

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8826]

RIN 1545-AX23

Qualified Zone Academy Bonds; Obligations of States and Political  
Subdivisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that provide guidance to state and local government issuers of qualified zone academy bonds. These temporary regulations change the method of ascertaining the qualified zone academy bond credit rate and provide reimbursement rules. State and local governments that issue qualified zone academy bonds will be affected by these temporary regulations. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective July 1, 1999.

Applicability Date: For dates of applicability, see §1.1397E-1T(j).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations,

Timothy L. Jones (202) 622-3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

Section 226(a) of the Taxpayer Relief Act of 1997, Public Law 105-34, (111 Stat. 788), amended the Internal Revenue Code by redesignating section 1397E as 1397F and adding a new section 1397E. Section 1397E authorizes a new type of debt instrument known as a qualified zone academy bond. Temporary regulations interpreting section 1397E were published on January 7, 1998 (63 FR 671).

**Explanation of Provisions**

In General

A qualified zone academy bond is a taxable bond issued by a state or local government, the proceeds of which are used to improve certain eligible public schools. In lieu of receiving periodic interest payments from the issuer, an eligible holder of a qualified zone academy bond is generally allowed annual federal income tax credits while the bond is outstanding. These credits compensate the holder for lending money to the issuer and function as payments of interest on the bond.

Credit Rate

Under section 1397E(b)(2), the Secretary shall determine a credit rate for qualified zone academy bonds that the Secretary estimates will permit the bonds to be issued without discount and without interest cost to the issuer. Section 1.1397E-1T(b) provides that the credit rate for a qualified zone academy bond

is equal to 110 percent of the long-term applicable Federal rate (AFR), compounded annually, for the month in which the bond is issued.

Comments have been received that the credit rate established by §1.1397E-1T(b) is generally lower than the rate required to permit the issuance of qualified zone academy bonds without discount and without interest cost to the issuer. Comments have also been received that a single credit rate applicable to obligations issued during a monthly period is too rigid and non-responsive to market interest rate movements.

The revised regulations state that the Secretary will determine monthly (or more often as the Secretary deems necessary) a credit rate that will generally permit the issuance of qualified zone academy bonds without discount and without interest cost to the issuers. The revised regulations also provide that the manner for ascertaining the credit rate determined by the Secretary will be set forth in procedures, notices, forms, and instructions as prescribed by the Commissioner. A notice to be published in the Internal Revenue Bulletin will further provide that, until otherwise provided, the qualified zone academy bond credit rate will be determined daily and will be published on the Internet site for State and Local Government Bonds. The credit rate to be applied to a qualified zone academy bond will be the daily rate for the first day on which there is a binding contract in writing for the sale or exchange of the bond. Treasury and the IRS will monitor the

issuance of qualified zone academy bonds to determine if future adjustments in the credit rate may be required.

#### Coordination with Reimbursement Rules

These temporary regulations provide that the proceeds of a qualified zone academy bond may be used to reimburse a qualified expenditure (including any qualified non-capital expenditure) made prior to the date the bond was issued. The temporary regulations provide that rules similar to the reimbursement rules set forth in §1.150-2 will apply. Comments are solicited about whether these rules provide adequate guidance regarding reimbursement matters for issuers of qualified zone academy bonds.

#### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. See also the Special Analysis Section of the notice of proposed rulemaking on qualified zone academy bonds in the Proposed Rules Section of this issue of the Federal Register. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal author of these regulations is Timothy L. Jones, Office of Assistant Chief Counsel (Financial Institutions & Products). However, other personnel from IRS and the Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

## PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.1397E-1T is amended as follows:

1. Revising paragraphs (b) and (j);
2. Redesignating paragraph (h) as paragraph (i);
3. Adding new paragraph (h).

The revisions and additions read as follows:

§1.1397E-1T Qualified zone academy bonds (temporary).

\* \* \* \* \*

(b) Credit Rate. The Secretary shall determine monthly (or more often as deemed necessary by the Secretary) the credit rate the Secretary estimates will generally permit the issuance of a qualified zone academy bond without discount and without interest cost to the issuer. The manner for ascertaining the credit rate

for a qualified zone academy bond as determined by the Secretary shall be set forth in procedures, notices, forms, or instructions prescribed by the Commissioner.

\* \* \* \* \*

(h) Reimbursement. An expenditure for a qualified purpose may be reimbursed with proceeds of a qualified zone academy bond. For this purpose, rules similar to those in §1.150-2 shall apply.

\* \* \* \* \*

(j) Effective dates. Except as provided in this paragraph (j), this section applies to a qualified zone academy bond issued on or after January 1, 1998. Paragraph (b) and paragraph (h) of this section shall apply to a qualified zone academy bond sold on or after July 1, 1999. Paragraph (b) of this section as in effect on January 7, 1998 (See 26 CFR Part 1 as revised April 1, 1999), shall apply to a qualified zone academy bond sold prior to July 1, 1999. This section shall not apply to a qualified zone academy bond sold after January 5, 2001.

Deputy Commissioner of Internal Revenue  
Robert E. Wenzel

Approved: June 22, 1999

Assistant Secretary of the Treasury (Tax Policy)  
Donald C. Lubick