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#### IX. Effective Date and Congressional Notification

82. These regulations are effective August 15, 2007. The Commission has determined, with the concurrence of the Administrator of the Office of Information and Regulatory Affairs of OMB, that this rule is not a "major rule" as defined in section 351 of the Small Business Regulatory Enforcement Fairness Act of 1996.

#### List of Subjects in 18 CFR Parts 38 and 284

Continental shelf, Natural gas, Incorporation by reference, Reporting and recordkeeping requirements.

By the Commission.

**Kimberly D. Bose,**  
Secretary.

■ In consideration of the foregoing, the Commission amends parts 38 and 284 of Chapter I, Title 18, *Code of Federal Regulations*, as follows.

#### PART 38—BUSINESS PRACTICE STANDARDS AND COMMUNICATION PROTOCOLS FOR PUBLIC UTILITIES

■ 1. The authority citation for part 38 continues to read as follows:

**Authority:** 16 U.S.C. 791-825r, 2601-2645; 31 U.S.C. 9701; 42 U.S.C. 7101-7352.

■ 2. Section 38.1 is revised to read as follows:

##### § 38.1 Applicability.

This part applies to any public utility that owns, operates, or controls facilities

used for the transmission of electric energy in interstate commerce or for the sale of electric energy at wholesale in interstate commerce and to any non-public utility that seeks voluntary compliance with jurisdictional transmission tariff reciprocity conditions.

■ 3. Section 38.2 is amended by adding new paragraph (a)(8) to read as follows:

##### § 38.2 Incorporation by reference of North American Energy Standards Board Wholesale Electric Quadrant standards.

(a) \* \* \*

(8) Gas/Electric Coordination Standards (WEQ-011, Version 1, as adopted in Recommendation R04021 July 8, 2005).

\* \* \* \* \*

#### PART 284—CERTAIN SALES AND TRANSPORTATION OF NATURAL GAS UNDER THE NATURAL GAS POLICY ACT OF 1978 AND RELATED AUTHORITIES

■ 4. The authority citation for part 284 continues to read as follows:

**Authority:** 15 U.S.C. 717-717w, 3301-3432; 42 U.S.C. 7101-7352; 43 U.S.C. 1331-1356.

■ 5. In § 284.12, paragraph (a)(1)(i) is revised to read as follows:

##### § 284.12 Standards for pipeline business operations and communications.

(a) \* \* \*

(1) \* \* \*

(i) Additional Standards (General Standards and Creditworthiness Standards) (Version 1.7, December 31, 2003) and Additional Standards (Gas/Electric Operational Communications) (Version 1.8, September 30, 2006, with minor corrections applied December 31, 2006).

\* \* \* \* \*

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#### DEPARTMENT OF THE TREASURY

##### Internal Revenue Service

##### 26 CFR Parts 1 and 602

[TD 9339]

RIN 1545-BG44

##### Qualified Zone Academy Bonds; Obligations of States and Political Subdivisions

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final and temporary regulations.

**SUMMARY:** This document contains final and temporary regulations that provide guidance to state and local governments that issue qualified zone academy bonds and to banks, insurance companies, and other taxpayers that hold those bonds on the program requirements for qualified zone academy bonds. The temporary regulations implement the amendments to section 1397E of the Internal Revenue Code (Code) (discussed in this preamble) and provide guidance on the maximum term, permissible use of proceeds, and remedial actions for qualified zone academy bonds. 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 in this issue of the **Federal Register**. The portions of this rule that are final regulations provide necessary cross-references to the temporary regulations.

**DATES:** *Effective Date:* These regulations are effective on September 14, 2007.

*Applicability Date:* For dates of applicability, see § 1.1397E-1(m) of these regulations.

##### FOR FURTHER INFORMATION CONTACT:

Timothy L. Jones or Zoran Stojanovic, (202) 622-3980 (not a toll-free number).

##### SUPPLEMENTARY INFORMATION:

##### Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed, and pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-1908. Responses to this collection of information are required to obtain or retain a benefit.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**.

Books and records relating to a collection of information must be

retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

### Background

Section 1397E(a) of the Code provides that an eligible taxpayer (within the meaning of section 1397E(d)(6)) that holds a qualified zone academy bond ("QZAB" or "QZABs") on a credit allowance date is allowed a credit against Federal income tax for the taxable year that includes the credit allowance date. In general, a QZAB is a bond issued by a state or local government to finance certain eligible public school purposes under section 1397E(d). Section 1397E(b) provides that the amount of the QZAB credit equals the product of the credit rate and the face amount of the bond held by the taxpayer on the credit allowance date. Under section 1397E(b)(2), the credit rate is determined by the Treasury Department and equals the percentage that the Department estimates generally will permit the issuance of QZABs without discount and without interest cost to the issuer. Section 1397E(i)(1) defines "credit allowance date" as the last day of the one-year period beginning on the issue date of the issue and the last day of each successive one-year period thereafter. Under section 1397E(d)(3), the maximum term of a QZAB is determined by the Treasury Department and equals the term that the Treasury Department estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50 percent of the face amount of the bond.

Section 1397E(j) provides that the amount of the QZAB credit allowed to the taxpayer is included in the taxpayer's gross income.

Section 1397E(e) imposes a national limitation on the amount of QZABs that may be issued for each calendar year. The limitation is allocated by the Treasury Department among the States on the basis of their respective populations of individuals below the poverty line.

Section 1397E was amended by section 107 of the Tax Relief and Health Care Act of 2006, Public Law 109-432, 120 Stat. 2922 (2006) (the "2006 Act"), by adding certain requirements for a bond to be a QZAB. In general, the 2006 Act added a new five-year spending period requirement, arbitrage investment restrictions, and information reporting requirements. Specifically, the 2006 Act added new section 1397E(f), which generally imposes spending

period restrictions under which an issuer of QZABs must reasonably expect, as of the issue date, that: (1) At least 95 percent of the proceeds from the sale of the issue are to be spent for one or more qualified purposes with respect to qualified zone academies within the 5-year period beginning on the issue date of the QZAB; (2) a binding commitment with a third party to spend at least 10 percent of the proceeds from the sale of the issue will be incurred within the six-month period beginning on the issue date of the QZAB; and (3) such purposes will be completed with due diligence and the proceeds from the sale of the issue will be spent with due diligence. New Section 1397E(f)(2) added by the 2006 Act provides authority to the Secretary of the Treasury to extend the five-year spending period. To the extent that less than 95 percent of the proceeds of the issue are spent within the five-year spending period (plus any extension granted by the Secretary of the Treasury), the 2006 Act requires the issuer to redeem the nonqualified bonds within 90 days after the end of such period.

In addition, the 2006 Act added new section 1397E(g), which generally requires that an issue of QZABs must satisfy the arbitrage investment restrictions of section 148 with respect to the proceeds of the issue.

Finally, the 2006 Act added new section 1397E(h), which generally requires that issuers of QZABs submit information reporting returns to the IRS similar to the information reporting returns required to be submitted to the IRS under section 149(e) for tax-exempt state or local bonds.

Temporary regulations (TD 8755) interpreting section 1397E were published on January 7, 1998 (63 FR 671), and amended on July 1, 1999 (TD 8826; 64 FR 35573). Final regulations under section 1397E (TD 8903) were published on September 26, 2000 (65 FR 57732) (the "Final Regulations"). On March 26, 2004, a notice of proposed rulemaking (REG-121475-03) was published in the **Federal Register** (69 FR 15747) (the "2004 Proposed Regulations"). The 2004 Proposed Regulations proposed to amend the existing Final Regulations by providing guidance on the maximum term, permissible use of proceeds, and remedial actions for QZABs. A public hearing was scheduled for July 21, 2004. The public hearing was cancelled because no requests to speak were received. Written comments on the 2004 Proposed Regulations were received. After consideration of the written comments, and in light of the statutory

changes made by the 2006 Act, the need for regulatory guidance on those statutory changes, and the close connection between that needed guidance and the guidance in the 2004 Proposed Regulations, the IRS and the Treasury Department have determined to issue coordinated guidance in these temporary regulations (the "Temporary Regulations"), with an opportunity for public comment in the corresponding proposed regulations (the "Proposed Regulations"). Set forth in this preamble is an explanation of certain provisions of the Temporary Regulations.

### Explanation of Provisions

#### I. Certain Definitions

##### A. In General

The Temporary Regulations employ certain definitions used in the tax-exempt bond area. Thus, the Temporary Regulations employ certain definitions used for general tax-exempt bond purposes in § 1.150-1 and certain definitions used for purposes of the arbitrage investment restrictions on tax-exempt bonds in § 1.148-1(b).

##### B. Definitions of Various Types of Proceeds in General

In general, § 1.148-1(b) defines "sale proceeds" as any amounts actually or constructively received from the sale of an issue, including amounts used to pay underwriters' discount or compensation. In addition, § 1.148-1(b) defines "investment proceeds" to mean any amounts actually or constructively received from investing proceeds of an issue. Further, § 1.148-1(c) defines "replacement proceeds" to include certain amounts with a reasonable nexus to a bond issue, such as sinking funds reasonably expected to be used to pay debt service on a bond issue and pledged funds pledged to pay debt service on a bond issue with a reasonable assurance that the funds will be available to pay such debt service.

##### C. Proceeds for Purposes of the Use and Spending Requirements

In general, the Temporary Regulations provide that, for purposes of the provisions of QZAB provisions regarding the use and expenditure of proceeds for qualified purposes within prescribed periods, "proceeds" means sale proceeds, as defined in § 1.148-1(b), plus investment proceeds, as defined in § 1.148-1(b). Thus, under the Temporary Regulations, the requirement in section 1397E(d)(1)(A) to use at least 95 percent of the proceeds of an issue for a qualified purpose with respect to a qualified zone academy applies by taking into account both the sale

proceeds of the issue and any investment proceeds received from investing those sale proceeds. Similarly, under the Temporary Regulations, the requirement in section 1397E(f) to spend at least 95 percent of the proceeds from the sale of an issue on qualified purposes within a five-year period and the associated requirements in section 1397E(f) apply to both sale proceeds of an issue and investment proceeds derived from investing sale proceeds.

Some commentators suggested that, for purposes of the 95-percent test, the definition of "proceeds" should be limited to sale proceeds and should exclude amounts received from investing sale proceeds. These commentators suggested that, when sizing a bond issue to comply with the 95-percent test, it could be difficult for an issuer to include investment earnings because interest rates may be volatile and the timing of expenditures may be uncertain. The IRS and the Treasury Department have considered this comment and have concluded that the definition of proceeds in the 2004 Proposed Regulations that applies for purposes of the 95-percent test is appropriate to ensure the use and expenditures of proceeds of QZABs for one or more qualified purposes under section 1397E(d)(5) and (f). Thus, the Temporary Regulations retain this provision. This approach is consistent with the view that, for purposes of certain similar provisions on qualified private activity bonds under section 141, which are based on use of 95% of the net proceeds, as defined in section 150(a)(3), for qualified purposes, net proceeds properly include both sale proceeds and investment proceeds pending expenditures for ultimate qualified governmental purposes, with certain reductions inapplicable to QZABs.

#### D. Proceeds for Purposes of Private Business Contribution

Section 1397E(d)(1)(C)(ii) provides that a bond is a QZAB only if, among other requirements, the issuer certifies that it has written assurances that the private business contribution requirement of section 1397E(d)(2) will be met with respect to the qualified zone academy. Section 1397E(d)(2)(A) provides that the private business contribution requirement is met if the eligible local education agency that established the qualified zone academy has written commitments from private entities to make qualified contributions (as defined in section 1397E(d)(2)(B)) having a present value (as of the issue date of the issue) of not less than ten percent of the proceeds of the issue. The

2004 Proposed Regulations provide that, for purposes of the private business contribution requirement of section 1397E(d)(2), proceeds means sale proceeds, as defined in § 1.148-1(b), without regard to any investment proceeds received or expected to be received from investing those sale proceeds. Commentators supported this narrower definition of "proceeds" in the 2004 Proposed Regulations for purposes of the private business contribution requirement. The Temporary Regulations retain this provision.

#### II. Maximum Term

Section 1397E(d)(3) provides that the Secretary of the Treasury Department shall determine, during each calendar month, the maximum term for QZABs issued during the following calendar month. Section 1397E(d)(3) states that the maximum term shall be the term that the Secretary estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50 percent of the face amount of the bond. Section 1.1397E-1(d) of the existing Final Regulations provides that the maximum term for a QZAB is determined under section 1397E(d)(3) by using a discount rate equal to 110 percent of the long-term adjusted applicable Federal rate (AFR), compounded semi-annually, for the month in which the bond is issued. The IRS publishes the long-term adjusted AFR each month in a revenue ruling. See § 601.601(d)(2)(ii)(b).

Section 1397E(b)(2) provides that the Secretary shall determine, during each calendar month, a credit rate for QZABs issued during the following calendar month. Section 1.1397E-1(b) provides that the Secretary shall determine monthly (or more often as deemed necessary by the Secretary) the credit rate the Secretary estimates generally will permit the issuance of a QZAB without discount and without interest cost to the issuer. Notice 99-35 (1999-2 CB 26), see § 601.601(d)(2)(ii)(b) ("Notice 99-35"), indicates that, until further notice, the credit rate for a QZAB will be published daily by the Bureau of Public Debt on its Internet site for State and Local Government Series securities (<https://www.treasurydirect.gov>). Notice 99-35 also provides that the credit rate shall be applied to a QZAB on the first day on which there is a binding contract in writing for the sale or exchange of the bond. Notice 99-35 states that the credit rate will be determined by the Treasury Department based on its estimate of the yield on outstanding AA rated corporate bonds of a similar maturity for the business day immediately prior to the

date on which there is a binding contract in writing for the sale or exchange of the bond.

Prior to the issuance of the 2004 Proposed Regulations, questions were raised regarding the maximum term of a QZAB that is sold in one month and issued in another month. Section 1.1397E-1(d) of the existing Final Regulations provides that the maximum term is determined based on the month in which the bond is issued. However, under Notice 99-35, the credit rate for a QZAB is determined based on the first day on which there is a binding contract in writing for the sale or exchange of the bond. The credit rate and maximum term should be determined on the same day because the credit rate for a bond depends on its maximum term. Accordingly, the 2004 Proposed Regulations would amend § 1.1397E-1(d) to provide that the maximum term for a QZAB is determined based on the first day on which there is a binding contract in writing for the sale or exchange of the bond.

Commentators supported the maximum term provisions in the 2004 Proposed Regulations. The Temporary Regulations retain these provisions.

At the present time, the Treasury Department is continuing its current practice of publishing the credit rate and maximum term for QZABs on the Bureau of Public Debt's Internet site for State and Local Government Series securities (<http://www.publicdebt.treas.gov>).

#### III. Use of Proceeds and Remedial Actions

##### A. In General

Section 1397E(d)(1) provides that a bond issued as part of an issue is a QZAB only if, among other requirements, at least 95 percent of the proceeds of the issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency (as defined in section 1397E(d)(4)(B)) and the issue meets the requirements of section 1397E(f) (relating to spending periods), section 1397E(g) (relating to arbitrage), and section 1397E(h) (relating to information reporting requirements). Section 1397E(d)(5) defines "qualified purposes" for any qualified zone academy to include: (i) Rehabilitating or repairing the public school facility in which such academy is established, (ii) providing equipment for use at such academy, (iii) developing course materials for education to be provided at such academy, and (iv) training teachers and other school personnel in such academy. Section 1397E(d)(4)(A)

defines “qualified zone academy” as any public school (or academic program within a public school) that is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level if: (1) The public school or program is designed in cooperation with business in accordance with section 1397E(d)(4)(A)(i); (2) students in the public school or program will be subject to the same academic standards and assessments as other students educated by the eligible local education agency; (3) the comprehensive education plan of the public school or program is approved by the eligible local education agency; and (4) the public school is located in an empowerment zone or enterprise community (as defined in section 1393), or there is a reasonable expectation (as of the issue date of the bonds) that at least 35 percent of the students attending the school or participating in the program will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act.

#### *B. Compliance With 95-Percent Test*

##### *1. In General*

The 2004 Proposed Regulations provide guidance on compliance with the 95-percent test in section 1397E(d)(1)(A). Specifically, the 2004 Proposed Regulations provide that, in general, an issue must satisfy two requirements to comply with section 1397E(d)(1)(A). First, the issuer must reasonably expect, as of the issue date of the issue, to use at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision). Second, except as otherwise provided in the remedial action provisions of the 2004 Proposed Regulations, at least 95 percent of the proceeds of the issue must actually be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision). For these purposes, under the 2004 Proposed Regulations, any unspent proceeds are treated as used for a qualified purpose with respect to a qualified zone academy during any period that the issuer reasonably expects that those proceeds will be spent with due diligence for a qualified purpose with respect to a qualified zone academy.

Some commentators suggested a modification of the requirement in the

2004 Proposed Regulations that at least 95 percent of the proceeds of an issue both be reasonably expected to be used and actually be used for a qualified purpose for the entire term of the issue. Specifically, these commentators requested that the requirement be altered to conform to the tax-exempt bond provisions of § 1.141–2(d), which look to a similar standard based on reasonable expectations and deliberate actions within an issuer’s control, with certain exceptions for involuntary conversions and actions in response to directives from the Federal government. These commentators noted that use of the standards under section 141 would be appropriate because the statutory language of sections 141 and 1397E both use the phrase “are to be used.” In substance, the standards for interpreting this phrase under the 2004 Proposed Regulations and under section 141 both incorporate reasonable expectations and actual use, with certain special exceptions to actual use in the case of the standard under section 141. The IRS and the Treasury Department believe, however, that compliance standards for the actual use of proceeds appropriately may take into account the particular governmental program involved.

The Temporary Regulations do not adopt the suggestion to conform the 95-percent test for QZABs to the deliberate action provisions of § 1.141–2(d). The Temporary Regulations retain the proposed standard based on reasonable expectations and actual use. The actual use test is set forth under section 1397E(f)(3), as introduced by the 2006 Act, and is appropriate for the circumstances involved with QZABs. In addition, the control-based exceptions to actual use under the deliberate action standard under section 141 raise certain administrability concerns in the context of QZABs. For example, it may be particularly difficult to determine if a loss of qualified zone academy status is within an issuer’s control.

The Temporary Regulations provide guidance on the spending period requirements introduced by the 2006 Act in section 1397E(f). Specifically, the Temporary Regulations provide that an issuer must both reasonably expect to spend and actually spend at least 95 percent of the proceeds of an issue of QZABs within the five-year period beginning on the issue date of the issue of QZABs (or be subject to the additional requirement to redeem bonds from unspent proceeds at the end of that five-year period). The Temporary Regulations clarify that the various requirements relating to “reasonable expectations” for the use of proceeds of QZABs and actual actions to proceed

with “due diligence” to spend such proceeds on qualified purposes are based on objective reasonableness standards, as used in the definition of “reasonable expectations or reasonableness” in § 1.148–1(b) of the arbitrage regulations.

##### *2. Proceeds Spent for Rehabilitation, Repair or Equipment*

Section 1397E(d)(5)(A) and (B) provides that the term “qualified purpose” with respect to any qualified zone academy includes rehabilitating or repairing the public school facility in which such academy is established, and providing equipment for use at such academy. The 2004 Proposed Regulations specify that, if proceeds of an issue are spent for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure that (1) the property financed with those proceeds is used for the purposes of the academy and (2) the academy maintains its status as a qualified zone academy. For this purpose, the retirement from service of financed property due to normal wear or obsolescence does not cause the property not to be used for a qualified purpose with respect to a qualified zone academy.

The Temporary Regulations provide guidance on the applicable standard for determining whether proceeds of QZABs are used for a qualified purpose of “rehabilitating” a public school facility under section 1397E(d)(5)(A), based on a known existing standard used for purposes of the rehabilitation tax credit under section 47. In particular, in determining whether proceeds of QZABs are used for a qualified purpose of “rehabilitating” a public school facility under section 1397E(d)(5)(A), rules similar to those used for purposes of the rehabilitation tax credit in section 47(c) (other than sections 47(c)(1)(B) and 47(c)(2)(B)(v)) shall apply. Set forth in this preamble is a general description of certain aspects of this rehabilitation expenditure standard. In general, the rehabilitation standard under section 47 requires a substantial rehabilitation involving a building that already has been placed in service and a rehabilitation process that preserves specified portions of the existing walls of the building. Specifically, at least 50 percent of the existing external walls of the rehabilitated building must be retained as external walls, at least 75 percent of the existing external walls must be retained as internal or external walls, and at least 75 percent of the

existing internal structural framework must be retained. Under this rehabilitation standard, eligible rehabilitation expenditures include some expenditures for reconstruction, subject, however, to the foregoing restrictions on retention of certain percentages of the existing walls. In addition, however, under this rehabilitation standard, eligible rehabilitation expenditures do not include expenditures to enlarge existing buildings or expenditures to acquire existing buildings. In adopting the rehabilitation standard used in section 47 for purpose of section 1397E, the IRS and the Treasury Department declined to adopt one public comment which suggested that rehabilitation should include complete reconstruction of a building. Here, the IRS and the Treasury Department determined that such a broad interpretation of rehabilitation effectively to include new construction would be beyond Congressional intent.

### 3. Proceeds Spent to Develop Course Materials or Train Teachers

Section 1397E(d)(5)(C) and (D) provides that the term “qualified purpose” with respect to any qualified zone academy includes developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. The 2004 Proposed Regulations provide that, if proceeds of an issue are spent for a purpose described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure. Commentators supported this provision of the 2004 Proposed Regulations. The Temporary Regulations retain this provision.

### 4. Special Rule for Determining Status as Qualified Zone Academy

Section 1397E(d)(4)(A)(iv) provides that a public school (or academic program within a public school) is a qualified zone academy only if, among other requirements, the public school is located in an empowerment zone or enterprise community, or there is a reasonable expectation (as of the issue date of the issue) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act.

For purposes of determining whether an issue complies with section

1397E(d)(4)(A)(iv), the 2004 Proposed Regulations provide that a public school is treated as located in an empowerment zone or enterprise community for the entire term of the issue if the public school is located in an empowerment zone or enterprise community on the issue date of the issue. Commentators agreed with this provision of the 2004 Proposed Regulations relating to empowerment zones and enterprise communities. The Temporary Regulations retain this provision.

Commentators also requested clarification of the relevant time period for determining compliance with the 35-percent free or reduced-cost school lunch program test. The Temporary Regulations provide that the test looks to whether there is a reasonable expectation (as of the issue date of the bonds) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches during the one-year period following the date the bonds are issued.

### C. Remedial Actions

#### 1. In General

Prior to the issuance of the 2004 Proposed Regulations, comments were received requesting guidance specifying remedial actions that may be taken to cure a violation of the 95-percent test in section 1397E(d)(1)(A). The 2004 Proposed Regulations specify two remedial actions that may be taken in certain circumstances if less than 95 percent of the proceeds of an issue actually are used for a qualified purpose with respect to a qualified zone academy. These remedial actions are available only if the issuer reasonably expected on the issue date of the bonds that: (1) The issue would meet the requirements of section 1397E(f)(1)(A), (B), and (C); and (2) at least 95 percent of the proceeds of the issue would be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision).

As discussed in this preamble, the two remedial actions specified in the 2004 Proposed Regulations are (1) redemption or defeasance of the nonqualified bonds, and (2) alternative use of the disposition proceeds. If the applicable requirements are met, the redemption or defeasance remedial action is available to cure any failure to satisfy the 95-percent test that was not reasonably expected as of the issue date. The alternative use of disposition proceeds remedial action applies only to

certain dispositions of financed property for cash.

Commentators recommended that the 2004 Proposed Regulations be amended to provide additional flexibility for issuers if the failure to properly use proceeds is based on a loss of status of the public school or academic program as a qualified zone academy. Consistent with the 2006 Act, the Treasury Department and the IRS have concluded that the remedial actions of redemption and defeasance in the 2004 Proposed Regulations will adequately address situations where there has been a disqualifying change in the status of an academy. The Temporary Regulations retain these two remedial actions with certain modifications relating to the amendments to section 1397E introduced by the 2006 Act.

#### 2. Redemption or Defeasance of Nonqualified Bonds

Under the 2004 Proposed Regulations, a redemption or defeasance remedial action is taken if: (1) All of the nonqualified bonds of the issue (determined by applying the principles of § 1.142-2(e)) are redeemed within 90 days after the date on which the failure to properly use proceeds occurs; (2) if any nonqualified bonds of the issue are not redeemed within 90 days after the date on which the failure to properly use proceeds occurs (the unredeemed nonqualified bonds), a defeasance escrow is established for the unredeemed nonqualified bonds within 90 days after the date on which the failure to properly use proceeds occurs; or (3) if the failure to properly use proceeds is a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition proceeds (as defined in § 1.141-12(c)(1)) are used within 90 days after the date of the disposition to redeem, or establish a defeasance escrow for, a pro rata portion of the nonqualified bonds of the issue.

The Temporary Regulations retain the remedial actions described in this preamble but, in accordance with new section 1397E(f)(3), the Temporary Regulations limit defeasance of nonqualified bonds to bonds the proceeds of which have actually been spent for a qualified purpose with respect to a qualified academy within the 5-year period beginning on the issue date of the bonds. For proceeds that have not been spent within the 5-year period, the only remedial action available to the issuer is redemption of nonqualified bonds under the principles of section 142.

### 3. Failure to Properly Use Proceeds

For unspent proceeds, the 2004 Proposed Regulations provide that a failure to properly use proceeds occurs on the earlier of: (1) The first date on which the public school (or academic program within the public school) fails to constitute a qualified zone academy; or (2) the first date on which the issuer fails to have a reasonable expectation to proceed with due diligence to spend at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy.

The Temporary Regulations retain the provisions concerning the failure to properly use unspent proceeds but implement section 1397E(f)(1)(A) by adding a provision that improper use also occurs if 95 percent of the bond proceeds have not been properly spent within the 5-year period beginning on the day the bonds are issued.

For proceeds that have been spent for rehabilitation, repair or equipment described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, the 2004 Proposed Regulations provide that a failure to properly use proceeds occurs on the earlier of: (1) The first date on which the public school (or academic program within the public school) fails to constitute a qualified zone academy; and (2) the first date on which an action is taken that causes the issuer to fail actually to use at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy. If proceeds have been spent for course materials or training described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, no event subsequent to such expenditure shall constitute a failure to properly use such proceeds under the 2004 Proposed Regulations.

### 4. Defeasance Escrow

The 2004 Proposed Regulations define "defeasance escrow" as an irrevocable escrow established to retire bonds on the earliest call date after the date on which the failure to properly use proceeds occurs in an amount that is sufficient to retire the bonds on that call date. At least 90 percent of the weighted average amount in a defeasance escrow must be invested in investments (as defined in § 1.148-1(b)), except that no amount in a defeasance escrow may be invested in any investment the obligor (or any person that is a related party with respect to the obligor within the meaning of § 1.150-1(b)) of which is a user of proceeds of the bonds. All purchases or sales of an investment in a defeasance escrow must be made at

the fair market value of the investment within the meaning of § 1.148-5(d)(6).

Under the 2004 Proposed Regulations, the issuer must pay to the United States, at the same time and in the same manner as rebate amounts are required to be paid under § 1.148-3 (or at such other time or in such other manner as the Commissioner may prescribe), 100 percent of the investment earnings on amounts in the defeasance escrow. For this purpose, the first computation period begins on the date on which the failure to properly use proceeds occurs.

Under the 2004 Proposed Regulations, proceeds of QZABs (other than unspent proceeds of the issue for which the failure to properly use proceeds occurs) are not permitted to be used to redeem or defease the nonqualified bonds. In addition, the issuer must provide written notice to the Commissioner of the establishment of the defeasance escrow within 90 days of the date the defeasance escrow is established.

Commentators suggested various modifications to the requirement that issuers rebate to the United States 100 percent of the investment earnings on amounts in a defeasance escrow. Alternative approaches suggested by commentators included: (1) Limiting the rebate requirement to investment earnings in excess of the yield on the issue of QZABs; (2) limiting the rebate amount to investment earnings in excess of the total debt service requirements to be paid out of the defeasance escrow; and (3) limiting the rebate amount to the amount of the QZAB credit.

The IRS and Treasury Department have concluded that the rebate requirement should only apply to earnings in excess of the yield on the issue of QZABs. Thus, the Temporary Regulations provide that the issuer of QZABs with a defeasance escrow must rebate to United States any investment earnings in the defeasance escrow that are in excess of the yield, as defined in § 1.148-1(b), on the issue of QZABs. For this purpose, the credit rate for the QZAB issue is not included in the yield on the issue.

Some commentators suggested that the first computation period for rebate purposes begin on the date the defeasance escrow is established, rather than the date on which the failure to properly use proceeds occurs. These commentators noted that the 2004 Proposed Regulations create a possible 90-day period during which an issuer would be required to compute yield on an escrow that is yet to be established. The Temporary Regulations adopt the change in start date for the computation period in accordance with this comment.

One commentator recommended that certain small, low-wealth local education agencies be exempt from the rebate requirement. The IRS and the Treasury Department have considered this recommendation and have concluded that the rebate requirement is appropriate to ensure compliance with the 95-percent use-of-proceeds requirement of section 1397E(d)(1)(A), regardless of the size or wealth of the local education agency. Thus, the Temporary Regulations do not adopt this recommendation.

Some commentators suggested that the regulations provide that a defeasance of a QZAB in the context of taking a remedial action not be treated as a significant modification (within the meaning of § 1.1001-3) and reissuance of the QZAB. The Temporary Regulations do not address the circumstances in which a reissuance of a QZAB will occur. The Temporary Regulations do provide, however, that, for purposes of determining whether the establishing of a defeasance escrow as a remedial action results in an exchange under § 1.1001-1(a), the QZAB is treated as a tax-exempt bond under § 1.1001-3(e)(5)(ii)(B)(1). Section 1.1001-3(e)(5)(ii)(B)(1) provides that a defeasance of a tax-exempt bond is not a significant modification even if the issuer is released from any liability to make payments under the instrument if the defeasance occurs by operation of the terms of the original bond and the issuer places in trust government securities or tax-exempt government bonds that are reasonably expected to provide interest and principal payments sufficient to satisfy the payment obligations under the bond.

### 5. Alternative Use of Disposition Proceeds

The alternative use of disposition proceeds remedial action in the 2004 Proposed Regulations has four requirements. First, the failure to properly use proceeds must be a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition must be exclusively cash. Second, the issuer must reasonably expect as of the date of the disposition that: (1) All of the disposition proceeds, plus any amounts received from investing the disposition proceeds, will be spent within two years after the date of the disposition for a qualified purpose with respect to a qualified zone academy; or (2) to the extent not expected to be so spent, used within 90 days after the date of the disposition to take a redemption or defeasance remedial action. Third, the disposition

proceeds, plus any amounts received from investing the disposition proceeds, must be treated as proceeds for purposes of section 1397E. Fourth, if all of the disposition proceeds, plus any amounts received from investing the disposition proceeds, are not actually spent for a qualified purpose within the two-year period beginning on the date of the disposition (or used within 90 days after the date of the disposition to take a redemption or defeasance remedial action), the remainder of such amounts must be used within 90 days after the end of that two-year period for a redemption or defeasance remedial action.

Some commentators recommended that the alternative use of disposition proceeds remedial action be modified to provide that the amounts relating to a disposition that are required to be spent for a qualified purpose be capped at the principal amount of the QZAB outstanding at the time of the disposition. The IRS and Treasury Department have considered this comment and have concluded that the requirement in the 2004 Proposed Regulations that all of the disposition proceeds, plus any amounts received from investing the disposition proceeds, be spent for a qualified purpose is appropriate to ensure that QZABs are issued for qualified purposes. Thus, the Temporary Regulations do not adopt this comment.

#### D. Payment of Principal, Interest or Redemption Price

The 2004 Proposed Regulations provide that the use of proceeds of a bond to pay principal, interest, or redemption price of the bond or another bond is not a qualified purpose within the meaning of section 1397E(d)(5). Thus, the use of proceeds of a bond to refund another bond is not a qualified purpose under the 2004 Proposed Regulations. In addition, the use of proceeds of a bond to fund a sinking fund to repay the bond is not a qualified purpose under the 2004 Proposed Regulations.

One commentator recommended that the 2004 Proposed Regulations be modified to permit proceeds of a QZAB to be used to repay an interim bridge loan incurred with the explicit intent to be refinanced with a subsequent issuance. In response to this comment, the Temporary Regulations provide an exception to the general rule that the use of proceeds of a bond to pay principal, interest, or redemption price of the bond or another bond is not a qualified purpose under section 1397E(d)(5).

#### IV. Arbitrage Investment Restrictions

New section 1397E(g) added by the 2006 Act provides that the arbitrage requirements of section 148 applicable to tax-exempt state or local governmental bonds under section 103 also apply to QZABs. The Temporary Regulations provide guidance regarding the application of the arbitrage requirements to QZABs.

In general, under section 148, subject to various prompt spending exceptions (for example, the 18-month prompt spending exception to arbitrage rebate for capital projects under § 1.148-7(d) and the 2-year construction spending exception to arbitrage rebate under section 148(f)(4)(C) and § 1.148-7(e)) and other specified exceptions (for example, the bona fide debt service exception for certain long-term tax-exempt governmental, non-private activity bonds under section 148(f)(4)(A)), the arbitrage investment restrictions, including the yield restrictions and the arbitrage rebate requirement, apply broadly to “gross proceeds” of tax-exempt bonds. “Gross proceeds” represents a broad catch-all category of bond proceeds which includes various subsidiary types of proceeds, including, among others, “sale proceeds” derived from the sale of bonds, “investment proceeds” derived from investing proceeds of bonds, and “replacement proceeds” with a reasonable nexus to a bond issue (for example, sinking funds reasonably expected to be used to pay debt service on bonds and pledged funds used to secure bonds).

The Temporary Regulation provide that, except as otherwise provided, the arbitrage investment restrictions under section 148 and the exceptions to those restrictions apply to gross proceeds of QZABs issued under section 1397E to the same extent and in the same manner as they apply to gross proceeds of tax-exempt state or local governmental bonds issued under section 103. For this purpose, references in the arbitrage restrictions to tax-exempt bonds generally shall be deemed to refer to QZABs and, to the extent that any particular arbitrage restriction depends on whether bonds are private activity bonds under section 141, the determination of whether QZABs are private activity bonds shall be based on the general definition of private activity bonds under section 141.

The Temporary Regulations provide limited guidance to tailor the application of the arbitrage investment restrictions to QZABs in certain specific respects. Thus, the Temporary Regulations provide that a five-year

temporary period exception to the arbitrage yield restriction requirement applies to proceeds of QZABs if an issuer reasonably expects to spend 95 percent of the proceeds of an issue of QZABs for qualified purposes within the 5-year period beginning on the issue date of the QZABs.

The Temporary Regulations provide that, in determining the yield on an issue of QZABs for arbitrage purposes, the QZAB credit is disregarded. Here, yield focuses on yield paid by the issuer on the QZABs rather than the tax credit benefit to the investor.

The Temporary Regulations provide that the yield restriction rules are inapplicable to amounts placed in defeasance escrow as a remedial action. The Treasury Department and IRS have a concern that QZAB issuers may be unable to find appropriate investments of the amounts in the escrow at or below the yield on the bonds.

The Temporary Regulations provide that the exception to arbitrage yield restriction for certain investments in non-AMT tax-exempt bonds is inapplicable to QZABs. The IRS and the Treasury Department have a concern about the clear arbitrage investment potential associated with investing zero-yielding QZABs in non-AMT tax-exempt bond investments at materially higher yields.

The Temporary Regulations provide that, in determining whether an issue of QZABs qualifies for the small issuer exception to the arbitrage rebate requirement under section 148(f)(4)(D), both QZABs and tax-exempt bonds (other than private activity bonds) that are reasonably expected to be issued or actually issued by the QZAB issuer (and other covered on-behalf-of entities and subordinate entities) within a calendar year are taken into account in measuring the applicable size limitation.

Finally, consistent with the treatment of defeasance escrows for purposes of yield restriction, in applying the small issuer exception to the rebate of earnings from investments of amounts in a defeasance escrow, the Temporary Regulations provide that the issuer is not treated as a small issuer and amounts earned from such investments must be rebated to the United States.

#### V. Information Reporting Requirement

Issuers of QZABs must submit information reporting returns to the IRS similar to the information reporting returns required to be submitted to the IRS under section 149(e) for tax-exempt State or local bonds at the same time and manner as those reports are required to be submitted to the IRS on

such forms as shall be prescribed by the Commissioner for such purpose.

### Effective/Applicability Dates

In general, except as otherwise provided, the Temporary Regulations apply to bonds sold on or after September 14, 2007.

In general, except as otherwise provided, § 1.1397E-1(h)(2), (i), and (j) of the Temporary Regulations regarding the five-year spending period, the arbitrage investment restrictions, and the information reporting requirement added by the 2006 Act apply to bonds issued pursuant to allocations of the national qualified zone academy bond volume cap authority arising in calendar years after 2005 and sold on or after September 14, 2007.

Issuers and taxpayers may apply the Temporary Regulations in whole, but not in part, to bonds sold before September 14, 2007.

Certain other special effective dates apply to particular provisions under § 1.1397E(m).

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 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) does not apply to these regulations. For applicability of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this **Federal Register**. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Drafting Information

The principal authors of these regulations are Timothy L. Jones and Zoran Stojanovic, Office of Division Counsel/Associate Chief Counsel, IRS (Tax Exempt and Governmental Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

### List of Subjects

#### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### 26 CFR Part 602

Reporting and recordkeeping requirements.

### Amendments to the Regulations

■ Accordingly, 26 CFR parts 1 and 602 are amended as follows:

#### PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*  
Section 1.1397E-1T also issued under 26 U.S.C. 1397E. \* \* \*

■ **Par. 2.** Section 1.1397E-1 is amended by:

- 1. Redesignating paragraphs (i), (j) and (k) as (k), (l) and (m), respectively.
- 2. Adding new paragraphs (i) and (j).
- 3. Revising newly-designated paragraph (m).

The additions and revisions read as follows:

#### § 1.1397E-1 Qualified zone academy bonds.

\* \* \* \* \*

(i) and (j) [Reserved]. For further guidance, see § 1.1397E-1T(i) and (j).

\* \* \* \* \*

(m) *Effective/applicability dates.* Except as provided in this paragraph (m), this section applies to bonds sold on or after September 26, 2000. Each of paragraphs (c) and (k) of this section may be applied by issuers to bonds that are sold before September 26, 2000.

■ **Par. 3.** Section 1.1397E-1T is added to read as follows:

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

(a) *In general—(1) Overview.* In general, a qualified zone academy bond (QZAB or QZABs) is a taxable bond issued by a state or local government the proceeds of which are used to improve certain eligible public schools. An eligible taxpayer that holds a QZAB generally is allowed annual Federal income tax credits in lieu of periodic interest payments. These credits compensate the eligible taxpayer for lending money to the issuer and function as payments of interest on the bond. Accordingly, this section generally treats the allowance of a credit as if it were a payment of interest on the bond. This section also provides other rules for QZABs, including rules governing the credit rate, the private business contribution requirement, the maximum term, use and expenditure of proceeds, remedial actions, eligible issuers, arbitrage investment restrictions, and information reporting.

(2) *Certain definitions—(i) In general.* For purposes of this section, except as otherwise provided in this section, the following definitions apply: the

definitions set forth in this section; the definitions used for general tax-exempt bond purposes in § 1.150-1; and the definitions used for purposes of the arbitrage investment restrictions on tax-exempt bonds in § 1.148-1(b).

(ii) *Applicable definition of proceeds—(A) Use and expenditure provisions.* Except as provided in paragraphs (a)(2)(ii)(B) and (a)(2)(ii)(C) of this section, for purposes of all applicable requirements regarding use and expenditure of proceeds of QZABs under section 1397E and this section, proceeds means “sale proceeds,” as defined in § 1.148-1(b), plus “investment proceeds,” as defined in § 1.148-1(b).

(B) *Private business contribution requirement.* For purposes of the private business contribution requirement of section 1397E(d)(2), proceeds means “sale proceeds,” as defined in § 1.148-1(b).

(C) *Arbitrage investment restrictions.* For purposes of the scope of application of the arbitrage investment restrictions under section 1397E(g) and paragraph (i) of this section, proceeds generally means gross proceeds, as defined in § 1.148-1(b). In addition, in applying the arbitrage investment restrictions under paragraph (i) of this section and section 148, the various applicable definitions of the various types of proceeds of tax-exempt bonds under § 1.148-1(b) shall apply.

(b) and (c) [Reserved]. For further guidance, see § 1.1397E-1(b) and (c).

(d) *Maximum term.* The maximum term for a QZAB is determined under section 1397E(d)(3) by using a discount rate equal to 110 percent of the long-term adjusted applicable Federal rate (AFR), compounded semi-annually, for the month in which the bond is sold. The Internal Revenue Service publishes this figure each month in a revenue ruling that is published in the Internal Revenue Bulletin. See § 601.601(d)(2)(ii)(b) of this chapter. A bond is sold on the sale date, as defined in § 1.150-1(c)(6), which is the first day on which there is a binding contract in writing for the sale or exchange of the bond.

(e) through (g) [Reserved]. For further guidance, see § 1.1397E-1(e) through (g).

(h) *Use of proceeds—(1) In general.* Section 1397E(d)(1) provides that a bond issued as part of an issue is a QZAB only if, among other requirements, at least 95 percent of the proceeds of the issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency (as defined in section 1397E(d)(4)(B)), and



the issue meets the requirements of section 1397E(f) and (g). Section 1397E(d)(5) defines *qualified purpose*, with respect to any qualified zone academy, as rehabilitating or repairing the public school facility in which such academy is established, providing equipment for use at such academy, developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. Section 1397E(d)(4)(A) defines *qualified zone academy* as any public school (or academic program within a public school) that is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level and that meets the requirements of section 1397E(d)(4)(A)(i), (ii), (iii) and (iv).

(2) *Use of proceeds requirements.* An issue meets the requirements of sections 1397E(d)(1)(A) and (f) only if—

(i) The issuer reasonably expects, as of the issue date of the issue, that—

(A) At least 95 percent of the proceeds from the sale of the issue are to be spent for 1 or more qualified purposes with respect to qualified zone academies within the 5-year period beginning on the issue date of the QZAB;

(B) A binding commitment with a third party to spend at least 10 percent of the proceeds from the sale of the issue will be incurred within the 6-month period beginning on the issue date of the QZAB;

(C) At least 95 percent of the proceeds from the sale of the issue will be spent for a qualified purpose with respect to a qualified zone academy with due diligence (with due diligence measured by the reasonableness standard under § 1.148-1(b)); and

(D) At least 95 percent of the proceeds of the issue will be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision); and

(ii) Except as otherwise provided in paragraph (h)(7) of this section, at least 95 percent of the proceeds of the issue are actually used for a qualified purpose with respect to a qualified academy for the entire term of the issue (without regard to any redemption provision).

(iii) *Extension of 5-year period.* The Commissioner may extend the period described in paragraph (h)(2)(i)(A) of this section if the issuer, prior to the end of such period, submits a private ruling request, and establishes to the satisfaction of the Commissioner that—

(A) The failure to satisfy the 5-year spending requirement is due to reasonable cause; and

(B) The expenditure of at least 95 percent of the proceeds from the sale of the issue will be spent for a qualified purpose with respect to a qualified zone academy will proceed with due diligence.

(3) *Unspent proceeds.* For purposes of paragraphs (h)(2)(i)(D) and (h)(2)(ii) of this section, during the period described in paragraph (h)(2)(i)(A) of this section, including any extension under paragraph (h)(2)(iii) of this section, unspent proceeds are treated as used for a qualified purpose with respect to a qualified zone academy if the issuer reasonably expects to proceed with due diligence to spend those proceeds for a qualified purpose with respect to a qualified zone academy during that period.

(4) *Proceeds spent for rehabilitation, repair or equipment—(i) In general.* Under section 1397E(d)(5)(A) the term *qualified purpose* with respect to any qualified zone academy includes rehabilitating or repairing the public school facility in which such academy is established. For this purpose, in determining whether proceeds are spent for rehabilitation, rules similar to those under section 47(c) (other than sections 47(c)(1)(B) and 47(c)(2)(B)(iv)) shall apply. Under section 1397E(d)(5)(B) the term *qualified purpose* also includes providing equipment for use at such academy. If proceeds of an issue are spent for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure that—

(A) The property financed with those proceeds is used for the purposes of the academy; and

(B) The academy maintains its status as a qualified zone academy under section 1397E(d)(4).

(ii) *Retirement from service.* The retirement from service of financed property due to normal wear or obsolescence does not cause the property to fail to be used for a qualified purpose with respect to a qualified zone academy.

(5) *Proceeds spent to develop course materials or train teachers.* Section 1397E(d)(5)(C) and (D) provides that the term *qualified purpose* with respect to any qualified zone academy includes developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. If proceeds of an issue are

spent for a purpose described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure.

(6) *Special rule for determining status as qualified zone academy.* Section 1397E(d)(4)(A)(iv) provides that a public school (or academic program within a public school) is a qualified zone academy only if, among other requirements, the public school is located in an empowerment zone or enterprise community (as defined in section 1393), or there is a reasonable expectation (as of the issue date of the issue) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act. For purposes of determining whether an issue complies with section 1397E(d)(4)(A)(iv)—

(i) A public school is treated as located in an empowerment zone or enterprise community for the entire term of the issue if the public school is located in an empowerment zone or enterprise community on the issue date of the issue; and

(ii) The determination of whether there is a reasonable expectation (as of the issue date of the issue) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act is based on expectations regarding the one-year period following the issue date.

(7) *Remedial actions—(i) General rule.* If less than 95 percent of the proceeds of an issue are properly used (as determined under paragraph (h)(7)(ii)(D) of this section), the issue will be treated as meeting the requirements of section 1397E(d)(1)(A) if the issue met the requirements of paragraph (h)(2)(i) of this section and a remedial action is taken under paragraph (h)(7)(ii) or (iii) of this section.

(ii) *Redemption or defeasance—(A) In general.* A remedial action is taken under this paragraph (h)(7)(ii) if the requirements of paragraphs (h)(7)(ii)(B) and (C) of this section are met.

(B) *Retirement of nonqualified bonds—(1) In general.* The requirements of this paragraph (h)(7)(ii)(B) are met if—

(i) All of the nonqualified bonds of the issue (determined by applying the

principles of § 1.142–2(e) are redeemed within 90 days after the date on which the failure to properly use proceeds occurs; or

(ii) To the extent of proceeds of the issue that have been actually spent for a qualified purpose with respect to a qualified zone academy, if any nonqualified bonds of the issue are not redeemed within 90 days after the date on which the failure to properly use such proceeds occurs (the unredeemed nonqualified bonds), a defeasance escrow is established for the unredeemed nonqualified bonds within 90 days after the date on which the failure to properly use proceeds occurs.

(2) *Special rule for dispositions for cash.* If the failure to properly use proceeds is a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash, the requirements of this paragraph (h)(7)(ii)(B) are met if all of the disposition proceeds (as defined in paragraph (h)(7)(iv) of this section) are used within 90 days after the date of the disposition to redeem, or establish a defeasance escrow for, a pro rata portion of the nonqualified bonds of the issue.

(3) *Definition of defeasance escrow.* For purposes of this section, a defeasance escrow is an irrevocable escrow established to retire nonqualified bonds on the earliest call date after the date on which the failure to properly use proceeds occurs in an amount that is sufficient to retire nonqualified bonds on that call date. At least 90 percent of the weighted average amount in a defeasance escrow must be invested in investments (as defined in § 1.148–1(b)), except that no amount in a defeasance escrow may be invested in any investment the obligor (or any person that is a related party with respect to the obligor within the meaning of § 1.150–1(b)) of which is a user of proceeds of the bonds. All purchases or sales of an investment in a defeasance escrow must be made at the fair market value of the investment within the meaning of § 1.148–5(d)(6).

(C) *Additional rules—(1) Limitation on source of funding.* Proceeds of an issue of QZABs (other than unspent proceeds of the issue for which the failure to properly use proceeds occurs) must not be used to redeem or defease nonqualified bonds under paragraph (h)(7)(ii)(B) of this section.

(2) *Rebate requirement.* The issuer must pay to the United States, at the same time and in the same manner as rebate amounts are required to be paid under § 1.148–3 (or at such other time or in such other manner as the

Commissioner may prescribe), any investment earnings on amounts in a defeasance escrow established under paragraph (h)(7)(ii)(B) of this section that are in excess of the yield on the issue of QZABs with respect to which the defeasance escrow was established. For this purpose, the first computation period begins on the date on which the defeasance escrow is established.

(3) *Notice of defeasance.* The issuer must provide written notice to the Commissioner, at the place designated in § 1.150–5(a), of the establishment of the defeasance escrow within 90 days of the date the defeasance escrow is established.

(D) *When a failure to properly use proceeds occurs—(1) Unspent proceeds.* For unspent proceeds, a failure to properly use proceeds occurs on the earlier of—

(i) The first date on which the public school (or academic program within the public school) fails to constitute a qualified zone academy;

(ii) The first date on which the issuer fails to have a reasonable expectation to proceed with due diligence to spend at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy; or

(iii) The last day of the period described in paragraph (h)(2)(i)(A) of this section, including any extension, if less than 95 percent of the proceeds of the issue are actually spent for a qualified purpose with respect to a qualified zone academy.

(2) *Proceeds spent for rehabilitation, repair or equipment.* For proceeds that have been spent for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, a failure to properly use proceeds occurs on the earlier of—

(i) The first date on which the public school (or academic program within the public school) fails to constitute a qualified zone academy; and

(ii) The first date on which an action is taken that causes the issuer to fail to actually use at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy.

(3) *Proceeds spent for course materials or training.* If proceeds have been spent for a purpose described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, no event subsequent to such expenditure shall constitute a failure to properly use such proceeds.

(iii) *Alternative use of disposition proceeds.* A remedial action is taken under this paragraph (h)(7)(iii) if all of the requirements of paragraphs

(h)(7)(iii)(A) through (D) of this section are met—

(A) The failure to properly use proceeds (as determined under paragraph (h)(7)(ii)(D) of this section) is a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash;

(B) The issuer reasonably expects as of the date of the disposition that—

(1) All of the disposition proceeds will be spent within the two-year period beginning with the date of the disposition for a qualified purpose with respect to a qualified zone academy; or

(2) To the extent not expected to be so spent, the disposition proceeds will be used within 90 days after the date of the disposition to redeem or defease bonds in a manner that meets the requirements of paragraph (h)(7)(ii) of this section;

(C) The disposition proceeds are treated as proceeds for purposes of section 1397E; and

(D) If all of the disposition proceeds are not actually used in the manner described in paragraph (h)(7)(iii)(B) of this section, the remainder of such amounts are used within 90 days after the end of the period described in paragraph (h)(7)(iii)(B)(1) of this section for a remedial action that meets the requirements of paragraph (h)(7)(ii) of this section.

(iv) *Definition of disposition proceeds and allocation among multiple funding sources.* For purposes of this paragraph (h)(7), disposition proceeds means *disposition proceeds*, as defined in § 1.141–12(c)(1), plus amounts derived from investing disposition proceeds. If property has been financed with an issue of QZABs and one or more other funding sources, any disposition proceeds from that property are allocated to the issue under the principles of § 1.141–12(c)(3).

(8) *Payment of principal, interest or redemption price—(i) In general.* Except as provided in paragraphs (h)(8)(ii) and (h)(8)(iii) of this section, the use of proceeds of a bond to pay principal, interest, or redemption price of the bond or another bond is not a qualified purpose within the meaning of section 1397E(d)(5).

(ii) *Exception for certain eligible reimbursements of interim refinancings.* The use of proceeds of a bond (the refinancing bond) to pay principal, interest or redemption price of another bond (the prior bond) is a qualified purpose within the meaning of section 1397E(d)(5) to the extent that—

(A) The prior bond was not a QZAB (and, in the case of a series of

refinancings, no earlier bond in the series was a QZAB);

(B) The proceeds of the prior bond (or the original bond in the case of a series of refinancings, as applicable) were spent for a qualified purpose under section 1397E(d)(5) (the original expenditure); and

(C) The issuer makes a valid reimbursement allocation to allocate the proceeds of the refinancing bond to the payment of the original expenditure (the reimbursement allocation), which allocation satisfies the requirements for reimbursements under paragraph (h)(9) of this section. For purposes of applying the rules for reimbursement, a refinancing bond which otherwise meets the requirements of this paragraph (h)(8)(ii) is eligible for reimbursement and is not treated as a disqualified refunding under § 1.150-2(g).

(iii) *Reissuance of a QZAB.* For purposes of determining whether the establishing of a defeasance escrow under paragraph (h)(7)(ii)(B)(1)(ii) of this section results in an exchange under § 1.1001-1(a), the QZAB is treated as a tax-exempt bond under § 1.1001-3(e)(5)(ii)(B)(1).

(9) *Reimbursement.* An expenditure for a qualified purpose may be reimbursed with proceeds of a QZAB. For this purpose, rules similar to those on reimbursement of expenditures in § 1.142-4(b) and § 1.150-2 shall apply. In applying these reimbursement rules, expenditures eligible for reimbursement under § 1.150-2(d)(3) shall be deemed to mean any expenditure for a qualified purpose under section 1397E(d)(5).

(i) *Arbitrage investment restrictions—*  
(1) *In general.* Under section 1397E(g) and this paragraph (i), and except as otherwise provided in this paragraph (i), the arbitrage investment restrictions and rebate requirements under section 148 and § 1.148-1 to § 1.148-11, inclusive, and the exceptions to those restrictions, apply broadly to gross proceeds of QZABs issued under section 1397E to the same extent and in the same manner as they apply to gross proceeds of tax-exempt state or local governmental bonds. For this purpose, references in those sections to tax-exempt bonds generally shall be deemed to refer to QZABs and, to the extent that any particular arbitrage restriction depends on whether bonds are private activity bonds under section 141, the determination of whether QZABs are private activity bonds shall be based on the general definition of private activity bonds under section 141. In applying section 148 and the regulations under that section to QZABs, the modifications set forth in paragraphs

(i)(2) through (6) of this section shall apply.

(2) *5-year temporary period exception to arbitrage yield restriction.* If an issue of QZABs meets the requirements of section 1397E(f)(1) and paragraph (h)(2)(i) of this section, then the proceeds of the issue of QZABs are treated as qualifying for a 5-year temporary period exception to arbitrage yield restriction under § 1.148-2(e)(2) beginning on issue date of the issue.

(3) *Disregard QZAB credit in QZAB yield for arbitrage purposes.* In determining the yield on an issue of QZABs for arbitrage purposes under § 1.148-4, the QZAB credit allowed under section 1397E(a) is disregarded.

(4) *Non-AMT tax-exempt bond investment exception inapplicable.* The exception to arbitrage yield restriction for investments of gross proceeds of tax-exempt bonds in specified tax-exempt bond investments not subject to section 148(b)(3)(B) (relating to an exception to the definition of "investment property" for specified tax-exempt bonds) and § 1.148-2(d)(2)(v) (relating to a corresponding exception to arbitrage yield limitations) is inapplicable.

(5) *Application of small issuer exception to the arbitrage rebate requirement.* Except as otherwise provided in paragraph (i)(6) of this section, for purposes of the small issuer exception to the arbitrage rebate requirement under section 148(f)(4)(D) and § 1.148-8, both QZABs and tax-exempt bonds (other than private activity bonds) that are actually issued or reasonably expected to be issued by the QZAB issuer (and applicable entities aggregated under section 148(f)(4)(D)) within a calendar year are taken into account in measuring the applicable size limitation.

(6) *Certain defeasance escrow earnings.* With respect to a defeasance escrow established in a remedial action for an issue of QZABs that meets the special rebate requirement under paragraph (d)(7)(ii)(C)(2) of this section, the QZAB issuer is treated as ineligible for the small issuer exception to arbitrage rebate under section 148(f)(4)(D) and paragraph (i)(5) of this section and compliance with that special rebate requirement is treated as satisfying applicable arbitrage investment restrictions under section 148 for that defeasance escrow.

(j) *Information reporting requirement.* Under section 1397E(h) and this paragraph (j), issuers of QZABs are required to submit information reporting returns to the IRS similar to the information reporting returns required to be submitted to the IRS under section 149(e) for tax-exempt

state or local governmental bonds at the same time and in the same manner as those reports are required to be submitted to the IRS on such forms as shall be prescribed by the Commissioner for such purpose.

(k) and (l) [Reserved]. For further guidance, see § 1.1397E-1(k) and (l).

(m) *Effective/applicability dates—*(1) *In general.* Except as otherwise provided in this paragraph (m), this section applies to bonds sold on or after September 14, 2007.

(2) *Special effective dates—*(i) *Effective dates for paragraphs (h)(2), (i), and (j) of this section in general.*

Paragraphs (h)(2), (i), and (j) of this section apply to bonds issued pursuant to allocations of the national qualified zone academy bond volume cap authority for calendar years after 2005 and sold on or after September 14, 2007.

(ii) *Permissive retroactive application—*(A) *In general.* Except as otherwise provided in this paragraph (m), issuers and taxpayers may apply this section in whole, but not in part, to bonds sold before September 14, 2007.

(B) *Special rule for certain provisions.* For purposes of the permissive retroactive application rule in paragraph (m)(2)(ii)(A) of this section, paragraphs (h)(2), (i), and (j) of this section need not be applied to any bonds to which those provisions do not otherwise apply under the general effective date provisions for those provisions in paragraph (m)(2)(i) of this section.

(C) *Definition of proceeds.* Issuers and taxpayers may apply paragraphs (d) and (h) of this section, without regard to the definition of proceeds in paragraph (a)(2)(ii) of this section, to bonds sold before September 14, 2007.

(D) *Bonds issued before July 1, 1999.* Paragraphs (d) and (h)(9) of this section may not be applied to bonds issued before July 1, 1999.

(3) *Expiration date.* The applicability of this section expires on or before July 13, 2010.

## PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ **Par. 4.** The authority citation for part 602 continues to read as follows:

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

■ **Par. 5.** In § 602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

### § 602.101 OMB Control numbers.

\* \* \* \* \*

(b) \* \* \*

CFR part or section where identified and described	Current OMB control No.
* * *	*
1.1397E-1T .....	1545-1908
* * *	*

**Kevin M. Brown,**  
Deputy Commissioner for Services and Enforcement.

Approved: July 3, 2007.

**Eric Solomon,**  
Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. E7-13665 Filed 7-13-07; 8:45 am]

BILLING CODE 4830-01-P

**NATIONAL LABOR RELATIONS BOARD**

**29 CFR Part 102**

**Privacy Act of 1974; Implementation**

**AGENCY:** National Labor Relations Board.

**ACTION:** Final rule.

**SUMMARY:** The National Labor Relations Board (NLRB) issues a final rule exempting three systems of records and portions of four other systems of records from certain provisions of the Privacy Act of 1974, 5 U.S.C. 552a, pursuant to Section (k)(2) of that Act, 5 U.S.C. 552a(k)(2), and amending existing Privacy Act regulations for clarity.

**DATES:** Effective July 16, 2007.

**FOR FURTHER INFORMATION CONTACT:** Tommie Gregg, Sr., Privacy Officer, National Labor Relations Board, Room 7608, 1099 14th Street, NW., Washington, DC 20570-0001, (202) 273-2833, [Tommie.Gregg@nlrb.gov](mailto:Tommie.Gregg@nlrb.gov).

**SUPPLEMENTARY INFORMATION:** On December 13, 2006, the NLRB published in the **Federal Register** a notice proposing twelve systems of records under the Privacy Act of 1974, nine of which consist of an electronic case tracking system and associated paper or electronic files, and the remaining three systems consist of electronic case tracking systems only. The same day, the NLRB also published in the **Federal Register** a notice of proposed rule exempting three of the systems of records and portions of four other systems of records from certain provisions of the Privacy Act, and amending the NLRB's existing Privacy Act regulations for clarity. Both notices provided for a public comment period.

In the absence of any comments, the proposed systems of records became final 40 days thereafter.

No comments were filed regarding the proposed rule exempting three of the systems of records and portions of four other systems of records from certain provisions of the Privacy Act, and amending the NLRB's existing Privacy Act regulations for clarity. Accordingly, the Board has decided to implement the proposed rule as a final rule, with changes to certain CFR section numbers. In particular, the proposed rule amended the Agency's existing Privacy Act regulations by removing them from Sections 102.117(f) through (q) of subpart K, and inserting them as Sections 102.117a(a) through (n) of subpart K. In order to maintain the orderly codification of the CFR, the Agency's Privacy Act regulations instead will be inserted as Sections 102.119(a) through (n) of subpart K. The Agency's current regulation at subpart L, Section 102.119 (Post-employment Restriction on Activities by Former Officers and Employees), is now re-designated as subpart L, Section 102.120.

This rule relates to individuals rather than small business entities. Accordingly, pursuant to the requirements of the Regulatory Flexibility Act, 5 U.S.C. 601-612, this rule will not have a significant impact on a substantial number of small business entities.

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Agency has determined that this rule will not impose new recordkeeping, application, reporting, or other types of information collection requirements on the public.

The rule will not have a substantial direct effect on the States, on the relationship between the national Government and the States, or on the distribution of power and responsibilities among levels of government. Therefore, it is determined that this rule does not have federalism implications under Executive Order 13132.

In accordance with Executive Order 12866, it has been determined that this rule is not a "significant regulatory action," and therefore does not require a Regulatory Impact Analysis.

**List of Subjects in 29 CFR Part 102**

Privacy, Reporting and recordkeeping requirements.

■ For the reasons stated in the above Supplementary Information section, Part 102 of title 29, ch. I of the Code of Federal Regulations, is amended as follows:

**PART 102—RULES AND REGULATIONS, SERIES 8**

■ 1. The authority citation for part 102 is revised to read as follows:

**Authority:** Sections 1, 6, National Labor Relations Act (29 U.S.C. 151, 156). Section 102.117 also issued under section 552(a)(4)(A) of the Freedom of Information Act, as amended (5 U.S.C. 552(a)(4)(A)), and Section 102.117a also issued under section 552a(j) and (k) of the Privacy Act of 1974 (5 U.S.C. 552a(j) and (k)). Sections 102.143 through 102.155 also issued under section 504(c)(1) of the Equal Access to Justice Act, as amended (5 U.S.C. 504(c)(1)).

■ 2. Section 102.117 is amended by removing paragraphs (f) through (q) and by revising the section heading to read as follows:

**§ 102.117 Freedom of Information Act Regulations: Board materials and formal documents available for public inspection and copying; requests for described records; time limit for response; appeal from denial of request; fees for document search and duplication; files and records not subject to inspection.**

\* \* \* \* \*

**§ 102.119 [Redesignated as § 102.120]**

■ 3. Section 102.119 is redesignated as § 102.120.

■ 4. A new § 102.119 is added to subpart K to read as follows:

**§ 102.119 Privacy Act Regulations: notification as to whether a system of records contains records pertaining to requesting individuals; requests for access to records, amendment of such records, or accounting of disclosures; time limits for response; appeal from denial of requests; fees for document duplication; files and records exempted from certain Privacy Act requirements.**

(a) An individual will be informed whether a system of records maintained by this Agency contains a record pertaining to such individual. An inquiry should be made in writing or in person during normal business hours to the official of this Agency designated for that purpose and at the address set forth in a notice of a system of records published by this Agency, in a Notice of Systems of Governmentwide Personnel Records published by the Office of Personnel Management, or in a Notice of Governmentwide Systems of Records published by the Department of Labor. Copies of such notices, and assistance in preparing an inquiry, may be obtained from any Regional Office of the Board or at the Board offices at 1099 14th Street, NW., Washington, DC 20570. The inquiry should contain sufficient information, as defined in the notice, to identify the record.

Reasonable verification of the identity of the inquirer, as described in