

Part I

Section 149.— Bonds Must Be Registered To Be Tax Exempt; Other Requirements

(Also §§ 103, 141-148, 150)

Rev. Rul. 2026-4

ISSUE

Whether bonds issued by the Alaska Railroad Corporation (Railroad Corporation) to finance the construction, acquisition, and improvement of certain property are required to satisfy the rules in §§ 141 through 147 of the Internal Revenue Code of 1986 (Code)¹ to qualify as tax-exempt bonds under § 103(a)?

FACTS

The Federal government built a railroad in the State of Alaska (State) to serve the transportation and development needs of the State and later transferred the assets of that railroad (State Railroad) to the State pursuant to the Alaska Railroad Transfer Act of 1982, Title VI of Public Law 97-468, 96 Stat. 2543, 2556 (1983) (Railroad Act). The Railroad Act contemplates that the State continue to operate the railroad as a rail carrier

¹ Unless otherwise specified, all “Section” or “§” references are to sections of the Code.

after the transfer. By statute, the State established the Railroad Corporation as a public corporation to operate the State Railroad.

In connection with a project in the State to extract, process, liquify, and transport natural gas (LNG Project), the Railroad Corporation intends to issue bonds to finance the construction, acquisition, and improvement of facilities and other property that are located within the State and that are directly related to the LNG Project. Such facilities and other property are collectively referred to in this revenue ruling as the “Property” and consist of:

- The facilities and other related project infrastructure described in Section I, *Background and Proposal*, of the *Order Granting Authorization Under Section 3 of the Natural Gas Act* issued by the Federal Energy Regulatory Commission on May 21, 2020, see 171 FERC ¶ 61,134 (2020);
- Railroad tracks and embankment, rail sidings, rail extensions, rail terminal yards, locomotives and rail cars to transport materials and equipment necessary for pipeline construction and project operations, as well as trains equipped to carry liquified natural gas (LNG);
- Port facilities to import pipe and transport construction materials (including supplies, fuel, and equipment), and infrastructure equipped to store LNG, to serve LNG carrier ships, to transfer LNG to carrier ships, to transfer LNG from carrier ships to LNG storage, and to regasify LNG;
- Airports and helicopter pads;
- Roads, highways, causeways, bridges;
- Power generation facilities;

- Communications infrastructure;
- Construction-related housing; and
- Other facilities directly related to the LNG Project.

For the avoidance of doubt, a facility or property does not qualify as Property solely because it uses natural gas produced by the LNG Project.

LAW

Internal Revenue Code of 1986

Section 103(a) generally provides that, except as otherwise provided in § 103(b), gross income does not include interest on any State or local bond. Section 103(b) provides that § 103(a) does not apply to any private activity bond that is not a qualified bond (within the meaning of § 141), to any arbitrage bond (within the meaning of § 148), or to any bond that does not meet the applicable requirements of § 149. Section 103(c)(1) defines a “State or local bond” as an obligation of a State or political subdivision thereof.

Section 141(a) defines the term “private activity bond” as any bond issued as part of an issue that meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2) or that meets the private loan financing test of § 141(c).

Section 141(b)(1) provides that, except as provided in that subsection, an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Under § 141(b)(6)(A), 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, although use as a member of the general public

is not taken into account. Under § 141(b)(6)(B), any activity carried on by a person other than a natural person is treated as a trade or business.

Section 141(c) provides that an issue meets the private loan financing test if the amount of the proceeds of the issue that are to be used (directly or indirectly) to make or finance loans (other than certain loans described in paragraph (c)(2)) to persons other than governmental units exceeds the lesser of five percent of such proceeds or \$5,000,000.

Section 141(e) defines a “qualified bond” as any private activity bond if such bond is: an exempt facility bond as defined in § 142, a qualified mortgage bond as defined in § 143(a), a qualified veterans’ mortgage bond as defined in § 143(b), a qualified small issue bond as defined in § 144(a), a qualified student loan bond as defined in § 144(b), a qualified redevelopment bond as defined in § 144(c), or a qualified 501(c)(3) bond as defined in § 145. A qualified bond must also meet the requirements of § 146 relating to volume cap and certain other requirements in § 147.

Under § 148(a), the term “arbitrage bond” means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected at the time of issuance to be used (or is intentionally used after issuance) to acquire higher yielding investments or to replace funds that were used directly or indirectly to acquire higher yielding investments. Under § 148(b), “higher yielding investments” means investment property with a yield that is materially higher than the yield on the issue of which the bond is a part.

Section 149 generally enumerates certain additional requirements for a bond to qualify as tax-exempt under § 103(a). Section 149(b) generally provides that, subject to

certain exceptions, § 103(a) does not apply to any State or local bond if such bond is federally guaranteed. For this purpose, a bond is federally guaranteed if: (A) the payment of principal or interest with respect to such bond is guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof); (B) such bond is issued as part of an issue and five percent or more of the proceeds of such issue is to be (i) used in making loans the payment of principal or interest with respect to which is to be guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof), or (ii) invested (directly or indirectly) in federally insured deposits or accounts; or (C) the payment of principal or interest on such bond is otherwise indirectly guaranteed (in whole or in part) by the United States (or an agency or instrumentality thereof).

Section 149(c)(1) provides that, except as provided in paragraph (c)(2), no interest on any bond shall be exempt from taxation under the Code unless such interest is exempt from taxation under the Code without regard to any provision of law that is not contained in the Code and that is not contained in a revenue Act.

Section 149(c)(2)(A) provides that for purposes of the Code, notwithstanding any provision of §§ 141 through 150, any bond the interest on which is exempt from taxation under the Code by reason of any provision of law (other than a provision of the Code) that is in effect on January 6, 1983, shall be treated as a bond described in § 103(a).

Section 149(c)(2)(B) provides that paragraph (c)(2)(A) shall not apply to a bond (not described in paragraph (c)(2)(C)) issued after 1983 if the appropriate requirements of §§ 141 through 150 (or the corresponding provisions of prior law) are not met with respect to such bond.

Section 149(c)(2)(C) provides that bonds issued under or pursuant to three specific statutory provisions are treated as described in section 149(c)(2)(A). Section 149(c)(2)(C)(ii) provides that a bond is described in paragraph (c)(2)(C) (and treated as described in paragraph (c)(2)(A)) if such bond is issued pursuant to § 608(a)(6)(A) of the Railroad Act, as in effect on October 22, 1986, the date of the enactment of the Tax Reform Act of 1986, Public Law 99-514, 100 Stat. 2085 (1986).

Section 150 contains definitions and special rules that are used for purposes of applying the requirements of §§ 103 and 141 through 149.

The Railroad Act as in Effect on October 22, 1986

Section 602(4) of the Railroad Act, as in effect on October 22, 1986,² states that the transfer of the railroad and provision for its operation by the State in the manner contemplated by §§ 601 through 616 of the Railroad Act is made pursuant to the Federal goal and ongoing program of transferring appropriate activities to the States.

Section 608(a)(1) of the Railroad Act provides in part that, after the date of transfer to the State pursuant to § 604 of the Railroad Act, the “State-owned railroad” shall be a rail carrier engaged in interstate and foreign commerce subject to the jurisdiction of the Interstate Commerce Commission under chapter 105 of subtitle IV of title 49, United States Code, and all other Acts applicable to rail carriers subject to that chapter. Section 603(14) of the Railroad Act defines “State-owned railroad” as the authority, agency, corporation or other entity which the State designates or contracts with to own, operate or manage the rail properties of the railroad or, as the context requires, the

² References to the Railroad Act in the balance of this notice are to the Railroad Act as in effect on October 22, 1986.

railroad owned, operated, or managed by such authority, agency, corporation, or other entity.

Section 608(a)(2) of the Railroad Act provides in part that the transfer to the State authorized by § 604 of the Railroad Act and the conferral of jurisdiction to the Interstate Commerce Commission pursuant to § 608(a)(1) of the Railroad Act are intended to confer upon the State-owned railroad all business opportunities available to comparable railroads.

Section 608(a)(6)(A) of the Railroad Act states:

After the date of transfer, continued operation of the Alaska Railroad by a public corporation, authority or other agency of the State shall be deemed to be an exercise of an essential governmental function, and revenue derived from such operation shall be deemed to accrue to the State for the purposes of section 115(a)(1) of the Internal Revenue Code of 1954 (26 U.S.C. 115(a)(1)). Obligations issued by such entity shall also be deemed obligations of the State for the purposes of section 103(a)(1) of the Internal Revenue Code of 1954 (26 U.S.C. 103(a)(1)), but not obligations within the meaning of section 103(b)(2) of the Internal Revenue Code of 1954 (26 U.S.C. 103(b)(2)).

Section 609(a) of the Railroad Act provides that the State or State-owned railroad may request the Secretary of the Interior or the Secretary of Agriculture, as appropriate under law, to expeditiously approve an application for a right-of-way in order that the State-owned railroad may have access across federal lands for transportation and related purposes.

Section 610(b) of the Railroad Act provides that, if the State discontinues use of any land within the right-of-way (defined as an area extending a certain distance on both sides of the center line of any main line or branch line of the railroad), the State's interest in such land shall revert to the United States. For this purpose, the State shall be considered to have discontinued use when, among other circumstances, the State has made no use of the land for a continuous period of eighteen years for transportation, communication, or transmission purposes.

Internal Revenue Code of 1954

Section 103(a)(1) of the Internal Revenue Code of 1954 (1954 Code), as in effect from the date of enactment of the Railroad Act until the date of enactment of the Tax Reform Act of 1986, provided that gross income does not include interest on the obligations of a State, a Territory, or possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia.

Section 103(b)(2) of the 1954 Code, as in effect from the date of enactment of the Railroad Act until the date of enactment of the Tax Reform Act of 1986, defined an "industrial development bond" as any obligation (A) which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person, and (B) the payment of the principal or interest on which (under the terms of such obligation or any underlying arrangement) is, in whole or in major part, (i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or (ii) to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

Section 103 of the 1954 Code, as in effect immediately prior to the date of enactment of the Tax Reform Act of 1986, imposed additional requirements on tax-exempt bonds, including rules in § 103(c) of the 1954 Code related to arbitrage bonds and rules in § 103(h) of the 1954 Code related to federally guaranteed bonds.

Under the Tax Reform Act of 1986, §§ 103 and 103A of the 1954 Code were recodified into §§ 103 and 141 through 150 of the Code. Section 103(a)(1) of the 1954 Code was recodified into § 103(a) of the Code. Section 103(b) of the 1954 Code (defining and governing industrial development bonds) was recodified into §§ 141 through 147 of the Code (defining and governing private activity bonds). Section 103(c) of the 1954 Code (defining and governing arbitrage bonds) was recodified into § 148 of the Code. Section 103(h) of the 1954 Code (defining and governing federally guaranteed bonds) was recodified into § 149(b) of the Code.

ANALYSIS

Under § 149(c)(1), except as provided in § 149(c)(2)(A), a bond is not tax-exempt unless the exemption is derived from the Code without regard to any provision of law that is not contained in the Code and that is not contained in a revenue act (Non-Code Provision). Under § 149(c)(2)(A), a bond that is tax-exempt by reason of a Non-Code Provision in effect on January 6, 1983, is treated as a State or local bond that is tax-exempt under § 103(a). Under § 149(c)(2)(B), the beneficial treatment provided in § 149(c)(2)(A) generally does not apply to a bond issued after 1983, unless the bond is described in § 149(c)(2)(C). Bonds “issued pursuant to section 608(a)(6)(A)” of the Railroad Act, a Non-Code Provision enacted after January 6, 1983, are described in § 149(c)(2)(C)(ii) and thus are treated as described in § 149(c)(2)(A). Consequently,

§ 149(c)(2)(C)(ii) makes clear that even though the Railroad Act was enacted after January 6, 1983, bonds issued pursuant to § 608(a)(6)(A) of the Railroad Act are nonetheless covered by § 149(c)(2)(A) and not subject to the issue date limitation in § 149(c)(2)(B).

The phrase “pursuant to” in § 149(c)(2)(C)(ii) signals that the content of § 608(a)(6)(A) of the Railroad Act circumscribes the nature of bonds to which § 149(c)(2)(C)(ii) applies. Under § 608(a)(6)(A) of the Railroad Act, bonds issued by “a public corporation, authority or other agency of the State” that is engaged in “the continued operation of the [State Railroad]” are “obligations of the State for the purposes of section 103(a)(1) of the Internal Revenue Code of 1954 (26 U.S.C. 103(a)(1)), but not obligations within the meaning of section 103(b)(2) of the Internal Revenue Code of 1954 (26 U.S.C. 103(b)(2)).”

The Railroad Corporation is a public corporation formed by State statute to operate the State Railroad. The Railroad Act contemplates that operation of the State Railroad entails operating as “a rail carrier engaged in interstate and foreign commerce” (§ 608(a)(1) of the Railroad Act), engaging in “all business opportunities available to comparable railroads” (§ 608(a)(2) of the Railroad Act), deploying the State Railroad’s assets for “transportation and related purposes” (§ 609(a) of the Railroad Act), and for “transportation, communication, or transmission purposes” (§ 610(b) of the Railroad Act). To the extent the Railroad Corporation engages in activities consistent with and related to the operation of the State Railroad as contemplated by the Railroad Act, the Railroad Corporation is an entity described in § 608(a)(6)(A) of the Railroad Act.

Therefore, under § 608(a)(6)(A) of the Railroad Act, bonds issued by the Railroad Corporation for purposes consistent with and related to the operation of the State Railroad as contemplated by the Railroad Act (Railroad-Related Bonds) are obligations of the State for purposes of § 103(a)(1) of the 1954 Code and are not industrial development bonds under § 103(b)(2) of the 1954 Code or private activity bonds under § 141(a) of the Code. Railroad-Related Bonds are also “issued pursuant to section 608(a)(6)(A)” of the Railroad Act within the meaning of § 149(c)(2)(C)(ii) and, therefore, under § 149(c)(2)(A), are treated as tax-exempt under § 103(a), notwithstanding any failure to comply with the rules in §§ 141 through 147 governing private activity bonds. Because § 608(a)(6)(A) of the Railroad Act exempts Railroad-Related Bonds only from the rules in §§ 141 through 147 governing private activity bonds, Railroad-Related Bonds must still satisfy the rules in §§ 148, 149, and 150 to qualify as tax-exempt bonds under § 103(a).

In connection with the LNG Project, the Railroad Corporation intends to engage in activities to finance the construction, acquisition, and improvement of the Property. Because the Railroad Corporation’s engagement in these activities is consistent with and related to the operation of the State Railroad as contemplated by the Railroad Act, the bonds issued by the Railroad Corporation to finance the construction, acquisition, and improvement of the Property are Railroad-Related Bonds and are not required to satisfy the rules in §§ 141 through 147 to qualify as tax-exempt bonds under § 103(a). This conclusion is limited to bonds issued by the Railroad Corporation to finance the construction, acquisition, and improvement of the Property, all of which must be located within the State and directly related to the LNG Project. For example, this conclusion

would not apply if the Railroad Corporation were to issue bonds to finance construction of a facility that uses natural gas generated by the LNG Project but has no other relationship to the LNG Project because such a facility does not qualify as Property.

HOLDING

Because financing the construction, acquisition, and improvement of the Property constitutes an activity consistent with and related to the operation of the State Railroad as contemplated by the Railroad Act, bonds issued by the Railroad Corporation to finance the construction, acquisition, and improvement of the Property are not required to satisfy the rules in §§ 141 through 147 to qualify as tax-exempt bonds under § 103(a). However, such bonds are required to satisfy the rules in §§ 148, 149, and 150 to qualify as tax-exempt bonds under § 103(a).

DRAFTING INFORMATION

The principal author of this revenue ruling is the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, call (202) 317-3900 (not a toll-free number).