

(iii) Certain refunding bonds not taken into account is determining small issuer status. There shall not be taken into account under subclause (IV) of clause (i) any bond issued to refund (other than to advance refund) any bond to the extent the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

(iv) Certain issues issued by subordinate governmental units, etc., exempt from rebate requirement. An issue issued by a subordinate entity of a governmental unit with general taxing powers shall be treated as described in clause (i)(I) if the aggregate face amount of such issue does not exceed the lesser of-

(I) \$5,000,000, or

(II) the amount which, when added to the aggregate face amount of other issues issued by such entity, does not exceed the portion of the \$5,000,000 limitation under clause (i)(IV) which such governmental unit allocates to such entity.

For purposes of the preceding sentence, an entity which issues bonds on behalf of a governmental unit with general taxing powers shall be treated as a subordinate entity of such unit. An allocation shall be taken into account under subclause (II) only if it is irrevocable and made before the issuance date of such issue and only to the extent that the limitation so allocated bears a reasonable relationship to the benefits received by such governmental unit from issues issued by such entity.

(v) Determination of whether refunding bonds eligible for exception from rebate requirement. If any portion of an issue is issued to refund other bonds, such portion shall be treated as a separate issue which does not meet the requirements of paragraphs (2) and (3) by reason of this subparagraph unless-

(I) the aggregate face amount of such issue does not exceed \$5,000,000,

(II) each refunded bond was issued as part of an issue which was treated as meeting the requirements of paragraphs (2) and (3) by reason of this subparagraph,

(III) the average maturity date of the refunding bonds issued as part of such issue is not later than the average maturity date of the bonds to be refunded by such issue, and

(IV) no refunding bond has a maturity date which is later than the date which is 30 years after the date the original bond was issued.

Subclause (III) shall not apply if the average maturity of the issue of which the original bond was a part (and of the issue of which the bonds to be refunded as a part) is 3 years or less. For purposes of this clause, average maturity shall be determined in accordance with section 147(b)(2)(A).

(vi) Refundings of bonds issued under law prior to Tax Reform Act of 1986. If section 141(a) did not apply to any refunded bond, the issue of which such refunded bond was a part shall be treated as meeting the requirements of subclause (II) of clause (v) if-

(I) such issue was issued by a governmental unit with general taxing powers,

(II) no bond issued as part of such issue was an industrial development bond (as defined in section 103(b)(2), but without regard to subparagraph (B) of section 103(b)(3) or a private loan bond (as defined in section 103(o)(2)(A)), but without regard to any exception from such definition other than section 103(o)(2)(C), and

(III) the aggregate face amount of all tax-exempt bonds (other than bonds described in subclause (II)) issued by such unit during the calendar year in which such issue was issued did not exceed \$5,000,000.

References in subclause (II) to section 103 shall be to such section as in effect on the day before the date of the enactment of the Tax Reform Act of 1986. Rules similar to the rules of clauses (ii) and (iii) shall apply for purposes of subclause (III). For purposes of subclause (II) of clause (i), bonds described in subclause (II) of this clause to which section 141(a) does not apply shall not be treated as private activity bonds.

(E) Exception for certain qualified student loan bonds.

(i) In general. In determining the aggregate amount earned on nonpurpose investments acquired with gross proceeds of an issue of bonds for a program described in section 144(b)(1)(A), the amount earned from investment of net proceeds of such issue during the initial temporary period under subsection (c) shall not be taken into account to the extent that the amount so earned is used to pay the reasonable-

(I) administrative costs of such program attributable to such issue and the costs of carrying such issue, and

(II) costs of issuing such issue,

but only to the extent such costs were financed with proceeds of such issue and for which the issuer was not reimbursed. Amounts designated as interest on student loans shall not be taken into account in determining whether the issuer is reimbursed for such costs. Except as otherwise hereafter provided in regulations prescribed by the Secretary, cost described in subclause (I) paid from amounts earned as described in the first sentence of this clause may also be taken into account in determining the yield on the student loans under a program described in section 144(b)(1)(A).

(ii) Only arbitrage on amounts loaned during temporary period taken into account for administrative costs, etc. The amount earned from investment of net proceeds of an issue during the initial temporary period under subsection (c) shall be taken into account under clause (i)(I) only to the extent attributable to proceeds which were used to make or finance (not later than the close of such period) student loans under a program described in section 144(b)(1)(A).

(iii) Election. This subparagraph shall not apply to any issue if the issuer elects not to

have the subparagraph apply to such issue.

(iv) Termination. This subparagraph shall not apply to any bond issued after December 31, 1988.

(5) Exemption from gross income of sum rebated. Gross income shall not include the sum described in paragraph (2). Notwithstanding any other provision of this title, no deduction shall be allowed for any amount paid to the United States under paragraph (2).

(6) Definitions. For purposes of this subsection and subsections (c) and (d)-

(A) Nonpurpose investment. The term "nonpurpose investment" means any investment property which-

(i) is acquired with the gross proceeds of an issue, and

(ii) is not acquired in order to carry out the governmental purpose of the issue.

(B) Gross proceeds. Except as otherwise provided by the Secretary, the gross proceeds of an issue include-

(i) amounts received (including repayments of principal) as a result of investing the original proceeds of the issue, and

(ii) amounts to be used to pay debt service on the issue.

(7) Penalty in lieu of loss of tax exemption. In the case of an issue which would (but for this paragraph) fail to meet the requirements of paragraph (2) or (3), the Secretary may treat such issue as not failing to meet such requirements if-

(A) no bond which is part of such issue is a private activity bond (other than a qualified 501(c)(3) bond),

(B) the failure to meet with such requirements is not due to willful neglect, and

(C) the issuer pays to the United States a penalty in an amount equal to the sum of-

(i) 50 percent to the amount which was not paid in accordance with paragraphs (2) and (3), plus

(ii) interest (at the underpayment rate established under section 6621) on the portion of the amount which was not paid on the date required under paragraph (3) for the period beginning on such date.

The Secretary may waive all or any portion of the penalty under this paragraph.

(g) Student loan incentive payments. Except to the extent otherwise provided in regulations,

payments made by the Secretary of Education pursuant to section 438 of the Higher Education Act of 1965 are not to be taken into account, for purposes of subsection (a)(1), in determining yields on student loan notes.

(h) Determinations of yield. For purposes of this section, the yield on an issue shall be determined on the basis of the issue price (within the meaning of section 1273 and 1274).

(i) Regulations. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

#### Section 149. Bonds must be registered to be tax exempt; other requirements

(a) Bonds must be registered to be tax exempt.

(1) General rule. Nothing in section 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any registration-required bond unless such bond is in registered form.

(2) Registration-required bond. For purposes of paragraph (1), the term "registration-required bond" means any bond other than a bond which-

(A) is not a type offered to the public

(B) has a maturity (at issue) of not more than 1 year, or

(C) is described in section 163(f)(2)(B).

(3) Special rules.

(A) Book entries permitted. For purposes of paragraph (1), a book entry bond shall be treated as in registered form if the right to the principal of, and stated interest on, such bond may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

(B) Nominees. The Secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where there is a nominee or chain of nominees.

(b) Federally guaranteed bond is not tax exempt-

(1) General rule. Nothing in section 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any registration-required bond unless such bond is in registered form.

(2) Registration-required bond. For purposes of paragraph (1), the term "registration-required bond" means any bond other than a bond which-

(A) is not of a type offered to the public,

(B) has a maturity (at issue) of not more than 1 year, or

(C) is described in section 163(f)(2)(B).

(3) Special rules.

(A) Book entries permitted. For purposes of paragraph (1), a book entry bond shall be treated as in registered form if the right to the principal of, and stated interest on, such bond may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

(B) Nominees. The Secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where there is a nominee or chain of nominees.

(b) Federally guaranteed bond is not tax exempt.

(1) In general. Section 103(a) shall not apply to any State or local bond if such bond is federally guaranteed.

(2) Federally guaranteed defined. For purposes of paragraph (1), a bond is federally guaranteed if-

(A) the payment of principal or interest with respect to such bond is guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof),

(B) such bond is issued as part of an issue and 5 percent or more of the proceeds of such issue is to be-

(i) used in making loans the payment of principal or interest with respect to which are to be guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof), or

(ii) invested (directly or indirectly) in federally insured deposits or accounts, or

(C) the payment of principal or interest on such bond is otherwise indirectly guaranteed (in whole or in part) by the United States (or an agency or instrumentality thereof).

(3) Exceptions.

(A) Certain insurance programs. A bond shall not be treated as federally guaranteed by reason of

(i) any guarantee by the Federal Housing Administration, the Veterans' Administration, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association,

(ii) any guarantee of student loans and any guarantee by the Student Loan Marketing

Association to finance student loans, or

(iii) any guarantee by the Bonneville Power Authority pursuant to the Northwest Power Act (16 USC 839d) as in effect on the date of the enactment of the Tax Reform Act of 1984.

(B) Debt service, etc. Paragraph (1) shall not apply to-

(i) proceeds of the issue invested for an initial temporary period until such proceeds are needed for the purpose for which such issue was issued,

(ii) investments of a bona fide debt service fund,

(iii) investments of a reserve which meet the requirements of section 148(d),

(iv) investments in bonds issued by the United States Treasury, or

(v) other investments permitted under regulations.

(C) Exception for housing program.

(i) In general. Except as provided in clause (ii), paragraph (1) shall not apply to-

(I) a private activity bond for a qualified residential rental project or a housing program obligation under section 11(b) of the United States Housing Act of 1937,

(II) a qualified mortgage bond, or

(III) a qualified veterans' mortgage bond.

(ii) Exception not to apply where bond invested in federally insured deposits or accounts.

Clause (i) shall not apply to any bond which is federally guaranteed within the meaning of paragraph (2)(B)(ii).

(D) Loans to, or guarantees by, financial institutions. Except as provided in paragraph (2)(B)(ii), a bond which is issued as part of an issue shall not be treated as federally guaranteed merely by reason of the fact that the proceeds of such issue are used in making loans to a financial institution or there is a guarantee by a financial institution unless such guarantee constitutes a federally insured deposit or account.

(4) Definitions. For purposes of this subsection-

(A) Treatment of certain entities with authority to borrow from United States. To the extent provided in regulations prescribed by the Secretary, any entity with statutory authority to borrow from the United States shall be treated as an instrumentality of the United States. Except in the case of an exempt facility bond, a qualified small issue bond, and a qualified student loan bond, nothing in the preceding sentence shall be construed as treating the District of Columbia or any possession of the United States as an instrumentality of the United States.

(B) Federally insured deposit or account. The term "federally insured deposit or account" means any deposit or account in a financial institution to the extent such deposit or account is insured under Federal law by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the National Credit Union Administration, or any similar federally chartered corporation.

(c) Tax exemption must be derived from this title.

(1) General rule. Except as provided in paragraph (2), no interest on any bond shall be exempt from taxation under this title unless such interest is exempt from tax under this title without regard to any provision of law which is not contained in this title and which is not contained in a revenue Act.

(2) Certain prior exemptions.

(A) Prior exemptions continued. For purposes of this title, notwithstanding any provision of this part, any bond the interest on which is exempt from taxation under this title by reason of any provision of law (other than a provision of this title) which is in effect on January 6, 1983, shall be treated as a bond described in section 103(a).

(B) Additional requirements for bonds issued after 1983. Subparagraph (A) shall not apply to a bond (not described in subparagraph (C)) issued after 1983 if the appropriate requirements of this part (or the corresponding provisions of prior law) are not met with respect to such bond.

(C) Description of bond. A Bond is described in the subparagraph (and treated as described in subparagraph (A)) if-

(i) such bond is issued pursuant to the Northwest Power Act (16 USC 839D), as in effect on July 18, 1984;

(ii) such bond is issued pursuant to section 608(a)(6)(A) of Public Law 97-468, as in effect on the date of the enactment of the Tax Reform Act of 1986; or

(iii) such bond is issued before June 19k, 1984 under section 11(b) of the United States Housing Act of 1937.

(d) Advance refundings.

(1) In general. Nothing in section 103(a) or in any other provision of law shall be construed to provide an exemption for Federal income tax for interest on any bond issued as part of an issue described in paragraph (2), (3), or (4).

(2) Certain private activity bonds. An issue is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund a private activity bond (other than a qualified 501(c)(3) bond).

(3) Other bonds.

(A) In general. An issue is described in this paragraph if any bond (issued as part of such issue), hereinafter in this paragraph referred to as the "refunding bond", is issued to advance refund a bond unless-

(i) the refunding bond is only-

(I) the 1st advance refunding of the original bond if the original bond is issued after 1985,

or

(II) the 1st or 2nd advance refunding of the original bond if the original bond was issued before 1986,

(ii) in the case of refunded bonds issued before 1986, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed at par or at a premium of 3 percent or less,

(iii) in the case of refunded bonds issued after 1985, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed,

(iv) the initial temporary period under section 148(c) ends-

(I) with respect to the proceeds of the refunding bond not later than 30 days after the date of issue of such bond, and

(II) with respect to the proceeds of the refunded bond on the date of issue of the refunding bond, and

(v) in the case of refunded bonds to which section 148(e) did not apply, on and after the date of issue of the refunding bond, the amount of proceeds of the refunded bond invested in higher yielding investments (as defined in section 148(b)) which are nonpurpose investments (as defined in section 148(f)(6)(A)) does not exceed-

(I) the amount so invested as part of a reasonably required reserve or replacement fund or during an allowable temporary period, and

(II) the amount which is equal to the lesser of 5 percent of the proceeds of the issue of which the refunded bond is a part or \$100,000 (to the extent such amount is allocable to the refunded bond).

(B) Special rules for redemptions.

(i) Issuer must redeem only if debt service savings. Clause (ii) and (iii) of subparagraph (A) shall apply only if the issuer may realize present value debt service savings (determined without regard to administrative expenses) in connection with the issue of which the refunding

bond is a part.

(ii) Redemptions not required before 90th day. For purposes of clauses (ii) and (iii) of subparagraph (A), the earliest date referred to in such clauses shall not be earlier than the 90th day after the date of issuance of the refunding bond.

(4) Abusive transactions prohibited. An issue is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund another bond and a device is employed in connection with the issuance of such issue to obtain a material financial advantage (based on arbitrage) apart from savings attributable to lower interest rates.

(5) Advance refunding. For purposes of this part, a bond shall be treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

(6) Special rules for purposes of paragraph (3). For purposes of paragraph (3), bonds issued before the date of the enactment of this subsection shall be taken into account under subparagraph (A)(i) thereof except-

(A) a refunding which occurred before 1986 shall be treated as an advance refunding only if the refunding bond was issued more than 180 days before the redemption of the refunded bond, and

(B) a bond issued before 1986, shall be treated as advance refunded not more than once before March 15, 1986.

(7) Regulations. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.

(e) Information reporting.

(1) In general. Nothing in section 103(a) or any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond unless such bond satisfies the requirements of paragraph (2).

(2) Information reporting requirements. A bond satisfies the requirements of this paragraph if the issuer submits to the Secretary, not later than the 15th day of the 2d calendar month after the close of the calendar quarter in which the bond is issued (or such later time as the Secretary may prescribed with respect to any portion of the statement), a statement concerning the issue of which the bond is part which contains-

(A) the name and address of the issuer,

(B) the date of issue, the amount of net proceeds of the issue, the stated interest rate, term, and face amount of each bond which is part of the issue, the amount of issuance costs of the issue, and the amount of reserves of the issue,

(C) where required, the name of the applicable elected representative who approved the issue, or a description of the voter referendum by which the issue was approved,

(D) the name, address, and employer identification number of-

(i) each initial principal user of any facility provided with the proceeds of the issue,

(ii) the common parent of any affiliated group of corporations (within the meaning of section 1504(a)) of which such initial principal user is a member, and

(iii) if the issue is treated as a separate issue under section 144(a)(6)(A), any person treated as a principal user under section 144(a)(6)(B),

(E) a description of any property to be financed from the proceeds of the issue,

(F) a certification by a State official designated by State law (or, where there is no such official, the Governor) that the bond meets the requirements of section 146 (relating to cap on private activity bonds), if applicable, and

(G) such other information as the Secretary may require.

Subparagraph (C) and (D) shall not apply to any bond which is not a private activity bond. The Secretary may provide that certain information specified in the 1st sentence need not be included in the statement with respect to an issue where the inclusion of such information is not necessary to carry out the purposes of this subsection.

(3) Extension of time. The Secretary may grant an extension of time for the filing of any statement required under paragraph (2) if the failure to file in a timely fashion is not due to willful neglect.

(f) Treatment of certain pooled financing bonds.

(1) In general. Section 103(a) shall not apply to any pooled financing bond unless, with respect to the issue of which such bond is a part, the requirements of paragraphs (2) and (3) are met.

(2) Reasonable expectation requirement.

(A) In general. The requirements of this paragraph are met with respect to an issue if the issuer reasonably expects that as of the close of the 3-year period beginning on the date of issuance of the issue, at least 95 percent of the net proceeds of the issue (as of the close of such period) will have been used directly or indirectly to make or finance loans to ultimate borrowers.

(B) Certain factors may not be taken into account in determining expectations. Expectations as to changes in interest rates or in the provisions of this title (or in the regulations or rulings thereunder) may not be taken into account in determining whether expectations are reasonable for purposes of this paragraph.

(C) Net proceeds. For purposes of subparagraph (A), the term "net proceeds" has the meaning given such term by section 150 but shall not include proceeds used to finance issuance costs and shall not include proceeds necessary to pay interest (during such period) on the bonds which are part of the issue.

(D) Refunding bonds. For purposes of subparagraph (A), in the case of a refunding bond, the date of issuance taken into account is the date of issuance of the original bond.

(3) Cost of issuance payment requirements. The requirements of this paragraph are met with respect to an issue if-

(A) the payment of legal and underwriting costs associated with the issuance of the issue is not contingent, and

(B) at least 95 percent of the reasonably expected legal and underwriting costs associated with the issuance of the issue are paid not later than the 180th day after the date of the issuance of the issue.

(4) Pooled financing bond. For purposes of this subsection

(A) In general. The term "pooled financing bond" means any bond issued as part of an issue more than \$5,000,000 of the proceeds of which are reasonably expected (at the time of the issuance of the bonds) to be used (or are intentionally used) directly or indirectly to make or finance loans to 2 or more ultimate borrowers.

(B) Exceptions. Such term shall not include any bond if-

(i) section 146 applies to the issue of which such bond is a part (other than by reason of section 141(b)(5)) or would apply but for section 146(i), or

(ii) section 143(l)(3) applies to such issue.

(5) Definition of loan; treatment of mixed use issues.

(A) Loan. For purposes of this subsection, the term "loan" does not include-

(i) any loan which is a nonpurpose investment (within the meaning of section 148(f)(6) (A), determined without regard to section 148(b)(3), and

(ii) any use of proceeds by an agency of the issuer unless such agency is a political subdivision or instrumentality of the issuer.

(B) Portion of issue to be used for loans treated as separate issue. If only a portion of the proceeds of an issue is reasonably expected (at the time of issuance of the bond) to be used (or is intentionally used) as described in paragraph (4)(A), such portion and the other portion of such issue shall be treated as separate issues for purposes of determining whether such portion meets

the requirements of this subsection.

(g) Treatment of hedge bonds.

(1) In general. Section 103(a) shall not apply to any hedge bond unless, with respect to the issue of which such bond is a part-

(A) the requirement of paragraph (2) is met, and

(B) the requirement of subsection (f)(3) is met.

(2) Reasonable expectations as to when proceeds will be spent. An issue meets the requirement of this paragraph if the issuer reasonably expects that-

(A) 10 percent of the spendable proceeds of the issue will be spent for the governmental purposes of this issue within the 1-year period beginning on the date the bonds are issued,

(B) 30 percent of the spendable proceeds of the issue will be spent for such purposes within the 2-year period beginning on such date,

(C) 60 percent of the spendable proceeds of the issue will be spent for such purposes within the 3-year period beginning on such date,

(D) 85 percent of the spendable proceeds of the issue will be spent for such purposes within the 5-year period beginning on such date.

(3) Hedge bond.

(A) In general. For purposes of this subsection, the term "hedge bond" means any bond issued as part of an issue unless-

(i) the issuer reasonably expects that 85 percent of the spendable proceeds of the issue will be used to carry out the governmental purposes of the issue within the 3-year period beginning on the date the bonds are issued, and

(ii) not more than 50 percent of the proceeds of the issue are invested in nonpurpose investments (as defined in section 148(f)(6)(A)) having a substantially guaranteed yield for 4 years or more.

(B) Exception for investment in tax-exempt bonds not subject to minimum tax.

(i) In general. Such term shall not include any bond issued as part of an issue 95 percent of the net proceeds of which are invested in bonds

(I) the interest on which is not includible in gross income under section 103, and

(II) which are not specified private activity bonds (as defined in section 57(a)(5)(C)).

(ii) Amounts in bona fide debt service fund. Amounts in a bona fide debt service fund shall be treated as invested in bonds described in clause (i).

(iii) Investment earnings held pending reinvestment. Investment earnings held for not more than 30 days pending reinvestment shall be treated as invested in bonds described in clause (i).

(C) Exception for refunding bonds.

(i) In general. A refunding bond shall be treated as meeting the requirements of this subsection only if the original bond met such requirements.

(ii) General rule for refunding of pre-effective date bonds. A refunding bond shall be treated as meeting the requirements of this subsection if-

(I) this subsection does not apply to the original bond,

(II) the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue, and

(III) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

(iii) Refunding of pre-effective date bonds entitled to 5-year temporary period. A refunding bond shall be treated as meeting the requirements of this subsection if-

(I) this subsection does not apply to the original bond,

(II) the issuer reasonably expected that 85 percent of the spendable proceeds of the issue of which the original bond is a part would be used to carry out the governmental purposes of the issue within the 5-year period beginning on the date the original bonds were issued but did not reasonably expect that 85 percent of such proceeds would be so spent within the 3-year period beginning on such date, and

(III) at least 85 percent of the spendable proceeds of the original issue (and all other prior original issues issued to finance the governmental purposes of such issue) were spent before the date the refunding bonds are issued.

(4) Special rules. For purposes of this subsection-

(A) Construction period in excess of 5 years. The Secretary may, at the request of any issuer, provide that the requirement of paragraph (2) shall be treated as met with respect to the portion of the spendable proceeds of an issue which is to be used for any construction project having a construction period in excess of 5 years if it is reasonably expected that such proceeds will be spent over a

reasonable construction schedule specified in such request.

(B) Rules for determining expectations. The rules of subsection (f)(2)(B) shall apply.

(5) Regulations. The Secretary may prescribe regulations to prevent the avoidance of the rules of this subsection, including through the aggregation of projects within a single issue.

## Section 150. Definitions and special rules

(a) General rule. For purposes of this part-

(1) Bond. The term "bond" includes any obligation.

(2) Governmental unit not to include federal government. The term "governmental unit" does not include the United States or any agency or instrumentality thereof.

(3) Net proceeds. The term "net proceeds" means, with respect to any issue, the proceeds of such issue reduced by amounts in a reasonably required reserve or replacement fund.

(4) 501(3) organization. The term "501(3) organization" means any organization described in section 501(c)(3) and exempt from tax under section 501(a).

(5) Ownership of property. Property shall be treated as owned by a governmental unit if it is owned on behalf of such unit.

(6) Tax-exempt bond. The term "tax-exempt" means, with respect to any bond (or issue), that the interest on such bond (or on the bonds issued as part of such issue) is excluded from gross income.

(b) Change in use of facilities financed with tax exempt private activity bonds.

(1) Mortgage revenue bonds.

(A) In general. In the case of any residence with respect to which financing is provided from the proceeds of a tax-exempt qualified mortgage bond or qualified veterans' mortgage bond, if there is a continuous period of at least 1 year during which such residence is not the principal residence of at least 1 of the mortgagors who received such financing, then no deduction shall be allowed under this chapter for interest on such financing which accrues on or after the date such period began and before the date such residence is again the principal residence of at least 1 of the mortgagors who received such financing.

(B) Exception. Subparagraph (A) shall not apply to the extent the Secretary determines that its application would result in undue hardship and that the failure to meet the requirements of subparagraph (A) resulted from circumstances beyond the mortgagor's control.

(2) Qualified residential rental projects. In the case of any project for residential rental

property-

(A) with respect to which financing is provided from the proceeds of any private activity bond which, when issued, purported to be a tax-exempt bond described in paragraph (7) of section 142(a), and

(B) which does not meet the requirements of section 142(d),

no deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the 1st day of the taxable year in which such project fails to meet such requirements and ending on the date such project meets such requirements. If the provisions of prior law corresponding to section 142(d) apply to a refunded bond, such provisions shall apply (in lieu or section 142(d)) to the refunding bond.

(3) Qualified 501(c)(3) bonds.

(A) In general. In the case of any facility with respect to which financing is provided from the proceeds of any private activity bond which, when issued, purported to be a tax-exempt qualified 501(c)(3) bond, if any portion of such facility-

(i) is used in a trade or business of any person other than a 501(c)(3) organization or a governmental unit, but

(ii) continues to be owned by a 501(c)(3) organization,

then the owner of such portion shall be treated for purposes of this title as engaged in an unrelated trade or business (as defined in section 513) with respect to such portion. The amount of gross income attributable to such portion for any period shall not be less than the fair rental value of such portion for such period.

(B) Denial of deduction for interest. No deduction shall be allowed under this chapter for interest on financing described in subparagraph (A) which accrues during the period beginning on the date such facility is used as described in subparagraph (A)(i) and ending on the date such facility is not so used.

(4) Certain exempt facility bonds and small issue bonds.

(A) In general. In the case of any facility with respect to which financing is provided from the proceeds of any private activity bond to which this paragraph applies, if such facility is not used for a purpose for which a tax exempt bond could be issue on the date of such issue, no deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the date such facility is not so used an ending on the date such facility is so used.

(B) Bonds to which paragraph applies. This paragraph applies to any private activity bond which, when issued, purported to be a tax exempt facility bond described in a paragraph (other than paragraph (7)) of section 142(a) or a qualified small issue bond.

(5) Facilities required to be owned by governmental units or 501(c)(3) organizations. If-

(A) financing is provided with respect to any facility from the proceeds of any private activity bond which, when issued, purported to be a tax exempt bond,

(B) such facility is required to be owned by a governmental unit or a 501(c)(3) organization as a condition of such tax exemption, and

(C) such facility is not so owned,

then no deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the date such facility is not so owned and ending on the date such facility is so owned.

(6) Small issue bonds which exceed capital expenditure limitation. In the case of any financing provided from the proceeds of any bond which, when issued, purported to be a qualified small issue bond, no deduction shall be allowed under this chapter for interest on such financing which accrues during the period such bond is not a qualified small issue bond.

(c) Exception and special rules for purposes of subsection (b). For purposes of subsection (b)-

(1) Exception. Any use with respect to facilities financed with proceeds of an issue which are not required to be used for the exempt purpose of such issue shall not be taken into account.

(2) Treatment of amounts other than interest. If the amount payable for the use of a facility are not interest, subsection (b) shall apply to such amounts as if they were interest but only to the extent such amounts for any period do not exceed the amount of interest accrued on the bond financing for such period.

(3) Use of portion of facility. In the case of any person which used only a portion of the facility, only the interest accruing on the financing allocable to such portion shall be taken into account by such person.

(4) Cessation with respect to portion of facility. In the case of any facility where part but not all of the facility is not used for an exempt purpose, only the interest accruing on the financing allocable to such part shall be taken into account.

(5) Regulations. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and subsection (b).

(d) Qualified scholarship funding bond. For purposes of this part and section 103-

(1) Treatment as State or local bond. A qualified scholarship funding bond shall be treated as a State or local bond.

(2) Qualified scholarship funding bond defined. The term "qualified scholarship funding bond" means a bond issued by a corporation which-

(A) is a corporation not for profit established and operated exclusively for the purpose of acquiring student loan notes incurred under the Higher Education Act of 1965, and

(B) is organized at the request of the State or 1 or more political subdivisions thereof or is requested to exercise such power by 1 or more political subdivisions and required by its corporate charter and bylaws, or required by State law, to devote any income (after payment of expenses, debt service, and the creation of reserves for the same) to the purchase of additional student loan notes or to pay over any income to the United States.

(e) Bonds of certain volunteer fire departments. For purposes of this part and section 103-

(1) In general. A bond of a volunteer fire department shall be treated as a bond of a political subdivision of a State if-

(A) such department is a qualified volunteer fire department with respect to an area within the jurisdiction of such political subdivision, and

(B) such bond is issued as part of an issue 95 percent or more of the net proceeds of which are to be used for the acquisition, construction, reconstruction, or improvement of a firehouse (including land which is functionally related and subordinate thereto) or firetruck used or to be used by such department.

(2) Qualified volunteer fire department. For purposes of this subsection, the term "qualified volunteer fire department" means, with respect to a political subdivision of a State, any organization-

(A) which is organized and operated to provide firefighting or emergency medical services of persons in an are (within the jurisdiction of such political subdivision) which is not provided with any other firefighting services, and

(B) which is required (by written agreement) by the political subdivision to furnish firefighting services in such area.

For purposes of subparagraph (A), other firefighting services provided in an are shall be disregarded in determining whether an organization is a qualified volunteer fire department if such other firefighting services are provided by a qualified volunteer fire department (determined with the application of this sentence) and such organization and the provider of such other services have been continuously providing firefighting services to such are since January 1, 1981.

(3) Treatment as private activity bonds only for certain purposes. Bonds which are part of an issue which meets the requirements of paragraph (1) shall not be treated as private activity bonds except for purposes of sections 147(f) and 149(d).

## Section 151. Allowance of deductions of personal exemptions

(a) Allowance of deductions. In the case of an individual, the exemptions provided by this section

shall be allowed as deductions in computing taxable income.

(b) Taxpayer and spouse. An exemption of the exemption amount for the taxpayer; and an additional exemption of the exemption amount for the spouse of the taxpayer if a joint return is not made by the taxpayer and his spouse, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(c) Additional exemption for dependents.

(1) In general. An exemption of the exemption amount for each dependent (as defined in section 152)

(A) whose gross income for the calendar year in which the taxable year of the taxpayer begins in less than the exemption amount, or

(B) who is a child of the taxpayer and who (i) has not attained the age of 19 at the close of the calendar year in which the taxable year of the taxpayer begins, or (ii) is a student who has not attained the age of 24 at the close of such calendar year.

(2) Exemption denied in case of certain married dependents. No exemption shall be allowed under this subsection for any dependent who has made a joint return with his spouse under section 6013 for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins.

(3) Child defined. For purposes of paragraph (1)(B), the term "child" means an individual who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer.

(4) Student defined. For purposes of paragraph (1)(B)(ii), the term "student" means an individual who during each of 5 calendar months during the calendar year in which the taxable year of the taxpayer begins-

(A) is a full-time student at an educational organization described in section 170(b)(1)(A)(ii);  
or

(B) in pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational organization described in section 170(b)(1)(A)(ii) or of a State or political subdivision of a State.

(5) Certain income of handicapped dependents not taken into account.

(A) In general. For purposes of paragraph (1)(A), the gross income of an individual who is permanently and totally disabled shall not include income attributable to services performed by the individual at a sheltered workshop if-

(i) the availability of medical care at such workshop is the principal reason for his presence there, and

(ii) the income arises solely from activities at such workshop which are incident to such medical care.

(B) Sheltered workshop defined. For purposes of subparagraph (A), the term "sheltered workshop" means a school

(i) which provides special instruction or training designed to alleviate the disability of the individual, and

(ii) which is operated by

(I) an organization described in section 501(c)(3) and exempt from tax under section 501(a),

or

(II) a State, a possession of the United States, any political subdivision of any of the foregoing, the United States, or the District of Columbia.

(C) Permanent and total disability defined. An individual shall be treated as permanently and totally disabled for purposes of this paragraph if such individual would be so treated under paragraph (3) of section 22(e).

(d) Exemption amount. For purposes of this section-

(1) In general. Except as otherwise provided in this subsection, the term "exemption amount" means \$2,000.

(2) Exemption amount disallowed in case of certain dependents. In the case of an individual with respect to whom a deduction under this section is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the exemption amount applicable to such individual for such individual's taxable year shall be zero.

(3) Phaseout.

(A) In general. In the case of any taxpayer whose adjusted gross income for the taxable year exceeds the threshold amount, the exemption amount shall be reduced by the applicable percentage.

(B) Applicable percentage. For purposes of subparagraph (A), the term "applicable percentage" means 2 percentage points for each \$2,500 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds the threshold amount. In the case of a married individual filing a separate return, the preceding sentence shall be applied by substituting "\$1,250" for "\$2,500". In the event shall the applicable percentage exceed 100 percent.

(C) Threshold amount. For purposes of this paragraph, the term "threshold amount" means

(i) \$150,000 in the case of a joint of a return or a surviving spouse (as defined in section 2(a)),

(ii) \$125,000 in the case of head of a household (as defined in section 2(b)),

(iii) \$100,000 in the case of an individual who is not married and who is not a surviving spouse or head of a household, and

(iv) \$75,000 in the case of a married individual filing a separate return.

For purposes of this paragraph, marital status shall be determined under section 7703.

(D) Coordination with other provisions. The provisions of this paragraph shall not apply for purposes of determining whether a deduction under this section with respect to any individual is allowable to another taxpayer for any taxable year.

(E) Termination. This paragraph shall not apply to any taxable year beginning after December 31, 1995.

(4) Inflation adjustments.

(A) Adjustment to basic amount of exemption. In the case of any taxable year beginning in a calendar year after 1989, the dollar amount contained in paragraph (1) shall be increased by an amount equal to-

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 1988" for "calendar year 1989" in subparagraph (B) thereof.

(B) Adjustment to threshold amounts for years after 1991. In the case of any taxable year beginning in a calendar year after 1991, each dollar amount contained in paragraph (3)(C) shall be increased by an amount equal to-

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 1990" for "calendar year 1980" in subparagraph (B) thereof.