

Internal Revenue

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Department of the Treasury
Internal Revenue Service

flows over the intertie flow from the utility to the Qualifying Facility (a "disqualification event"), then the Qualifying Facility will be deemed to have made a transfer to the utility which constitutes a CIAC under section 118(b) as of the last day of the third such year. At the option of the utility, the taxable year in which the property is placed in service shall not be taken into account in determining whether there has been a disqualification event. The amount of the CIAC shall be that percentage of the fair market value of the intertie as of the date of the deemed transfer which is reflective of the use of the intertie for the purpose of selling power to the Qualifying Facility, determined by the Internal Revenue Service by taking into account all facts and circumstances. Relevant factors include (1) the use of the intertie during the period immediately preceding the disqualification event; (2) the use of the intertie since the date it was placed in service; (3) the reasonably anticipated use of the intertie during the remaining term of the power purchase contract. See section III of Notice 87-82 for guidance as to the fair market value of a CIAC. For example, suppose a Qualifying Facility contributes an intertie to a utility that is a calendar year taxpayer. The utility places the intertie in service in 1990, and reasonably projects that over the ten taxable years beginning in 1990 power flows over the intertie to the Qualifying Facility will be less than 5% of total power flows over the intertie. Power flows over the intertie to the Qualifying Facility constitute the following percentages of total flows over the intertie: 10% in 1990; 7% in 1991; 6% in 1992; 3% in 1993; 1% in 1994; and 6% in 1995. The utility excludes 1990 (the year in which the intertie is placed in service) from the determination of whether a disqualification event has occurred. A disqualification event occurs due to power flows in 1995, the third year within the five year period from 1991 to 1995 in which more than 5% of power flows over the intertie flow to the Qualifying Facility. Therefore, the Qualifying Facility is deemed to have made a CIAC transfer to the utility as of December 31, 1995.

Proportionate disqualification does not apply to any property necessary for, and used solely to facilitate, the transmission of power by the Qualifying Facility to the utility. For example, suppose the contract between a Qualifying Facility and a utility requires the utility to relocate a major transmission line and to construct an intertie to the Qualifying

Facility including protective devices which are necessary and used solely for the delivery of power to the utility. Several years into the contract, the use of the intertie by the utility for delivery of power results in a disqualification event. Payments made for the construction of the protective devices are not subject to proportionate disqualification, while payments made for the relocation of the transmission lines are subject to proportionate disqualification (because the transmission line is used for the delivery of power over the intertie by the utility to the Qualifying Facility).

(B) *Termination of Power Purchase Contract.* Upon the termination of the power purchase contract between a Qualifying Facility and a utility, if the utility obtains or retains ownership (for tax purposes) of property transferred in a QF transfer, the Qualified Facility will be deemed to have made a transfer to the utility which constitutes a CIAC under section 118(b) as of the first day of such termination. The amount of the CIAC shall be the fair market value of the intertie, less the amount, if any, paid by the utility to obtain or retain ownership of the property for tax purposes. Therefore, if the amount paid by the utility is fair market value, the Qualified Facility will not be deemed to have made a CIAC transfer. See Section III of Notice 87-82 for guidance as to the fair market value of a CIAC.

5. Notification Requirements.

If for any taxable year power flows to the Qualifying Facility exceed 5% of total power flows over the intertie, then the utility must attach a statement to this effect to its return for such taxable year. If a power supply contract subject to the provisions of this notice terminates, the utility must attach a statement to this effect to its return for the year in which the termination occurs. The notification requirements of this section 5 apply to taxable years ending more than 180 days after December 27, 1988, the date this notice is published in the Bulletin.

6. Cost Recovery of QF Transfer Property.

Sections 1.461-1(a)(1) and (2) of the Income Tax Regulations provide that taxpayers using the cash and accrual methods of accounting, respectively, may not currently deduct the total amount of an expenditure which results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year. Instead,

such taxpayers are required to capitalize such expenditures as assets and recover the cost of the expenditures over the useful life of the asset in question. See, e.g., Rev. Rul. 70-413, 1970-2 C.B. 103. The cost of property transferred in a QF transfer must be capitalized by the Qualified Facility as an intangible asset and recovered as appropriate. Cf. Section VII of Notice 87-82 (amortization of the cost of a CIAC by the contributor).

A utility may not take depreciation (or amortization) deductions with respect to property transferred in a QF transfer. This rule applies regardless of whether the Qualifying Facility initially transfers intertie property to the utility or whether the Qualifying Facility initially transfers cash followed by a deemed QF transfer to the utility. However, if property which is the subject of a QF transfer is subsequently transferred or deemed transferred to the utility as a CIAC, the utility may be allowed to take depreciation deductions with respect to the property.

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or a revenue procedure.

Reissuance of Bonds under Section 103 of the Code

Notice 88-130¹

This notice provides guidance to issuers of state and local bonds concerning regulations to be issued under section 150 of the Internal Revenue Code providing rules for determining when such bonds will be considered retired and, in some cases, reissued solely for purposes of sections 103 and 141-150. The guidance provided in this notice does not apply for purposes of any other section of the Code. Accordingly, no inference should be drawn from this notice as to whether any alteration described in this notice would constitute a retirement or other disposition of an obligation for purposes of any other section of the Code. All section references in this notice are to the Code.

SECTION A. GUIDANCE

1.1 General Rule. Regulations will provide that a bond which is not a qualified tender bond is treated as retired

¹Also released as News Release IR-88-165, dated December 14, 1988.

on the first day that: (a) there is a change to the terms of the bond that results in a disposition of the bond for purposes of section 1001; (b) the bond is purchased or otherwise acquired by or on behalf of the issuer or a true obligor which is a governmental unit or an agency or instrumentality thereof; or (c) the bond is otherwise retired or redeemed.

1.2 For these purposes, a bond will be treated as purchased or otherwise acquired by or on behalf of a person if the bond is purchased or otherwise acquired (other than pursuant to the terms of a third party guarantee) by that person (or by any other person in consideration for any payment provided directly or indirectly by such first person) in a manner that liquidates the bondholder's investment. Except as specifically provided in section C of this notice, a bond that is subject to a tender right but is not a qualified tender bond will be treated as if purchased on each tender date pursuant to the tender right (whether or not the tender right is exercised).

2.1 Rules for Qualified Tender Bonds. Regulations will provide that the determination of whether or not a qualified tender bond is retired shall be made solely by reference to the rules set forth in this subsection.

2.2 A qualified tender bond will be treated as retired only if: (a) in a transaction or series of transactions there is any change to the terms of the bond (other than a qualified corrective change) in connection with a qualified tender change which qualified tender change increases the period between tender dates from a period not exceeding one year to a period exceeding one year or vice versa; (b) there is a change in the period between tender dates that is not a qualified tender change; (c) there is a change to the terms of the bond (other than a qualified corrective change) which would cause a disposition of the bond under section 1001 without regard to the existence or exercise of the tender right; (d) the bond is purchased or otherwise acquired by or on behalf of the issuer or a true obligor which is a governmental unit or an agency or instrumentality thereof; or (e) the bond is otherwise retired or redeemed. For these purposes, a bond will be treated as purchased or otherwise acquired by or on behalf of a person if the bond is purchased or otherwise acquired (other than pursuant to the terms of a third party guarantee) by that person (or by any other person in consideration for any payment provided directly or indirectly by such first person)

in a manner that liquidates the bondholder's investment.

2.3 A qualified tender bond will not be treated as retired merely by reason of: (a) the existence of the tender right; (b) a qualified tender purchase; (c) a qualified tender change; (d) a qualified corrective change; or (e) any combination of the foregoing.

2.4 Any reissuance which occurs as a result of a "change" occurs on the date the terms of the bond are altered, even though the effect of that alteration may occur later (for example, the addition to the terms of a bond of a new tender and interest rate mode results in a reissuance on the date the terms of the bond are amended, even though the issuer does not elect at such time to convert the bonds to that mode).

SECTION B. DEFINITIONS

1. Bond subject to a tender right. A bond is subject to a "tender right" if the holder of the bond may or must in all events tender the bond for purchase or redemption at par (plus any accrued interest) pursuant to the terms of the bond on one or more tender dates before the final stated maturity date.

2. Tender bond. The term "tender bond" means any bond that is subject to a tender right if all interest on the bond (other than in the event of a remote contingency) accrues at a tender rate, and such interest is actually and unconditionally due at periodic intervals of one year or less.

3. Tender rate. Interest on a bond that is subject to a tender right accrues at a "tender rate" if: (a) in the case of interest accruing to the first tender date, the interest rate is set on or after the sale date at the lowest rate that would enable the bond to be marketed at par (plus any accrued interest) on the date of issue and (b) in the case of interest accruing for each period between tender dates (including the final period to maturity), under the terms of the bond the interest rate is reset for each period at the lowest rate that would enable the bond to be remarketed at par (plus any accrued interest) at the beginning of the period. The interest accruing for each period may be subject to a minimum and/or maximum rate if the minimum and/or maximum rate is not designed to front-load or back-load interest.

4. Qualified tender bond. The term "qualified tender bond" means any tender bond the final stated maturity date of which is no later than the earlier of:

(a) the date that is 35 years after the date of issue or (b) the latest date reasonably expected (as of the date of issue) to be required to carry out the governmental purpose of the issue of which the bond is a part. A bond will be deemed to meet the requirements of (b) of the preceding sentence if the average maturity of the issue of which the bond is a part does not exceed 120 percent of the average reasonably expected economic life of the facilities being financed with the proceeds of such issue (determined under section 147(b)).

5.1 Change. The term "change" means, with respect to the terms of a bond, any discretionary alteration in the legal rights or remedies of the holder that occurs after the date of issue. An alteration to the terms of the bond is discretionary unless all elements of the alteration are entirely outside of the control of the issuer, any true obligor, any holder of the bond, any related person (as defined in section 147(a)(2)), anyone acting on behalf of any such person or persons, or any combination of the foregoing.

5.2 Accordingly, an alteration in the period between the tender dates applicable to the bond (for example, a conversion from a daily tender and interest rate mode to a weekly tender and interest rate mode or a conversion from a weekly tender and interest rate mode to an interest rate fixed to final stated maturity with no tender right) that occurs at the option of the issuer is a change. Similarly, alterations occurring, pursuant to the terms of the bond, "at the completion of construction," "upon obtaining a guarantee," or "upon obtaining necessary permits" are changes.

5.3 The resetting of the interest rate on a bond to a tender rate from another tender rate pursuant to the terms of the bond is not a change; neither is the accrual (pursuant to the terms of the bond, including the incorporation by reference of a guarantee) of a higher interest rate during a period when the bond is owned by a guarantor (or a holder who has purchased the bond with funds provided pursuant to a guarantee) pending successful remarketing of the bond.

5.4 An alteration in the terms of a bond which occurs automatically as a result of a discretionary alteration (for example, an automatic alteration in the security for a bond occurring when the interest rate is converted at the option of the issuer from a variable interest rate to an interest rate fixed to the maturity of the bond) is not a change. However, if

the terms of a bond initially secured by a guarantee from a guarantor rated "AA" by a nationally recognized rating agency require that on March 15, 1989, the issuer remarket the bond without a tender right and obtain a guarantee of the principal of, and interest on, the bond from a guarantor rated either "AAA" or "AA" by a nationally recognized rating agency, the remarketing of the bond on March 15, 1989, with a guarantee of a guarantor rated "AAA" is an alteration in the security for the bond which is a change, but the remarketing of the bond without the tender right is not a change.

6. Qualified tender change. The term "qualified tender change" means a change in the period between tender dates (including the final period to maturity) that occurs pursuant to the terms of the bond (when issued).

7.1 Qualified corrective change. The term "qualified corrective change" means any one of the following:

(a) A change that does not materially alter the rights or remedies of the holder. Examples of such changes include: a change that requires the holder to exercise a tender right no later than 12 noon on the tender date rather than no later than 3:00 p.m. on the tender date and a change in the list of permitted investments to include shares of regulated investment companies that invest in permitted investments. Such changes do not include: any change in the final stated maturity date of the bond, any change in the interest rate on the bond, any change in the payment dates of a bond, or any change in the security for a bond.

(b) A change that corrects a term of the bond to eliminate a result that could not reasonably have been intended on the date of issue. Such a change would include clarification of a provision to prevent an unintended windfall to the issuer or holder of the bond under a literal reading of the provision. A change will be deemed to clarify the original intent of the issuer and the bondholder to prevent an unintended windfall to either party if the change is of the type which would be ordered by a state court having jurisdiction over the matter under its power of reformation.

(c) A change which is necessary solely by reason of circumstances occurring after the date of issue which: (i) could not have been reasonably anticipated on the date of issue; (ii) are not related to bond market conditions or the creditworthiness of the issue; and (iii) are not

within the control of the issuer, any true obligor, any holder of the bond, any related person (as defined in section 147(a)(2)), anyone acting on behalf of any such person or persons, or any combination of the foregoing. Examples of such a change include: (A) a change in the maximum and/or minimum interest rate provisions of the bond to substitute a current index for a current index that is no longer widely relied upon and (B) a change to permit a guarantee that is required in the event the bond is remarketed without a tender right to be provided by a "AA" rated bank of a particular type rather than a "AAA" rated bank of such type if the number of qualifying banks with "AAA" ratings is materially and unexpectedly reduced after the date of issue.

8. Qualified tender purchase. The term "qualified tender purchase" means any purchase of a qualified tender bond pursuant to a tender right if such purchase occurs pursuant to the terms of the bond, the terms of the bond require that best efforts be used to remarket the bond, and the bond is remarketed no later than 30 days after the date of such purchase.

SECTION C. EFFECTIVE DATES

Except as otherwise provided in this section C, the rules set forth in this notice will apply to any bond originally sold after December 14, 1988. The rules set forth in this notice will apply to any bond that is subject to a tender right regardless of when sold, except that, with respect to a bond originally sold on or before December 14, 1988: (1) no bond that is subject to a tender right will be treated as if retired on a tender date solely by reason of the existence or exercise of the tender right; (2) the rule set forth in section A.2.2(a) shall not apply; and (3) a change which would have caused a retirement of a bond under the rule set forth in section A.2.2(a) will result in a retirement of the bond only if it would result in a disposition of the bond for purposes of section 1001.

SECTION D. EXAMPLES

Example (1). On December 30, 1989, CI, a city, issues an issue consisting of \$10 million par amount of its bonds. The issue price of each bond is par. The final stated maturity date of the bonds is July 1, 2027. All the proceeds of the issue are loaned to X, a private developer, to finance the construction of a multifamily housing project. The sole source of the

repayment of the bonds is amounts to be received from X in repayment of this loan. The average reasonably expected economic life of the project is 40 years. Interest on the bonds is payable on July 1 of each year. In connection with the issuance of the bonds, X unconditionally agrees to purchase at par any bond tendered to Z, a remarketing agent, on any interest payment date. Under the terms of the bonds, the interest rate is reset on each July 1 at the lowest rate that would enable the bonds to trade at par on that date. All the bonds are outstanding on July 1, 1992. All bonds tendered to Z are purchased with proceeds received by Z from the immediate remarketing of the bonds.

Although the bonds are tender bonds, they are not qualified tender bonds, because the final stated maturity date of the bonds (July 1, 2027) is later than 35 years after the date of issue (December 30, 1989). Accordingly, all the bonds are treated as retired on July 1, 1990 (the first tender date). On July 1, 1990, CI is considered to have "reissued" the bonds. The new issue is a refunding issue the proceeds of which are immediately used to retire the original bonds. Similar "reissuances" occur on the July 1, 1991 and July 1, 1992 tender dates. Since the final stated maturity date of the bonds that are part of the refunding issue, which is treated as issued on July 1, 1992, is not later than 35 years after the date of issue, the bonds that are part of this issue will not be treated as retired solely by reason of the tender right or the purchase of the bonds on a tender date pursuant to the tender right.

Example (2). On December 15, 1989, CI, a city, issues \$10 million par amount of bonds the proceeds of which are used to provide facilities to be owned and operated by CI. The average reasonably expected economic life of the facilities is 35 years. The issue price of each bond is par. The final stated maturity date of each bond is December 1, 2019. Under the terms of each bond, the holder is required to tender the bond to Z, a remarketing agent, on each mandatory tender date for purchase at par. If the holder does not actually tender the bond for purchase on a mandatory tender date, the bond is deemed to have been tendered for purchase. The principal and accrued interest to the mandatory tender date are paid directly by CI to the holder on the mandatory tender date. Z is required to use best efforts to remarket each tendered bond (the holder of which has not agreed with CI upon a new

tender period pursuant to the following paragraph) at par on the mandatory tender date and to use the proceeds received from the remarketing to pay the purchase price of the tendered bond. If the bond cannot be remarketed on the mandatory tender date, Z is required to draw on a letter of credit issued by X, a bank, to pay the purchase price of the tendered bond. If the letter of credit is drawn upon, the advance under the letter of credit bears interest at the prime rate of X. If Z is later successful in remarketing the bond, the proceeds received from the remarketing must be used to repay the principal of the letter of credit advance. CI ultimately is liable for repayment of all principal advanced under the letter of credit and interest thereon.

Under the terms of each bond, CI determines the next mandatory tender date for each bond. The interest rate on each bond for the period beginning on the date the bond is tendered and ending on the next mandatory tender date selected by CI is the rate determined by Z to be the lowest rate necessary to remarket the bond at par on the date the bond is tendered. Alternatively, on any mandatory tender date CI may elect to eliminate the tender feature of the bond. If CI so elects, several other basic terms of the bond (including the interest rate, redemption, and payment provisions) are automatically significantly altered. Any bond to which the election applies is remarketed on the mandatory tender date at par. The interest rate on the remarketed bond is the fixed interest rate determined by Z to be necessary to remarket the bond at par. On December 1, 1991, \$1 million of the bonds are tendered to Z. CI elects to eliminate the tender feature of all these bonds, and the bonds are remarketed on the same date at par.

The bonds are qualified tender bonds. None of the bonds is treated as retired merely by reason of the mandatory tender right, the purchase of the bond on a mandatory tender date pursuant to the tender right, the remarketing of the bond in accordance with the terms of the bond on a mandatory tender date, the selection by CI of the next mandatory tender date for a bond, the election by CI to eliminate the tender feature of some of the bonds and to cause those bonds to be remarketed at a fixed interest rate to maturity, and the automatic alterations of the interest rate, redemption, and payment provisions of the bond. The result would be the same if the bonds were originally sold on or before _____.

Example (3). On March 15, 1989, TN, a town issues \$25 million of its wastewater treatment plant bonds. The bonds are qualified tender bonds and the terms of the bonds provide that until construction of the plant is completed the bonds will be in a weekly tender and interest rate mode and will be guaranteed by a guarantor rated "AAA" by a nationally recognized rating agency. Pursuant to the terms of the bonds, 30 days after "completion of construction" the bonds must convert to an interest rate fixed to maturity with no tender right and must be guaranteed by a guarantor rated "at least AA" by a nationally recognized rating agency." Construction of the project is completed on April 1, 1992, and on May 1, 1992, pursuant to the terms of the bonds, TN remarkets the bonds without a tender right and substitutes a guarantor rated "AA" for the guarantor rated "AAA." On May 1, 1992, the number of qualifying banks with "AAA" ratings is not materially different from the number of such banks on March 15, 1989.

The bonds are deemed retired and reissued on May 1, 1992, because a change in the security for the bonds is made on that date, and such change is made in connection with a qualified tender change that extends the period between tender dates from a period not exceeding one year to a period exceeding one year.

Example (4). On July 15, 1989, AU, an authority, issues \$100 million of bonds for a solid waste disposal facility. The bonds are qualified tender bonds that after the issue date accrue interest at a weekly rate. The terms of the bonds authorize AU at its discretion to convert the variable interest rate to an interest rate fixed to the stated maturity of the bond (July 1, 2014). The terms of the bonds require the redemption of 20 percent of the bonds on July 1, 1999, if the bonds are converted to a fixed interest rate. The bonds to be called for redemption must be selected by lot. The terms of the bonds require AU to provide the holders of the bonds selected by lot for redemption with "not less than 60 days prior notice" of the redemption.

On July 1, 1991, AU converts the variable interest rate on the bonds to an interest rate fixed to the stated maturity of the bonds. AU also selects by lottery the 20 percent of the bonds to be called on July 1, 1999, and provides notice of this selection to the appropriate bondholders.

Under these circumstances, the entire \$100 million of bonds is deemed retired

and reissued on July 1, 1991, because the serialization of the term bonds is a change (other than a qualified corrective change) to the terms of the bonds in connection with a qualified tender change which qualified tender change increases the period between the tender dates from a period not exceeding one year to a period exceeding one year.

COMMENTS

Comments regarding this notice should be sent to: Internal Revenue Service, 1111 Constitution Avenue N.W., Attention: CC:FI&P (FI-90-86), Washington, D.C. 20224.

ADMINISTRATIVE PRONOUNCEMENT

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Plan Amendments and Protected Accruals Under Section 411(d)(6)

Notice 88-131

I. PURPOSE AND BACKGROUND

The purpose of this notice is to provide relief to sponsors of qualified pension, profit-sharing and stock bonus plans under section 401(a) and annuity plans under section 403(a) of the Internal Revenue Code, including sponsors and adopting employers of master and prototype plans, in order to provide time to review regulations and make decisions about benefit program redesign without incurring impractical costs in order to comply with the Tax Reform Act of 1986, the Omnibus Budget Reconciliation Act of 1986 and the Omnibus Budget Reconciliation Act of 1987 (collectively, TRA '86).

Regulations issued pursuant to section 401(b) of the Code have been amended to include provisions of TRA '86 within the definition of disqualifying provisions, thus permitting plan sponsors an extended remedial amendment period in which to amend their plans to comply retroactively with TRA '86. See Income Tax Regulations 1.401(b)-1(b)(2)(ii). Section 401(b), however, does not permit plan sponsors to retroactively reduce or eliminate benefits protected by section 411(d)(6).

Although plan sponsors will be able to comply with newly effective qualifica-