

## TREASURY REGULATION SECTION 1.150-2 REIMBURSEMENT OF EXPENDITURES PAID BEFORE BOND ISSUANCE

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Because of concerns over arbitrage abuses, the IRS has promulgated regulations regarding when the use of bond proceeds to reimburse expenditures paid prior to the date of issue of the bonds (“Original Expenditures”) will be treated as an expenditure of the bond proceeds. These regulations apply only to Original Expenditures actually **paid** (not accrued) prior to the date of issue of the bonds and reimbursed with bond proceeds. Original Expenditures paid after the date of issue of the bonds are not subject to these rules and may be reimbursed without limitation (so long as they comply with other relevant tax requirements). If a reimbursement fails to meet the requirements of the regulations, the reimbursement is not treated as an expenditure of the bond proceeds and therefore those bond proceeds remain unspent and continue to be subject to tax requirements such as arbitrage limitations and rebate. There are three basic requirements under the reimbursement rules: (i) the official intent requirement, (ii) the reimbursement period requirement and (iii) the capital expenditure requirement.

### **Official Intent Requirement**

The official intent requirement provides that, no later than **60 days** after payment of the Original Expenditures, the issuer must adopt official intent that (i) declares the issuer’s **intent to reimburse** expenditures for the project, (ii) generally **describes the project**, and (iii) states the **maximum principal amount** of obligations expected to be issued for the project. The official intent may be in any reasonable form, “including issuer resolution, action by an appropriate representative of the issuer (e.g., a person authorized or designated to declare official intent on behalf of the issuer), or specific legislative authorization for the issuance of obligations for a particular project.” The general description of the project need not be detailed and may include a description of a financing program (e.g., a highway capital improvement program, hospital equipment acquisition, or school building renovation).

### ***Reasonableness of Intent and Blanket Declarations***

On the date of the declaration, there must be a reasonable expectation to reimburse the Original Expenditures with bond proceeds. Also, a declaration of official intent is prohibited from being made as a matter of course (e.g., “blanket declarations”) or in amounts substantially in excess of the amount expected to be necessary for the project. A pattern of failure to reimburse actual expenditures is evidence of unreasonableness. For example, a declaration of official intent that



is added as a matter of course to all of an issuers ordinances or resolutions authorizing expenditures would not be reasonable.

### **Reimbursement Period Requirement**

Expenditures must be reimbursed (*i.e.*, "a reimbursement allocation must be made") not later than **18 months** (3 years in the case of \$5,000,000 rebate-exempt small issuers) after the later of (i) the **date the expenditures were paid** or (ii) the **date the project is placed in service** or abandoned, but not (except for small issuers) more than 3 years after the Original Expenditures are paid (or, with an architect's or engineer's certificate for long-period construction projects, 5 years after the Original Expenditures are paid).

### **Capital Expenditure Requirement**

The Original Expenditures to be reimbursed must be a capital expenditure, a cost of issuance, a specified type of extraordinary working capital expenditure, a grant, a qualified student loan, a qualified mortgage loan, or a qualified veterans' mortgage loan.

### **Exceptions to the Official Intent and Reimbursement Period Requirements**

The official intent requirement and the reimbursement period requirement do not apply to bond proceeds used to reimburse (i) **costs of issuance**, (ii) amounts not in excess of the lesser of **\$100,000 or 5 percent of the proceeds** of the bonds, or (iii) certain **preliminary expenditures** (not in excess of 20 percent of that portion of the issue price of the bonds allocable to the financing of the project. Original Expenditures meeting these exceptions must still comply with the capital expenditure requirement. Preliminary expenditures generally mean "soft costs" of a project and include architectural, engineering, surveying, soil testing, reimbursement bond issuance costs, and similar costs incurred prior to commencement of acquisition, construction or rehabilitation of a project. Preliminary expenditures do not include "hard costs" related to the construction or acquisition of a project including land acquisition, site preparation and similar costs.

### **Special Refunding and Anti-Abuse Rules**

Generally, if Original Expenditures were paid with proceeds of another obligation, that expenditure may not be reimbursed and the transaction is instead treated as a refunding of the obligation that financed the Original Expenditures. Also, proceeds of a bond used to pay principal or interest on an obligation do not qualify as a reimbursement expenditure but are treated as a refunding. If proceeds of a bond that is being refunded (the "Prior Bond") were used to reimburse an expenditure and that reimbursement did not comply with the reimbursement regulations, then the proceeds of the Prior Bonds are deemed to be unspent as of the date of issue of the refunding bonds. This rule is intended to prevent the issuance of taxable debt to reimburse expenditures that do not qualify for reimbursement under the regulations followed by a tax-exempt refunding of such taxable debt.

A reimbursement allocation is not treated as an expenditure if it employs an abusive arbitrage device under the arbitrage regulations. Also, if within one year after the reimbursement allocation, the reimbursed moneys are used to create replacement proceeds for any bond issue,



the reimbursement allocation is invalid. This rule is generally meant to prevent the reimbursement bond from being used for advance refunding purposes. For example, if the proceeds of issue X are used to reimburse Original Expenditures then such proceeds are immediately deposited in an advance refunding escrow for issue Y, the reimbursement allocation is ineffective.

***This memorandum is intended to be a general summary of Federal tax rules applicable to tax-exempt bonds. It is not intended to be a comprehensive discussion of any particular tax rule and should not be relied upon as guidance for specific tax questions or issues. You should discuss specific tax issues with Dave Walton, Tax Partner, or another Jones Hall attorney.***