

Section 135. Income from United States savings bonds used to pay higher education tuition and fees

(a) General rule. In the case of an individual who pays qualified higher education expenses during the taxable year, no amount shall be includible in gross income by reason of the redemption during such year of any qualified United States savings bond.

(b) Limitations.

(1) Limitation where redemption proceeds exceed higher education expenses.

(A) In general. If-

(i) the aggregate proceeds of qualified United States savings bonds redeemed by the taxpayer during the taxable year exceed

(ii) the qualified higher education expenses paid by the taxpayer during such taxable year,

the amount excludable from gross income under subsection (a) shall not exceed the applicable fraction of the amount excludable from gross income under subsection (a) without regard to this subsection.

(B) Applicable fraction. For purposes of subparagraph (A), the term "applicable fraction" means the fraction the numerator of which is the amount described in subparagraph (A)(ii) and the denominator of which is the amount described in subparagraph (A)(i).

(2) Limitation based on modified adjusted gross income.

(A) In general. If the modified adjusted gross income of the taxpayer for the taxable year exceeds \$40,000 (\$60,000 in the case of a joint return), the amount which would (but for this paragraph) be excludable from gross income under subsection (a) shall be reduced (but not below zero) by the amount which bears the same ratio to the amount which would be so excludable as such excess bears to \$15,000 (\$30,000 in the case of a joint return).

(B) Inflation adjustment. In the case of any taxable year beginning in a calendar year after 1990, the \$40,000 and \$60,000 amounts contained in subparagraph (A) shall be increased by an amount equal to-

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment under section 1(f)(3) for the calendar year in which the taxable year begins.

(C) Rounding. If any amount as adjusted under subparagraph (B) is not a multiple of \$50., such amount shall be rounded to the nearest multiple of \$50. (or if such amount is a multiple of \$25, such amount shall be rounded to the next highest multiple of \$50).

(c) Definitions. For purposes of this section-

(1) Qualified United States savings bond. The term "qualified United States savings bond" means any United States savings bond issued-

(A) after December 31, 1989,

(B) to an individual who has attained age 24 before the date of issuance, and

(C) at discount under section 3105 of title 31, United States Code.

(2) Qualified higher education expenses.

(A) In general. The term "qualified higher education expenses" means tuition and fees required for the enrollment or attendance of-

(i) the taxpayer,

(ii) the taxpayer's spouse, or

(iii) any dependent of the taxpayer with respect to whom the taxpayer is allowed a deduction under section 151,

at an eligible educational institution.

(B) Exception for education involving sports, etc. Such term shall not include expenses with respect to any course or other education involving sports, games, or hobbies other than as part of a degree program.

(3) Eligible educational institution. The term "eligible educational institution" means-

(A) an institution described in section 1201(a) or subparagraph (C) or (D) of section 481(a)(1) of the Higher Education Act of 1965 (as in effect on October 21, 1988), and

(B) an area vocational education school (as defined in subparagraph (C) or (D) of section 521(3) of the Carl D. Perkins Vocational Education Act) which is in any State (as defined in section 521(27) of such Act), as such sections are in effect on October 21, 1988.

(4) Modified adjusted gross income. The term "modified adjusted gross income" means the adjusted gross income of the taxpayer for the taxable year determined-

(A) without regard to this section and sections 911, 931, and 933, and

(B) after the application of sections 86, 469, and 219.

(d) Special rules.

(1) Adjustment for certain scholarships and veterans benefits. The amount of qualified higher education expenses otherwise taken into account under subsection (a) with respect to the education of an individual shall be reduced (before the application of subsection (b)) by the sum of the amounts received with respect to such individual for the taxable year as-

(A) a qualified scholarship which under section 117 is not includable in gross income,

(B) an educational assistance allowance under chapter 30, 31, 32, 34, or 35 of title 38, United States Code, or

(C) a payment (other than a gift, bequest, devise, or inheritance within the meaning of section 102(a)) for educational expenses, or attributable to attendance at an eligible educational institution, which is exempt from income taxation by any law of the United States.

(2) No exclusion for married individuals filing separate returns. If the taxpayer is a married individual (within the meaning of section 7703), this section shall apply only if the taxpayer and his spouse file a joint return for the taxable year.

(3) Regulations. The Secretary may prescribe such regulations as may be necessary or appropriate to carry out this section, including regulations requiring record keeping and information reporting.

Section 136. Cross references to other acts

(a) For exemption of

(1) Allowances and expenditures of meet losses sustained by persons serving the United States abroad, due to appreciation of foreign currencies, see section 5943 of Title 5, United States Code.

(2) Amounts credited to the Maritime Administration under section 9(b)(6) of the Merchant Ship sales Act of 1946, see section 9(c)(1) of that Act (50 USC App. 1742).

(3) Benefits under laws administered by the Veteran's Administration, see section 3101 of title 38, United States Code.

(4) Earnings of slip contractors deposited in special reserve funds, see section 607(d) of the Merchant Marine Act, 1936 (46 USC 1177).

(5) Income derived from Federal Reserve banks, including capital stock and surplus, see section 7 of the Federal Reserve Act (12 USC 531).

(6) Special pensions of persons on Army and Navy medal of honor roll, see 38 USC 562(a)-(c).

(b) For extension of military income-tax-exemption benefits to commissioned officers of Public

Health Service in certain circumstances, see section 212 of the Public Health Service Act (42 USC 213).

Section 141. Private activity bond; qualified bond

(a) Private activity bond. For purposes of this title, the term "private activity bond" means any bond issued as part of an issue-

(1) which meets-

(A) the private business use test of paragraph (1) of subsection (b), and

(B) the private security or payment test of paragraph (2) of subsection (b), or

(2) which meets the private loan financing test of subsection (c).

(b) Private business tests.

(1) Private business use test. Except as otherwise provided in the subsection, an issue meets the test of this paragraph if more than 10 percent of the proceeds of the issue are to be used for any private business use.

(2) Private security or payment test. Except as otherwise provided in this subsection, an issue meets the test of this paragraph if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly-

(A) secured by any interest in-

(i) property used or to be used for a private business use, or

(ii) payments in respect of such property, or

(B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

(3) 5 percent test for private business use not related or disproportionate to government use financed by the issue.

(A) In general. An issue shall be treated as meeting the tests of paragraphs (1) and (2) if such tests would be met if such paragraphs were applied-

(i) by substituting "5 percent" for "10 percent" each place it appears, and

(ii) by taking into account only-

(I) the proceeds of the issue which are to be used for any private business use which is not related to any government use of such proceeds,

(II) the disproportionate related business use proceeds of the issue, and

(III) payments, property, and borrowed money with respect to any use of proceeds described in subclause (I) or (II).

(B) Disproportionate related business use proceeds. For purposes of subparagraph (A), the disproportionate related business use proceeds of an issue is an amount equal to the aggregate of the excesses (determined under the following sentence) for each private business use of the proceeds of an issue which is related to a government use of such proceeds. The excess determined under this sentence is the excess of-

(i) the proceeds of the issue which are to be used for the private use, over

(ii) the proceeds of the issue which are to be used for the government use to which such private business use relates.

(4) Lower limitation for certain output facilities. An issue 5 percent or more of the proceeds of which are to be used with respect to any output facility (other than a facility for the furnishing of water) shall be treated as meeting the tests of paragraphs (1) and (2) if the nonqualified amount with respect to such issue exceeds the excess of-

(A) \$15,000,000, over

(B) the aggregate nonqualified amounts with respect to all prior tax-exempt issues 5 percent or more of the proceeds of which are or will be used with respect to such facility (or any other facility which is part of the same project).

There shall not be taken into account under subparagraph (B) any bond which is not outstanding at the time of the later issue or which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue.

(5) Coordination with volume cap where nonqualified amount exceeds \$15,000,000. If the nonqualified amount with respect to an issue-

(A) exceeds \$15,000,000, but

(B) does not exceed the amount which would cause a bond & which is part of such issue to be treated as a private activity bond without regard to this paragraph.

such bond shall nonetheless be treated as a private activity bond unless the issuer allocates a portion of its volume cap under section 146 to such issue in an amount equal to the excess of such nonqualified amount over \$15,000,000.

(6) Private business use defined.

(A) In general. For purposes of this subsection, the term "private business use" means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For purposes of the preceding sentence, use as a member of the general public shall not be taken into account.

(B) Clarification of trade or business. For purposes of the 1st sentence of subparagraph (A), any activity carried on by a person other than a natural person shall be treated as a trade or business.

(7) Government use. The term "government use" means any use other than a private business use.

(8) Nonqualified amount. For purposes of this subsection, the term "non-qualified amount" means, with respect to an issue, the lessor of-

(A) the proceeds of such issue which are to be used for any private business use, or

(B) the proceeds of such issue with respect to which there are payments (or property or borrowed money) described in paragraph (2).

(9) Exception for qualified 501(c)(3) bonds. There shall not be taken into account under this subsection or subsection (c) the portion of the proceeds of an issue which (if issued as a separate issue) would be treated as a qualified 501(c)(3) bond if the issuer elects to treat such portion as a qualified 501(c)(3) bond.

(c) Private loan financing test.

(1) In general. An issue meets the test of this subsection if the amount of the proceeds of the issue which are to be used (directly or indirectly) to make or finance loans (other than loans described in paragraph (2)) to persons other than governmental units exceeds the lessor of-

(A) 5 percent of such proceeds, or

(B) \$5,000,000

(2) Exception for tax assessment, etc., loans. For purposes of paragraph (1), a loan is described in this paragraph if such loan-

(A) enables the borrower to finance any governmental tax or assessment of general application for a specific essential governmental function, or

(B) is a nonpurpose investment (within the meaning of section 148(f)(6)(A)).

(d) Certain issues use to acquire nongovernmental output property treated as private activity bonds.

(1) In general. For purposes of this title, the term "private activity bond" includes any bond issued as part of an issue if the amount of the proceeds of the issue which are to be used (directly or indirectly) for the acquisition by a governmental unit of nongovernmental output property exceeds the lesser of-

(A) 5 percent of such proceeds, or

(B) \$5,000,000.

(2) Nongovernmental output property. Except as otherwise provided in this subsection, for purposes of paragraph (1), the term "nongovernmental output property" means any property (or interest therein) which before such acquisition was used (or held for use) by a person other than a governmental unit in connection with an output facility (within the meaning of subsection (b)(4) (other than a facility for the furnishing of water). For purposes of the preceding sentence, use (or the holding for use) before October 14, 1987, shall not be taken into account.

(3) Exception for property acquired to provide output to certain areas. For purposes of paragraph (1)-

(A) In general. The term "nongovernmental output property" shall not include any property which is to be used in connection with an output facility 95 percent or more of the output of which will be consumed in-

(i) a qualified service area of the governmental unit acquiring the property, or

(ii) a qualified annexed area of such unit.

(B) Definitions. For purposes of subparagraph (A)-

(i) Qualified service area. The term "qualified service area" means, with respect to the governmental unit acquiring the property, any area throughout which such unit provided (at all times during the 10-year period ending on the date such property is acquired by such unit) output of the same type as the output to be provided by such property. For purposes of the preceding sentence, the period before October 14, 1987, shall not be taken into account.

(ii) Qualified annexed area. The term "qualified annexed area" means, with respect to the governmental unit acquiring the property, any area if-

(I) such area is contiguous to, and annexed for general governmental purposes into, a qualified service area of such unit,

(II) output from such property is made available to all members of the general public in the annexed area, and

(III) the annexed area is not greater than 10 percent of such qualified service area.

(C) Limitation on size of annexed area not to apply where output capacity does not

increase by more than 10 percent. Subclause (III) of subparagraph (B)(ii) shall not apply to an annexation of an area by a governmental unit if the output capacity of the property acquired in connection with the annexation, when added to the output capacity of all other property which is not treated as nongovernmental output property by reason of subparagraph (A)(II) with respect to such annexed area, does not exceed 10 percent of the output capacity of the property providing output of the same type to the qualified service area into which it is annexed.

(D) Rules for determining relative size, etc. For purposes of subparagraphs (B)(ii) and (C)-

(i) The size of any qualified service area and the output capacity of property serving such area shall be determined as the close of the calendar year preceding the calendar year in which the acquisition of nongovernmental output property or the annexation occurs.

(ii) A qualified annexed area shall be treated as part of the qualified service area into which it is annexed for purposes of determining whether any other area annexed in a later year is a qualified annexed area.

(4) Exception for property converted to nonoutput use. For purposes of paragraph (1)-

(A) In general. The term "nongovernmental output property" shall not include any property which is to be converted to a use not in connection with an output facility.

(B) Exception. Subparagraph (A) shall not apply to any property which is part of the output function of a nuclear power facility.

(5) Special rules. In the case of a bond which is a private activity bond solely by reason of this subsection-

(A) subsections (c) and (d) of section 147 (relating to limitations on acquisition of land and existing property) shall not apply, and

(B) paragraph (8) of section 142(a) shall be applied as if it did not contain "local".

(6) Treatment of joint action agencies. With respect to nongovernmental output property acquired by a joint action agency the members of which are governmental units, this subsection shall be applied at the member level by treating each member as acquiring its proportionate share of such property.

(e) Qualified bond. For purposes of this part, the term "qualified bond" means any private activity bond if-

(1) In general. Such bond is-

(A) an exempt facility bond,

(B) a qualified mortgage bond,

- (C) a qualified veterans' mortgage bond,
- (D) a qualified small issue bond,
- (E) a qualified student loan bond,
- (F) a qualified redevelopment bond, or
- (G) a qualified 501(c)(3) bond.

(2) Volume cap. Such bond is issued as part of an issue which meets the applicable requirements of section 146, and

(3) Other requirements. Such bond meets the applicable requirements of each subsection of section 147.

Section 142. Exempt facility bond

(a) General rule. For purposes of this part, the term "exempt facility bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide-

- (1) airports,
- (2) docks and wharves,
- (3) mass commuting facilities,
- (4) facilities for the furnishing of water,
- (5) sewage facilities,
- (6) solid waste disposal facilities,
- (7) qualified residential rental projects,
- (8) facilities for the local furnishing of electric energy or gas,
- (9) local district heating or cooling facilities,
- (10) qualified hazardous waste facilities, or
- (11) high-speed intercity rail facilities.

(b) Special exempt facility bond rules. For purposes of subsection (a)-

(1) Certain facilities must be governmentally owned.

(A) In general. A facility shall be treated as described in paragraph (1), (2), and (3) of subsection (a) only if all of the property to be financed by the net proceeds of the issue is to be owned by a governmental unit.

(B) Safe harbor for leases and management contracts. For purposes of subparagraph (A), property leased by a governmental unit shall be treated as owned by such governmental unit if-

(i) the lessee makes an irrevocable election (binding on the lessee and all successors in interest under the lease) not to claim depreciation or an investment credit with respect to such property.

(ii) the lease term (as defined in section 168 (i)(3)) is not more than 80 percent of the reasonable expected economic life of the property (as determined under section 147(b)), and

(iii) the lessee has no option to purchase the property other than at fair market value (as of the time such option is exercised).

Rules similar to the rules of the preceding sentence shall apply to management contracts and similar types of operating agreements.

(2) Limitation on office space. An office shall not be treated as described in a paragraph of subsection (a) unless-

(A) the office is located on the premises of a facility described in such a paragraph, and

(B) not more than a de minimis amount of the functions to be performed at such office is not directly related to the day-to-day operations at such facility.

(c) Airports, docks and wharves, mass commuting facilities and high-speed intercity rail facilities. For purposes of subsection (a)-

(1) Storage and training facilities. Storage or training facilities directly related to a facility described in paragraph (1), (2), (3) or (11) of subsection (a) shall be treated as described in the paragraph in which such facility is described.

(2) Exception for certain private facilities. Property shall not be treated as described in paragraph (1), (2), (3) or (11) of subsection (a) if such property is described in any of the following subparagraphs and is to be used for any private business use (as defined in section 141(b)(6)).

(A) Any lodging facility.

(B) Any retail facility (including food and beverage facilities) in excess of a size necessary to serve passengers and employees at the exempt facility.

(C) Any retail facility (other than parking) for passengers or the general public located outside the exempt facility terminal.

(D) Any office building for individuals who are not employees of a governmental unit or of the operating authority for the exempt facility.

(E) Any industrial park or manufacturing facility.

(d) Qualified residential rental project. For purposes of this section-

(1) In general. The term "qualified residential rental project" means any project for residential rental property if, at all times during the qualified project period, such project meets the requirements of subparagraph (A) or (B), whichever is elected by the issuer at the time of the issuance of the issue with respect to such project:

(A) 20-50 test. The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income.

(B) 40-60 test. The project meets the requirements of this subparagraph if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income.

For purposes of this paragraph, any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.

(2) Definitions and special rules. For purposes of this subsection-

(A) Qualified project period. The term "qualified project period" means the period beginning on the 1st day on which 10 percent of the residential units in the project are occupied and ending on the latest of-

(i) the date which is 15 years after the date on which 50 percent of the residential units in the project are occupied.

(ii) the 1st day on which no tax-exempt private activity bond issued with respect to the project is outstanding, or

(iii) the date on which any assistance provided with respect to the project under section 8 of the United States Housing Act of 1937 terminates.

(B) Income of individuals; area median gross income. The income of individuals and area median gross income shall be determined by the Secretary in a manner consistent with determinations of lower income families and area median gross income under section 8 of the United States Housing Act of 1937 (or, if such program is terminated, under such program as in

effect immediately before such termination). Determinations under the preceding sentence shall include adjustments for family size. Section 7872(g) shall not apply in determining the income of individuals under the subparagraph.

(3) Current income determinations. For purposes of this subsection-

(A) In general. The determination of whether the income of a resident of a unit in a project exceeds the applicable income limit shall be made at least annually on the basis of the current income of the resident.

(B) Continuing resident's income may increase above the applicable limit. If the income of a resident of a unit in a project did not exceed the applicable income limit upon commencement of such resident's occupancy of such unit (or as of any prior determination under subparagraph (A)), the income of such resident shall be treated as continuing to not exceed the applicable income limit. The preceding sentence shall cease to apply to any resident whose income as of the most recent determination under subparagraph (A) exceeds 140 percent of the applicable income limit if after such determination, but before the next determination, any residential unit of comparable or smaller size in the same project is occupied by a new resident whose income exceeds the applicable income limit.

(4) Special rule in case of deep rent skewing.-

(A) In general. In the case of any project described in subparagraph (B), the 2d sentence of subparagraph (B) of paragraph (3) shall be applied by substituting-

(i) "170 percent" for "140 percent", and

(ii) "any low-income unit in the same project is occupied by a new resident whose income exceeds 40 percent of area median gross income" for "any residential unit of comparable or smaller size in the same project is occupied by a new resident whose income exceeds the applicable income limit".

(B) Deep rent skewed project. A project is described in this subparagraph if the owner of the project elects to have this paragraph apply and, at all times during the qualified project period, such project meets the requirements of clauses (i), (ii), and (iii):

(i) The project meets the requirements of the clause if 15 percent or more of the low-income units in the project are occupied by individuals whose income is 40 percent or less of area median gross income.

(ii) The project meets the requirements of this clause if the gross rent with respect to each low-income unit in the project does not exceed 30 percent of the applicable income limit which applies to individuals occupying the unit.

(iii) The project meets the requirements of this clause if the gross rent with respect to each low-income unit in the project does not exceed 1/2 of the average gross rent with respect to units of comparable size which are not occupied by individuals who meet the applicable income

limit.

(C) Definitions applicable to subparagraph (B). For purposes of subsection (B)-

(i) Low-income unit. The term "low-income unit" means any unit which is required to be occupied by individuals who meet the applicable income limit.

(ii) Gross rent. The term "gross rent" includes-

(I) any payment under section 8 of the United States Housing Act of 1937, and

(II) any utility allowance determined by the Secretary after taking into account such determinations under such section 8.

(5) Applicable income limit. for purposes of paragraphs (3) and (4), the term "applicable income limit" means-

(A) the limitation under subparagraph (A) or (B) of paragraph (1) which applies to the project, or

(B) in the case of a unit to which paragraph (4)(B)(i) applies, the limitation which applies to such unit.

(6) Special rule for certain high cost housing area. In the case of a project located in a city having 5 boroughs and a population in excess of 5,000,000, subparagraph (B) of paragraph (1) shall be applied by substituting "25 percent" for "40 percent".

(7) Certification to secretary. The operator of any project with respect to which an election was made under this subsection shall submit to the Secretary (at such time and in such manner as the Secretary shall prescribe) an annual certification as to whether such project continues to meet the requirements of this subsection. Any failure to comply with the provisions of the preceding sentence shall not affect the tax-exempt status of any bond but shall subject the operator to penalty, as provided in section 6652(j).

(e) Facilities for the furnishing of water. For purposes of subsection (a)(4), the term "facilities for the furnishing of water" means any facility for the furnishing of water if-

(1) the water is or will be made available to members of the general public (including electric utility, industrial, agricultural, or commercial users), and

(2) either the facility is operated by a governmental unit or the rates for the furnishing or sale of the water have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State of political subdivision thereof.

(f) Local furnishing of electric energy or gas. For purposes of subsection (a)(8), the local furnishing of electric energy or gas from a facility shall only include furnishing solely within the

area consisting of-

- (1) a city and 1 contiguous county, or
- (2) 2 contiguous counties.

(g) Local district heating or cooling facility.

(1) In general. For purposes of subsection (a)(9), the term "local district heating or cooling facility" means property used as an integral part of a local district heating or cooling system.

(2) Local district heating or cooling system.

(A) In general. For purposes of paragraph (1), the term "local district heating or cooling system" means any local system consisting of a pipeline or network (which may be connected to a heating or cooling source) providing hot water, chilled water, or steam to 2 or more users for-

- (i) residential, commercial, or industrial heating or cooling, or
- (ii) process steam.

(B) Local system. For purposes of this paragraph, a local system includes facilities furnishing heating and cooling to an area consisting of a city and 1 contiguous county.

(h) Qualified hazardous waste facilities. For purposes of subsection (a)(10), the term "qualified hazardous waste facility" means any facility for the disposal of hazardous waste by incineration or entombment but only if-

(1) the facility is subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect of the date of the enactment of the Tax Reform Act of 1986), and

(2) the portion of such facility which is to be provided by the issuer does not exceed the portion of the facility which is to be used by persons other than-

(A) the owner or operator of such facility, and

(B) any related person (within the meaning of section 144(a)(3)) to such owner or operator.

(i) High-speed intercity rail facilities.

(1) In general. For purposes of subsection (a)(11), the term "high-speed intercity rail facilities" means any facility (not including rolling stock) for the fixed guideway rail transportation of passengers and their baggage between metropolitan statistical areas (within the meaning of section 143(k)(2)(B)) using vehicles that are reasonably expected to operate at

speeds in excess of 150 miles per hour between scheduled stops, but only if such facility will be made available to members of the general public as passengers.

(2) Election by nongovernmental owners. A facility shall be treated as described in subsection (a)(11) only if any owner of such facility which is not a governmental unit irrevocably elects not to claim-

(A) any deduction under section 167 or 168, and

(B) any credit under this subtitle,

with respect to the property to be financed by the net proceeds of the issue.

(3) Use of proceeds. A bond issued as part of an issue described in subsection (a)(11) shall not be considered an exempt facility bond unless any proceeds not used within a 3-year period of the date of the issuance of such bond are used (not later than 6 months after the close of such period) to redeem bonds which are part of such issue.