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## **Understanding Private Activity Bonds.**

**In the fixed-income world, a private activity bond (PAB) is tax-exempt security issued by or on behalf of a local or state government. For bond investors, PABs can provide higher yields than other bonds due to their unique tax treatment.**

A PAB is issued by local governments for the purpose of extending special financing benefits for qualified projects. In general, PABs finance projects for a private user, which means the local government doesn't usually pledge its credit. In this way, they are used to attracting private investments for projects that have public or common utility.

For municipal security to be considered a PAB, it must meet two conditions set out in Section 141 of the Internal Revenue Code.

The first condition is that more than 10% of the proceeds must be used for a private business project and that at least 10% of the payments of the principal or interest comes from property used for private business use.

Secondly, a PAB requires "the amount of proceeds of the issue used to make loans to non-governmental borrowers exceeds the lesser of 5 percent of the proceeds or \$5 million, which is the "private loan financing test," according to MSRB.

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Sam Bourgi

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