

Effective Date

The provision applies to taxable years beginning after December 31, 2017.

2. Repeal of advance refunding bonds

Present Law

Section 103 generally provides that gross income does not include interest received on State or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental facilities or the debt is repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (e.g., private businesses or individuals).³⁹⁵ Bonds issued to finance the activities of charitable organizations described in section 501(c)(3) (“qualified 501(c)(3) bonds”) are one type of private activity bond. The exclusion from income for interest on State and local bonds only applies if certain Code requirements are met.

The exclusion for income for interest on State and local bonds applies to refunding bonds but there are limits on advance refunding bonds. A refunding bond is defined as any bond used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond). Different rules apply to current as opposed to advance refunding bonds. A current refunding occurs when the refunded bond is redeemed within 90 days of issuance of the refunding bonds. Conversely, a bond is classified as an advance refunding if it is issued more than 90 days before the redemption of the refunded bond.³⁹⁶ Proceeds of advance refunding bonds are generally invested in an escrow account and held until a future date when the refunded bond may be redeemed.

Although there is no statutory limitation on the number of times that tax-exempt bonds may be currently refunded, the Code limits advance refundings. Generally, governmental bonds and qualified 501(c)(3) bonds may be advance refunded one time.³⁹⁷ Private activity bonds, other than qualified 501(c)(3) bonds, may not be advance refunded at all.³⁹⁸ Furthermore, in the case of an advance refunding bond that results in interest savings (e.g., a high interest rate to low interest rate refunding), the refunded bond must be redeemed on the first call date 90 days after the issuance of the refunding bond that results in debt service savings.³⁹⁹

³⁹⁵ Sec. 141.

³⁹⁶ Sec. 149(d)(5).

³⁹⁷ Sec. 149(d)(3). Bonds issued before 1986 and pursuant to certain transition rules contained in the Tax Reform Act of 1986 may be advance refunded more than one time in certain cases.

³⁹⁸ Sec. 149(d)(2).

³⁹⁹ Sec. 149(d)(3)(A)(iii) and (B); Treas. Reg. sec. 1.149(d)-1(f)(3). A “call” provision provides the issuer of a bond with the right to redeem the bond prior to the stated maturity.

Description of Proposal

The proposal repeals the exclusion from gross income for interest on a bond issued to advance refund another bond.

Effective Date

The proposal applies to advance refunding bonds issued after December 31, 2017.

3. Cost basis of specified securities determined without regard to identification

Present Law

In general

Gain or loss generally is recognized for Federal income tax purposes on realization of that gain or loss (for example, as the result of sale of property). The taxpayer's gain or loss on a disposition of property is the difference between the amount realized on the sale and the taxpayer's adjusted basis in the property disposed of.⁴⁰⁰

To compute adjusted basis, a taxpayer must first determine the property's unadjusted or original basis and then make adjustments prescribed by the Code.⁴⁰¹ The original basis of property is its cost, except as otherwise prescribed by the Code (for example, in the case of property acquired by gift or bequest or in a tax-free exchange). Once determined, the taxpayer's original basis generally is adjusted downward to take account of depreciation or amortization, and generally is adjusted upward to reflect income and gain inclusions or capital improvements with respect to the property.

Basis computation rules

If a taxpayer has acquired stock in a corporation on different dates or at different prices and sells or transfers some of the shares of that stock, and the lot from which the stock is sold or transferred is not adequately identified, the shares sold are deemed to be drawn from the earliest acquired shares (the "first-in-first-out rule").⁴⁰² However, if a taxpayer makes an adequate identification ("specific identification") of shares of stock that it sells, the shares of stock treated as sold are the shares that have been identified.⁴⁰³ A taxpayer who owns shares in a regulated investment company ("RIC") generally is permitted to elect, in lieu of the specific identification

⁴⁰⁰ Sec. 1001.

⁴⁰¹ Sec. 1016.

⁴⁰² Treas. Reg. sec. 1.1012-1(c)(1).

⁴⁰³ Treas. Reg. sec. 1.1012-1(c)(2).