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FEDERAL RESERVE BANK OF NEW YORK

Fiscal Agent of the United States

June 14, 1972

To All Commercial Banks, and Others Concerned, in the Second Federal Reserve District:

The following statement was issued May 31 by the Treasury Department:

TREASURY PROPOSES NEW RULES ON "ARBITRAGE BONDS," OFFERS SPECIAL SECURITIES TO STATE, LOCAL GOVERNMENTS

The Treasury Department today announced a series of related actions affecting the marketing of bond issues by State, county, and municipal governments throughout the country.

Treasury's moves are designed to clarify the Federal tax status of State and local bond issues under the "arbitrage bonds" provision of the 1969 Tax Reform Act, and to assist State and local governments in selling their bonds.

The Internal Revenue Code provides that interest paid on bonds issued by a State or local government is exempt from Federal income tax. However, under the Reform Act, if a State or local government will use funds from a bond issue to purchase other securities providing a "materially higher yield" than the bonds themselves—that is, will engage in an "arbitrage" transaction— the interest paid to the bond holders will be subject to Federal income tax.

For example, if a local government plans to issue bonds at 5 percent and invest the proceeds in obligations yielding 7 percent, the bonds will generally be treated as arbitrage bonds and the interest paid to the bond holders will be taxable.

In today's actions, the Treasury:

—Issued proposed arbitrage bond regulations which supplement temporary regulations announced by the Department on November 12, 1970.

—Amended the temporary regulations, principally to re-define "materially higher yield".

—Announced issuance of two special series of nonmarketable Treasury securities tailored to the needs of State and local governments, to facilitate compliance with the applicable provisions of the Tax Reform Act.

The proposed regulations announced today incorporate most of the previously announced rules, including guidelines for computing the yield on State and local bonds and on obligations acquired with the bond proceeds. In addition, the new regulations give guidance on other matters, including:

1. How a State or local government can identify the "proceeds" of a bond issue for purposes of computing the yield on investment of the bond-raised funds.

2. A definition of the "temporary periods" provided for in the Tax Reform Act during which a State or local government may invest bond proceeds in obligations of a materially higher yield without loss of the tax-exempt status of interest paid on their bonds.

3. The method of determining a "reasonably required reserve or replacement fund"—also as provided for in the Reform Act—that may be invested without restriction in obligations producing a materially higher yield.

4. The treatment of advance refunding issues.

The amendment to the temporary regulations defines "materially higher yield" as more than 1/8 of one percentage point, compared to 1/2 of one percentage point under the previous regulations. This amendment applies to bonds issued more than 30 days after date of publication of the amendments in the Federal Register.

The proposed regulations and amendment to the temporary regulations will be published in the Federal Register for Thursday, June 1, 1972, and will provide an opportunity for interested persons to comment on the proposals. Treasury also will hold a public hearing on the proposals on August 15, 1972.

In another action, Treasury offered new nonmarketable securities to State and local government bodies. The nonmarketable securities are United States Treasury Certificates of Indebtedness—State and Local Government Series, and United States Treasury Notes—State and Local Government Series. Certificates will be issued for periods of three, six and nine months, and one year. Notes will be available for terms of 18 months to seven years.

The interest rate on the new securities will be established by the State or local government, so long as that rate is lower than the yield on marketable Treasury securities of comparable maturities. Thus, the new special securities will provide a convenient means of investment by which State and local governments can avoid loss of exemption from Federal income tax for the interest on their own obligations.

Subscriptions for the new securities, which will be issued in book-entry form, must be in multiples of $5,000.

Application for purchase of the certificates and notes may be made at any Federal Reserve Bank or Branch. Although subscription forms will not be available immediately, the Treasury said that applications for the new offering will be accepted without delay, provided they are accompanied by full payment and appropriate instructions, including the amount of the certificates or notes desired, the terms of maturity thereof, the interest rates, and the title of the State or local official authorized to redeem the securities.

Printed on the following pages is a copy of Treasury Department Circular No. 3-72, Public Debt Series, containing the terms of the offering referred to in the above statement. Subscriptions for the securities, which will be issued in book-entry form on the books of the Bureau of the Public Debt, Treasury Department, should be made on the enclosed Form PD 4144, and should be sent, by State and local government bodies, or by commercial banks on their behalf, to the Government Bond Division at the Head Office of this Bank, or to the Collection, Loans, and Fiscal Agency Division at our Buffalo Branch. Payment for subscriptions cannot be made by credit to Treasury Tax and Loan Accounts. The issue date of the securities will be the date on which funds in full payment therefor are available at this Bank or its Branch.

ALFRED HAYES,
President.

REGULATIONS GOVERNING U.S. TREASURY CERTIFICATES OF INDEBTEDNESS—STATE AND LOCAL GOVERNMENT SERIES, AND U.S. TREASURY NOTES—STATE AND LOCAL GOVERNMENT SERIES

DEPARTMENT CIRCULAR
Public Debt Series No. 3-72

The Department of the Treasury
Washington, May 22, 1972

The regulations in the Department of the Treasury Circular, Public Debt Series No. 3–72 (31 CFR Part 344), set forth below, are issued under the authority of 26 U.S.C. 103(d), 83 Stat. 656; 31 U.S.C. 753, 754, 754b, and 5 U.S.C. 301.

This offer of U.S. Treasury Certificates of Indebtedness—State and Local Government Series, and U.S. Treasury Notes—State and Local Government Series, relates to the fiscal policy of the United States and notice and public procedures thereon are unnecessary.

The regulations were adopted on May 22, 1972.

[SEAL] JOHN K. CARLOCK,
Fiscal Assistant Secretary of the Treasury.

Sec.
344.0 Offering of securities.
344.1 Description of securities
344.2 Subscription for purchase.
344.3 Issue date and payment.
344.4 Redemption.
344.5 General provisions.

AUTHORITY: The provisions of this Part 344 issued under 26 U.S.C. 103(d), 83 Stat. 656; 31 U.S.C. 753, 754, 754b, and 5 U.S.C. 301.

§ 344.0 Offering of securities.

(a) In order to provide States, municipalities, and other government bodies described in section 103(a)(1) of the Internal Revenue Code of 1954 and the regulations thereunder with investments tailored to their needs under those provisions, the Secretary of the Treasury offers, under the authority of the Second Liberty Bond Act, as amended—

(1) U.S. Treasury Certificates of Indebtedness—State and Local Government Series, and

(2) U.S. Treasury Notes—State and Local Government Series,

for sale to those entities. The term "government body" as used herein refers to any one of these entities. The term "securities" herein refers jointly to the certificates and notes. This offering will continue until terminated by the Secretary of the Treasury.

§ 344.1 Description of securities.

(a) *General.* The securities will be issued in book-entry form on the books of the Department of the Treasury, Bureau of the Public Debt, Washington, D.C. 20226, They may not be transferred by sale, exchange, assignment, or pledge, or otherwise.

(b) *Terms and rates of inteerst.*—(1) *Certificates of indebtedness.* The certificates will be issued in multiples of $5,000 with periods of maturity fixed, at the option of the government body, for (i) 3 months, (ii) 6 months, (iii) 9 months, or (iv) 1 year. Each certificate will bear such rate of interest as the government body may designate, provided that it shall not be more than the current Treasury rate on a comparable maturity, reduced by one-eighth of 1 percent. The applicable Treasury rates will be determined by the Treasury not less often than monthly, and will be available at Federal Reserve banks and Branches. Interest on the certificates will be computed on an annual basis and will be payable at maturity with the prinicipal amount.

(2) *Notes.* The notes will be issued in multiples of $5,000 with periods of maturity fixed, at the option of the government body, from 1 year 6 months up to and including 7 years, or for any intervening half-yearly period. Each note will bear such rate of interest as the government body may designate, provided that it shall not be more than the current Treasury rate on a comparable maturity, reduced by one-eighth of 1 percent. The applicable Treasury rates will be determined by the Treasury not less often than monthly, and will be available at Federal Reserve Banks and Branches. Interest on the notes will be payable on a semiannual basis by Treasury check on June 1 and December 1, and at maturity if other than June 1 or December 1. Final interest will be paid with the principal.

§ 344.2 Subscription for purchase.

A government body may purchase a security under this offering by submitting a subscription and making payment to a Federal Reserve Bank or Branch. A commercial bank may act on behalf of a government body in submitting subscriptions. The subscription, dated and signed by an official authorized to make the purchase, must state the amount, maturity, and interest rate of the security desired, and give the title of the designated official authorized to redeem it. Separate subscriptions must be submitted for certificates and notes, and for securities of each maturity and each interest rate.

§ 344.3 Issue date and payment.

The issue date of a security will be the date on which funds in full payment therefor are available at a Federal Reserve Bank or Branch.

§ 344.4 Redemption.

(a) *At maturity.* A security may not

be called for redemption by the Secretary of the Treasury prior to maturity. Upon the maturity of a security, the Treasury will make payment of the principal amount and interest to the owner thereof by Treasury check, or in accordance with other prior arrangements made by the government body with the Bureau of the Public Debt.

(b) *Prior to maturity.* (1) Securities may be redeemed at the owner's option on 2 days' notice after 1 month from the issue date in the case of certificates, and after 1 year from the issue date in the case of notes. Where redemption prior to maturity occurs, the interest for the entire period the security was outstanding shall be calculated on the basis of the lesser of (i) the original interest rate at which the security was issued, or (ii) an adjusted interest rate reflecting both the shorter period during which the security was actually outstanding and a penalty. The adjusted interest rate is the Treasury rate which would have been in effect on the date of issuance for a marketable Treasury certificate or note maturing on the quarterly maturity date prior to redemption (in the case of certificates), or on the semiannual maturity period prior to redemption (in the case of notes), reduced in either case by a penalty which shall be the lesser of (iii) one-eighth of 1 percent times the number of months from the date of issuance to original maturity, divided by the number of full months elapsed from the date of issue to redemption, or (iv) one-fourth of 1 percent. There shall be deducted from the redemption proceeds, if necessary, any overpayment of interest resulting from previous payments made at a higher rate based on the original longer period to maturity. A schedule showing the adjusted interest rates that apply to securities redeemed prior to their maturity dates will be available at the time of issuance of the securities.

A notice to redeem a security prior to the maturity date must be given by the official authorized to redeem it, as shown in the subscription for purchase, to the Bureau of the Public Debt, Division of Securities Operations, Washington, D.C. 20226, by letter, wire, or telex, or by telephone confirmed by wire or telex. The telephone number is 202—964–7007, and the telex number is 892428.

§ 344.5 General provisions.

(a) *Regulations.* U.S. Treasury Certificates of Indebtedness—State and Local Government Series, and U.S. Treasury Notes—State and Local Government Series, shall be subject to the general regulations with respect to U.S. securities, which are set forth in the Department of the Treasury Circular No. 300, current revision (Part 306 of this chapter), to the extent applicable. Copies of the circular may be obtained from the Bureau of the Public Debt, Division of Securities Operations, Washington, D.C. 20226, or a Federal Reserve Bank or Branch.

(b) *Fiscal agents.* Federal Reserve Banks and Branches, as fiscal agents of the United States, are authorized to perform such services as may be requested of them by the Secretary of the Treasury in connection with the purchase of, and transactions in, the securities.

(c) *Reservations.* The Secretary of the Treasury reserves the right to reject any application for the purchase of securities hereunder, in whole or in part, and to refuse to issue or permit to be issued any such securities in any case or any class or classes of cases if he deems such action to be in the public interest, and his action in any such respect shall be final. The Secretary of the Treasury may also at any time, or from time to time, supplement or amend the terms of these regulations, or of any amendments or supplements thereto.

Form PD 4144
Dept. of the Treasury
Bureau of the Public Debt

SUBSCRIPTION FOR PURCHASE AND ISSUE OF UNITED STATES TREASURY CERTIFICATE OF INDEBTEDNESS/TREASURY NOTE – STATE AND LOCAL GOVERNMENT SERIES

USE A SEPARATE FORM FOR EACH SECURITY DESIRED

To: Federal Reserve Bank or Branch at ______________________

PART I

Pursuant to the provisions of Department of the Treasury Circular, Public Debt Series 3-72, the undersigned hereby subscribes and submits payment in full for the purchase of a:

Check two boxes, one for the security desired and the other for the length of term for the security.

☐ UNITED STATES TREASURY CERTIFICATE OF INDEBTEDNESS – STATE AND LOCAL GOVERNMENT SERIES to mature ☐ 3 mos. ☐ 6 mos. ☐ 9 mos. ☐ 1 year from the date of issue thereof,

☐ UNITED STATES TREASURY NOTE – STATE AND LOCAL GOVERNMENT SERIES to mature ☐ 1½ yrs. ☐ 2 yrs. ☐ 2½ yrs. ☐ 3 yrs. ☐ 3½ yrs. ☐ 4 yrs. ☐ 4½ yrs. ☐ 5 yrs. ☐ 5½ yrs. ☐ 6 yrs. ☐ 6½ yrs. ☐ 7 yrs. from the date of issue thereof,

to be issued as an entry on the books of the Bureau of the Public Debt, Department of the Treasury, in the amount and registration shown in Part II below, at the interest rate of __________ percent per annum (or, where the current Treasury rate on a security of comparable maturity is less, at such lower rate reduced by one-eighth of 1 percent).

Dated this __________ day of __________, 19____.

____
(Name of State, Municipality or other Government Body)

____
(Telephone – include Area Code)

By ______________________________
(Signature) (Title)

PART II

Amount of purchase ($5,000 minimum and multiples thereof) - - - - - - - - - $ __________

Name of owner ______________________________

Address of owner *(Include ZIP code)* ______________________________

Address for mailing interest checks on note (If different than address shown above) ______________________________

Title(s) of official(s) authorized to request redemption of security issued in accordance with this subscription ______________________________

Employer Identification Number ☐☐ – ☐☐☐☐☐☐☐

FOR USE BY BANK IN TRANSMITTING PAYMENT FOR ABOVE SECURITY

(If payment is submitted separately it should be accompanied by a copy of this subscription)

☐ Check enclosed

☐ Charge our reserve a/c

____
(Name of institution)

____
(City) (State)

____
(Authorized signature)

FOR USE OF FEDERAL RESERVE BANK

SUBSCRIPTION NO.	ISSUE DATE	MATURITY DATE	DATE CREDITED IN TREAS. ACCT.

FOR USE OF THE DIVISION OF SECURITIES OPERATIONS			FOR USE OF THE DIVISION OF PUBLIC DEBT ACCOUNTS	
APPROVED By ________ Date ________	ACCOUNT NO.	FRB WIRED By ________ Date ________	DATE POSTED (ACCTG. DATE)	OWNER NOTIFIED Date ________