Internal Revenue Service

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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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May 15, 2002

LEGEND:

Issuer

Facility

Month

Year 1

Year 2

Year 3

Year 4

Year 5

Dear

This is in response to your request for the following rulings:

1. The issuance, maturities and mandatory sinking fund redemptions of the Refunding Bonds and Subsequent Bonds (as defined below and together, the "Proposed Bonds") will not give rise to replacement proceeds as defined in § 1.148-1(c) of the Income Tax Regulations.

2. The Proposed Bonds will not be considered to finance restricted working capital expenses, and the proceeds-spent-last rule in § 1.148-6(d)(3)(i) will not apply.

3. The issuance of the Proposed Bonds will not be considered as the use of an abusive arbitrage device or to be an overburdening of the tax-exempt bond market under § 1.148-10.

FACTS AND REPRESENTATIONS:

In Year 1, the Issuer issued four series of revenue bonds as part of a single issue to fund construction of the Facility (the "Prior Bonds"). The Facility is expected to be placed into service in Month of Year 2. Revenues of the Facility will not be generated until the Facility is placed into service and, thereafter, are expected to increase over an extended period of time as usage increases.

The Prior Bonds include current interest bonds, capital appreciation bonds (the "Prior Capital Appreciation Bonds"), and convertible capital appreciation bonds. The Issuer selected the particular mix of the types, amounts and maturities of bonds in a manner designed to finance the Facility at the lowest possible debt service cost, with the entire issue having a payment schedule that could be paid from the estimated amounts of revenues available from the Facility. The Issuer sought to accomplish this goal by issuing as many bonds as possible with investment-grade ratings. The Issuer also sought to use current interest bonds to the maximum extent possible and minimize the use of capital appreciation bonds. This is because capital appreciation bonds, which allow the Issuer to defer payment of interest until redemption, would sell at yields higher than those for current interest bonds with similar maturities. Factors affecting the number of current interest bonds that could be issued were the revenues expected to be available to make interest payments on current interest bonds, and in the absence of such revenues, the market's willingness to purchase bonds the proceeds of which will be used to pay interest on current interest bonds. The weighted average maturity of the Prior Bonds is not greater than 120 percent of the reasonably expected economic useful life of the Facility.

The Issuer wishes to enter into the transaction described below to refund all or a portion of the Prior Capital Appreciation Bonds (the "Refunded Bonds"). The Refunded Bonds mature on June 15th of years spanning from Year 3 through Year 5. The weighted average maturity of the Refunded Bonds is not greater than 120 percent of the reasonably expected economic useful life of the Facility.

The Issuer proposes to issue current refunding bonds (the "Refunding Bonds") that will be variable rate demand bonds paying interest semiannually. The Refunding Bonds will mature in Year 5, but will be subject to mandatory sinking fund redemptions from Year 3 through Year 4 in amounts that, to the extent feasible, correspond to the amounts that would have been payable on the Refunded Bonds were they not refunded. The weighted average maturity of the Refunding Bonds will not be greater than the weighted average maturity of the Refunded Bonds.

In addition, the Issuer proposes to issue separate issues of bonds periodically to fund the payment of the semiannual interest payable on the Refunding Bonds and on any bonds previously issued for this purpose (the "Subsequent Bonds"). Any Subsequent Bonds would be issued on interest payment dates in an amount necessary to make the interest payment due on that date. However, to the extent monies in the debt service fund for the Proposed Bonds exceed the amount of principal payable within the next 12 months on the Proposed Bonds (*i.e.*, to the extent the Issuer has funds on deposit in the debt service fund to pay interest), the Issuer expects to use the excess to pay interest on the Proposed Bonds rather than issuing Subsequent Bonds. Moreover, the Issuer will not issue Subsequent Bonds and will retire outstanding Subsequent Bonds if, and to the extent that, in the exercise of the Issuer's prudent judgment, the Issuer's funds exceed the amounts reasonably required to satisfy its anticipated business needs. Notwithstanding, the Issuer does not expect that it will make periodic monthly deposits to the debt service fund to pay the interest payments on the Proposed Bonds. The Issuer anticipates issuing Subsequent Bonds on each interest payment date of the Refunding Bonds to pay the then-current interest payment on the Refunding Bonds and on any previously issued Subsequent Bonds. The Issuer does not expect the issuance of Subsequent Bonds will exceed in either maturity or amount the bonds which would be issued if the interest on such bonds were not excludable under § 103(a) of the Internal Revenue Code (the "Code") (assuming that the hypothetical taxable interest rate would be the same as the actual tax-exempt interest rate).

The Subsequent Bonds, like the Refunding Bonds, will be variable rate demand bonds that pay interest semiannually. The Subsequent Bonds similarly will mature in Year 5, but be subject to mandatory sinking fund redemptions from Year 3 through Year 4 in amounts that, to the extent feasible, correspond to the amounts that would have been payable on the Refunded Bonds. The weighted average maturity of the Proposed Bonds, considered as a whole, will be less than the remaining weighted average maturity of the Refunded Bonds.

The Issuer will hedge the variable interest payments on the Proposed Bonds. To accomplish this, the Issuer will enter into one or more agreements (the "Agreements") with a counterparty in which the Issuer will make payments based on a fixed rate of interest and receive payments based on an indexed floating rate expected to be substantially equivalent to the rate on the Proposed Bonds throughout their term. The total notional principal amount on the Agreements will be equal to the principal amount of the Refunding Bonds. The amount of each party's payment will compound semiannually on the dates interest payments on the Refunding Bonds are due. The fixed payments will compound at the fixed interest rate, and the variable payments will compound at the then-variable rate. Although amounts are calculated at these intervals, payments are not made at these intervals. Rather, the counterparty's payments will occur on the retirement or redemption dates of the Proposed Bonds. The Issuer's corresponding payments to the counterparty will be made within 15 days of the counterparty's payments. The term of the Agreements will correspond with the term of the Proposed Bonds. However, the Issuer will be able to terminate any of the Agreements, in whole or in part, on any date at the then-market value of such agreements, potentially resulting in a termination payment by the Issuer or the counterparty. For example, if the Issuer does not issue Subsequent Bonds on a particular date, it may terminate the portion of the Agreements that relates to such bonds.

The structure proposed by the Issuer is economically equivalent to the issuance of fixed rate capital appreciation bonds, but at a lower debt service cost to the Issuer than the Refunded Bonds or a refunding actually utilizing fixed rate capital appreciation bonds.

In addition to the debt service fund referred to above, the indenture for the Prior Bonds and the Proposed Bonds provides for the creation of the debt service reserve fund, the construction fund, the capitalized interest fund, the operating reserve fund, the renewal and replacement fund, the supplemental reserve fund, the rebate fund and the surplus fund. The indenture describes the flow of revenues of the Facility into certain of these funds, and specifies the sequence of the funds into which the deposits of revenues will be made and the funding requirements for these funds. Generally, the indenture requires the revenues to be deposited into each fund in the sequence until the amount of the funding requirement of that fund is reached (the last fund in the flow of revenues, the surplus fund, has no funding requirement). The funding requirements for the funds created under the indenture will not exceed the levels that would be required if the interest on the Proposed Bonds were not excludable under § 103(a) (assuming that the hypothetical taxable interest rate would be the same as the actual tax-exempt interest rate).

With respect to the operating reserve fund, the supplemental reserve fund and the renewal and replacement fund, the funding requirements were established at the levels reasonably expected to be necessary to serve the purposes for which such funds were created, and were based on discussions with the bond rating agencies and the bond insurer, the anticipated needs of the Authority, and the market requirements as reflected in other similar financings, whether taxable or tax-exempt. However, to the extent that the amount on deposit in any of the operating reserve fund, the supplemental reserve fund and the renewal and replacement fund is less than its funding requirement, the indenture imposes no obligation to deposit amounts into the fund other than to the extent of available revenues. Moreover, there is no event of default under the indenture if the available revenues are insufficient to fully satisfy the funding requirements for these funds.

With respect to the operating reserve fund, the renewal and replacement fund, the supplemental reserve fund, the rebate fund and the surplus fund (*i.e*., the funds that are not funded with proceeds), the amounts in such funds are not expected to be used to pay debt service on the Proposed Bonds, and there is no assurance that such amounts will be available to pay debt service on the Proposed Bonds. The operating reserve fund may be used to pay operating expenses of the Facility not paid from other sources. The renewal and replacement fund may be used for maintenance and repair of, and environmental mitigation for the Facility. The rebate fund may only be used to pay Federal arbitrage rebate payments. The supplemental reserve fund may be used for capital expenditures related to the Facility. The surplus fund may be used by the Issuer for any authorized purpose. The indenture does not contain any restrictions on the use of the funds for these respective purposes, other than in the circumstances described below. In the event of default on the Proposed Bonds, amounts in each of these funds (other than the rebate fund) may be used for debt service on the Proposed Bonds. Also, if on any date, the amount in the debt service fund for the Proposed Bonds is insufficient to pay the debt service or redemption price due on that date (*e.g.*, if no Subsequent Bonds are issued), the indenture will require monies to be transferred to the debt service fund from the surplus fund, the supplemental reserve fund, the renewal and replacement fund, the debt service reserve fund, the capitalized interest fund, and the construction fund, in that order, to the extent necessary.

LAW:

Section 103(a) of the Internal Revenue Code (the "Code") provides that, except as provided in subsection (b), gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that subsection (a) shall not apply to any arbitrage bond (within the meaning of § 148).

Section 148(a) provides that the term "arbitrage bond" means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly (1) to acquire higher yielding investments, or (2) to replace funds which were used directly or indirectly to acquire higher yielding investments. Further, for purposes of § 148(a), a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described in (1) or (2).

Section 1.148-1(c)(1) provides that amounts are replacement proceeds of an issue if the amounts have a sufficiently direct nexus to the issue or to the governmental purpose of the issue to conclude that the amounts would have been used for that governmental purpose if the proceeds of the issue were not used or to be used for that governmental purpose. For this purpose, governmental purposes include the expected use of amounts for the payment of debt service on a particular date. The mere availability or preliminary earmarking of amounts for a governmental purpose, however, does not in itself establish a sufficient nexus to cause those amounts to be replacement proceeds. Replacement proceeds include, but are not limited to, sinking funds, pledged funds, and other replacement proceeds described in §1.148-1(c)(4), to the extent that those funds or amounts are held by or derived from a substantial beneficiary of the issue. A substantial beneficiary of an issue includes the issuer and any related party to the issuer, and, if the issuer is not a state, the state in which the issuer is located. A person is not a substantial beneficiary of an issue solely because it is a guarantor under a qualified guarantee.

Section 1.148-1(c)(2) provides that a sinking fund includes a debt service fund, redemption fund, reserve fund, replacement fund, or any similar fund, to the extent reasonably expected to be used directly or indirectly to pay principal or interest on the issue.

Section 1.148-1(c)(3)(i) provides that a pledged fund is any amount that is directly or indirectly pledged to pay principal or interest on the issue. A pledge need not be cast in any particular form but, in substance, must provide reasonable assurance that the amount will be available to pay principal or interest on the issue, even if the issuer encounters financial difficulties.

Section 1.148-1(c)(3)(ii) provides that an amount is treated as pledged to pay principal or interest on an issue if it is held under an agreement to maintain the amount at a particular level for the direct or indirect benefit of the bondholders or a guarantor of the bonds. An amount is not treated as pledged, however, if: (A) the issuer or a substantial beneficiary may grant rights in the amount that are superior to the rights of the bondholders or the guarantor; or (B) the amount does not exceed reasonable needs for which it is maintained, the required level is tested no more frequently than every 6 months, and the amount may be spent without any substantial restriction other than a requirement to replenish the amount by the next testing date.

Section 1.148-1(c)(4)(i)(A) provides that replacement proceeds arise to the extent that the issuer reasonably expects as of the issue date that: (1) the term of an issue will be longer than is reasonably necessary for the governmental purposes of the issue, and (2) there will be available amounts during the period that the issue remains outstanding longer than necessary. Whether an issue is outstanding longer than necessary is determined under § 1.148-10. Replacement proceeds are created under § 1.148-1(c)(4)(i)(A) at the beginning of each fiscal year during which an issue remains outstanding longer than necessary in an amount equal to available amounts of the issuer as of that date.

Section 1.148-1(c)(4)(i)(B) provides, as a safe harbor, that replacement proceeds do not arise under §1.148-1(c)(4)(i)(A):

(*1*) For the portion of an issue that is to be used to finance restricted working capital expenditures, if that portion is not outstanding longer than 2 years;

(*2*) For the portion of an issue (including a refunding issue) that is to be used to finance or refinance capital projects, if that portion has a weighted average maturity that does not exceed 120 percent of the average reasonably expected economic life of the financed capital projects, determined in the same manner as under § 147(b); or

(*3*) For the portion of an issue that is a refunding issue, if that portion has a weighted average maturity that does not exceed the remaining weighted average maturity of the prior issue, and the issue of which the prior issue is a part satisfies § 1.148(c)(4)(i)(B)(1) or (2).

Revenue Ruling 79-134, 1979-1 C.B. 76, addressed the application of the arbitrage provisions to a depreciation reserve fund pledged as security for certain bonds issued to finance construction of a hospital. The hospital owner derived nearly 90 percent of its revenues from medical reimbursement plans that required the owner to set aside the portion of reimbursed medical payments allocated to the cost of depreciation and make such funds available to replace the owner's depreciable property. Under the indenture, the owner agreed to deposit monthly in the depreciation reserve fund an amount equal to one-twelfth of its annual depreciation expense. The depreciation reserve fund consisted of a restricted account and a surplus account. The amounts in the surplus account were not expected to exceed the amount needed to replace the depreciable property. The monies in the surplus account could be used in the absence of default for the construction of improvements, the purchase of depreciable property, or for any lawful purpose. The ruling concluded that the issuer did not reasonably expect the amounts in the surplus account to be used for debt service and held that the amounts in the surplus account would not be subject to the arbitrage rules.

Section 1.148-1(b) defines restricted working capital expenditures as working capital expenditures that are subject to the proceeds-spent-last rule in § 1.148-6(d)(3)(i) and are ineligible for any exception to that rule.

Section 1.148-1(b) defines capital project as all capital expenditures, plus related working capital expenditures to which the de minimis rule under § 1.148-6(d)(3)(ii)(A) applies, that carry out the governmental purposes of an issue.

Section 1.148-6(d)(3)(i) provides that, except as otherwise provided in § 1.148-6(d)(3) or (d)(4), proceeds of an issue may only be allocated to working capital expenditures as of any date to the extent that those working capital expenditures exceed available amounts (as defined in § 1.148-6(d)(3)(iii)) as of that date (*i.e.*, a "proceeds-spent-last" method). For this purpose, proceeds include replacement proceeds described in § 1.148-1(c)(4).

Section 1.148-6(d)(3)(ii)(C) provides that § 1.148-6(d)(3)(i) does not apply to expenditures for payment of principal, interest, or redemption prices on a prior issue and, for a crossover refunding issue, interest on that issue.

Section 1.148-6(d)(3)(ii)(D) provides that the exceptions provided in § 1.148-6(d)(3)(ii) do not apply if the allocation merely substitutes gross proceeds for other amounts that would have been used to make those expenditures in a manner that gives rise to replacement proceeds. For example, if a purported reimbursement allocation of proceeds of a reimbursement bond does not result in an expenditure under § 1.150-2, those proceeds may not be allocated to pay interest on an issue that, absent this allocation, would have been paid from the issuer's current revenues.

Section 1.148-10(a)(1) provides that bonds of an issue are arbitrage bonds under § 148 if an abusive arbitrage device under § 1.148-10(a)(2) is used in connection with the issue. Section 1.148-10(a) is to be applied and interpreted broadly to carry out the purposes of § 148, as further described in § 1.148-0. Except as otherwise provided in § 1.148-10(c), any action that is expressly permitted by § 148 or §§ 1.148-1 through 1.148-11 is not an abusive arbitrage device (*e.g.*, investment in higher yielding investments during a permitted temporary period under § 148(c)).

Section 1.148-10(a)(2) provides that any action is an abusive arbitrage device if the action has the effect of: (i) enabling the issuer to exploit the difference between tax-exempt and taxable interest rates to obtain a material financial advantage; and (ii) overburdening the tax-exempt bond market. Section 1.148-10(a)(4) provides that an action overburdens the tax-exempt bond market if it results in issuing more bonds, issuing bonds earlier, or allowing bonds to remain outstanding longer than is otherwise reasonably necessary to accomplish the governmental purposes of the bonds, based on all the facts and circumstances. Whether an action is reasonably necessary to accomplish the governmental purposes of the bonds depends on whether the primary purpose of the transaction is a bona fide governmental purpose (e.g., an issue of refunding bonds to achieve a debt service restructuring that would be issued independent of any arbitrage benefit). An important factor bearing on this determination is whether the action would reasonably be taken to accomplish the governmental purpose of the issue if the interest on the issue were not excludable from gross income under § 103(a) (assuming that the hypothetical taxable interest rate would be the same as the actual tax-exempt interest rate). Factors evidencing an overissuance include the issuance of an issue the proceeds of which are reasonably expected to exceed by more than a minor portion the amount necessary to accomplish the governmental purposes of the issue, or an issue the proceeds of which are, in fact, substantially in excess of the amount of sale proceeds allocated to expenditures for the governmental purposes of the issue. One factor evidencing an early issuance is the issuance of bonds that do not qualify for a temporary period under § 1.148-2(e)(2), (e)(3), or (e)(4). One factor evidencing that bonds may remain outstanding longer than necessary is a term that exceeds the safe harbors against the creation of replacement proceeds under § 1.148-

1(c)(4)(i)(B). These factors may be outweighed by other factors, however, such as bona fide cost underruns or long-term financial distress.

Section 1.150-1(d)(1) defines refunding issue as an issue of obligations the proceeds of which are used to pay the principal, interest, or redemption price on another issue (a prior issue, as more particularly defined in § 1.150-1(d)(5)), including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue.

Section 1.150-1(d)(2) provides that an issue is not a refunding issue if the only principal and interest that is paid with proceeds of the issue (determined without regard to the multipurpose issue rules of § 1.148-9(h)) is interest on another issue that (A) accrues on the other issue during a one-year period including the issue date of the issue that finances the interest; (B) is a capital expenditure; or (C) is a working capital expenditure to which the de minimis rule of § 1.148-6(d)(3)(ii)(A) applies.

ANALYSIS:

Certain of the Issuer's representations concerning its proposed actions are expressed in terms of its expectations. Our analysis is based on the Issuer's acting in accordance with those expectations.

Replacement Proceeds

We conclude that the issuance, maturities and mandatory sinking fund redemptions of the Proposed Bonds will not give rise to replacement proceeds. As more specifically described below, there are no amounts that have a sufficiently direct nexus to the Proposed Bonds or to the governmental purposes of the Proposed Bonds to conclude that the amounts would have been used for that governmental purpose if the proceeds of the Proposed Bonds were not used or to be used for that purpose.

The issuance of the Proposed Bonds will not replace any amounts in the debt service fund. The Issuer expects to issue the Subsequent Bonds to pay interest on the Proposed Bonds and, therefore, does not expect to make any deposits to the debt service fund to pay such interest. To the extent that the Issuer deposits monies into the debt service fund to pay interest on the Proposed Bonds, the Issuer will not issue the Subsequent Bonds.

In addition, amounts on deposit in the operating reserve fund, the renewal and replacement fund, the supplemental reserve fund, the rebate fund, and the surplus fund will not be replacement proceeds of the Proposed Bonds. The amounts in these funds will not be a sinking fund as they are not expected to be used to pay debt service on the Proposed Bonds. They will not be a pledged fund because there is no assurance that such monies will be available to pay debt service on the Proposed Bonds. In general, these funds are designated for specified purposes (other than debt service) under the indenture and may be used by the Issuer for such purposes without limitation. With respect to the operating reserve fund, the supplemental reserve fund and the renewal and replacement fund, the funding requirements were established at the levels expected to be reasonably necessary to serve the purposes for which such funds were created, and were based on discussions with the bond rating agencies and the bond insurer, the anticipated needs of the Authority, and the market requirements as reflected in other similar financings, whether taxable or tax-exempt. The funding requirements for these funds will not exceed the levels that would be required if the interest on the Proposed Bonds were not excludable under § 103(a) (assuming that the hypothetical taxable interest rate would be the same as the actual tax-exempt interest rate).

Moreover, there is no negative pledge, as there is no agreement to maintain such funds at a particular level. To the extent that the amount on deposit in any of the operating reserve fund, the supplemental reserve fund and the renewal and replacement fund is less than its funding requirement, the indenture imposes no obligation to deposit amounts into the fund other than to the extent of available revenues. There is no event of default under the indenture if the available revenues are insufficient to fully satisfy the funding requirements for these funds.

While the amounts in these funds may be used for debt service in the case of an event of default or if monies in the debt service fund on a given date are insufficient to pay debt service due on such date, these provisions do not, by themselves, cause the amounts to be replacement proceeds. *See* Rev. Rul. 79-134, 1979-1 C.B. 76. If, however, either of these eventualities were to occur, then the amounts that are transferred or for which the use becomes restricted would become replacement proceeds.

Finally, the Proposed Bonds will not lead to the creation of other replacement proceeds. The Refunding Bonds meet the safe harbor in § 1.148-1(c)(4)(B)(*2*), as the weighted average maturity of the Refunding Bonds is less than 120 percent of the reasonably expected useful life of the Facility. However, there is no safe harbor applicable to the Subsequent Bonds to determine if they result in the creation of other replacement proceeds, as they will not be used to finance restricted working capital expenditures (as discussed below) and they do not finance a capital project under § 1.148-1(b) or constitute a refunding issue under § 1.150-1(d)(2)(i)(A).

Regardless, we conclude that the Subsequent Bonds will not be outstanding longer than necessary and, therefore, do not result in the creation of other replacement proceeds. In the first instance, the maturities of the Refunded Bonds were reasonably determined as part of a larger issue based on the revenues expected to be available from the Facility and the Refunded Bonds met the safe harbor in § 1.148-1(c)(4)(B)(*2*).

As capital appreciation bonds, the Refunded Bonds had an issue price, with interest accruing and compounding on such amount to maturity. The Subsequent Bonds are being issued to perform the same function as the interest that would otherwise have permissibly accrued and compounded on the Refunded Bonds without the creation of other replacement proceeds, and the maturities and mandatory sinking fund redemptions will correspond, to the extent feasible, to the amounts that would have been payable on the Refunded Bonds. Ultimately, the substance of the proposed transaction is the same as if the Issuer refunded the Refunded Bonds with fixed rate capital appreciation bonds, but at a lower debt service cost to the Issuer than actually issuing fixed rate capital appreciation bonds. Moreover, the Issuer does not expect the maturity of the Subsequent Bonds to exceed that which would be issued if the interest on such bonds were not excludable under § 103 (assuming that the hypothetical taxable interest rate would be the same as the actual tax-exempt interest rate). Finally, the Issuer will retire outstanding Subsequent Bonds to the extent that the Issuer has funds in excess of its anticipated business needs.

Restricted Working Capital Expenses

The proceeds-spent-last rule will not apply to the Proposed Bonds. The Proposed Bonds qualify for the exception under § 1.148-6(d)(3)(ii)(C) for the payment of principal, interest and redemption prices on a prior issue and, thus, will not be considered to be used to finance restricted working capital expenses. The Refunding Bonds will be used to pay principal and interest on the Refunded Bonds. The Subsequent Bonds will be used to pay interest on the Refunding Bonds and previously issued Subsequent Bonds. Moreover, as discussed above and as required by § 1.148-6(d)(3)(ii)(D), the issuance of the Proposed Bonds will not result in the creation of replacement proceeds.

Abusive Arbitrage Device/Overburdening

The issuance of the Proposed Bonds will not be an abusive arbitrage device or an overburdening under § 1.148-10, because neither the Refunding Bonds nor the Subsequent Bonds overburden the tax-exempt market.

The Refunding Bonds will not overburden the tax-exempt market. There is not an issuance of more bonds than necessary because the proceeds will be issued in an amount necessary to pay the Refunded Bonds. They will not be issued too early because, as current refunding bonds, the proceeds will be used to pay off the Refunded Bonds within 90 days. Last, the Refunding Bonds will not be outstanding longer than necessary. The maturities of the Refunded Bonds were reasonably determined as part of a larger issue based on the revenues expected to be available from the Facility. The Refunding Bonds do not extend the average maturity of the Refunded Bonds. Also, the Refunding Bonds meet the safe harbor against the creation of replacement proceeds under § 1.148-1(c)(4)(i)(B)(*2*)

The Subsequent Bonds will not overburden the tax-exempt market. There is not an issuance of more bonds than necessary because the amount of such bonds issued will be that needed to pay interest on the Refunding Bonds and previously issued Subsequent Bonds, reduced to take into account any monies in the debt service fund available to pay interest on such bonds. This amount corresponds to the amount of interest that would have permissibly accrued and compounded on the Refunded Bonds in the absence of the refunding transaction. As noted earlier, the structure of the transaction is the economic equivalent of fixed rate capital appreciation bonds, but at a lower debt service cost to the Issuer. The Issuer does not expect the issuance of Subsequent Bonds to exceed in either maturity or amount the bonds that would be issued if the interest on such bonds were not excludable under § 103(a) (assuming that the hypothetical taxable interest rate would be the same as the actual tax-exempt interest rate). Further, the Issuer will not issue the Subsequent Bonds and will retire outstanding Subsequent Bonds if and to the extent that, in the exercise of its prudent judgment, their funds exceed the amounts reasonably necessary to satisfy its anticipated business needs. The Subsequent Bonds will not be issued too early, as they will be issued on interest payment dates to fund the interest payment on that date. Finally, as discussed under "Replacement Proceeds" above, the Subsequent Bonds will not be outstanding longer than necessary.

CONCLUSIONS:

In its representations, the Issuer indicated its expectations as to certain actions as reflected in the above description of facts and representations. Provided that the Issuer acts in accordance with its expectations:

1. The issuance, maturities and mandatory sinking fund redemptions of the Proposed Bonds will not give rise to replacement proceeds as defined in § 1.148-1(c) of the Income Tax Regulations.

2. The Proposed Bonds will not be considered to finance restricted working capital expenses, and the proceeds-spent-last rule in § 1.148-6(d)(3)(i) will not apply.

3. The issuance of the Proposed Bonds will not be considered as the use of an abusive arbitrage device or to be an overburdening of the tax-exempt bond market under § 1.148-10.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether interest on the Proposed Bonds is excludable from gross income under § 103(a) or whether the Agreements are a qualified hedge under § 1.148-4(h).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)

By: ______________________________
Bruce M. Serchuk
Senior Technician Reviewer
Tax Exempt Bond Branch