

§ 1.103-6

he owned directly a proportionate part of the bonds held by the partnership. For rules relating to partially tax-exempt interest see section 702(a)(7) and the regulations thereunder.

§ 1.103-6 Interest upon United States obligations in the case of non-resident aliens and foreign corporations, not engaged in business in the United States.

By virtue of section 4 of the Victory Liberty Loan Act of March 3, 1919 (31 U.S.C. 750), amending section 3 of the Fourth Liberty Bond Act of July 9, 1918 (31 U.S.C. 750), the interest received on and after March 3, 1919, on bonds, notes, and certificates of indebtedness of the United States while beneficially owned by a nonresident alien individual, or a foreign corporation, partnership, or association, if such individual, corporation, partnership, or association is not engaged in business in the United States, is exempt from income taxes. Such exemption applies only to such bonds, notes, or certificates as have been issued before March 1, 1941. Interest derived by a nonresident alien individual, or by a foreign corporation, partnership, or association on such bonds, notes, or certificates issued on or after March 1, 1941, is subject to tax as in the case of taxpayers generally as provided in paragraph (b) of § 1.103-4.

§ 1.103-7 Industrial development bonds.

(a) *In general.* Under section 103(c)(1) and this section, an industrial development bond issued after April 30, 1968, shall be treated as an obligation not described in section 103(a)(1) and § 1.103-1. Accordingly, interest paid on such a bond is includable in gross income unless the bond was issued by a State, or local governmental unit to finance certain exempt facilities (see section 103(c)(4) and § 1.103-8), to finance an industrial park (see section 103(c)(5) and § 1.103-9), or as part of an exempt small issue (see section 103(c)(6) and § 1.103-10). For applicable rules when an industrial development bond is held by a substantial user (or a person related to a substantial user) of such an exempt facility, or an industrial park, or a facility financed with the proceeds of such an exempt small issue, see section

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103(c)(7) and § 1.103-11. See also § 1.103-12 for the transitional provisions concerning the interest paid on certain industrial development bonds issued before January 1, 1969, and certain other industrial development bonds. Even if section 103(c) does not prevent a bond from being treated as an obligation described in section 103(a)(1) and § 1.103-1, such bond shall nevertheless be treated as an obligation which is not described in section 103(a)(1) and § 1.103-1 if under section 103(d) it is an arbitrage bond. For purposes of section 103(c), the term "issue" includes a single obligation such as a single note issued in connection with a bank loan as well as a series of notes or bonds.

(b) *Industrial development bonds—(1) Definition.* For purposes of this section, the term "industrial development bond" means any obligation—

(i) 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 (as defined in subparagraph (2) of this paragraph), and

(ii) The payment of the principal or interest on which, under the terms of such obligation or any underlying arrangement (as described in subparagraph (4) of this paragraph), is in whole or in major part (i.e., major portion)—

(a) Secured by any interest in property used or to be used in a trade or business,

(b) Secured by any interest in payments in respect of property used or to be used in a trade or business, or

(c) To be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

See subparagraphs (3) and (4) of this paragraph for the trade or business test and the security interest test respectively. See § 1.103-8(a)(6) to determine the amount of proceeds of an issue for which the amount payable during each annual period over the term of the issue is less than the amount of interest accruing thereon in such period, e.g., in the case of an issue sold by the issuer for less than its face amount.

(2) *Exempt person.* The term "exempt person" means a governmental unit as