Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–106143–07]

RIN 1545–BG41

Arbitrage Guidance for Tax-Exempt Bonds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of Proposed Rulemaking and Notice of Public Hearing.

SUMMARY: This document contains proposed regulations on the arbitrage restrictions under section 148 of the Internal Revenue Code applicable to tax-exempt bonds issued by State and local governments. These proposed regulations are being issued in order to update existing regulations to address certain current market developments, to simplify and correct certain provisions, and to make existing regulations more administrable. These proposed regulations affect State and local governmental issuers of tax-exempt bonds. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by December 26, 2007. Outlines of topics to be discussed at the public hearing scheduled for January 30, 2008, at 10 a.m., must be received by January 2, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–106143–07), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–106143–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–106143–07). The public hearing will be held in the Main IRS Auditorium at the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Carla Young, (202) 622–3980; concerning submissions of comments and the hearing, *Richard.A.Hurst@irscounsel.treas.gov*, or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) on the arbitrage investment restrictions under section 148 of the Internal Revenue Code (Code). On June 18, 1993, the Treasury Department and the Internal Revenue Service (IRS) published comprehensive final regulations in the **Federal Register** (TD 8476, 58 FR 33510) on the arbitrage investment restrictions and related provisions on tax-exempt bonds under sections 103, 148, 149, and section 150 of the Code, and, since that time, those final regulations have been amended in certain limited respects (the regulations issued in 1993 and the amendments thereto are collectively referred to as the Existing Regulations). The Treasury Department and the IRS have since determined that certain provisions in the Existing Regulations need to be modified. This document contains proposed discrete amendments to the Existing Regulations (the Proposed Regulations) to update the Existing Regulations to address certain current market developments, to simplify certain provisions in the Existing Regulations, to correct certain technical issues in the Existing Regulations, and to make the Existing Regulations more administrable.

In addition, the Treasury Department and the IRS are in the process of reviewing the Existing Regulations for future regulatory guidance on additional discrete issues for the same purposes.

Explanation of Provisions

I. Existing Regulations

Section 103(a) of the Code generally excludes from gross income interest on a State or local bond. Under section 103(b), however, the interest exclusion does not apply to an arbitrage bond, as defined in section 148. Section 148 provides two related, but independent types of restrictions to determine whether a bond is an arbitrage bond: A yield restriction requirement and an arbitrage rebate requirement. Generally, these restrictions limit the ability of an issuer to invest bond proceeds in investments at a yield that materially exceeds the yield on the bond issue and require that certain excess earnings above the yield on the bond issue be rebated to the Federal government. Investment earnings that exceed the yield on the bond issue are commonly referred to as arbitrage.

Under section 148(a) of the Code, the yield restriction requirement generally provides that a bond is an arbitrage bond if an issuer reasonably expects to earn arbitrage or if the issuer, subsequent to the issuance of the bonds, engages in a deliberate action to earn arbitrage on bond proceeds. Exceptions to the yield restriction requirement permit an issuer to earn arbitrage in limited circumstances, such as during limited temporary periods for prompt spending of bond proceeds and other similar temporary periods.

Under section 148(f) of the Code, the arbitrage rebate requirement provides that a bond is an arbitrage bond if the issuer fails to timely rebate to the United States arbitrage otherwise permitted to be earned on certain investments acquired with bond proceeds. Generally, arbitrage rebate is paid every 5 years and upon the redemption of the bond issue.

The Existing Regulations provide detailed rules for applying the two types of arbitrage restrictions, including rules for determining yield on the bond issue and yield on the investments, and rules for computing and paying arbitrage rebate. The Treasury Department and the IRS believe that discrete changes need to be made to the Existing Regulations to simplify and clarify certain provisions, to make certain provisions more administrable, and to update the regulations to reflect current market practices.

II. Proposed Regulations

The Proposed Regulations make a number of discrete changes to the Existing Regulations. Highlighted in this preamble are certain more substantive changes which are discussed in further detail. In addition, certain more minor changes are addressed in summary form.

(1) *Hedges based on taxable interest rates*. The Proposed Regulations make revisions to accommodate certain hedges in which floating payments under the hedge are based on a taxable interest rate and to clarify that bonds covered by such a hedge are ineligible for treatment as fixed yield bonds under the special hedging rule in § 1.148–4(h)(4).

(2) *Joint Bond Yield Authority*. The Proposed Regulations remove the provision in the Existing Regulations that permits the IRS Commissioner to authorize a single yield computation on multiple bond issues.

(3) *Electronic GIC Bidding*. The Proposed Regulations revise the bidding safe harbor for establishing the fair market value of guaranteed investment contracts (GICs) to accommodate electronic bidding.

(4) *Refunds of Overpayments of Rebate*. The Proposed Regulations clarify that the amount that an issuer is entitled to receive under a rebate refund claim is the excess of the total amount actually paid over the rebate amount.

A. Changes To Accommodate Certain Hedges

Section 1.148–4 of the Existing Regulations sets forth rules for determining the yield on an issue of bonds for purposes of applying the arbitrage rules. In general, § 1.148–4(h) of the Existing Regulations permits issuers to compute the yield on an issue by taking into account payments under ''qualified hedges.'' The Existing Regulations provide two ways in which a qualified hedge can be taken into account in computing yield on the issue, known commonly as ''simple integration'' and ''super integration.''

For both simple integration and super integration, a hedge must be a ''qualified hedge,'' which is a hedge that meets a series of eligibility requirements. Generally, in order to be a qualified hedge, a hedge must be interest based, the terms of the hedge must correspond closely with the terms of the hedged bonds, the issuer must duly identify the hedge, and the hedge must contain no significant investment element. For super integration, the hedge must meet additional eligibility requirements which focus on assuring that the terms of the hedge and the hedge bonds sufficiently correspond so as to warrant treating the hedged bonds as fixed-yield bonds for arbitrage purposes.

In the case of simple integration, generally all net payments on the hedge and the hedged bonds are taken into account in determining the yield on the bond issue. For example, if an issuer issues bonds paying interest at a variable rate and enters into a hedge under which the issuer receives floating interest rate payments from the hedge provider and pays fixed interest payments to the hedge provider (a variable-to-fixed hedge), the variable rate that the issuer pays to the bondholders, the floating rate that the issuer receives on the hedge, and the fixed payments that the issuer pays on the hedge are all taken into account on a net basis in determining the yield on the bond issue. In the case of simple integration, the hedged bonds are treated as variable yield bonds, which means that the yield on the bond issue is periodically recomputed and the rebate the issuer must pay to the United States is based on the issuer's actual net payments and receipts on the bond and the hedge. Thus, for example, any ''basis risk'' difference between the actual interest rate that the issuer pays on its variable-yield hedged bond and the actual interest rate it receives on the floating interest rate on the hedge (along with the fixed payments on the hedge) is taken into account in determining the yield on the hedged bonds.

In the case of super integration where the payments on the hedge and the hedged bonds sufficiently correspond so that the yield on the hedged bonds is fixed and determinable with certain assumptions, the hedged bonds are treated as fixed-yield bonds for arbitrage purposes. In the case of super integration, any basis risk difference between the floating-rate interest payments on the hedge and the variable-rate interest payments on the hedged bonds is ignored in determining the yield on the hedged bonds for arbitrage purposes through an assumption that treats those floating and variable rates as the same.

One of the eligibility requirements for a qualified hedge under the Existing Regulations is that it be interest based. For simple integration, one of the subsidiary aspects used in determining whether a variable-to-fixed interest rate hedge is interest based focuses on whether the variable interest rate on the hedged bonds and the floating interest rate on the hedge are ''substantially the same.'' For super integration purposes, such rates must be ''reasonably expected to be substantially the same throughout the term of the hedge.'' This aspect of the interest-based contract standard has raised technical issues in recent years in connection with its application to certain kinds of hedges, as discussed further in this preamble.

In general, hedging plays an increasingly important role in the tax-exempt bond market. An issuer of bonds may use hedges to protect itself against interest rate risks. For example, an issuer that issues variable-rate bonds may hedge or protect itself against unfavorable interest rate changes in the market by entering into a variable-to-fixed interest rate swap. Historically, issuers of tax-exempt bonds generally used a type of swap under which the hedge provider paid a floating interest rate that was determined based on a market index of tax-exempt interest rates, such as the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index.

A significant development in the tax-exempt bond market since the promulgation of the Existing Regulations has been the trend toward the use by issuers of variable-to-fixed interest rate swaps as hedges in which the floating interest rate that the swap provider pays to the issuer is determined based on a percentage of a market index of taxable interest rates, such as the London Interbank Offered Rate (LIBOR) (a taxable-index hedge). Issuers have indicated that these taxable-index hedges offer more liquidity, more transparency in pricing, and lower costs than hedges based on a tax-exempt interest index.

Issuers have raised interpretative questions about how to apply the qualified hedge provisions of the Existing Regulations to taxable-index hedges because interest rates on taxable indices generally do not correspond as closely as interest rates on tax-exempt market indices to actual market interest rates on tax-exempt, variable-rate bonds. These interpretative questions are particularly important for taxable-index hedges used with advance refunding bond issues because issuers generally need to use the qualified hedge rules or some other regime to determine with certainty the yield on the tax-exempt advance refunding bonds in order to comply with the applicable arbitrage yield restrictions on investments in defeasance escrows.

The IRS and the Treasury Department have determined that taxable-index hedges based on widely-used taxable indices, such as LIBOR based hedges, sufficiently improve the efficiency of the tax-exempt bond market to warrant accommodation. The Proposed Regulations accommodate these hedges by modifying (1) the provisions for ''yield reduction payments,'' which permit an issuer to reduce yield on an investment by making payments to the Federal government in certain permitted circumstances to comply with yield restriction rules and (2) the qualified hedge provisions. The Proposed Regulations make clear, however, that while taxable-index hedges can be qualified hedges, and therefore eligible for simple integration, they are not eligible for super integration because there is an insufficient correlation between tax-exempt bond interest rates and taxable market interest rate indices. However, the IRS and the Treasury Department understand that issuers have recently issued variable-rate bonds that bear interest equal to a percentage of LIBOR, and seek public comments on whether special accommodation under the super integration rule is required for those bond issues.

Yield reduction payments effectively integrate the yield restriction requirements with the arbitrage rebate requirements. For certain limited situations, § 1.148–5(c) of the Existing Regulations permits yield reduction payments to be paid to the United States to satisfy yield restriction requirements on certain investments. Yield reduction payments are similar to, but not identical to, rebate payments. In general, the purpose of the yield reduction payment rules is to simplify compliance with the sometimes overlapping yield restriction and arbitrage rebate requirements by allowing issuers to make payments similar to rebate payments to the United States to satisfy yield restriction and rebate in appropriate circumstances. For example, an issuer may effectively reduce the yield on an investment to a yield that will not violate the yield restriction rules and also satisfy the arbitrage rebate requirement through a yield reduction payment.

The Proposed Regulations modify the yield reduction payment rules to permit issuers to make yield reduction payments on certain variable-yield advance refunding issues in which the issuer has entered into a qualified hedge in the form of a variable-to-fixed interest rate swap to hedge its interest rate risk. This modification to the yield reduction rule applies for nonpurpose investments allocable to gross proceeds of an advance refunding issue deposited into an advance refunding escrow when: (1) The issuer has entered into a qualified hedge in the form of a variable-to-fixed interest rate swap on all of its variable-rate bonds that are allocable to the yield restricted defeasance escrow, (2) the hedge covers a period from the issue date of the bonds until the final payment is made from the defeasance escrow, and (3) the yield on the advance refunding escrow is not reasonably expected to exceed the yield on the issue, determined by taking into account the fixed payments that the issuer is expected to make under the hedge and by assuming that the corresponding variable interest payments to be made by the issuer on the hedged bonds and to be received by the issuer on the hedge are equal and paid on the same date. In effect, the Proposed Regulations allow yield reduction payments in this context only to be made to cover the basis risk differences between the hedge and the hedged bonds.

The Proposed Regulations also modify the qualified hedge provisions to provide that the floating rate on the taxable-index hedge and the variable rate on the hedged bonds will be treated as substantially the same for purposes of § 1.148–4(h)(2)(v)(B) if: (1) The difference between the two rates is not greater than one-quarter of one percent (.25 percent, or 25 basis points) on the date the issuer enters into the hedge, and (2) for a three-year period that ends on the date the issuer enters into the hedge, the average difference between the issuer's actual tax-exempt interest rate on comparable variable-rate bonds (or, if no such comparable bonds exist, a reasonable tax-exempt interest rate index, such as the SIFMA Municipal Swap Index, for that same period) and an interest rate determined in the same manner as the floating interest rate on the hedge does not exceed one-quarter of one percent (.25 percent, or 25 basis points). For example, if the floating rate on the hedge is 67 percent of LIBOR, then 67 percent of LIBOR, determined on the same days as the issuer's actual interest rates (or tax-exempt index, if applicable) are determined, is compared to the issuer's actual interest rates (or the tax-exempt index, if applicable) for the three-year period ending on the date the hedge is entered into and the differences are averaged to determine whether the average difference exceeds one-quarter of one percent. For this purpose, a reasonable sample may be used if the sample for the issuer's actual rates (or tax-exempt market index rates, if applicable) and the sample of floating rates used for the hedge are determined as of the same dates.

The Proposed Regulations also make certain other limited changes to the hedging and yield reduction rules which are discussed with other miscellaneous changes in this preamble.

B. Joint Yield Authority

In general, for arbitrage purposes, the yield on a bond issue is determined on an issue-by-issue basis. Section 1.148–4(a) of the Existing Regulations, however, authorizes the IRS Commissioner to permit issuers of certain types of tax-exempt bonds, specifically qualified mortgage bonds and qualified student loan bonds, to compute a single joint bond yield for purposes of applying the arbitrage restrictions to two or more issues of these types of tax-exempt bonds.

Since the promulgation of the Existing Regulations, the IRS has received numerous private letter ruling requests for joint bond yield computations and has ruled on one of these requests. The Treasury Department and the IRS, based on what the IRS has learned from these ruling requests, are concerned about the highly factual nature of the requests, and the potential for arbitrage manipulations with joint yield computations that would not be apparent from a private letter ruling request and that could not reasonably be discovered in the context of such a request. For these reasons, the Proposed Regulations eliminate the regulatory provision that permits joint yield computations. However, the Treasury Department and the IRS are considering whether generally applicable, objective standards can be created under which joint yield computations should be allowed. Accordingly, the Proposed Regulations solicit public comments on when joint yield computations are needed for sound business reasons and whether objective standards can be created that would allow these computations in a manner that is consistent with the purposes of section 148. In addition, comments are sought on the following: The treatment of open-ended joint yield calculations that allow future issues to be included in the joint yield computation, the treatment of qualified hedges or guarantees that cover some but not all of the bonds, the treatment of reserves, the application of prepayment assumptions, the effect of partial refundings, and other issues that impact the administrability of joint yield calculations. Pending final resolution of this issue, the IRS will not entertain any private letter ruling requests for permission to use a joint yield computation.

C. Modified Fair Market Value Safe Harbor for Guaranteed Investment Contracts

Under § 1.148–5(d)(3) of the Existing Regulations, investments purchased with bond proceeds must be valued at fair market value. Section 1.148–5(d)(6)(iii) of the Existing Regulations provides a safe harbor for establishing the fair market value of a guaranteed investment contract (GIC) for arbitrage purposes. That safe harbor generally relies on a prescribed bidding procedure and the receipt of at least three bids from independent parties. The bidding process requirements under the safe harbor include a requirement that all bidders be given an equal opportunity to bid with no opportunity to review other bids (that is, the ''no last look'' rule) and a requirement that the bid specifications be provided to prospective bidders ''in writing.''

In the past several years, the tax-exempt bond market has seen the advent of various electronic bidding procedures and internet platforms for bidding GICs. While the particular features of specific GIC bidding procedures may vary, characteristics of these electronic GIC bidding procedures generally include using the internet to receive bid specifications and to make bids. The electronic bidding process permits providers, under prescribed times and procedures, to continuously bid and to continuously view the current highest bids (without identification of the bidders). The electronic platforms also provide the capability to print out the results of the GIC bidding process. The electronic GIC bidding procedures have raised certain technical issues regarding whether they can comply with the fair market value safe harbor for GICs under the Existing Regulations.

The Treasury Department and the IRS believe that electronic GIC bidding procedures generally offer the constructive potential for increasing the transparency of pricing of investments purchased with proceeds of tax-exempt bonds. Accordingly, the Proposed Regulations amend the fair market value safe harbor for GICs to accommodate electronic bidding procedures by (1) permitting bid specifications to be sent electronically over the Internet or by fax and (2) amending the no last look rule to provide that there is not a prohibited last look if all bidders have an equal opportunity for a last look.

D. Recovery of Overpayment of Rebate

Generally, an issuer computes the amount of arbitrage rebate that it owes under a method that future values payments and receipts on investments using the yield on the bond issue. Under this method, an arbitrage payment made on one computation date is future valued to the next computation date to determine the amount of arbitrage rebate owed on that subsequent computation date. Section 1.148–3(i)(1) of the Existing Regulations provides that an issuer may recover an overpayment of arbitrage rebate with respect to an issue of tax-exempt bonds if the issuer establishes to the satisfaction of the IRS Commissioner that an overpayment occurred. Section 1.148–3(i)(1) further defines an overpayment as the excess of ''*the amount paid*'' (emphasis added) to the United States for an issue under section 148 over the sum of the rebate amount for that issue as of the most recent computation date and all amounts that are otherwise required to be paid under section 148 as of the date the recovery is requested. Thus, even if the future value of the issuer's arbitrage rebate payment on a computation date, computed under the method for determining arbitrage rebate, is greater than the issuer's rebate amount on that date, an issuer is only entitled to a refund to the extent that the amount actually paid exceeds that rebate amount. The Existing Regulations limit the amount of the refund in this manner because the Treasury Department and the IRS were concerned about whether the IRS had statutory authority to pay interest on arbitrage rebate payments. To permit a refund in an amount calculated in whole or in part based upon a future value of the amount actually paid would effectively result in an interest payment on that payment.

Example 2(iii)(D) in § 1.148–3(j) of the Existing Regulations has caused confusion because it could be interpreted to mean that an issuer can receive a refund of a rebate payment when the future value of such rebate payment exceeds the rebate amount on the next computation date, even though the actual amount of the previous rebate payment does not exceed the rebate amount on that next computation date. The Proposed Regulations make a technical amendment to this example to conform this example to the intended purpose of § 1.148–3(i)(1). Because the proposed change does not change the regulatory rule, but merely makes an existing example conform to that rule, the Proposed Regulations provide that the effective date for this provision is the same as the effective date for the regulatory rule. However, the IRS will not reopen rebate refund claims that have been processed before the date the Proposed Regulations are published in the **Federal Register**.

E. Other Miscellaneous Changes

1. Qualified Hedge Provisions

The Proposed Regulations make the following additional changes to the hedging rules in § 1.148–4(h) and specifically seek the following comments on the hedging rules.

a. *Cost of Funds Hedges.* The Proposed Regulations clarify that for purposes of applying the definition of periodic payment under § 1.446–3(e)(1) to determine whether a hedge has a significant investment element under § 1.148–4(h)(2)(ii)(A), a ''specified index'' under § 1.446–3(c)(2) (upon which periodic payments are based) is deemed to include payments under a cost-of-funds swap, thereby eliminating any doubt that these hedges can be qualified hedges.

b. *Size and Scope of a Qualified Hedge.* The Proposed Regulations add an express requirement under § 1.148–4(h)(2)(v) that limits the size and scope of a qualified hedge to a level that is reasonably necessary to hedge the issuer's risk with respect to interest rate changes on the hedged bonds. This proposed limitation is comparable to a former provision that was in the arbitrage regulations from 1993 to 1997, but was removed in connection with 1997 amendments to the Existing Regulations. The Treasury Department and the IRS believe that this principle was implicitly carried forward in the subsidiary standards under the interest-based contract requirement in the Existing Regulations in 1997. The Proposed Regulations, however, provide an explicit separate requirement to clarify the continued application of this principle.

c. *Correspondence of Payments for Simple Integration.* Commentators have requested guidance on what time period satisfies the rule under § 1.148–4(h)(2)(vi) that requires payments on a hedge to correspond closely in time to the payments on the hedged bonds. The Proposed Regulations add a rule for simple integration that treats payments as corresponding closely in time for this purpose if the payments are made within 60 calendar days of each other. This proposed rule contrasts with the rules for super integration, which require that payments be made within 15 days of each other. The Proposed Regulations provide a more flexible time period for correspondence of payments for simple integration purposes consistent with the fact that simple integration results in more accurate accounting for all net payments.

d. *Time for Identification of Qualified Hedges.* Commentators have indicated that the three-day period for identifying a hedge under § 1.148–4(h)(2)(viii) of the Existing Regulations raises practical difficulties, particularly with respect to hedges that are not entered into contemporaneously with the issuance of the hedged bonds. The Proposed Regulations extend the time in § 1.148–4(h)(2)(viii) for when an issuer must identify a qualified hedge from three days to fifteen days and clarify that these are calendar days. The Proposed Regulations, however, retain the requirement that the actual State or local governmental issuer, rather than the conduit borrower, identify the hedge because the Treasury Department and the IRS believe that it is important for State and local governments to be responsible for qualified hedges on their bonds.

e. *Termination of Hedges at Fair Market Value.* The Proposed Regulations clarify that under § 1.148–4(h)(3)(iv)(B), the termination payment for a termination or a deemed termination is equal to the fair market value of the hedge on the termination date.

f. *Solicitation of Comment on Offsetting Hedges.* The Treasury Department and the IRS have received requests for clarification of the scope of the rule that treats offsetting hedges as deemed terminations of qualified hedges under § 1.148–4(h)(3)(iv)(A). The Treasury Department and the IRS seek express public comment regarding the types of offsetting hedges that are necessary for valid business purposes and recommendations on how to clarify the scope of this rule on offsetting hedges.

2. Yield Reduction Payment Rules

The Proposed Regulations permit issuers to make yield reduction payments for nonpurpose investments allocable to proceeds of an issue, including an advance refunding issue, that an issuer purchases on a date when the issuer is unable to purchase State and Local Government Series Securities (SLGS) because the Department of Treasury, Bureau of Public Debt, has suspended sales of SLGS. This provision incorporates and expands Revenue Procedure 95–47, 1995–2 CB 417, which permits yield reduction payments in more limited situations than the Proposed Regulations when SLGS are unavailable.

The Proposed Regulations also reorganize the yield reduction rules to make them easier to read.

3. Modification of Yield Computation for Yield-to-Call Premium Bonds

The Proposed Regulations simplify the rules for computing yield on an issue that has certain callable premium bonds. Existing Regulations generally provide that the yield on an issue is based on the yield to maturity, taking into account certain assumptions. The Existing Regulations have a special rule for certain callable bonds issued with significant amounts of bond premium (sometimes called yield-to-call bonds), which requires a determination of yield to a call date, based on certain assumed optional redemptions. The general purpose of this rule is to recognize that a yield-to-maturity computation may not be economically accurate in this circumstance because these yield-to-call bonds are more likely than other bonds to be called before maturity and before amortization of the premium.

Section 1.148–4(b)(3)(i) of the Existing Regulations treats a yield-to-call bond as redeemed at the stated redemption price on the optional redemption date that would produce the lowest yield on the *issue* (as contrasted with the lowest yield on the particular premium bond). This methodology, which considers the lowest yield on the issue for these yield-to-call bonds, requires computations of possible combinations of redemption dates in circumstances in which the variations of redemption dates may have very limited impact on yield.

The Proposed Regulations simplify the yield calculations for these yield-to-call bonds to focus on the redemption date that results in the lowest yield on the particular premium bond (rather than the more complex existing focus on the lowest yield on the issue). This change corresponds to a former version of this regulatory rule which was in effect under applicable arbitrage regulations from 1989 through 1992.

4. Arbitrage Rebate Computation Credit

Section 1.148–3(d)(1)(iv) of the Existing Regulations provides that an issuer may take certain credits against payment of arbitrage rebate in the amount of $1,000 for each rebate computation date, subject to certain limitations, to help offset the cost of computing rebate. The Proposed Regulations increase this rebate credit to $1,400 for any bond year ending in the year 2007 to reflect the change in the Consumer Price Index since the $1,000 rebate credit was published. The Proposed Regulations further adjust the computation date credit for inflation for bond years ending in each year thereafter.

5. External Commingled Investment Funds

The Existing Regulations provide certain preferential rules for the treatment of administrative costs to certain widely-held ''external commingled funds,'' as defined in § 1.148–5(e)(2)(ii)(B). Under the Existing Regulations, a fund is treated as widely held if the fund, on average, has more than 15 unrelated investors, each of which maintains prescribed minimum average investments in the fund. The Proposed Regulations make a technical change to allow additional smaller investors to invest in an external commingled fund without disqualifying the fund so long as at least 16 unrelated investors each maintain the required minimum average investments in the fund.

6. Pooled Bonds

The Proposed Regulations make conforming changes to § 1.148–8(d) to reflect legislative changes made to section 148(f)(4)(D) by section 508 of the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109–222, 120 Stat. 345 (TIPRA). Under TIPRA, Congress eliminated the rule in § 148(f)(4)(D)(ii)(II) that permitted a pool bond issuer to ignore its pool bond issue in computing whether it had exceeded its $5 million limit for purposes of the small issuer rebate exception of section 148(f)(4)(D). Correspondingly, the Proposed Regulations eliminate the provisions in the Existing Regulations that permit a pool bond issuer to ignore the amount of its pool bond issue in determining whether the issuer meets the small issuer exception of section 148(f)(4)(D). The Proposed Regulations retain the provision that permits a State or local governmental conduit borrower to ignore the amount of certain pool bond issues in excess of the amount it borrows from that pool. Consistent with the statutory change, the Proposed Regulations provide that the change for pool bond issuers is effective for bonds issued after May 17, 2006, the effective date of the relevant provision of TIPRA.

III. Effective Dates

The Proposed Regulations are proposed to apply to bonds sold on or after a date that is 90 days after publication of final regulations in the **Federal Register**, but an issuer may apply certain specified provisions of the Proposed Regulations to bonds sold before the date that is 90 days after publication of the final regulations in the **Federal Register** as provided in proposed § 1.148–11(k). Except for the changes to the qualified hedging rules which must be applied in their entirety, issuers that are permitted, but not required, to apply the proposed changes may apply some or all of the changes to a bond issue.

The Proposed Regulations contain a technical amendment to the example in the general arbitrage rebate rules. This change applies to bonds subject to § 1.148–3(i), the dates of applicability for which are set forth in the Existing Regulations.

The Proposed Regulations contain a special effective date provision for the regulatory change that conforms the arbitrage regulations to the legislative change made to the small issuer rebate exception for pooled bond issuers. This change applies to bonds issued after May 17, 2006, the effective date of the relevant provision of TIPRA.

Effect on Other Documents

On the date of applicability of the final regulations, Revenue Procedure 95–47, 1995–2 CB 417, will be obsoleted.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Some of the proposed changes clarify existing regulatory provisions, conform the regulations to a recent statutory change, or otherwise involve simplifying or clarifying changes that will not have a significant economic impact on governmental jurisdictions or other entities of any size. Other proposed changes involve the treatment of certain hedging transactions, such as interest rate swaps, for purposes of the arbitrage investment restrictions on tax-exempt bonds issued by State and local governments. Although there is a lack of available data regarding the extent of usage of these hedging transactions by small entities, the IRS and the Treasury Department understand that these hedging transactions are used primarily by larger State and local governments and other eligible larger entities. The IRS and the Treasury Department specifically solicit comment from any party, particularly affected small entities, on the accuracy of this certification. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Small Business Administration for comment on its impact on small governmental jurisdictions.

Comments and Public Hearing

Before these Proposed Regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and IRS request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 30, 2008 at 10 a.m. in the Main IRS Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by January 2, 2008. A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Rebecca L. Harrigal and Carla A. Young, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Sections 1.148–0, 1.148–3, 1.148–4, 1.148–5, 1.148–8 and 1.148–11 also issued under 26 U.S.C. 148(i).

Par. 2. Section 1.148–0(c) is amended as follows:

1. Add entry for new paragraph (d)(4) in the table of contents for § 1.148–3.

2. Revise entry for paragraph (d) in the table of contents for § 1.148–8.

3. Remove entries for paragraph (d)(1) and paragraph (d)(2) in the table of contents for § 1.148–8.

4. Add entries for new paragraphs (k), (k)(1), (k)(2), (k)(3) and (k)(4) in the table of contents for § 1.148–11.

The revised and added provisions read as follows:

§ 1.148–0 Scope and Table of Contents.

* * * * *

§ 1.148–3 General arbitrage rebate rules.

* * * * *

(d) * * *

(4) Cost-of living adjustment.

* * * * *

§ 1.148–8 Small issuer exception to rebate requirement.

* * * * *

(d) Pooled financings—treatment of conduit borrowers.

* * * * *

§ 1.148–11 Effective dates.

* * * * *

(k) Certain arbitrage guidance updates.

(1) In general.

(2) Permissive earlier application.

(3) Rebate overpayment recovery.

(4) Small issuer exception to rebate requirement for conduit borrowers of pooled financings.

* * * * *

Par. 3. Section 1.148–3 is amended by revising paragraph (d)(1)(iv) and adding a new paragraph (d)(4) as follows:

§ 1.148–3 General arbitrage rebate rules.

* * * * *

(d) * * *

(1) * * *

(iv) On the last day of each bond year during which there are amounts allocated to gross proceeds of an issue that are subject to the rebate requirement, and on the final maturity date, a computation credit of $1,400 for any bond year ending in 2007 and, for bond years ending after 2007, a computation credit in the amount determined under paragraph (d)(4) of this section; and

* * * * *

(4) *Cost-of-living adjustment.* For any calendar year after 2007, the $1,400 computation credit set forth in paragraph (d)(1)(iv) shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such year as modified by this paragraph (d)(4). In applying section 1(f)(3) to determine this cost-of-living adjustment, the reference to ''calendar year 1992'' in section 1(f)(3)(B) shall be changed to ''calendar year 2006.'' If any such increase determined under this paragraph (d)(4) is not a multiple of $10, such increase shall be rounded to the nearest multiple thereof.

* * * * *

Par. 4. Section 1.148–3(j) is amended by revising Example 2(iii)(D) to read as follows:

§ 1.148–3 General arbitrage rebate rules.

* * * * *

(j) * * *

Example 2. * * *

(iii) * * *

(D) If the yield during the second computation period were, instead, 7.0000 percent, the rebate amount computed as of July 1, 2004, would be $1,320,891. The future value of the payment made on July 1, 1999, would be $1,471,007. Although the future value of the payment made on July 1, 1999 ($1,471,007), exceeds the rebate amount computed as of July 1, 2004 ($1,320,891), § 1.148–3(i) limits the amount recoverable as a defined overpayment of rebate under section 148 to the excess of the total ''amount paid'' over the sum of the amount determined under the future value method to be the ''rebate amount'' as of the most recent computation date and all other amounts that are otherwise required to be paid under section 148 as of the date the recovery is requested. Because the total amount that the issuer paid on July 1, 1999 ($1,042,824.60), does not exceed the rebate amount as of July 1, 2004 ($1,320,891), the issuer would not be entitled to recover any overpayment of rebate in this case.

* * * * *

Par. 5. Section 1.148–4(a) is revised to read as follows:

§ 1.148–4 Yield on an issue of bonds.

(a) *In general.* The yield on an issue of bonds is used to apply investment yield restrictions under section 148(a) and to compute rebate liability under section 148(f). Yield is computed under the economic accrual method using any consistently applied compounding interval of not more than one year. A short first compounding interval and a short last compounding interval may be used. Yield is expressed as an annual percentage rate that is calculated to at least four decimal places (for example, 5.2525 percent). Other reasonable, standard financial conventions, such as the 30 days per month/360 days per year convention, may be used in computing yield but must be consistently applied. The yield on an issue that would be a purpose investment (absent section 148(b)(3)(A)) is equal to the yield on the conduit financing issue that financed that purpose investment.

* * * * *

Par. 6. Section 1.148–4 is amended by:

1. Revising paragraph (b)(3)(i), and adding a new sentence at the end of paragraph (h)(2)(ii)(A).

2. Revising the heading and introductory text of paragraph (h)(2)(v).

3. Amending paragraph (h)(2)(v)(B) by revising the last sentence.

4. Adding paragraphs (h)(2)(v)(B)(*1*), (*2*) and (*3*).

5. Adding a new sentence at the end of paragraph (h)(2)(vi).

6. Revising the heading and first sentence of paragraph (h)(2)(viii).

7. Amending paragraph (h)(3)(iv)(B) by adding a new sentence immediately after the first sentence.

8. Adding a new sentence at the end of paragraph (h)(4)(i)(C).

The revised and added provisions read as follows:

§ 1.148–4 Yield on an issue of bonds.

* * * * *

(b) * * *

(3) *Yield on certain fixed yield bonds subject to optional early redemption*—(i) *In general.* If a fixed yield bond is subject to optional early redemption and is described in paragraph (b)(3)(ii) of this section, the yield on the issue containing the bond is computed by treating the bond as redeemed at its stated redemption price on the optional redemption date that would produce the lowest yield on that bond.

* * * * *

(h) * * *

(2) * * *

(ii) * * *

(A) * * * For purposes of applying the definition of periodic payment under § 1.446–3 to determine whether a hedge has a significant investment element under this paragraph (h)(2)(ii)(A), the definition of ''specified index'' under § 1.446–3 (upon which periodic payments are required to be based) is deemed also to include payments an issuer receives under a hedge that are computed to be equal to the issuer's cost of funds, such as the issuer's actual market-based tax-exempt variable interest rate on its bonds.

* * * * *

(v) *Interest-based contract and size and scope of hedge.* The contract is primarily interest-based (for example, a hedge based on a debt index rather than an equity index). In addition, the size and scope of the hedge under the contract is limited to that which is reasonably necessary to hedge the issuer's risk with respect to interest rate changes on the hedged bonds. For example, a contract is limited to hedging an issuer's risk with respect to interest rate changes on the hedged bonds if the hedge is based on the issuer's principal amount of bonds and reasonably expected interest requirements rather than based on a greater notional amount or an interest rate level greater than the expected interest requirements. A contract is not primarily interest based unless—

* * * * *

(B) * * * For this purpose, differences that would not prevent the resulting bond from being substantially similar to another type of bond or to result in overhedging include:

(*1*) A difference between the interest rate used to compute payments on the hedged bond and the interest rate used to compute payments on the hedge where one interest rate is substantially the same as, but not identical to, the other. For this purpose, if an interest rate swap under which the issuer pays the hedge provider a fixed interest payment and receives from the hedge provider a floating interest rate that is based on a taxable interest rate or a taxable market interest rate index, the floating rate on the hedge and the variable rate on the hedged bonds will be treated as being substantially the same only if:

(*i*) The difference between the interest rate on the issuer's hedged bonds and the floating interest rate on the hedge does not exceed one quarter of one percent (.25 percent, or 25 basis points) on the date that the issuer enters into the hedge; and

(*ii*) For a three-year period that ends on the date the issuer enters into the hedge, the average difference between the issuer's actual tax-exempt interest rate on comparable variable-rate bonds (or, if no such comparable bonds exist, rates from a reasonable tax-exempt interest rate index, such as the SIFMA Municipal Swap Index, for that same period) and interest rates determined in the same manner as the floating interest rate on the hedge and as of the same dates as the issuer's comparable variable-rate bonds (or the tax-exempt market index, if applicable) does not exceed one-quarter of one percent (.25 percent, or 25 basis points). For example, if the floating rate on the hedge is 67 percent of LIBOR, then 67 percent of LIBOR, determined as of the same dates as the issuer's actual interest rates (or tax-exempt market index, if applicable) is compared to those actual interest rates (or the tax-exempt market index, if applicable) for the three-year period ending on the date the hedge is entered into and the differences are averaged to determine whether the average difference exceeds one-quarter of one percent. For this purpose, a reasonable sample may be used if the sample for the issuer's actual rates (or tax-exempt market index rates, if applicable) and the sample of floating rates used for the hedge are determined as of the same dates.

(*2*) A difference resulting from the payment of a fixed premium for a cap (for example, payments for a cap that are made in other than level installments).

(*3*) A difference resulting from the allocation of a termination payment if the termination was unexpected as of the date that the parties entered into the hedge contract.

(vi) * * * For this purpose, such payments will be treated as corresponding closely in time under this paragraph (h)(2)(vi) if they are made within 60 calendar days of each other.

* * * * *

(viii) *Reasonably contemporaneous identification.* The contract must be identified by the actual issuer on its books and records maintained for the hedged bonds not later than 15 calendar days after the date on which the issuer and the hedge provider enter into the hedge contract. * * *

(3) * * *

(iv) * * *

(B) * * * The amount of the termination payment in a termination or deemed termination is equal to the fair market value of the qualified hedge on the date of the termination. * * *

* * * * *

(4) * * *

(i) * * *

(C) * * * Except for an anticipatory hedge that is terminated or otherwise closed substantially contemporaneously with the hedged bond in accordance with paragraph (h)(5)(ii) or (h)(5)(iii) of this section, a hedge based on a taxable interest rate or taxable interest index (for example, the London Interbank Offered Rate or LIBOR) does not meet the requirements of this paragraph (C).

* * * * *

Par. 7. Section 1.148–5(c) is amended by:

1. Removing existing paragraph (c)(3)(ii).

2. Adding introductory language to paragraph (c)(3).

3. Removing the heading in paragraph (c)(3)(i) and redesignating the existing text in paragraph (c)(3)(i)(A) as the text in paragraph (c)(3)(i).

4. Redesignate existing paragraphs (c)(3)(i)(B), (c)(3)(i)(C), (c)(3)(i)(D), (c)(3)(i)(E), (c)(3)(i)(F), and (c)(3)(i)(G) as paragraphs (c)(3)(ii), (c)(3)(iii), (c)(3)(iv), (c)(3)(v), (c)(3)(vi), and (c)(3)(vii), respectively.

5. Redesignate existing paragraphs (c)(3)(i)(C)(*1*) and (c)(3)(i)(C)(*2*) as paragraphs (c)(3)(iii)(A) and (c)(3)(iii)(B), respectively, in newly redesignated paragraph (c)(3)(iii).

6. Redesignate existing paragraphs (c)(3)(i)(E)(*1*) and (c)(3)(i)(E)(*2*) as paragraphs (c)(3)(v)(A) and (c)(3)(v)(B), respectively, in newly redesignated paragraph (c)(3)(v).

7. Amend newly redesignated paragraph (c)(3)(i), (c)(3)(ii), (c)(3)(iii), (c)(3)(iv), (c)(3)(v), (c)(3)(vi) and (c)(3)(vii) by adding headings to each paragraph.

8. Revise newly redesignated paragraph (c)(3)(v).

9. Revise newly redesignated paragraph (c)(3)(vi).

10. Amend newly redesignated paragraph (c)(3)(vii) by removing the period at the end of the paragraph and replacing it with a semicolon.

11. Amending paragraph (c)(3) by adding new paragraphs (c)(3)(viii) and (c)(3)(ix).

The revised and added provisions read as follows:

§ 1.148–5 Yield and valuation of investments.

* * * * *

(c) * * *

(3) *Applicability of special yield reduction rule.* Except as otherwise expressly provided in paragraphs (c)(3)(i) through (ix) of this section, paragraph (c) applies only to investments listed in paragraphs (c)(3)(i) through (c)(3)(ix) of this section that are allocated to proceeds of an issue other than gross proceeds of an advance refunding issue.

(i) *Nonpurpose investments allocated to proceeds of an issue that qualified for certain temporary periods.* * * *

(ii) *Investments allocable to certain variable yield issues.* * * *

(iii) *Nonpurpose investments allocable to certain transferred proceeds.* * * *

(A) * * *

(B) * * *

(iv) *Purpose investments allocable to certain qualified student loans.* * * *

(v) *Nonpurpose investments allocable to gross proceeds in certain reserve funds.* Nonpurpose investments allocable to gross proceeds of an issue in a reasonably required reserve or replacement fund or a fund that, except for its failure to satisfy the size limitation in § 1.148–2(f)(2)(ii), would qualify as a reasonably required reserve or replacement fund, but only to the extent the requirements in paragraphs (c)(3)(v)(A) or (B) of this section are met. This paragraph (c)(3)(v) includes nonpurpose investments described in this paragraph that are allocable to transferred proceeds of an advance refunding issue, 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.

(A) * * *

(B) * * *

(vi) *Nonpurpose investments allocable to certain replacement proceeds of refunded issues.* Nonpurpose investments allocated to replacement proceeds of a refunded issue, including a refunded issue that is an advance refunding issue, as a result of the application of the universal cap to amounts in a refunding escrow;

(vii) *Investments allocable to replacement proceeds under a certain transition rule.* * * *

(viii) *Nonpurpose investments allocable to proceeds when SLGS are unavailable.* Nonpurpose investments allocable to proceeds of an issue, including an advance refunding issue, that an issuer purchases on a date when the issuer is unable to purchase State and Local Government Series Securities (SLGS) because the U.S. Department of Treasury, Bureau of Public Debt, has suspended sales of those securities; and

(ix) *Nonpurpose investments allocable to proceeds of certain variable-yield advance refunding issues.* Nonpurpose investments allocable to proceeds of a variable-yield advance refunding issue (the hedged bond issue) deposited in a yield restricted defeasance escrow if—

(A) The issuer has entered into a qualified hedge under § 1.148–4(h)(2) with respect to all of the variable-yield bonds of the issue allocable to the yield restricted defeasance escrow and that hedge is in the form of a variable-to-fixed interest rate swap under which the issuer pays the hedge provider a fixed interest rate and receives from the hedge provider a floating interest rate;

(B) Such qualified hedge covers a period beginning on the issue date of the hedged bond issue and ending on or after the date on which the final payment is to be made from the yield restricted defeasance escrow; and

(C) The issuer restricts the yield on the yield restricted defeasance escrow to a yield that is not greater than the yield on the hedged bond issue, determined by taking into account the issuer's fixed payments to be made under the hedge and by assuming that the issuer's variable yield payments to be paid on the hedged bonds are equal to the floating payments to be received by the issuer under the qualified hedge and are paid on the same dates (that is, such yield reduction payments can only be made to address basis risk differences between the variable yield payments on the hedged bonds and the floating payments received on the hedge).

* * * * *

Par. 8. Section 1.148–5(d)(6) is amended by revising paragraphs (d)(6)(iii)(A)(*1*) and (d)(6)(iii)(A)(*6*) to read as follows:

§ 1.148–5 Yield and valuation of investments.

* * * * *

(d) * * *

(6) * * *

(iii) * * *

(A) * * *

(*1*) The bid specifications are in writing and are timely forwarded, or are made available on an internet website or other similar electronic media that is regularly used to post bid specifications, to potential bidders. For purposes of this paragraph (d)(6)(iii)(A), a writing includes a hard copy, a fax, or an electronic e-mail copy.

* * * * *

(*6*) All potential providers have an equal opportunity to bid. If the bidding process affords any opportunity for a potential provider to review other bids before providing a bid, then providers have an equal opportunity to bid only if all potential providers have an equal opportunity to review other bids. Thus, no potential provider may be given an opportunity to review other bids that is not equally given to all potential providers (that is, no exclusive ''last look'').

* * * * *

Par. 9. Section 1.148–5(e)(2) is amended by revising the second sentence of paragraph (e)(2)(ii)(B) to read as follows:

§ 1.148–5 Yield and valuation of investments.

* * * * *

(e) * * *

(2) * * *

(ii) * * *

(B) *External commingled funds.* * * * For purposes of this paragraph (e)(2)(ii)(B), a fund is treated as widely held only if, during the immediately preceding fixed, semiannual period chosen by the fund (for example, semiannual periods ending June 30 and December 31), the fund had a daily average of more than 15 investors that were not related parties, and at least 16 of the unrelated investors each maintained a daily average amount invested in the fund that was not less than the lesser of $500,000 and one percent (1%) of the daily average of the total amount invested in the fund (with it being understood that additional smaller investors will not disqualify the fund). * * *

* * * * *

Par. 10. Section 1.148–8(d) is revised to read as follows:

§ 1.148–8 Small Issuer Exception to Rebate Requirement.

* * * * *

(d) *Pooled financings—treatment of conduit borrowers.* A loan to a conduit borrower in a pooled financing qualifies for the small issuer exception, regardless of the size of either the pooled financing or of any loan to other conduit borrowers, only if—

(1) The bonds of the pooled financing are not private activity bonds;

(2) None of the loans to conduit borrowers are private activity bonds; and

(3) The loan to the conduit borrower meets all the requirements of the small issue exception.

* * * * *

Par. 11. Section 1.148–11 is revised by adding new paragraph (k) as follows:

§ 1.148–11 Effective Dates.

* * * * *

(k) *Certain arbitrage guidance updates.*

(1) *In general.* Sections 1.148–3(d)(1)(iv); 1.148–3(d)(4); 1.148–4(a); 1.148–4(b)(3)(i); 1.148–4(h)(2)(ii)(A); 1.148–4(h)(2)(v); 1.148–4(h)(2)(vi); 1.148–4(h)(2)(viii); 1.148–4(h)(3)(iv)(B); 1.148–4(h)(4)(i)(C); 1.148–5(c)(3); 1.148–5(d)(6)(iii)(A) and 1.148–5(e)(2)(ii)(B), as in effect on the effective date of the final regulations (the revised provisions), apply to bonds sold on or after the date that is 90 days after publication of the final regulations in the **Federal Register**, for bonds subject to such applicable section of the regulations as in effect before the effective date of the final regulations.

(2) *Permissive earlier application.* To the extent provided in paragraphs (k)(2)(i) through (vi) of this section, issuers may apply the proposed regulations to bonds sold before the date that is 90 days after publication of the final regulations in the **Federal Register**.

(i) Section 1.148–3(d)(1)(iv) and § 1.148–3(d)(4) may be applied for bond years ending on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which 1.148–3(d)(1)(iv) applies.

(ii) Section 1.148–4(b)(3)(i) may be applied for bonds sold on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which that section applies.

(iii) Sections 1.148–4(h)(2)(ii)(A), 1.148–4(h)(2)(v), 1.148–4(h)(2)(vi), 1.148–4(h)(2)(viii), 1.148–4(h)(3)(iv)(B), and 1.148–4(h)(4)(i)(C) may be applied, in whole but not in part, for qualified hedges entered into on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which § 1.148–4(h) applies.

(iv) Section 1.148–5(c)(3) may be applied for investments purchased on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which that section applies.

(v) Section 1.148–5(d)(6)(iii)(A) may be applied to guaranteed investment contracts entered into on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which § 1.148–5(d)(6)(iii) applies.

(vi) Section 1.148–5(e)(2)(ii)(B) may be applied with respect to investors investing in the fund on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which that section applies.

(3) *Rebate overpayment recovery.* Section 1.148–3(j) applies to bonds subject to § 1.148–3(i).

(4) *Small issuer exception to rebate requirement for conduit borrowers of pooled financings.* Section 1.148–8(d) applies to bonds issued after May 17, 2006.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

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BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–148393–06]

RIN 1545–BG12

Medical and Accident Insurance Benefits Under Qualified Plans; Correction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to notice of proposed rulemaking that was published in the **Federal Register** on Monday, August 20, 2007 (72 FR 46421), regarding the tax treatment of payments by qualified plans for medical or accident insurance.

FOR FURTHER INFORMATION CONTACT: Pamela Kinard at (202) 622–6060.

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–148393–06) that is the subject of these corrections is under section 402(a) of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–148393–06) contains