

Bond Case Briefs

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IRS LTR: Advance Refunding Bonds Won't Become Transferred Proceeds.

The IRS ruled that none of the unspent proceeds or allocable investments of the advance refunding bonds of a utility system owner will become transferred proceeds or investments of the proposed tax-exempt current refunding bonds.

Citations: LTR 201424002

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: ***, ID No. ***

Telephone Number: ***

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LEGEND:

Issuer = ***

Advance Refunding Bonds = ***

Proposed Tax-Exempt Current Refunding Bonds = ***

Date 1 = ***

a = ***

b = ***

c = ***

Dear ***:

This is in response to your request for a ruling that none of the proceeds of the Advance Refunding Bonds in the defeasance escrow described below will become transferred proceeds, under § 1.148-9(b) of the Income Tax Regulations, of the proposed tax-exempt bonds, the proceeds of which are to be used to currently refund a specified portion of the Advance Refunding Bonds.

FACTS AND REPRESENTATIONS

Issuer makes the following factual representations. Issuer owns, operates, and maintains a combined water and sewer utility system (the Utility System). Issuer financed the construction and improvement of the Utility System with a number of issues of bonds. As part of an effort to obtain relief from certain requirements relating to the use of the Utility System revenues, Issuer issued the Advance Refunding Bonds, on Date 1, to defease a issues of revenue bonds (the Prior Issues). Certain of the Advance Refunding Bonds were issued as non-callable bonds. The proceeds of the

Advance Refunding Bonds and the proceeds of a bona fide debt service fund allocable to the outstanding Prior Issues were deposited in a defeasance escrow fund (the Escrow) and used to purchase investments to repay the Prior Issues.

Issuer has fully redeemed b of the a Prior Issues (the Discharged Prior Issues) using a portion of the Escrow. Issuer expects to use the unspent proceeds of the Advance Refunding Bonds in the Escrow (the Unspent Proceeds) to pay the debt service on the outstanding bonds of the remaining c Prior Issues (the Outstanding Prior Issues).

Prior to the issuance of the proposed bonds (described below), Issuer proposes to use the multipurpose allocation rules of § 1.148-9(h) to allocate the bonds, proceeds, and investments of the Advance Refunding Bonds into a separate issues, the purpose of each of which is to refund one of the Prior Issues. Issuer represents it will allocate the bonds of the Advance Refunding Bonds ratably to those separate issues and allocate the sales proceeds based on the present value of the refunded debt service on the Prior Issues in accordance with §§ 1.148-9(h)(4)(i) and (ii). It will allocate the investments in the Escrow purchased with proceeds of the Advance Refunding Bonds, based on the maturities and amounts of the investments, to the separate issues in accordance with the debt service payments of the Prior Issues that the respective investments are expected to pay.

Issuer intends to issue bonds to refund the callable portion of the Advance Refunding Bonds. Issuer proposes to issue the Proposed Tax-Exempt Current Refunding Bonds to currently refund the callable Advance Refunding Bonds it will have allocated to the separate issues the purposes of which are to refund the respective Discharged Prior Issues and issue taxable bonds (the Proposed Taxable Bonds) to refund the callable Advance Refunding Bonds it will have allocated to the separate issues the purposes of which are to refund the respective Outstanding Prior Issues.

LAW AND ANALYSIS

Section 148(a) of the Internal Revenue Code (Code) provides that, for purposes of § 103, 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 of the bond) to be used directly or indirectly to acquire higher yielding investments, or to replace funds which were used directly or indirectly to acquire higher yielding investments. For purposes of § 148(a), a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described above.

Section 1.148-0(b) provides that §§ 1.148-1 through 1.148-11 apply generally for purposes of the arbitrage restrictions on State and local bonds under § 148.

Section 1.148-9(b) provides that when proceeds of the refunding issue discharge any of the outstanding principal amount of the prior issue, proceeds of the prior issue become transferred proceeds of the refunding issue and cease to be proceeds of the prior issue. The amount of proceeds of the prior issue that becomes transferred proceeds of the refunding issue is an amount equal to the proceeds of the prior issue on the date of that discharge multiplied by a fraction the numerator of which is the principal amount of the prior issue discharged with proceeds of the refunding issue on the date of that discharge and the denominator of which is the total outstanding principal amount of the prior issue on the date immediately before the date of the discharge. Principal amount means, in reference to a plain par bond, its stated principal amount, and in reference to any other bond, its present value.

Section 1.148-9(c)(1)(ii) provides that, when proceeds of a prior issue become transferred proceeds of a refunding issue, investments (and the related payments and receipts) of proceeds of the prior issue that are held in a refunding escrow for another issue are allocated to the transferred proceeds

under the ratable allocation method described in § 1.148-9(c)(1)(iii). Section 1.148-9(c)(1)(iii) provides that, under the ratable allocation method, a ratable portion of each nonpurpose and purpose investment of proceeds of the prior issue is allocated to transferred proceeds of the refunding issue.

Section 1.148-9(h)(1) provides that the portion of the bonds of a multipurpose issue reasonably allocated to any separate purpose under § 1.148-9(h) is treated as a separate issue for all purposes of § 148, except for certain arbitrage purposes listed therein. Such exceptions include determining the yield on a multipurpose issue and the yield on investments for purposes of the arbitrage yield restrictions of § 148 and the arbitrage rebate requirements of § 148(f).

Section 1.148-1(b) defines a multipurpose issue as an issue the proceeds of which are used for two or more separate purposes determined in accordance with § 1.148-9(h). Section 1.148-9(h)(3)(i) provides, in part, that separate purposes of a multipurpose issue include refunding a separate prior issue, financing a separate purpose investment, financing a construction issue (as defined in § 1.148-7(f)) and any clearly discrete governmental purpose reasonably expected to be financed by the issue.

Section 1.148-9(h)(2)(i) provides that § 1.148-9(h) applies to allocations of multipurpose issues, including allocations involving the refunding purposes of the issue. Except as otherwise provided in § 1.148-9(h), proceeds, investments, and bonds of a multipurpose issue may be allocated among the various separate purposes of the issue using any reasonable, consistently applied allocation method. An allocation is not reasonable if it achieves more favorable results under sections 148 or 149(d) than could be achieved with actual separate issues. Allocations under § 1.148-9(h) may be made at any time, but once made may not be changed.

Section 1.148-9(h)(4)(i) provides that after reasonable adjustment of the issue price to account for common costs, the portion of the bonds of a multipurpose issue allocated to a separate purpose must have an issue price that bears the same ratio to the aggregate issue price of the multipurpose issue as the portion of the sale proceeds of the multipurpose issue used for that separate purpose bears to the aggregate sale proceeds of the multipurpose issue. For a refunding issue used to refund two or more prior issues, the portion of the sales proceeds allocated to the refunding of a separate prior issue is based on the present value of the refunded debt service on that prior issue, using the yield on investments in the refunding escrow allocable to the entire refunding issue as the discount rate.

Section 1.148-9(h)(4)(ii) provides that the use of the relative amount of sales proceeds used for each separate purpose to ratably allocate each bond or a ratable number of substantially identical whole bonds is a reasonable method for allocating bonds of a multipurpose issue.

Section 1.148-9(h)(4)(v) provides, in part, that for each portion of a multipurpose issue that is used to refund a separate prior issue, a method of allocating bonds of that issue is reasonable under § 1.148-9(h) if, in addition to the requirements of §§ 1.148-9(h)(1) and (2), the portion of the bonds allocated to the refunding of that prior issue results from a pro rata allocation under § 1.148-9(h)(4)(ii).

Section 1.148-9(i)(1) provides that, for purposes of § 1.148-9(h)(3)(i), the separate purposes of a prior issue include the refunded and unrefunded portions of the prior issue. Thus, the refunded and unrefunded portions are treated as separate issues under § 1.148-9(h)(1). Those separate issues must satisfy the requirements of §§ 1.148-9(h) and (i). The refunded portion of the bonds of a prior issue is based on the fraction the numerator of which is the principal amount of the prior issue to be paid with the proceeds of the refunding issue and the denominator of which is the outstanding principal amount of the bonds of the prior issue, each determined as of the issue date of the refunding issue.

Section 1.148-9(i)(2) provides that, as of the issue date of a partial refunding issue under § 1.148-9(i), unspent proceeds of the prior issue are allocated ratably between the refunded and unrefunded portions of the prior issue and the investments allocable to those unspent proceeds are allocated in the manner required for the allocation of investments to transferred proceeds under § 1.148-9(c)(1)(ii).

Section 1.148-9(i)(3) provides that if the refunded and unrefunded portions of a prior issue are treated as separate issues under § 1.148-9(i), then, except to the extent that the context clearly requires otherwise (e.g., references to the aggregate prior issue in the mixed escrow rule in § 1.148-9(c)(2)), all references in § 1.148-9 to prior issue refer only the refunded portion of that prior issue.

When proceeds of a refunding issue discharge any of the outstanding principal of a prior issue, unspent proceeds of the prior issue become transferred proceeds of the refunding issue and investments allocated to unspent proceeds of the prior issue are allocated to those transferred proceeds. For none of the Unspent Proceeds (and allocable investments) in the Escrow to become transferred proceeds (and investments) of the Proposed Tax-Exempt Current Refunding Bonds, the Unspent Proceeds (and investments) must have been allocated to an issue other than one to be refunded by the Proposed Tax-Exempt Current Refunding Bonds. To achieve this result, Issuer proposes to apply the multipurpose issue allocation rules to separate the Advance Refunding Bonds into separate issues. This requires, first, that the Advance Refunding Bonds be a multipurpose issue, that is, an issue the proceeds of which are used for two or more separate purposes under 1.148-9(h). Under § 1.148-9(h)(3)(i), separate purposes of a multipurpose issue include refunding of a separate prior issue. The Advance Refunding Bonds refunded a separate prior issues, i.e., the Prior Issues. Accordingly, the Advance Refunding Bonds issue is a multipurpose issue.

Second, the Issuer must allocate the bonds, proceeds, and investments of the Advance Refunding Bonds among the separate purposes using a reasonable, consistently applied method. Issuer represents that it will allocate the bonds and sale proceeds of the Advance Refunding Bonds among the separate purposes of refunding the respective Prior Issues in accordance with §§ 1.148-9(h)(4)(i) and (ii). As stated in these provisions and § 1.148-9(h)(4)(v) applicable to refunding bonds, these allocations are reasonable. Further, Issuer will apply these methods consistently to all the bonds and sale proceeds. Because the present value of the debt service on the Discharged Prior Issues is zero as of the date of the multipurpose allocation, no Unspent Proceeds will be allocated to the b separate issues of the Advance Refunding Bonds the purposes of which are to refund the respective Discharged Prior Issues.

Issuer will allocate the investments of the Advance Refunding Bonds among the separate purposes according to the debt service payments of the Prior Issues that the respective investments are expected to pay. Issuer expects to use all of the investments remaining in the Escrow to pay debt service on the c Outstanding Prior Issues, and thus Issuer will allocate all of the investments among the c separate issues the purposes of which are to refund the respective Outstanding Prior Issues. All investments allocable to the debt service of the b Discharged Prior Issues have been liquidated and the proceeds spent to fully repay the Discharged Prior Issues. This allocation of investments does not achieve more favorable results under § 148 or § 149(d) than could be achieved with actual separate issues to refund the respective Prior Issues. Thus, we conclude that Issuer's method of allocating the investments to the separate purposes is a reasonable, consistently applied method.

Because Issuer's methods of allocating the bonds, proceeds, and investments of the Advance Refunding Bonds among the separate purposes of that issue are reasonable, consistently applied methods, the bonds allocated to the refunding of each of the Prior Issues may be treated as separate issues under § 1.148-9(h). As a result, all of the Unspent Proceeds and allocable investments in the Escrow will be allocated among the separate issues of the Advance Refunding Bonds the respective

purposes of which are to refund one of the Outstanding Prior Issues, and no Unspent Proceeds or investments will be allocated among the separate issues of the Advance Refunding Bonds the respective purposes of which are to refund one of the Discharged Prior Issues.

Finally, the Proposed Tax-Exempt Current Refunding Bonds and the Proposed Taxable Bonds will not refund the non-callable bonds of the Advance Refunding Bonds. In allocating all of the Advance Refunding Bonds ratably among the a separate purposes, Issuer will allocate the non-callable bonds ratably among those purposes. Thus, each of the a separate issues will include non-callable bonds that will not be refunded.

Pursuant to § 1.148-9(i), the refunded and unrefunded portions of a prior issue are separate purposes of the prior issue and treated as separate issues. Further, unspent proceeds of the prior issue and allocable investments held in a refunding escrow are to be allocated ratably between the refunded and unrefunded portions. Accordingly, each of the separate issues within the Advance Refunding Bonds will be further divided into its refunded and unrefunded portions. Thus, the Unspent Proceeds and allocable investments to be allocated to each of the separate issues the purpose of which is to refund one of the Outstanding Prior Issues will be further allocated ratably between the refunded and unrefunded portions of each of those separate issues of the Advance Refunding Bonds. Because no Unspent Proceeds or investments will be allocated to the separate issues of the Advance Refunding Bonds the respective purposes of which are to refund one of the Discharged Prior Issues, no Unspent Proceeds or investments will be allocated to the refunded or unrefunded portions of those separate issues.

Accordingly, when proceeds of the Proposed Tax-Exempt Current Refunding Bonds refund portions of those separate issues of the Advance Refunding Bonds, no Unspent Proceeds or investments of the Advance Refunding Bonds will become transferred proceeds of the Proposed Tax-Exempt Current Refunding Bonds.

CONCLUSION

Accordingly, we conclude that, under the facts and circumstances described above, none of the Unspent Proceeds or allocable investments of the Advance Refunding Bonds will become transferred proceeds or investments of the Proposed Tax-Exempt Current Refunding Bonds under § 1.148-9(b).

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.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the 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.

A copy of this letter must be attached to any return to which it is relevant.

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,

Associate Chief Counsel

(Financial Institutions & Products)

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