24351, May 11, 1994; T.D. 8718, 62 FR 25512, May 9, 1997]

§1.148–11 Effective dates.

(a) *In general.* Except as otherwise provided in this section, §§1.148–1 through 1.148–11 apply to bonds sold on or after July 8, 1997.

(b) *Elective retroactive application in whole*—(1) *In general.* Except as otherwise provided in this section, and subject to the applicable effective dates for the corresponding statutory provisions, an issuer may apply the provisions of §§1.148–1 through 1.148–11 in whole, but not in part, to any issue that is outstanding on July 8, 1997, and is subject to section 148(f) or to sections 103(c)(6) or 103A(i) of the Internal Revenue Code of 1954, in lieu of otherwise applicable regulations under those sections.

(2) *No elective retroactive application for 18-month spending exception.* The provisions of §1.148–7(d) (relating to the 18-month spending exception) may not be applied to any issue issued on or before June 30, 1993.

(3) *No elective retroactive application for hedges of fixed rate issues.* The provisions of §1.148–4(h)(2)(i)(B) (relating to hedges of fixed rate issues) may not be applied to any bond sold on or before July 8, 1997.

(4) *No elective retroactive application for safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.* The provisions of §§1.148–5(d)(6)(iii) (relating to the safe harbor for establishing fair market value of guaranteed investment contracts and yield restricted defeasance escrow investments) and 1.148–5(e)(2)(iv) (relating to a special rule for yield restricted defeasance escrow investments) may not be applied to any bond sold before December 30, 1998.

(c) *Elective retroactive application of certain provisions and special rules*—(1) *Retroactive application of overpayment recovery provisions.* An issuer may apply the provisions of §1.148–3(i) to any issue that is subject to section 148(f) or to sections 103(c)(6) or 103A(i) of the Internal Revenue Code of 1954.

(2) *Certain allocations of multipurpose issues.* An allocation of bonds to a refunding purpose under §1.148–9(h) may be adjusted as necessary to reflect allocations made between May 18, 1992, and August 15, 1993, if the allocations satisfied the corresponding prior provision of §1.148–11(j)(4) under applicable prior regulations.

(3) *Special limitation.* The provisions of §1.148–9 apply to issues issued before August 15, 1993, only if the issuer in good faith estimates the present value savings, if any, associated with the effect of the application of that section on refunding escrows, using any reasonable accounting method, and applies those savings, if any, to redeem outstanding tax-exempt bonds of the applicable issue at the earliest possible date on which those bonds may be redeemed or otherwise retired. These savings are not reduced to take into account any administrative costs associated with applying these provisions retroactively.

(d) *Transition rule excepting certain state guarantee funds from the definition of replacement proceeds*—(1) *Certain perpetual trust funds.* A guarantee by a fund created and controlled by a State and established pursuant to its constitution does not cause the amounts in the fund to be pledged funds treated as replacement proceeds if—

(i) Substantially all of the corpus of the fund consists of nonfinancial assets, revenues derived from these assets, gifts, and bequests;

(ii) The corpus of the guarantee fund may be invaded only to support specifically designated essential governmental functions (*designated functions*) carried on by political subdivisions with general taxing powers;

(iii) Substantially all of the available income of the fund is required to be applied annually to support designated functions;

(iv) The issue guaranteed consists of general obligations that are not private activity bonds substantially all of the proceeds of which are to be used for designated functions;

(v) The fund satisfied each of the requirements of paragraphs (d)(1)(i) through (d)(1)(iii) of this section on August 16, 1986; and

(vi) The guarantee is not attributable to a deposit to the fund made after May 14, 1989, unless—

(A) The deposit is attributable to the sale or other disposition of fund assets; or

(B) Prior to the deposit, the outstanding amount of the bonds guaranteed by the fund did not exceed 250 percent of the lower of the cost or fair market value of the fund.

(2) *Permanent University Fund.* Replacement proceeds do not include amounts allocable to investments of the fund described in section 648 of Public Law 98–369.

(e) *Transition rule regarding special allowance payments.* Section 1.148–5(b)(5) applies to any bond issued after January 5, 1990, except a bond issued exclusively to refund a bond issued before January 6, 1990, if the amount of the refunding bond does not exceed 101 percent of the amount of the refunded bond, and the maturity date of the refunding bond is not later than the date that is 17 years after the date on which the refunded bond was issued (or, in the case of a series of refundings, the date on which the original bond was issued), but only if §1.148–2(d)(2)(iv) is applied

by substituting *1 and one-half percentage points* for *2 percentage points*.

(f) *Transition rule regarding applicability of yield reduction rule.* Section 1.148–5(c) applies to nonpurpose investments allocable to replacement proceeds of an issue that are held in a reserve or replacement fund to the extent that—

(1) Amounts must be paid into the fund under a constitutional provision, statute, or ordinance adopted before May 3, 1978;

(2) Under that provision, amounts paid into the fund (and investment earnings thereon) can be used only to pay debt service on the issues; and

(3) The size of the payments made into the fund is independent of the size of the outstanding issues or the debt service thereon.

(g) *Provisions applicable to certain bonds sold before effective date.* Except for bonds to which paragraph (b)(1) of this section applies—

(1) Section 1.148–11A provides rules applicable to bonds sold after June 6, 1994, and before July 8, 1997; and

(2) Sections 1.148–1 through 1.148–11 as in effect on July 1, 1993 (see 26 CFR part 1 as revised April 1, 1994), and § 1.148–11A(i) (relating to elective retroactive application of certain provisions) provide rules applicable to certain issues issued before June 7, 1994.

(h) *Safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.* The provisions of § 1.148–5(d)(6)(iii) are applicable to bonds sold on or after March 1, 1999. Issuers may apply these provisions to bonds sold on or after December 30, 1998, and before March 1, 1999.

(i) *Special rule for investments purchased for a yield restricted defeasance escrow.* The provisions of § 1.148–5(e)(2)(iv) are applicable to bonds sold on or after March 1, 1999. Issuers may apply these provisions to bonds sold on or after December 30, 1998, and before March 1, 1999.

[T.D. 8476, 58 FR 33547, June 18, 1993; 58 FR 44453, Aug. 23, 1993, as amended by T.D. 8538, 59 FR 24046, May 10, 1994; T.D. 8718, 62 FR 25512, May 9, 1997; T.D. 8476, 64 FR 37037, July 9, 1999]

§ 1.149(b)–1 Federally guaranteed bonds.

(a) *General rule.* Under section 149(b) and this section, nothing in section 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond issued as part of an issue that is federally guaranteed.

(b) *Exceptions.* Pursuant to section 149(b)(3)(B), section 149(b)(1) and paragraph (a) of this section do not apply to—

(1) Investments in obligations issued pursuant to § 21B(d)(3) of the Federal Home Loan Bank Act, as amended by § 511 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, or any successor provision; or

(2) Any investments that are held in a refunding escrow (as defined in § 1.148–1).

(c) *Effective date.* This section applies to investments made after June 30, 1993.

[T.D. 8476, 58 FR 33548, June 18, 1993]

§ 1.149(d)–1 Limitations on advance refundings.

(a) *General rule.* Under section 149(d) and this section, nothing in section 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond issued as part of an issue described in paragraphs (2), (3), or (4) of section 149(d).

(b) *Advance refunding issues that employ abusive devices*—(1) *In general.* An advance refunding issue employs an abusive device and is described in section 149(d)(4) if the issue violates any of the anti-abuse rules under § 1.148–10.

(2) *Failure to pay required rebate.* An advance refunding issue is described in section 149(d)(4) if the issue fails to meet the requirements of § 1.148–3. This paragraph (b)(2) applies to any advance refunding issue issued after August 31, 1986.

(3) *Mixed escrows invested in tax-exempt bonds.* An advance refunding issue is described in section 149(d)(4) if—

(i) Any of the proceeds of the issue are invested in a refunding escrow in