

Bond Case Briefs

Municipal Finance Law Since 1971

Hot Topics from the Tax and Securities Law Institute's Annual Meeting: Squire Patton Boggs

Every year, the National Association of Bond Lawyers (“NABL”) hosts the Tax and Securities Law Institute (“TSLI”), which is an advanced conference with various workshops related to pressing issues confronting tax and securities lawyers in the public finance arena. Essentially, the annual TSLI is like [Chrismukkah](#) for tax and securities lawyers. This year’s meeting was held on March 11th and 12th and was sure to be a barn burner in light of the meaningful guidance released by the IRS over the last year including the [proposed issue price regulations](#), the [allocation and accounting regulations](#) (the “Allocation Regulations”) and, most recently, the [proposed political subdivision regulations](#) (the “Proposed Political Subdivision Regulations”). This year’s meeting did not disappoint as one tax practitioner loudly interrupted a panel consisting in part of IRS and Treasury agents to proclaim that the proposed political subdivision regulations were the worst piece of guidance to come out of the Treasury in recent history.

Below is a list of tax items discussed at TSLI that this blogger thought were particularly noteworthy. When reading the information below, please keep in mind that statements made by personnel from the IRS or Treasury reflect the individual’s personal beliefs and are not necessarily reflective of an official position taken by the IRS or the Treasury.

Helpful commentary on the Allocation Regulations

The Allocation Regulations have been the subject of multiple prior blogs (see [here](#), [here](#), [here](#), and [here](#)). The Allocation Regulations released last fall are extremely taxpayer friendly; however, there remain a number of important items regarding their application.

One open item is whether the definition of “mixed-use project” is broad enough to encompass projects financed exclusively with proceeds other than tax-exempt bond proceeds. The heightened value of “qualified equity” (discussed [here](#)) under the Allocation Regulations has encouraged practitioners to try to incorporate as much qualified equity as possible. To do this, one possibility is to expand the project to include ancillary projects that are not expected to have any private business use and that were not originally considered for tax-exempt financing. Confusingly, the inclusive definition of “project” in the Allocation Regulations would seem to permit this approach while the narrower definition of “mixed-use project” may not. A “mixed-use project” is any “project” that is financed with proceeds other than tax-exempt bond proceeds as well as tax-exempt bond proceeds. Therefore, an ancillary project financed exclusively with proceeds other than tax-exempt bond proceeds may fall outside the definition of “mixed-use project.”

When considering what “mixed-use project” was intended to include, officials from the IRS and Treasury made two interesting observations. First, in response to a panelist suggesting that any ancillary project needs to be related to the bond-financed project, a senior Treasury official indicated there is no “relatedness” requirement when determining the scope of what constitutes a mixed-use project. Second, the same official indicated that there should be some “intent” to finance a portion of each component of the mixed-use project (including any ancillary project) with tax-exempt bond

proceeds.

Issuers and borrowers often finance multiple, unrelated project expenditures with a single bond issue so disavowing any “relatedness” requirement was not surprising. However, suggesting that a project cannot be extended to incorporate ancillary projects not anticipated to be tax-exempt bond-financed would be a substantive limit. For an issue of qualified 501(c)(3) bonds, query whether listing the ancillary project in a public notice for a TEFRA hearing would be sufficient? Alternatively, for qualified 501(c)(3) or other types of tax-exempt bonds, is it necessary to affirmatively allocate tax-exempt bond proceeds under Treas. Reg. Section 1.148-6(d) or by a reimbursement allocation to a component of a project not otherwise financed with proceeds of tax-exempt bonds?

Applying the Allocation Regulations to Refunded Bonds

In response to a question about how to apply the Allocation Regulations to bonds issued prior to the release of the Allocation Regulations, a senior Treasury official acknowledged that the application of the Allocation Regulations to bonds outstanding prior to October 27, 2015 (including bonds refunded subsequent to that date) is uncertain and that the Allocation Regulations were written primarily to address new money issues. In addition, that same Treasury official acknowledged that “qualified equity” excludes certain expenditures that could have been included such as invoices paid after the project’s placed-in-service date and preliminary expenditures paid prior to the beginning of the period during which qualified equity can be contributed to a project.

Political Subdivision

As suggested in the introductory paragraph, the recently released Proposed Political Subdivision Regulations have been extremely controversial, initially because of the transition rule but also because of the introduction of what many practitioners consider to be new requirements that political subdivisions be shown to (i) operate in furtherance of a “governmental purpose” (with no more than an incidental benefit to private persons) and (ii) be “governmentally controlled”. In response to a panelist’s observation that the Proposed Political Subdivision Regulations shift away from the historic reliance exclusively on the Shamborg powers (discussed here),¹ a senior Treasury official commented that the Proposed Political Subdivision Regulations were not intended to be a radical departure from the historic approach. Rather, notwithstanding the development of the law surrounding application of the Shamborg powers, the senior Treasury official suggested that the requirement that a political subdivision have a governmental purpose and operate under government control has always been a historic, albeit less developed, requirement for political subdivisions. The official emphasized that imposing heightened scrutiny on what entities qualify to be political subdivisions was not an imposition on a state’s constitutional rights because the exemption is from *federal* income taxes.

In response to one panelist indicating that the incidental benefit limit is troubling, a senior Treasury official responded by requesting that those concerns be included in comment submissions. The same official emphasized that practitioners should take comfort in the historically broad definition of governmental purpose. Throughout TSLI, Treasury and the IRS emphasized the need to receive comments to the Proposed Political Subdivision Regulations and it seems likely there could be significant changes to the regulations before they become final.

In discussing the policy behind the proposed regulations, a senior Treasury official indicated that, historically, reliance on the Shamborg powers was predicated under the belief that states do not delegate certain rights very easily. However, in certain circumstances, the official indicated that this may not be the case.

Upcoming Guidance

A senior Treasury official and a senior IRS official indicated that guidance on the following issues is “on the horizon”:

- Finalize the 2007 and 2013 proposed arbitrage regulations;
- Update safe-harbors in Rev. Proc. 97-132 to include longer term contracts (possibly 15-years) and provide factors to distinguish management contracts from leases;³
- Finalize the proposed issue price regulations;
- Streamline the Voluntary Closing Agreement Program (“VCAP”) to address an escrow agent’s failure to reinvest proceeds in SLGS (see [IRM 7.2.3.4.2\(9\)](#)).⁴

In addition, although not imminent, the same senior Treasury official suggested that the following items will be next in line:

- Incorporating Notice 2008-41 (reissuance rules originally intended to apply to qualified tender bonds) into regulations under Section 150 of the Code to address certain issues that are present with refunding tax-advantaged bonds including Build America Bonds (“BABs”);⁵
- Guidance involving change-in-use; and
- Finalize the proposed 2008 TEFRA regulations.

Odds and Ends

The following odds and ends were also discussed:

- In response to criticism that the IRS never utilizes its authority to waive the arbitrage rebate penalty for bonds under audit (a discussion of which is [here](#)), a senior IRS official said that the Service has not historically waived the penalty for fear that they could not do so on a consistent basis applying a consistent standard. However, the IRS official indicated that a “penalty committee” has recently been formed to determine how to consistently waive certain penalties, including the arbitrage rebate penalty; and
- When discussing the recent change in the IRM which indicates that it is no longer necessary to have written post-issuance compliance procedures, one senior IRS official indicated that the IRS is much more concerned about the content of procedures and that unwritten procedures (e.g., electronic monitoring) could be sufficient depending on the content of such procedures.

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