# INCOME TAX REGULATIONS

## FINAL AND PROPOSED

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matured on January 1, 1986, and as though the obligation were purchased at a discount of $80 (two-fifths of the $200 discount on the obligation).

(5) *Certain administrative costs.* If acquired purpose obligations are allocable (under § 1.103-13(f)) to an issue, then the following rules apply:

(i) In determining the yield on the acquired purpose obligations, administrative costs paid by the obligor shall not be taken into account.

(ii) Subdivision (i) of this subparagraph applies whether or not the obligor's payments are made from bond proceeds and whether or not such payments merely reimburse the issuer. For this purpose, any payments made by the obligor may be treated as reimbursements of administrative costs, *provided* That the present value of such payments does not exceed the present value of administrative costs paid by the issuer.

(iii) In determining the present value of any payments or costs, the yield on the issue (as determined under § 1.103-13 (c) and (d)) shall be used as the discount rate.

(iv) For purposes of this subparagraph, the term "administrative costs" means—

(A) The cost of issuing, carrying, or repaying the issue,

(B) The underwriter's spread, and

(C) The cost of purchasing, carrying, and selling or redeeming acquired purpose obligations.

(6) *Monthly payments.* An issuer may treat regular monthly payments on an acquired purpose obligation as if they were received semiannually.

(7) *Examples.* The following examples illustrate the application of subparagraphs (5) and (6) of this paragraph:

*Example (1).* On January 1, 1989, authority A sells $1,050,000 of single-family housing bonds. The yield on the bonds is 7 percent (determined under § 1.103-13(c) and (d) on the basis of semiannual compounding). Authority A uses the bond proceeds to make 50 identical 25-year mortgage loans of $20,000 each. The mortgage loans are acquired program obligations (within the meaning of § 1.103-13(h)). Authority A uses the remaining $50,000 of proceeds to cover the underwriter's spread and to pay other administrative costs on January 1, 1989. Under the terms of each mortgage loan, authority A will receive level monthly payments of $168.98. Of each payment, $161.87 will be denominated principal and interest, and the remaining $7.11 will be denominated a "finance fee." On January 1, 1989, the present value of all these finance fees (using a discount rate of 7 percent) is $50,000. Therefore, these fees merely reimburse authority A for $50,000 of administrative costs. Accordingly, the finance fees are not taken into account in determining the yield on the mortgage notes. Consequently, the yield on the mortgage notes (computed by treating monthly payments as received semiannually on January 1 and July 1 of each year) is only 8.5 percent. Under § 1.103-13(b)(5)(viii), this yield of 8.5 percent is not materially higher than the yield on the single-family housing bonds.

*Example (2).* The facts are the same as in example (1), except that the entire monthly payment of $168.98 on each mortgage note will be denominated principal and interest. Although the stated interest rate on the mortgage notes is 9.02 percent, the results are the same as in example (1). There is no requirement that reimbursement for administrative costs must be stated separately as a finance fee; it may be included in interest.

(8) *Insurance.* (i) Premiums paid to insure a governmental issue are treated as interest paid on the issue, provided that the present value of the premiums is less than the present value of the interest reasonably expected to be saved as a result of the insurance.

(ii) In determining present value for purposes of this subparagraph, the yield on the governmental issue (determined without regard to this subparagraph) shall be used as the discount rate.

(d) *Administrative costs and purchase price*—(1) *Treatment of administrative costs.* Despite anything in paragraph (c) to the contrary, administrative costs shall not be taken into account in determining yield on obligations.

(2) *Purchase price.* (i) If an issue of governmental obligations is sold to the public, the term "purchase price" means the initial offering price to the public (excluding bond houses, brokers, and other intermediaries).

(ii) If an issue of governmental obligations is privately placed, the purchase price of each obligation is the price paid by the first buyer of the obligation. For this purpose, the term "first buyer" does not incude any bond house, broker, or other intermediary.

(iii) If the purchase price of an obligation is unreasonably low, then the yield on the obligation shall be determined as if its purchase price were equal to its fair market value on the date of issue.

(3) *Illustrations.* The following examples illustrate the application of this paragraph: