(b)(2)(ii) *Exceptions to certification requirement.* An issuer is not required to make a certification for an issue under §1.148–2(b)(2)(i) if—

(A) The issuer reasonably expects as of the issue date that there will be no unspent gross proceeds after the issue date, other than gross proceeds in a bona fide debt service fund (e.g., *equipment lease* financings in which the issuer purchases equipment in exchange for an installment payment note); or

(B) The issue price of the issue does not exceed $1,000,000.

[T.D. 8538, 59 FR 24042, May 10, 1994. Redesignated by T.D. 8718, 62 FR 25507, May 9, 1997]

§ 1.148–3A General arbitrage rebate rules.

(a) through (h)(2) [Reserved]. For guidance see §1.148–3.

(h)(3) *Waivers of the penalty.* For purposes of §1.148–3(h)(3), willful neglect does not include a failure that is attributable solely to the permissible retroactive selection of a short first bond year if the rebate amount that the issuer failed to pay is paid within 60 days of the selection of that bond year.

[T.D. 8538, 59 FR 24042, May 10, 1994. Redesignated by T.D. 8718, 62 FR 25507, May 9, 1997]

§ 1.148–4A Yield on an issue of bonds.

(a) through (b)(4) [Reserved]. For guidance see §1.148–4.

(b)(5) *Special aggregation rule treating certain bonds as a single fixed yield bond.* Two variable yield bonds of an issue are treated in the aggregate as a single fixed yield bond if—

(i) Aggregate treatment would result in the single bond being a fixed yield bond; and

(ii) The terms of the bonds do not contain any features that could distort the aggregate fixed yield from what the yield would be if a single fixed yield bond were issued. For example, if an issue contains a bond bearing interest at a floating rate and a related bond bearing interest at a rate equal to a fixed rate minus that floating rate, those two bonds are treated as a single fixed yield bond only if neither bond may be redeemed unless the other bond is also redeemed at the same time.

(c) through (f) [Reserved]. For guidance see §1.148–4.

(g) *Yield on certain mortgage revenue and student loan bonds.* For purposes of section 148 and §1.148–4, section 143(g)(2)(C)(ii) applies to the computation of yield on an issue of qualified mortgage bonds or qualified veterans' mortgage bonds. For purposes of applying sections 148 and 143(g) to a variable yield issue of qualified mortgage bonds, qualified veterans' mortgage bonds, or qualified student loan bonds, the yield on that issue is computed over the term of the issue, and §1.148–4(d) does not apply to the issue. As of any date before the final maturity date, the yield over the term of the issue is based on the actual amounts paid or received to that date and the amounts that are reasonably expected (as of that date) to be paid or received over the remaining term of the issue.

(h) *Qualified hedging transactions*—(1) *In general.* Payments made or received by an issuer under a qualified hedge (as defined in §1.148–4(h)(2)) relating to bonds of an issue are taken into account (as provided in paragraph (h)(3) of this section) to determine the yield on the issue. Except as provided in paragraphs (h)(4) and (h)(5)(ii)(C) of this section, the bonds to which a qualified hedge relates are treated as variable yield bonds. These hedging rules apply solely for purposes of sections 143(g), 148, and 149(d).

(2) (i) through (vi) [Reserved]. For guidance see §1.148–4(h)(2).

(2)(vii) *Timing and duration.* For a contract to be a qualified hedge under §1.148–4(h)(2), payments must not begin to accrue under the contract on a date earlier than the issue date of the hedged bonds and must not accrue longer than the hedged interest payments on the hedged bonds.

(viii) [Reserved]. For guidance see §1.148–4(h).

(ix) *Identification.* For a contract to be a qualified hedge under §1.148–4(h)(2), the contract must be identified by the actual issuer on its books and records maintained for the hedged bonds not later than three days after the date on which the parties enter into the contract. The identification must specify the hedge provider, the terms of the contract, and the hedged bonds. The identification must contain sufficient detail to establish that the requirements of §1.148–4(h)(2), and if applicable, paragraph (h)(4) of this section are satisfied. The existence of the hedge must be noted on all forms filed with the Internal Revenue Service for the issue on or after the date on which the hedge is entered into.

(3) *Accounting for qualified hedges*—(i) *In general.* Except as otherwise provided in paragraph (h)(4) of this section, payments made or received by the issuer under a qualified hedge are treated as payments made or received, as appropriate, on the hedged bonds that are taken into account in determining the yield on those bonds. These payments are reasonably allocated to the hedged bonds in the period to which the payments relate, as determined under paragraph (h)(3)(iii) of this section. Payments made or received by the issuer include payments deemed made or received when a contract is terminated or deemed terminated under this paragraph (h)(3). Payments reasonably allocable to the reduction of risk of interest rate changes and to the hedge provider's overhead under this paragraph (h) are included as payments made or received under a qualified hedge.

(ii) *Exclusions from hedge.* Payments for services or other items under the contract that are not expressly treated as payments under the qualified hedge under paragraph (h)(3)(i) of this section are not payments with respect to a qualified hedge.

(iii) *Timing and allocation of payments.* The period to which a payment made by the issuer relates is determined under general Federal income tax principles, including, without limitation, §1.446–3, and adjusted as necessary to reflect the end of a computation period and the start of a new computation period. Except as provided in paragraphs (h)(3)(iv) and (h)(5)(ii) of this section, a payment received by the issuer is taken into account in the period that the interest payment that the payment hedges is required to be made.

(iv) *Termination payments*—(A) *Termination defined.* A termination of a qualified hedge includes any sale or other disposition of the hedge by the issuer, or the acquisition by the issuer of an offsetting hedge. A deemed termination occurs when the hedged bonds are redeemed and when a hedge ceases to be a qualified hedge of the hedged bonds. In the case of an assignment by a hedge provider of its remaining rights and obligations on the hedge to a third party or a modification of the hedging contract, the assignment or modification is treated as a termination with respect to the issuer only if it results in a deemed exchange of the hedge and a realization event under section 1001.

(B) *General rule.* A payment made or received by an issuer to terminate a qualified hedge, including loss or gain realized or deemed realized, is treated as a payment made or received on the hedged bonds, as appropriate. The payment is reasonably allocated to the remaining periods originally covered by the terminated hedge in a manner that reflects the economic substance of the hedge.

(C) *Special rule for terminations when bonds are redeemed.* Except as otherwise provided in this paragraph (h)(3)(iv)(C) and in paragraph (h)(3)(iv)(D) of this section, when a qualified hedge is deemed terminated because the hedged bonds are redeemed, the fair market value of the contract on the redemption date is treated as a termination payment made or received on that date. When hedged bonds are redeemed, any payment received by the issuer on termination of a hedge, including a termination payment or a deemed termination payment, reduces, but not below zero, the interest payments made by the issuer on the hedged bonds in the computation period ending on the termination date. The remainder of the payment, if any, is reasonably allocated over the bond years in the immediately preceding computation period or periods to the extent necessary to eliminate the excess.

(D) *Special rules for refundings.* To the extent that the hedged bonds are redeemed using the proceeds of a refunding issue, the termination payment is accounted for under paragraph (h)(3)(iv)(B) of this section by treating it as a payment on the refunding issue, rather than the hedged bonds. In addition, to the extent that the refunding issue, rather than the hedged bonds, has been redeemed, paragraph (h)(3)(iv)(C) of this section applies to the termination payment by treating it as a payment on the redeemed refunding issue.

(E) *Safe harbor for certain non-level payments*. A non-level payment to terminate a hedge does not result in that hedge failing to satisfy the applicable provisions of paragraph (h)(3)(iv)(B) of this section if the payment is allocated to each bond year for which the hedge would have been in effect in accordance with this paragraph (h)(3)(iv)(E). For a variable yield issue, an equal amount (or for any short bond year, a proportionate amount of the equal amount) must be allocated to each bond year such that the sum of the present values of the annual amounts equals the present value of the non-level payment. Present value is computed as of the day the hedge is terminated, using the yield on the hedged bonds, determined without regard to the non-level payment. The yield used for this purpose is computed for the period beginning on the first date the hedge is in effect and ending on the date the hedge is terminated. On the other hand, for a fixed yield issue, the non-level payment is taken into account as a single payment on the date it is paid.

(4) *Certain variable yield bonds treated as fixed yield bonds*—(i) *In general*. Except as otherwise provided in this paragraph (h)(4), if the issuer of variable yield bonds enters into a qualified hedge, the hedged bonds are treated as fixed yield bonds paying a fixed interest rate if:

(A) *Start date*. The date on which payments begin to accrue on the hedge is not later than 15 days after the issue date of the hedged bonds.

(B) *Maturity*. The term of the hedge is equal to the entire period during which the hedged bonds bear interest at variable interest rates.

(C) *Payments closely correspond*. Payments to be received under the hedge correspond closely in time to the hedged portion of the payments on the hedged bonds. Hedge payments received within 15 days of the related payments on the hedged bonds generally so correspond.

(D) *Aggregate payments fixed*. Taking into account all payments made and received under the hedge and all payments on the hedged bonds (i.e., after netting all payments), the issuer's aggregate payments are fixed and determinable as of a date not later than 15 days after the issue date of the hedged bonds. Payments on bonds are treated as fixed for purposes of this paragraph (h)(4)(i)(D) if payments on the bonds are based, in whole or in part, on one interest rate, payments on the hedge are based, in whole or in part, on a second interest rate that is substantially the same as, but not identical to, the first interest rate and payments on the bonds would be fixed if the two rates were identical. Rates are treated as substantially the same if they are reasonably expected to be substantially the same throughout the term of the hedge. For example, an objective 30-day tax-exempt variable rate index or other objective index (e.g., J.J. Kenny Index, PSA Municipal swap index, a percentage of LIBOR) may be substantially the same as an issuer's individual 30-day interest rate.

(ii) *Accounting*. Except as otherwise provided in this paragraph (h)(4)(ii), in determining yield on the hedged bonds, all the issuer's actual interest payments on the hedged bonds and all payments made and received on a hedge described in paragraph (h)(4)(i) of this section are taken into account. If payments on the bonds and payments on the hedge are based, in whole or in part, on variable interest rates that are substantially the same within the meaning of paragraph (h)(4)(i)(D) of this section (but not identical), yield on the issue is determined by treating the variable interest rates as identical. For example, if variable rate bonds bearing interest at a weekly rate equal to the rate necessary to remarket the bonds at par are hedged with an interest rate swap under which the issuer receives payments based on a short-term floating rate index that is substantially the same as, but not identical to, the weekly rate on the bonds, the interest payments on the bonds are treated as equal to the payments received by the issuer under the swap for purposes of computing the yield on the bonds.

(iii) *Effect of termination*—(A) *In general*. Except as otherwise provided in this paragraph (h)(4)(iii) and paragraph (h)(5) of this section, the issue of which the hedged bonds are a part is treated as if it were reissued as of the termination date of the qualified hedge covered by paragraph (h)(4)(i) of this section in determining yield on the hedged bonds for purposes of §1.148–3. The redemption price of the retired issue and the issue price of the new issue equal the aggregate values of all the bonds of the issue on the termination date. In computing the yield on the new issue for this purpose, any termination payment is accounted for under paragraph (h)(3)(iv) of this section, applied by treating the termination payment as made or received on the new issue under this paragraph (h)(4)(iii).

(B) *Effect of early termination.* Except as otherwise provided in this paragraph (h)(4)(iii), the general rules of paragraph (h)(4)(i) of this section do not apply in determining the yield on the hedged bonds for purposes of §1.148–3 if the hedge is terminated or deemed terminated within 5 years after the issue date of the issue of which the hedged bonds are a part. Thus, the hedged bonds are treated as variable yield bonds for purposes of §1.148–3 from the issue date.

(C) *Certain terminations disregarded.* This paragraph (h)(4)(iii) does not apply to a termination if, based on the facts and circumstances (e.g., taking into account both the termination and any qualified hedge that immediately replaces the terminated hedge), there is no change in the yield. In addition, this paragraph (h)(4)(iii) does not apply to a termination caused by the bankruptcy or insolvency of the hedge provider if the Commissioner determines that the termination occurred without any action by the issuer (other than to protect its rights under the hedge).

(5) *Special rules for certain hedges*—(i) *Certain acquisition payments.* A payment to the issuer by the hedge provider (e.g., an up-front payment for an off-market swap) in connection with the acquisition of a hedge that, but for that payment, would be a qualified hedge, does not cause the hedge to fail to be a qualified hedge provided the payment to the issuer and the issuer's payments under the hedge in excess of those that it would make if the hedge bore rates equal to the on-market rates for the hedge are separately identified in a certification of the hedge provider and not taken into account in determining the yield on the issue of which the hedged bonds are a part. The on-market rates are determined as of the date the parties enter into the contract.

(ii) *Anticipatory hedges*—(A) *In general.* A contract does not fail to be a hedge under §1.148–4(h)(2)(i)(A) solely because it is entered into with respect to an anticipated issuance of tax-exempt bonds. The identification required under §1.148–4T(h)(2)(ix) must specify the reasonably expected governmental purpose, principal amount, and issue date of the hedged bonds, and the manner in which interest is reasonably expected to be computed.

(B) *Special rules.* Payments made in connection with the issuance of a bond to terminate or otherwise close (*terminate*) an anticipatory hedge of that bond do not prevent the hedge from satisfying the requirements of §1.148–4(h)(2)(vi) and paragraph (h)(2)(vii) of this section. Amounts received or deemed to be received by the issuer in connection with the issuance of the hedged bonds to terminate an anticipatory hedge are treated as proceeds of the hedged bonds.

(C) *Fixed yield treatment.* A bond that is hedged with an anticipatory hedge is a fixed yield bond if, taking into account payments on the hedge that are made or fixed on or before the issue date of the bond and the payments to be made on the bond, the bond satisfies the definition of fixed yield bond. See also paragraph (h)(4) of this section.

(6) *Authority of the Commissioner*—(i) *In general.* A contract is not a qualified hedge if the Commissioner determines, based on all the facts and circumstances, that treating the contract as a qualified hedge would provide a material potential for arbitrage, or a principal purpose for entering into the contract is that arbitrage potential. For example, a contract that requires a substantial nonperiodic payment may constitute, in whole or part, an embedded loan, investment-type property, or other investment.

(ii) *Other qualified hedges.* The Commissioner, by publication of a revenue ruling or revenue procedure, may specify contracts that do not otherwise meet the requirements of § 1.148–4(h)(2) as qualified hedges and contracts that do not otherwise meet the requirements of paragraph (h)(4) of this section as causing the hedged bonds to be treated as fixed yield bonds.

(iii) *Recomputation of yield.* If an issuer enters into a hedge that is not properly identified, fails to properly associate an anticipatory hedge with the hedged bonds, or otherwise fails to meet the requirements of this section, the Commissioner may recompute the yield on the issue taking the hedge into account if the failure to take the hedge into account distorts that yield or otherwise fails to clearly reflect the economic substance of the transaction.

[T.D. 8538, 59 FR 24042, May 10, 1994. Redesignated by T.D. 8718, 62 FR 25507, May 9, 1997]

§ 1.148–5A Yield and valuation of investments.

(a) through (b)(2)(ii) [Reserved]. For guidance see § 1.148–5.

(b)(2)(iii) *Permissive application of single investment rules to certain yield restricted investments for all purposes of section 148.* For all purposes of section 148, an issuer may treat all of the yield restricted nonpurpose investments in a refunding escrow and a sinking fund that is reasonably expected as of the issue date to be maintained to reduce the yield on the investments in the refunding escrow as a single investment having a single yield, determined under § 1.148(b)(2).

(b) (2)(iv) through (c)(1) [Reserved]. For guidance see § 1.148–5.

(c)(2) *Manner of payment*—(i) *In general.* Except as otherwise provided in § 1.148–5(c)(2)(ii), an amount is paid under § 1.148–5(c) if it is paid to the United States at the same time and in the same manner as rebate amounts are required to be paid or at such other time or in such manner as the Commissioner may prescribe. For example, yield reduction payments must be made on or before the date of required rebate installment payments as described in § 1.148–3(f). The date a payment is required to be paid is determined without regard to § 1.148–3(h). An amount that is paid untimely is not taken into account under this paragraph (c) unless the Commissioner determines that the failure to pay timely is not due to willful neglect. The provisions of § 1.148–3(i) apply to payments made under § 1.148–5(c).

(c)(2)(ii) through (c)(3)(i) [Reserved] For guidance see § 1.148–5.

(c)(3)(ii) *Exception to yield reduction payments rule for advance refunding issues.* Section 1.148–5(c)(1) does not apply to investments allocable to gross proceeds of an advance refunding issue, other than—

(A) Transferred proceeds to which § 1.148–5(c)(3)(i)(C) applies;

(B) Replacement proceeds to which § 1.148–5(c)(3)(i)(F) applies; and

(C) Transferred proceeds to which § 1.148–5(c)(3)(i)(E) applies, but only to the extent necessary to satisfy yield restriction under section 148(a) on those proceeds treating all investments allocable to those proceeds as a separate class.

(d)(1) through (d)(3)(i) [Reserved]. For guidance see § 1.148–5.

(d)(3)(ii) *Exception to fair market value requirement for transferred proceeds allocations, universal cap allocations, and commingled funds.* Section 1.148–5(d)(3)(i) does not apply if the investment is allocated from one issue to another issue as a result of the transferred proceeds allocation rule under § 1.148–9(b) or the universal cap rule under § 1.148–6(b)(2), provided that both issues consist exclusively of tax-exempt bonds. In addition, § 1.148–5(d)(3)(i) does not apply to investments in a commingled fund (other than a bona fide debt service fund) unless it is an investment being initially deposited in or withdrawn from a commingled fund described in § 1.148–6(e)(5)(iii).

(e)(1) through (e)(2)(ii)(A) [Reserved]. For guidance see § 1.148–5.

(e)(2)(ii)(B) *External commingled funds.* For any semiannual period, a commingled fund satisfies the 10 percent requirement of § 1.148–5(e)(2)(ii)(B) if—

(*1*) Based on average amounts on deposit, this requirement was satisfied for the prior semiannual period; and

(*2*) The fund does not accept deposits that would cause it to fail to meet this requirement.

(iii) *Special rule for guaranteed investment contracts.* For a guaranteed investment contract, a broker's commission