

has until June 1 of that year to comply with the requirements of this section.

\* \* \* \* \*

[FR Doc. 2010-18312 Filed 7-29-10; 8:45 am]

BILLING CODE 6717-01-P

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[TD 9490]

RIN 1545-BJ12

#### Extended Carryback of Losses to or From a Consolidated Group; Correction

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

**ACTION:** Correcting amendment.

**SUMMARY:** This document contains corrections to final and temporary regulations (TD 9490) that were published in the *Federal Register* on Wednesday, June 23, 2010 (75 FR 35643) affecting corporations filing consolidated returns under section 1502. These regulations contain rules regarding the implementation of section 172(b)(1)(H) within a consolidated group and also permit certain acquiring consolidated groups to elect to waive all or a portion of the pre-acquisition carryback period pursuant to section 172(b)(1)(H) for specific losses attributable to certain acquired members.

**DATES:** This correction is effective on July 30, 2010, and is applicable on June 23, 2010.

**FOR FURTHER INFORMATION CONTACT:** Grid Glycer, (202) 622-7930 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

The final and temporary regulations (TD 9490) that are the subject of this document are under section 1502 of the Internal Revenue Code.

##### Need for Correction

As published, the final and temporary regulations (TD 9490) contain errors that may prove to be misleading and are in need of clarification.

##### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

##### Correction of Publication

■ Accordingly, 26 CFR part 1 is corrected by making the following correcting amendments:

## 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 \* \* \*

■ **Par. 2.** Section 1.1502-21T(b)(3)(v) is amended by revising paragraphs (B), (C)(1), (C)(2), the last sentence of paragraph (E) *Example 1*(i), the fourth sentence of paragraph (E) *Example 1*(iii) and the fourth sentence of paragraph (E) *Example 2*(ii) to read as follows:

#### § 1.1502-21T Net operating losses (temporary).

\* \* \* \* \*

(B) *Taxpayer's taxable income.* For purposes of computing the limitation under section 172(b)(1)(H)(iv) on a Five-Year Carryback to any consolidated return year from any consolidated return year or separate return year, *taxpayer's taxable income* as used in section 172(b)(1)(H)(iv)(I) means consolidated taxable income (CTI) in the consolidated return year that is the fifth taxable year preceding the year of the loss. For purposes of the preceding sentence, CTI is computed without regard to any CNOL deduction attributable to the particular Five-Year Carryback or any NOL from any member's taxable year ending on the same date as the taxable year in which the Five-Year Carryback arises, or any taxable year thereafter.

(C) *Limitation on Five-Year Carrybacks to a consolidated group—(1) Annual limitation.* The aggregate amount of Five-Year Carrybacks from years ending on the same date (Testing Date) to any consolidated return year may not exceed the excess of 50 percent of the CTI for that year over the total of Five-Year Carrybacks to that consolidated return year from years ending before the Testing Date (Annual Limitation). For purposes of the preceding sentence, CTI is computed without regard to—

(i) Any CNOL deduction attributable to Five-Year Carrybacks to such year; or

(ii) Any NOL from any member's taxable year ending on the Testing Date or any taxable year thereafter.

(2) *Pro rata absorption of limited and non-limited losses.* Any Five-Year Carryback, and other net operating losses, from years ending on the same date that are available to offset CTI in the same year are absorbed on a pro rata basis. *See* § 1.1502-21(b)(1).

\* \* \* \* \*

(E) \* \* \*

*Example 1.* \* \* \* (i) \* \* \* There are no other NOL carrybacks into the X Group's 2004 consolidated taxable year.

\* \* \* \* \*

(iii) \* \* \* The Annual Limitation on Five-Year Carrybacks will be \$250 (\$500 × 50 percent), with CTI determined without taking into account the portion of P's 2008 CNOL carried back to the X Group's 2004 consolidated return year or the X Group's 2008 CNOL, which arises from a taxable year ending on the same date as the Five-Year Carryback. \* \* \*

*Example 2.* \* \* \*

(ii) \* \* \* Because S is making the sole Five-Year Carryback to the X Group's 2004 consolidated return year, S will make a Five-Year Carryback of the full \$400. \* \* \*

\* \* \* \* \*

LaNita Van Dyke,

Chief, Publications and Regulations Branch,  
Legal Processing Division, Associate Chief  
Counsel (Procedure and Administration).

[FR Doc. 2010-18677 Filed 7-29-10; 8:45 am]

BILLING CODE 4830-01-P

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Parts 1 and 602

[TD 9495]

RIN 1545-BC61

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

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

**ACTION:** Final regulations and removal of temporary regulations.

**SUMMARY:** This document removes the temporary regulations and provides final regulations that provide guidance to state and local governments that issue qualified zone academy bonds and to banks, insurance companies, and other taxpayers that hold those bonds on the program requirements for qualified zone academy bonds. The final regulations implement the amendments to section 1397E (discussed in this preamble) and provide guidance on the maximum term, permissible use of proceeds, and remedial actions for qualified zone academy bonds.

**DATES:** *Effective Date:* These regulations are effective on July 30, 2010.

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

**FOR FURTHER INFORMATION CONTACT:** Zoran Stojanovic, (202) 622-3980 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Paperwork Reduction Act

The collection of information contained in these final regulations has

been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1908. This information will be used to identify issuers of qualified zone academy bonds that have established a defeasance escrow as a remedial action taken because of failure to satisfy certain requirements of section 1397E.

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

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

### Background

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

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

Section 1397E(e) imposes a national limitation on the amount of QZABs that

may be issued for each calendar year. The limitation is allocated by the Treasury Department among the States on the basis of their respective populations of individuals below the poverty line.

Section 1397E was amended by section 107 of the Tax Relief and Health Care Act of 2006, Public Law 109–432, 120 Stat. 2922 (2006) (the “2006 Act”), by adding certain requirements for a bond to be a QZAB. In general, the 2006 Act added a new five-year spending period requirement, arbitrage investment restrictions, and information reporting requirements. Specifically, the 2006 Act added new section 1397E(f), which generally imposes spending period restrictions under which an issuer of QZABs must reasonably expect, as of the issue date, that: (1) At least 95 percent of the proceeds from the sale of the issue are to be spent for one or more qualified purposes with respect to qualified zone academies within the 5-year period beginning on the issue date of the QZAB; (2) a binding commitment with a third party to spend at least 10 percent of the proceeds from the sale of the issue will be incurred within the six-month period beginning on the issue date of the QZAB; and (3) such purposes will be completed with due diligence and the proceeds from the sale of the issue will be spent with due diligence. New section 1397E(f)(2) added by the 2006 Act provides authority to the Secretary of the Treasury to extend the five-year spending period. To the extent that less than 95 percent of the proceeds of the issue are spent within the five-year spending period (plus any extension granted by the Secretary of the Treasury), the 2006 Act requires the issuer to redeem the nonqualified bonds within 90 days after the end of such period.

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

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

Section 15316 of the Food, Conservation, and Energy Act of 2008, Public Law 110–246, 122 Stat. 1651 (2008) (the “2008 Energy Act”), added section 54A to the Code. Section 54A(a) provides that a taxpayer that holds a qualified tax credit bond on one or more

credit allowance dates of the bond occurring during any taxable year is allowed as a credit against Federal income tax for the taxable year an amount equal to the sum of the credits determined under section 54A(b) with respect to such dates. Section 54A(d)(1) provides that the term *qualified tax credit bond* (“QTCB”) means a certain bond which is part of an issue that meets the requirements of section 54A(d)(2), (3), (4), (5), and (6) regarding expenditures of bond proceeds, information reporting, arbitrage, maturity limitations, and prohibitions against financial conflicts of interest. At the time of its enactment, the 2008 Energy Act did not treat QZABs as QTCBs.

Section 313 of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, Div. C of Public Law 110–343, 122 Stat. 3765 (2008) (the “2008 Act”) added new section 1397E(m) providing that section 1397E shall not apply to any obligation issued after the date of the enactment of the 2008 Act on October 3, 2008. Effective for obligations issued after October 3, 2008, the 2008 Act amended section 54A(d)(1) defining a QTCB to include a qualified zone academy bond under section 54E of the Code. The 2008 Act also added section 54E, which provides revised program provisions for QZABs in lieu of the existing provisions under section 1397E and amended section 54A(d)(2)(C) to provide that, for purposes of section 54A(d)(2), the term “qualified purpose” for a QZAB means a purpose specified in section 54E(a)(1).

Section 301 of the Hiring Incentives to Restore Employment Act, Public Law 111–147, 124 Stat. 71 (2010) (the “HIRE Act”) added subsection (f) to section 6431 of the Code, which authorizes issuers to elect irrevocably to receive Federal direct payments of allowances of refundable tax credits to subsidize a prescribed portion of their borrowing costs instead of the Federal tax credits that otherwise would be allowed to holders of certain qualified tax credit bonds under section 54A. Under section 6431(f)(3)(A)(iii), the direct payment subsidy option under section 6431(f) applies to qualified zone academy bonds issued under section 54E that meet the requirements to be qualified tax credit bonds under section 54A.

Temporary regulations (TD 8755) interpreting section 1397E were published on January 7, 1998 (63 FR 671), and amended on July 1, 1999 (TD 8826; 64 FR 35573). Final regulations under section 1397E (TD 8903) were published on September 26, 2000 (65 FR 57732) (the “First Final Regulations”). On March 26, 2004, a notice of proposed

rulemaking (REG-121475-03) was published in the **Federal Register** (69 FR 15747) (the "2004 Proposed Regulations"). The 2004 Proposed Regulations proposed to amend the First Final Regulations by providing guidance on the maximum term, permissible use of proceeds, and remedial actions for QZABs. A public hearing was scheduled for July 21, 2004. The public hearing was cancelled because no requests to speak were received. Written comments on the 2004 Proposed Regulations were received. After consideration of the written comments, and in light of the statutory changes made by the 2006 Act, the need for regulatory guidance on those statutory changes, and the close connection between that needed guidance and the guidance in the 2004 Proposed Regulations, the IRS and the Treasury Department determined to issue coordinated guidance as temporary regulations under TD 9339 which were published in the **Federal Register** on July 16, 2007 (72 FR 38767) and which became effective as of September 14, 2007 (the "Temporary Regulations"), with an opportunity for public comment in the corresponding proposed regulations (the "2007 Proposed Regulations"). The 2004 Proposed Regulations were withdrawn. No public hearing was requested and no written comments were received pursuant to the 2007 Proposed Regulations.

Accordingly, the IRS and the Treasury Department adopt the 2007 Proposed Regulations, in substantially the same form as the 2007 Proposed Regulations, as final regulations by this Treasury Decision.

#### Effective/Applicability Dates

In general, except as otherwise provided, these final regulations generally apply to QZABs issued under section 1397E that are sold on or after September 14, 2007.

Pursuant to section 313(b) of the 2008 Act, effective for QZABs that are sold on or after October 3, 2008, section 1397E is inapplicable and successor modified statutory provisions for QZABs apply under sections 54A and 54E. These final regulations generally do not apply to QZABs issued under sections 54A and 54E. However, Notice 2009-30, 2009-16 IRB 852 (April 20, 2009) and Notice 2010-22, 2010-10 IRB 435 (March 8, 2010) (relating to 2009 and 2010 volume cap allocations for QZABs respectively), provide that for QZABs issued under sections 54A and 54E that are sold on or after October 4, 2008, pending the promulgation and effective date of future administrative or regulatory guidance, taxpayers may rely on the

interim guidance provided in these notices and, to the extent not inconsistent with these notices and the provisions of sections 54A and 54E, the Temporary Regulations issued under section 1397E. See § 601.601(d)(2)(ii)(b).

The final regulations include a limited reliance provision for QZABs issued under sections 54A and 54E. Under this reliance provision, except to the extent inconsistent with the successor statutory provisions for QZABs in sections 54A and 54E and public administrative or regulatory guidance under those provisions and except as otherwise provided in a special restriction against reliance on the remedial action provisions in the final regulations, issuers and taxpayers may rely on the final regulations for QZABs that are issued under sections 54A and 54E. In the case of QZABs that are issued under sections 54A and 54E for which the issuer elects the Federal direct payment subsidy option under section 6431(f), issuers and taxpayers may not rely on the remedial action provisions in § 1.1397E-1(h) of the final regulations. The IRS and Treasury Department expect to announce appropriate remedial actions tailored to bonds involving the Federal direct payment subsidy option under section 6431 in future public guidance.

In addition, except as otherwise provided, § 1.1397E-1(h)(2), (h)(3), (h)(4), (i), and (j) of the final regulations regarding the five-year spending period, the arbitrage investment restrictions, and the information reporting requirement added by the 2006 Act apply to bonds issued under section 1397E pursuant to allocations of the national qualified zone academy bond volume cap authority arising in calendar years after 2005 and sold on or after September 14, 2007.

In addition, issuers and taxpayers also may apply the final regulations in whole, but not in part, to bonds issued under section 1397E that are sold before September 14, 2007.

Certain other special effective dates apply to particular provisions under § 1.1397E-1(m).

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information contained in this regulation

will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. The collection of information in this proposed regulation is in § 1.1397E-1(h)(8). This collection of information is required by the IRS to verify compliance with section 1397E. This information will be used to identify issuers of qualified zone academy bonds that have established a defeasance escrow as a remedial action taken because of failure to satisfy certain requirements of section 1397E. The collection of information is required to obtain or retain a benefit. The likely respondents are states or local governments that issue qualified zone academy bonds. The estimated number of respondents is 6, and the estimated average annual burden hours per respondent is 30 minutes. In addition, the establishment of a defeasance escrow need only be reported once. Accordingly, the number of, and the burden on, affected small entities is not significant. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

#### Drafting Information

The principal author of these regulations is Zoran Stojanovic, Office of Associate Chief Counsel, IRS (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in their development.

#### List of Subjects

##### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

##### 26 CFR Part 602

Reporting and recordkeeping requirements.

#### Adoption of Amendments to the Regulations

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

#### PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by removing the entry for "1.1397E-1T" and revising the entry for "§ 1.1397E-1" to read as follows:

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

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

■ **Par. 2.** Section 1.1397E–1 is amended by revising paragraphs (a), (d), (h), (i), (j) and (m) to read as follows:

**§ 1.1397E–1 Qualified zone academy bonds.**

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

(2) *Certain definitions*—(i) *In general.* For purposes of this section, except as otherwise provided in this section, the following definitions apply: the definitions set forth in this section; the definitions used for general tax-exempt bond purposes in § 1.150–1; and the definitions used for purposes of the arbitrage investment restrictions on tax-exempt bonds in § 1.148–1(b).

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

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

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

types of proceeds of tax-exempt bonds under § 1.148–1(b) shall apply.

\* \* \* \* \*

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

\* \* \* \* \*

(h) *Use of proceeds*—(1) *In general.* Section 1397E(d)(1) provides that a bond issued as part of an issue is a QZAB only if, among other requirements, at least 95 percent of the proceeds of the issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency (as defined in section 1397E(d)(4)(B)), and the issue meets the requirements of section 1397E(f) and (g). Section 1397E(d)(5) defines *qualified purpose*, with respect to any qualified zone academy, as rehabilitating or repairing the public school facility in which such academy is established, providing equipment for use at such academy, developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. Section 1397E(d)(4)(A) defines *qualified zone academy* as any public school (or academic program within a public school) that is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level and that meets the requirements of section 1397E(d)(4)(A)(i), (ii), (iii) and (iv).

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

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

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

(B) A binding commitment with a third party to spend at least 10 percent of the proceeds from the sale of the

issue will be incurred within the 6-month period beginning on the issue date of the QZAB;

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

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

(ii) Except as otherwise provided in paragraph (h)(8) of this section, at least 95 percent of the proceeds of the issue are actually used for qualified purposes with respect to a qualified academy for the entire term of the issue (without regard to any redemption provision).

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

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

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

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

(5) *Proceeds spent for rehabilitation, repair or equipment*—(i) *In general.*

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

1397E(d)(5)(A) or (B) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure that—

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

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

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

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

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

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

(ii) The determination of whether there is a reasonable expectation (as of the issue date of the issue) that at least 35 percent of the students attending the school or participating in the program

(as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act is based on expectations regarding the one-year period following the issue date.

(8) *Remedial actions*—(i) *General rule.* If less than 95 percent of the proceeds of an issue are properly used (as determined under paragraph (h)(8)(ii)(D) of this section), the issue will be treated as meeting the requirements of section 1397E(d)(1)(A) if the issue met the requirements of paragraph (h)(2)(i) of this section and a remedial action is taken under paragraph (h)(8)(ii) or (iii) of this section.

(ii) *Redemption or defeasance*—(A) *In general.* A remedial action is taken under this paragraph (h)(8)(ii) if the requirements of paragraphs (h)(8)(ii)(B) and (C) of this section are met.

(B) *Retirement of nonqualified bonds*—(1) *In general.* The requirements of this paragraph (h)(8)(ii)(B) are met if—

(i) All of the nonqualified bonds of the issue (as determined under § 1.142–2(e)) are redeemed within 90 days after the date on which the failure to properly use proceeds occurs; or

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

(2) *Special rule for dispositions for cash.* If the failure to properly use proceeds occurs because of a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash, the requirements of this paragraph (h)(8)(ii)(B) are met if all of the disposition proceeds (as defined in paragraph (h)(8)(iv) of this section) are used within 90 days after the date of the disposition to redeem, or establish a defeasance escrow for, the nonqualified bonds (as determined under § 1.142–2(e)).

(3) *Definition of defeasance escrow.* For purposes of this section, a defeasance escrow is an irrevocable escrow established to retire nonqualified bonds on the earliest call date after the date on which the failure to properly use proceeds occurs in an amount that is sufficient to retire nonqualified bonds on that call date. At

least 90 percent of the weighted average amount in a defeasance escrow must be invested in investments (as defined in § 1.148–1(b)), except that no amount in a defeasance escrow may be invested in any investment the obligor (or any person that is a related party with respect to the obligor within the meaning of § 1.150–1(b)) of which is a user of proceeds of the bonds. All purchases or sales of an investment in a defeasance escrow must be made at the fair market value of the investment within the meaning of § 1.148–5(d)(6).

(C) *Additional rules*—(1) *Limitation on source of funding.* Proceeds of an issue of QZABs (other than unspent proceeds of the issue for which the failure to properly use proceeds occurs) must not be used to redeem or defease nonqualified bonds under paragraph (h)(8)(ii)(B) of this section.

(2) *Rebate requirement.* The issuer must pay to the United States, at the same time and in the same manner as rebate amounts are required to be paid under § 1.148–3 (or at such other time or in such other manner as the Commissioner may prescribe), any investment earnings on amounts in a defeasance escrow established under paragraph (h)(8)(ii)(B) of this section that are in excess of the yield on the issue of QZABs with respect to which the defeasance escrow was established. For this purpose, the first computation period begins on the date on which the defeasance escrow is established.

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

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

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

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

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

(2) *Proceeds spent for rehabilitation, repair or equipment.* For proceeds that

have been spent for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, a failure to properly use proceeds occurs on the earlier of—

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

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

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

(iii) *Alternative use of disposition proceeds.* A remedial action is taken under this paragraph (h)(8)(iii) if all of the requirements of paragraphs (h)(8)(iii)(A) through (D) of this section are met—

(A) The failure to properly use proceeds (as determined under paragraph (h)(8)(ii)(D) of this section) is a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash;

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

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

(2) To the extent not expected to be so spent, the disposition proceeds will be used within 90 days after the date of the disposition to redeem or defease bonds in a manner that meets the requirements of paragraph (h)(8)(ii) of this section;

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

(D) If all of the disposition proceeds are not actually used in the manner described in paragraph (h)(8)(iii)(B) of this section, the remainder of such amounts are used within 90 days after the end of the period described in paragraph (h)(8)(iii)(B)(1) of this section for a remedial action that meets the requirements of paragraph (h)(8)(ii) of this section.

(iv) *Definition of disposition proceeds and allocation among multiple funding sources.* For purposes of this paragraph (h)(8), *disposition proceeds* means disposition proceeds, as defined in § 1.141–12(c)(1), plus amounts derived

from investing disposition proceeds. If property has been financed with an issue of QZABs and one or more other funding sources, any disposition proceeds from that property are allocated to the issue under the principles of § 1.141–12(c)(3).

(9) *Payment of principal, interest or redemption price—(i) In general.* Except as provided in paragraphs (h)(9)(ii) and (h)(9)(iii) of this section, the use of proceeds of a bond to pay principal, interest, or redemption price of the bond or another bond is not a qualified purpose within the meaning of section 1397E(d)(5).

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

(A) The prior bond was not a QZAB (and, in the case of a series of refinancings, no earlier bond in the series was a QZAB);

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

(C) The issuer makes a valid reimbursement allocation to allocate the proceeds of the refinancing bond to the payment of the original expenditure (the reimbursement allocation), which allocation satisfies the requirements for reimbursements under paragraph (h)(10) of this section. For purposes of applying the rules for reimbursement, a refinancing bond which otherwise meets the requirements of this paragraph (h)(9)(ii) is eligible for reimbursement and is not treated as a disqualified refunding under § 1.150–2(g).

(iii) *Reissuance of a QZAB.* For purposes of determining whether the establishing of a defeasance escrow under paragraph (h)(8)(ii)(B)(1)(ii) of this section results in an exchange under § 1.1001–1(a), the QZAB is treated as a tax-exempt bond under § 1.1001–3(e)(5)(ii)(B)(1).

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

(i) *Arbitrage investment restrictions—(1) In general.* Under section 1397E(g) and this paragraph (i), and except as otherwise provided in this paragraph (i), the arbitrage investment restrictions and rebate requirements under section 148 and §§ 1.148–1 through 1.148–11, inclusive, and the exceptions to those restrictions, apply broadly to gross proceeds of QZABs issued under section 1397E to the same extent and in the same manner as they apply to gross proceeds of tax-exempt state or local governmental bonds. For this purpose, references in those sections to tax-exempt bonds generally shall be deemed to refer to QZABs and, to the extent that any particular arbitrage restriction depends on whether bonds are private activity bonds under section 141, the determination of whether QZABs are private activity bonds shall be based on the general definition of private activity bonds under section 141. In applying section 148 and the regulations under that section to QZABs, the modifications set forth in paragraphs (i)(2) through (i)(6) of this section shall apply.

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

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

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

(5) *Application of small issuer exception to the arbitrage rebate requirement.* Except as otherwise provided in paragraph (i)(6) of this section, for purposes of the small issuer exception to the arbitrage rebate requirement under section 148(f)(4)(D) and § 1.148–8, QZABs that are actually issued or reasonably expected to be issued by the QZAB issuer (and applicable entities aggregated under section 148(f)(4)(D)) within a calendar

year are taken into account in measuring the applicable size limitation.

(6) *Certain defeasance escrow earnings.* With respect to a defeasance escrow established in a remedial action for an issue of QZABs that meets the special rebate requirement under paragraph (h)(8)(ii)(C)(2) of this section, the QZAB issuer is treated as ineligible for the small issuer exception to arbitrage rebate under section 148(f)(4)(D) and paragraph (i)(5) of this section and compliance with that special rebate requirement is treated as satisfying applicable arbitrage investment restrictions under section 148 for that defeasance escrow.

(j) *Information reporting requirement.* Under section 1397E(h) and this paragraph (j), issuers of QZABs are required to submit information reporting returns to the IRS similar to the information reporting returns required to be submitted to the IRS under section 149(e) for tax-exempt state or local governmental bonds at the same time and in the same manner as those reports are required to be submitted to the IRS on such forms as shall be prescribed by the Commissioner for such purpose.

\* \* \* \* \*

(m) *Effective/applicability dates—(1) In general.* Except as otherwise provided in this paragraph (m), this section applies to bonds issued under section 1397E that are sold on or after September 14, 2007.

(2) *Special effective dates—(i) Effective dates for paragraphs (h)(2), (h)(3), (h)(4), (i), and (j) of this section in general.* Paragraphs (h)(2), (h)(3), (h)(4), (i), and (j) of this section apply to bonds issued under section 1397E pursuant to allocations of the national qualified zone academy bond volume cap authority for calendar years after 2005 and sold on or after September 14, 2007.

(ii) *Permissive retroactive application—(A) In general.* Except as otherwise provided in this paragraph (m), issuers and taxpayers may apply this section in whole, but not in part, to bonds issued under section 1397E that are sold before September 14, 2007.

(B) *Special rule for certain provisions.* For purposes of the permissive retroactive application rule in paragraph (m)(2)(ii)(A) of this section, paragraphs (h)(2), (h)(3), (h)(4), (i), and (j) of this section need not be applied to any bonds issued under section 1397E to which those provisions do not otherwise apply under the general effective date provisions for those provisions in paragraph (m)(2)(i) of this section.

(C) *Definition of proceeds.* Issuers and taxpayers may apply paragraph (h) of this section, without regard to the definition of proceeds in paragraph (a)(2)(ii) of this section, to bonds issued under section 1397E that are sold before September 14, 2007.

(D) *Bonds issued before July 1, 1999.* Paragraphs (b) and (h)(10) of this section may not be applied to bonds issued under section 1397E that are issued before July 1, 1999.

(3) *Scope of reliance for bonds issued under sections 54A and 54E.* Except to the extent inconsistent with the successor statutory provisions for QZABs in sections 54A and 54E or applicable public administrative or regulatory guidance under those provisions and except as otherwise provided in this paragraph (m)(3), issuers and taxpayers may apply these regulations to QZABs issued under sections 54A and 54E that are sold on or after October 3, 2008. In the case of QZABs that are issued under sections 54A and 54E for which the issuer makes an irrevocable election under section 6431(f) to receive payments with respect to credits under section 6431, issuers and taxpayers may not apply the remedial action provisions under paragraph (h)(8) of this section.

#### § 1.1397E-1T [Removed]

■ **Par. 3.** Section 1.1397E-1T is removed.

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

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

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

■ **Par. 5.** In § 602.101, paragraph (b) is amended by removing the entry for “1.1397E-1T” and adding the following entry in numerical order to the table to read as follows:

#### § 602.101 OMB Control numbers.

\* \* \* \* \*

(b) \* \* \*

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

**Steven T. Miller,**  
*Deputy Commissioner for Services and Enforcement.*

Approved: July 16, 2010.

**Michael Mundaca,**  
*Assistant Secretary of the Treasury (Tax Policy).*

[FR Doc. 2010-18678 Filed 7-29-10; 8:45 am]

**BILLING CODE 4830-01-P**

## DEPARTMENT OF THE TREASURY

### Office of Foreign Assets Control

#### 31 CFR Part 549

#### Lebanon Sanctions Regulations

**AGENCY:** Office of Foreign Assets Control, Treasury.

**ACTION:** Final rule.

**SUMMARY:** The Department of the Treasury's Office of Foreign Assets Control (“OFAC”) is adding regulations to implement Executive Order 13441 of August 1, 2007, “Blocking Property of Persons Undermining the Sovereignty of Lebanon or Its Democratic Processes and Institutions.”

**DATES:** *Effective Date:* July 30, 2010.

**FOR FURTHER INFORMATION CONTACT:** Assistant Director for Compliance, Outreach & Implementation, tel.: 202/622-2490, Assistant Director for Licensing, tel.: 202/622-2480, Assistant Director for Policy, tel.: 202/622-4855, Office of Foreign Assets Control, or Chief Counsel (Foreign Assets Control), tel.: 202/622-2410, Office of the General Counsel, Department of the Treasury (not toll free numbers).

#### SUPPLEMENTARY INFORMATION:

#### Electronic and Facsimile Availability

This document and additional information concerning OFAC are available from OFAC's Web site (<http://www.treas.gov/ofac>). Certain general information pertaining to OFAC's sanctions programs also is available via facsimile through a 24-hour fax-on-demand service, tel.: 202/622-0077.

#### Background

On August 1, 2007, the President, invoking the authority of, *inter alia*, the International Emergency Economic Powers Act (50 U.S.C. 1701-1706) (“IEEPA”), issued Executive Order 13441 (72 FR 43499, Aug. 3, 2007) (“E.O. 13441”). In E.O. 13441, the President determined that the actions of certain persons to undermine Lebanon's legitimate and democratically elected government or democratic institutions, to contribute to the deliberate