

# proposed rules

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## DEPARTMENT OF THE TREASURY

Internal Revenue Service

[ 26 CFR Part 1 ]

### INTEREST UPON OBLIGATIONS OF A STATE, TERRITORY, ETC.

#### Income Tax Regulations

Notice is hereby given that the regulations set forth in tentative form in the attached appendix are proposed to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury or his delegate. Prior to the final adoption of such regulations, consideration will be given to any comments pertaining thereto which are submitted in writing (preferably six copies) to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224, by March 18, 1976. Pursuant to 26 CFR 601.601(b), designations of material as confidential or not to be disclosed, contained in such comments, will not be accepted. Thus, persons submitting written comments should not include therein material that they consider to be confidential or inappropriate for disclosure to the public. It will be presumed by the Internal Revenue Service that every written comment submitted to it in response to this notice of proposed rule making is intended by the person submitting it to be subject in its entirety to public inspection and copying in accordance with the procedures of 26 CFR 601.702(d) (9). Any person submitting written comments who desires an opportunity to comment orally at a public hearing on these proposed regulations should submit a request, in writing, to the Commissioner by March 18, 1976. In such case, a public hearing will be held, and notice of the time, place, and date will be published in a subsequent issue of the FEDERAL REGISTER, unless the person or persons who have requested a hearing withdraw their requests for a hearing before notice of the hearing has been filed with the Office of the Federal Register.

(Sec. 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

DONALD C. ALEXANDER,  
Commissioner of Internal Revenue.

**Preamble.** This document contains a proposed amendment to the Income Tax Regulations (26 CFR Part 1) to revise the regulations under section 103(a) of the Internal Revenue Code of 1954, relating to interest upon obligations of a State, a territory, or a possession of the United States, or any political subdivision thereof, or the District of Columbia.

Section 1.103-1(b) of the proposed regulations provides rules relating to ob-

ligations issued directly by a State or local governmental unit.

Section 1.103-1(c) of the proposed regulations provides rules to determine whether obligations are issued on behalf of a State or local governmental unit. Paragraph (c) supercedes prior revenue rulings such as Rev. Rul. 57-187, 1957-1 C.B. 65, Rev. Rul. 60-248, 1960-2 C.B. 35, and Rev. Rul. 63-20, 1963-1 C.B. 24 relating to entities issuing obligations on behalf of a State or local governmental unit.

In general, the proposed amendment provides that only a constituted authority of a State or local governmental unit may issue obligations on behalf of the unit. The authority must be specifically authorized pursuant to State law to issue obligations on behalf of the unit to accomplish a public purpose of the unit. The authorization must specify the public purpose of the governmental unit on behalf of which the authority is authorized to issue obligations and also must create the authority or provide that the governmental unit may create the authority. The authority must be created and operated solely to accomplish a public purpose of the governmental unit.

The proposed amendment requires a close connection between the authority and the governmental unit including control of the authority's board and organizational or supervisory control over the authority by the governmental unit.

**Proposed amendments to the regulations.** To provide rules to determine whether obligations are the obligations of a State, a territory, or a possession of the United States, or any political subdivision of the foregoing, or of the District of Columbia, the Income Tax Regulation (26 CFR Part 1) under section 103 (a) of the Internal Revenue Code of 1954 are amended as follows:

1. Section 1.103-1 is amended by revising paragraphs (a) and (b) and by adding a new paragraph (c). These revised and added provisions read as follows:

**§ 1.103-1 Interest upon obligations of a State, territory, etc.**

(a) *In general.* Interest upon obligations of a State, a territory, or a possession of the United States, or any political subdivision thereof or the District of Columbia (hereinafter collectively or individually referred to as "State or local governmental unit") is not includible in gross income except as provided under section 103 (c) and (d) and the regulations thereunder. Section 103(a) (1) does not apply to industrial development bonds or to arbitrage bonds except as otherwise provided in section 103 (c) and (d). See section 103(c) and

§§ 1.103-7 through 1.103-12 for rules concerning interest paid on industrial development bonds. See section 103(d) for rules concerning interest paid on arbitrage bonds. See paragraph (b) (2) of this section for the definition of the term "political subdivision".

(b) *Obligations of a State or local governmental unit.* (1) Obligations issued by or on behalf of any State or local governmental unit by constituted authorities empowered to issue such obligations are the obligations of such unit. See paragraph (c) of this section for rules relating to obligations which are not issued directly by a State or local governmental unit but are issued by a constituted authority of a State or local governmental unit.

(2) For purposes of this section, the term "political subdivision" denotes any division of any State, territory or possession of the United States which is a municipal corporation or to which has been delegated the right to exercise part of the sovereign power of such State, territory or possession. Such term also denotes any unit which is a political subdivision of more than one State, territory, possession of the United States, or political subdivision (as described in the preceding sentence), i.e., is a municipal corporation of, or a unit to which has been delegated the right to exercise part of the sovereign power of, each of the several participating State or local governmental units. As thus defined, a political subdivision may, for purposes of this section, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of any such unit.

(3) Certificates issued by a political subdivision for public improvements (such as sewers, sidewalks, streets, etc.) which are evidence of special assessments against specific property, which assessments become a lien against such property and which the political subdivision is required to enforce, are, for purposes of this section, obligations of the political subdivision even though the obligations are to be satisfied out of special funds and not out of general funds or taxes.

(c) *Constituted authorities—(1) In general.* This paragraph provides rules to determine whether obligations that are not issued directly by a State or local governmental unit (hereinafter in this paragraph referred to as the "unit") are nonetheless considered to be the obligations of such unit because issued by a constituted authority of such unit empowered to issue such obligations on behalf of such unit. An issuer is such a con-

stituted authority only if the requirements of paragraph (c) (2) of this section are satisfied. Such a constituted authority may be organized as a corporation, trust, or other entity. An issuer is not such a constituted authority if it issues obligations for more than one unit. The determination that an issuer is a constituted authority under paragraph (c) (2) of this section is solely for purposes of this section and is not determinative of whether the issuer is an authority, agency, or instrumentality under any other section of this title. See paragraph (a) of this section for a definition of the term "State or local governmental unit" and see paragraph (b) of this section for a definition of the term "political subdivision".

(2) *Requirements to be a constituted authority.* The requirements of this subparagraph are satisfied if—

(i) The authority is specifically authorized pursuant to State law to issue obligations to accomplish a public purpose or purposes of the unit. Such specific authorization must either create the authority or provide that the unit may create the authority. Furthermore, such authorization must specify the public purpose or purposes of the unit for the accomplishment of which such authority is empowered to issue obligations. If the unit is a State, territory, or possession of the United States, such authorization must be specifically set forth in the Constitution, charter or other organic act creating or providing for the unit's government, or in a statute of such unit. If the unit is a political subdivision or is the District of Columbia, such authorization must be specifically set forth in its charter or other organic act creating the unit, or in the Constitution or a statute of a State, territory or possession of which the unit is a part (including, in the case of the District of Columbia, a statute of the United States) and such authorization must also provide that the unit is authorized to utilize the authority to issue obligations to accomplish a public purpose or purposes of the unit.

(ii) The unit controls the governing board of the authority. To satisfy this requirement, the governing board of the authority must be composed in its entirety of—

(A) Public officials of the unit as members ex-officio,

(B) Persons elected by the voters of such unit for a specified term, or

(C) Persons appointed by the unit or by other members of the governing board described in (c) (2) (ii) (A) or (B) of this section if such other members comprise a majority of the board.

In addition, if the unit does not have organizational control over the authority as described in paragraph (c) (2) (iii) (B) of this section, a majority of the members of the governing body of the authority must be members described in (c) (2) (ii) (A) or (B) of this section. Members described in (c) (2) (ii) (C) of this section must be removable for cause or at will and must not be appointed for a term in excess of 6 years. The term of

any member of the governing board described in (c) (2) (ii) (A) of this section shall not exceed the period for which such member will be a public official of the unit.

(iii) (A) The unit has either the organizational control over the authority, described in (c) (2) (iii) (B) of this section, or the supervisory control over the activities of the authority, described in (c) (2) (iii) (C) of this section.

(B) A unit has organizational control over an authority if—

(1) The authority is created by or organized under a constitution, statute, or charter or other organic act creating or providing for the unit's government, which either creates the authority or provides that only a unit may create or organize an authority,

(2) The constitution, statute, or charter or other organic act itself provides for the organization, structure, and powers of the authority, and the authority is organized under such constitution, statute, or charter or other organic act and not under a statute providing generally for the organization of entities, such as a statute providing for the organization of nonprofit corporations, and

(3) The unit may, at its sole discretion, and at any time, alter or change the structure, organization, programs, or activities of the authority (including the power to terminate the authority), subject to any limitation on the impairment of contracts entered into by such authority.

If the unit is a political subdivision or is the District of Columbia, the power to alter or change described in paragraph (c) (2) (iii) (B) (3) of this section must be specifically set forth in the authorization described in paragraph (c) (2) (i) of this section.

(C) Supervisory control by a unit over an authority ordinarily includes (1) except to the extent otherwise fixed by the terms of the authorization described in paragraph (c) (2) (i) of this section, approval by the unit of the provisions of the governing instrument and bylaws of the authority and power to amend the same; (2) annual approval by the unit of the projected programs and projected expenditures of the authority and annual post-review of the programs and expenditures; (3) approval by the unit of each issue of obligations of the authority not more than 60 days prior to the date of issue, except that where obligations are to be issued in series at prescribed intervals over a period not exceeding 5 years, all obligations in such series may be approved at one time within 60 days prior to the date of the first issue in such series; (4) annual review of the authority's annual financial statements (including a statement of income and expenditures) by the unit; (5) access by the unit at any time to all books and records of the authority; (6) in the event of default with respect to obligations issued to finance the acquisition of property, the unit has the exclu-

sive option to purchase such property for the amount required to discharge such obligations and is provided a reasonable time to exercise such option; and

(7) agreement by the unit, in conjunction with the issuance of the obligations, to accept title to any tangible personal or real property financed by such obligations upon the retirement of such obligations. Such property must have significant value at the time that such property is conveyed to the unit. Instruments conveying title to such property must, in conjunction with the issuance of such obligations, be placed in escrow with instructions that the escrow agent deliver such instruments of title to such unit upon the retirement of the obligations. Such unit must obtain, upon retirement of the obligations, full legal title to the property with respect to which the indebtedness is incurred free of encumbrances created subsequent to the acquisition of the property by the authority. Examples of title encumbrances are options, leases which continue beyond the date of the retirement of the obligations, lease renewals or lease extensions exercisable by any person other than such unit. The requirements of paragraph (c) (2) (iii) (C) (1) through (5) of this section shall not apply if the governing board of the authority is composed in its entirety of public officials or elected persons (or both) described in paragraph (c) (2) (ii) (A) and (B) of this section.

(iv) Any net earnings of such authority (beyond that necessary for retirement of the indebtedness or to implement the public purpose or purposes or program of the unit) may not inure to the benefit of any person other than the unit.

(v) Upon dissolution of the authority, title to all property owned by such authority will vest in the unit.

(vi) The authority must be created and operated solely to accomplish one or more of the public purposes of the unit specified in the authorization described in paragraph (c) (2) (i) of this section.

The requirements of paragraph (c) (2) (i) of this section must be satisfied at the time of issuance of the obligations and the requirements of paragraph (c) (2) (ii) through (vi) of this section must be satisfied at all times during the period beginning on the date of issuance of the obligations and ending on the date of dissolution of the authority or on the date that title to all property owned by the authority is conveyed to the unit, whichever is earlier. In applying paragraph (c) (2) (ii) through (v) of this section to an authority of a political subdivision the term "unit" shall include any State, territory or possession of which the political subdivision is a part. Except as provided in paragraph (c) (2) (iii) (B) of this section, if the requirements of paragraph (c) (2) (ii) through (vi) of this section are not provided for in the authorization described in paragraph (c) (2) (i), they must be stated in the governing instruments of the entity.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

*Example (1).* The Education Act of state A provides in part:

Section 100. *Student Loan Authorities.* (a) *Purpose.* An incorporated municipality of the State is hereby authorized to issue obligations for the purpose of creating and maintaining a loan fund to provide loans to further the education of any resident of such municipality in accordance with the provisions of section 102 of this Act. Obligations issued pursuant to this section may be issued directly by a municipality or by a student loan authority of such municipality.

(b) *Authority.* A student loan authority of the municipality may be created by the municipality under the not-for-profit corporation act for the sole purpose of obtaining and loaning funds for the purpose described in subsection (a). Such authority is hereby authorized to issue obligations on behalf of the municipality for such purpose. An authority organized under this Act shall be governed by a board of directors comprised of elected officials of the municipality or persons appointed by the municipal council.

Pursuant to the Education Act, city B took the formal action necessary to create a corporation under the State not-for-profit corporation law for the sole purpose of having the corporation act as a student loan authority and to issue specified obligations for such purpose on behalf of the city. The formal action also provided that the authority shall be governed by a board of directors consisting of seven members, four of whom were designated elected officials serving as members ex officio and three of whom were appointed by the city council for a term not in excess of 2 years. The appointed members of the board can be removed at will by the city council. The formal action further provided that the city must approve the governing instrument and the bylaws (and any amendment thereof) of the authority, may amend the governing instrument and bylaws, must approve, in advance, each issue of obligations, and both review and approve annually the projected programs and projected expenditures of the authority, as well as annually post-reviewing program and expenditures. Also, annual financial statements (including a statement of income and expenditures) were required to be reviewed by the city council, and the city council was provided access to all books and records of the authority. Pursuant to the formal action, the city B student loan authority was incorporated. The articles of incorporation of the authority, in addition to providing for the supervisory authority of the city, described above, state that the authority is not organized for profit and that any of the authority's net earnings will inure only to the benefit of the city. The articles of incorporation state further that upon dissolution of the authority, title to all property owned by the authority will vest in city B. The bond resolution for the obligations issued by the authority provides that in the event of default with respect to obligations issued to finance the acquisition of the student loan

notes, the city has the exclusive option to purchase the loan notes and is provided a reasonable time to exercise such option and to finance such purchase. The city B student loan authority meets the requirements of paragraph (c) (2) of this section and the obligations issued by the authority qualify under this paragraph as obligations issued on behalf of a State or local governmental unit if prior to the issuance of any such obligations the obligations are approved by the city council or voters of city B.

*Example (2).* The S Corporation, incorporated under the nonprofit corporation law of State T was organized for the purpose of financing and operating a hospital located in city U, a municipality of state T. S Corporation's articles of incorporation state that the corporation is not organized for profit and that none of its net earnings will inure to the benefit of any private person. The board of directors of the corporation consists of representatives of private business groups in city U elected by the members of S Corporation and approved by city U. S Corporation issued obligations to finance the construction of a new wing for the hospital. In conjunction with the issuance of the obligations, a deed conveying title to the new wing was placed in escrow by S Corporation with the instructions that the escrow agent deliver the deed to city U upon retirement of the obligations. Also, S Corporation granted city U the right at any time to purchase the new wing for an amount sufficient to retire the outstanding indebtedness on such obligations. City U, prior to the issuance of obligations by S Corporation, approved S Corporation and the issue of obligations issued by S Corporation. City U also agreed to accept title to the new wing upon retirement of the obligations. The obligations issued by S Corporation are not issued "on behalf of" city U since the following requirements for an "on behalf of" issuer have not been met:

(i) There was no specific authorization, as described in paragraph (c) (2) (i) of this section.

(ii) S Corporation was not created by such specific authorization or by city U, pursuant to any such specific authorization, as required by paragraph (c) (2) (i) of this section.

(iii) City U does not control S Corporation, within the meaning of paragraph (c) (2) (ii) of this section.

(iv) City U does not have organizational control or supervisory control over S Corporation, as required by paragraph (c) (2) (iii) of this section.

*Example (3).* City C, a municipal corporation located in state D, was incorporated pursuant to a statute of state D which provides in part that "municipalities incorporated under this Act may issue obligations to provide funds for any purpose related to the general welfare of the residents of such municipality". The city C Airport Agency was incorporated under state D's not-for-profit corporation law for the purpose of constructing a municipal airport with the proceeds of obligations issued by the corporation "on behalf of" city C. Neither the state statute under which city C was incorporated nor any other statute of state D provides the specific authorization described in paragraph (c) (2) (i) of this section. Thus, obligations issued by the city C airport agency will not qualify under this section as obligations issued "on behalf of" city C.

*Example (4).* Assume the same facts as in Example (3) except that the State statute provides as follows:

"Except as limited by express provision or necessary implication of general law, a municipality may take all action necessary or convenient for the government of its local affairs."

Neither the state statute under which city C was incorporated nor any other statute of state D provides the specific authorization described in paragraph (c) (2) (i) of this section. Thus, obligations issued by the city C airport agency will not qualify under this section as obligations issued "on behalf of" city C.

*Example (5).* A statute of state E provides that any incorporated municipality of the state is authorized to utilize an authority to issue obligations for a public purpose of the municipality. The Municipal Parking Act of state E provides that any incorporated municipality may create an authority under the Act for the purpose of utilizing the authority to issue obligations to provide a municipal parking garage. The Act provides that the authority is to be created under provisions of the Act which govern the structure, creation, and powers of the authority. In addition the Act provides that the municipality creating the authority may alter or change the structure, organization, program, or activities of the authority and may terminate the authority. City F creates a Municipal Parking Authority under the provisions of the Act. The charter of the authority provides that the sole purpose of the authority is to construct and operate a municipal parking garage, that any net earnings of the authority will be paid to city F, that title to all property owned by the authority at the time of its dissolution will vest in city F, and that all members of the authority are to be appointed by the mayor of city F. The authority satisfies the requirements of paragraph (c) (2) of this section, and obligations issued by the authority qualify under this section as obligations issued on behalf of a State or local governmental unit.

(4) *Effective date.* The provisions of this paragraph apply to obligations issued on or after 180 days after the adoption of this paragraph by a Treasury decision, or, at the option of the State or local governmental unit, to obligations issued on or after February 2, 1976.

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## DEPARTMENT OF THE INTERIOR

Office of the Secretary

[ 43 CFR Parts 3500 and 3520 ]

### COAL LEASES

Diligent Development and Continuous Operations; Extension of Comment Period

Notice was published in the FEDERAL REGISTER on Wednesday, December 31, 1975 (40 FR 60070, 60071) inviting interested parties to submit written comments to the Director, Bureau of Land Management on proposed regulations which would define the terms "logical mining unit," "logical mining unit reserves," "diligent development," and "continuous operation." The proposed regulations would also modify the existing regulations relating to the duration