



This letter is in response to your request for a ruling that the demolition of the Project Facilities (defined below) (1) will not cause the interest on the Bonds to fail to be excludable from gross income under section 103 of the Internal Revenue Code of 1954 ("the 1954 Code") and (2) will not cause section 150(b) of the Internal Revenue Code of 1986 ("the 1986 Code") to apply, precluding Borrower from deducting interest on the financing agreements relating to the Bonds.

## FACTS

Issuer is a political subdivision of State. In Year 1, Year 2, and Year 3, Issuer issued bonds (the "Prior Bonds"), the proceeds of which were lent to Borrower to finance, in part, certain pollution control facilities (the "Project Facilities") used in connection with an electric generating station (the "Plant"). The Prior Bonds were issued pursuant to section 1312(a) of the Tax Reform Act of 1986 ("the 1986 Tax Act"). The Project Facilities were financed and installed for the sole purpose of ensuring Borrower's compliance with applicable federal and state environmental regulations.

In Year 4, Issuer issued Bonds to refund the Prior Bonds. In Year 5 (which date is on or after May 16, 1997), Issuer reissued Bonds. The reissuance of Bonds was pursuant to section 1313(a) of the 1986 Tax Act.

In Year 6, Borrower entered into a consent decree in settlement of a lawsuit concerning claims that the operation of the Plant resulted in violations of certain federal and state environmental laws (the "Consent Decree"). Among other stipulations, the Consent Decree required that the owners of the Plant install enhanced pollution control equipment with respect to the Plant in order for the Plant to continue in operation after Date 1. Also on Date 1, the Plant's fuel supply contract terminated.

Plant operations were discontinued as of Date 1 because of the uncertainty surrounding the Plant's fuel supply and because of the cost of installing the enhanced pollution control equipment as required by the Consent Decree. After discontinuation of the Plant operations, the Plant owners attempted to sell the Plant. After this proved unsuccessful, the Plant owners decided to decommission and demolish the Plant, including the Project Facilities. As a result of the demolition, the Project Facilities will not be susceptible of any use, except perhaps as scrap materials. Net of decommissioning costs, the scrap value of the Project Facilities will be less than zero.

## LAW AND ANALYSIS

Section 1312(a)(1) of the 1986 Tax Act provides that the amendments made by section 1301 of the 1986 Tax Act (which relate to state and local bonds) shall not apply to bonds (other than a refunding bond) with respect to a facility (A)(i) the original use of which commences with the taxpayer, and the construction, reconstruction, or

rehabilitation of which began before September 26, 1985, and was completed on or after such date, (ii) the original use of which begins with the taxpayer and with respect to which a binding contract to incur significant expenditures for construction, reconstruction, or rehabilitation was entered into before September 26, 1985, and some of such expenditures are incurred on or after such date, or (iii) acquired on or after September 26, 1985, pursuant to a binding contract entered into before such date, and (B) described in an inducement resolution or other comparable preliminary approval adopted by an issuing authority (or by a voter referendum) before September 26, 1985.

Section 1312(a)(2) of the 1986 Tax Act provides that for purposes of section 1312(a)(1) of the Tax Act, the term “significant expenditures” means expenditures greater than 10 percent of the reasonably anticipated cost of the construction, reconstruction, or rehabilitation of the facility involved.

Section 1312(b)(1) of the 1986 Tax Act provides, in part, that, in the case of bonds issued after August 15, 1986, and described in section 1312(a) of the 1986 Tax Act, (a) the requirement that 95 percent or more of the net proceeds of an issue are to be used for a purpose described in section 103(b)(4) of the 1954 Code in order for section 103(b)(4) of the 1954 Code to apply; and (b) section 150(b) of the 1986 Code shall be treated as included in section 103 of the 1954 Code.

Section 1313(a)(1) of the 1986 Tax Act provides that, except as provided in section 1313(a)(3) of the 1986 Tax Act, the amendments made by section 1301 of the 1986 Tax Act (which relate to state and local bonds) shall not apply to any bond the proceeds of which are used exclusively to refund (other than to advance refund) a qualified bond (or a bond which is part of a series of refundings of a qualified bond) if (A) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and (B)(i) the average maturity of the issue of which the refunding bonds is a part does not exceed 120 percent of the average reasonably expected life of the facilities being financed with the proceeds of such issue, or (ii) the refunding bond has a maturity date not later than the date which is 17 years after the date on which the qualified bond was issued.

Section 1313(a)(2) of the 1986 Tax Act provides in part that, for purposes of section 1313(a)(1) of the 1986 Tax Act, the term “qualified bond” means any bond (other than a refunding bond) issued after August 15, 1986, if section 1312(a) of the 1986 Tax Act applies to such bond.

Section 1313(a)(3) of the 1986 Tax Act provides, in part, that section 150(b) of the 1986 Code shall be treated as included in section 103 of the 1954 Code and shall apply to refunding bonds described in section 1313(a)(1) of the 1986 Tax Act.

Section 103(a)(1) of the 1954 Code provides that gross income does not include interest on the obligations of a State, a territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia.

Section 103(b)(1) of the 1954 Code provides, except as otherwise provided in section 103(b) of the 1954 Code, any industrial development bond shall be treated as an obligation not described in section 103(a)(1) of the 1954 Code.

Section 103(b)(4)(E) of the 1954 Code provides that section 103(b)(1) of the 1954 Code shall not apply to any obligation which is issued as part of an issue substantially all of the proceeds of which are to be used to provide air or water pollution control facilities.

Section 150(b)(4) of the 1986 Code provides, in the case of any facility with respect to which financing is provided from the proceeds of certain private activity bond, if such facility is not used for a purpose for which a tax-exempt bond could be issued on the date of such issue, no deduction shall be allowed for interest on such financing which accrues during the period beginning on the date such facility is not so used and ending on the date such facility is so used.

The Consent Decree provides that the Project Facilities, without specific action on the part of Issuer or Borrower, could no longer function in the manner expected when the Bonds were issued. Demolition of the Project Facilities precludes any further use of the Project Facilities by causing them to change from what is currently an unexpected, non-functional use to no use at all except potentially as scrap materials for recycling (and whose value as scrap materials for recycling, net of decommissioning costs, would be less than zero). Demolition of the Project Facilities does not cause Bonds to fail to satisfy the requirements of section 103(b)(4) of the 1954 Code nor does it constitute a change of use within the meaning of section 150(b)(4) of the 1986 Code.

## CONCLUSIONS

Based on the facts described above, we conclude that the demolition of the Project Facilities will not (1) cause the interest on Bonds to fail to be excludable from gross income under section 103 of the 1954 Code, nor (2) cause section 150(b) of the 1986 Code to apply to Bonds, precluding Borrower from deducting the interest it paid on the financing agreements relating to Bonds.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, we express no opinion as to whether the interest on Bonds is excludable under section 103 of the 1954 Code, whether the Prior Bonds meet the requirements of section 1312(a) of the 1986 Tax Act, or whether the Bonds meet the requirements of section 1313(a) of the 1986 Tax Act.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the 1986 Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James A. Polfer  
Branch Chief, Branch 5  
(Financial Institutions & Products)

cc: