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TREASURY ADOPTS RULES FOR TAXING INTEREST ON INDUSTRIAL DEVELOPMENT BONDS

The Treasury Department today announced final rules governing the Federal income tax status of interest which State and local governments pay on industrial development bonds. The rules will be published as a Treasury Decision in the Federal Register for Thursday, August 3, 1972.

Treasury published proposed rules for the tax treatment of interest on industrial development bonds on January 14, 1969. After a public hearing, the Department issued revised proposals on June 5, 1971. The final regulations announced today have been changed from the June 5, 1971 proposals, in response to many public comments received in writing and at a second public hearing. The final regulations also reflect changes in the industrial development bond provisions of the Internal Revenue Code made by the Revenue Act of 1971.

Under the Federal tax laws, a bond issued by a State or local government generally is treated as an "industrial development bond," and the interest paid on the bond is subject to Federal income tax, if (1) a "major portion" of the bond proceeds will be used in the business of a taxable person, and (2) if repayment of the bonds is secured by, or will be derived from, payments by such a taxable business for the use or purchase of property.

Even though an obligation may be an industrial development bond, the interest paid on it may nevertheless be exempt from Federal income tax if the bond proceeds are used in certain exempt activities specified by law.

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These exempt activities include, for example, the local furnishing of electric energy, gas, or water, and air and water pollution control facilities.

Also exempt from Federal income tax is the interest paid on industrial development bond issues of less than $1 million, or in some cases of less than $5 million.

Treasury's regulations are designed to implement the industrial development bond provisions of the tax laws by defining the meaning and scope of the various terms and exemptions. For example, the final regulations provide that a "major portion" of the proceeds of a bond issue will be defined as generally being more than 25 percent.

The final regulations also provide simplified rules for applying the "major portion" test contained in the definition of industrial development bonds to public utilities providing electric energy, gas, or water facilities which have contracts with taxable persons either to take, or take or pay, for the output of the facilities. Under Treasury's proposed regulations, the output would have been considered used in the trades or businesses of taxable persons if more than 50 percent of the output was to be used by them for 15 years or one-half the useful life of the facility, whichever is shorter. The final rules simply provide, in effect, that the test is whether 25 percent of the output over the term of the bond issue will be so used.

Among other provisions, the final rules also:

-- Define and give examples of "the local furnishing of electric energy or gas", "air and water pollution control facilities" and "solid waste disposal facilities". However, rules for determining whether facilities to remove potential pollutants from fuel are pollution control facilities are reserved for future consideration.

-- Specify that to qualify as an exempt activity, a facility must serve or be available on a regular basis for general public use, or be part of a facility of this type. The final rules make it easier to satisfy this public use test in certain cases.

-- Explain the manner of determining whether bond issues meet the exemption for those of less than $1 million or $5 million. The final regulations make it clear that with respect to future bond issues a facility that is physically located on the border between two jurisdictions will be treated as located in both jurisdictions and thus limited to exempt capital expenditures of $5 million in the aggregate, rather than an exemption of $5 million in each of the jurisdictions.

-- Specify that the use of the proceeds to provide exempt facilities - e.g., sports facilities or pollution control facilities - does not include the refinancing of existing facilities.

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