

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

---

## **IRS Releases Final Issue Price Regulations with Significant Changes: Andrews Kurth**

On December 9, 2016, the Internal Revenue Service (the “IRS”) released final regulations regarding issue price for tax-exempt obligations (the “Final Regulations”) that will be effective for bonds sold on or after June 7, 2017.

### **Summary of Current Law**

The Existing Regulations define issue price generally as the first price at which ten percent of the bonds of any maturity is sold to the public. The Existing Regulations further provide that the issue price of bonds for which a bona fide public offering is made may be determined as of the sale date based on reasonable expectations regarding the initial public offering price. Most bond counsel now interpret this rule to permit issuers to determine the issue price of any maturity of bonds for which at least 10% was not sold to the public based on a certificate of the underwriters regarding their reasonable expectations on the sale date.

### **Summary of Final Regulations**

The Final Regulations provide three options for determining issue price: the general actual facts rule, a special reasonable expectations rule, and a special rule for competitive sales. Underwriters will be required to provide certain certifications in order to fall under the special reasonable expectations rule and special rule for competitive sales. An issuer may use its discretion to select among the rules and may select a different rule for different maturities of the same issue, but must identify the rules selected in its books and records on or before the issue date of the bonds.

#### **1. General Rule (Actual Facts Test)**

##### **A. Public Offerings**

The Final Regulations provide that generally the issue price of bonds issued for money is the first price at which a substantial amount (ten percent) of the bonds is sold to the public.

##### **B. Private Placements**

For a bond issued for money in a private placement to a single buyer that is not an underwriter or a related party to an underwriter, the issue price of the bond is the price paid by that buyer.

#### **2. Special Reasonable Expectations Rule (Hold-the-Offering Price Rule)**

**In addition to the general rule, an issuer may treat the initial offering price to the public as the issue price of the bonds if:**

A. The underwriters offered the bonds to the public at a specified initial offering price on or before the sale date, and the lead underwriter in the underwriting syndicate or selling group (or, if applicable, the sole underwriter) provides, on or before the issue date, a certification to that effect to

the issuer, together with reasonable supporting documentation for that certification, such as a copy of the pricing wire or equivalent communication; and

B. Each underwriter agrees in writing that it will neither offer nor sell the bonds to any person at a price that is higher than the initial offering price to the public during the period starting on the sale date and ending on the earlier of (1) the close of the fifth (5th) business day after the sale date, or (2) the date on which the underwriters have sold at least 10% of the bonds of that maturity to the public at a price that is no higher than the initial offering price to the public of that maturity. Sales of bonds to anyone at a price that is lower (rather than higher) than the initial offering price to the public during the holding period are allowed.

We expect the certifications required in (B) will be included in bond purchase agreements and any agreements among underwriters for bonds sold after the Final Regulations take effect on June 7, 2017.

### **3. Special Rule for Competitive Sales**

For bonds issued for money pursuant to an eligible competitive sale, an issuer may treat the reasonably expected initial offering price to the public as of the sale date as the issue price of the bonds if the issuer obtains a certification from the winning bidder regarding the reasonably expected initial offering price to the public of the bonds upon which the price in the winning bid is based.

For purposes of this special rule, the Final Regulations define “competitive sale” to mean a sale of bonds by an issuer to an underwriter that is the winning bidder in a bidding process in which the issuer offers the bonds for sale to underwriters at specified written terms and that meets the following requirements:

A. The issuer disseminates the notice of sale to potential underwriters in a manner reasonably designed to reach potential underwriters;

B. All bidders have an equal opportunity to bid;

C. The issuer receives bids from at least three underwriters of municipal bonds who have established industry reputations for underwriting new issuances of municipal bonds; and

D. The issuer awards the sale to the bidder who offers the highest price (or lowest interest cost).

### **4. Definitions**

“Public” is defined for purposes of determining the issue price of tax-exempt bonds to mean any person other than an underwriter or a related party to an underwriter.

“Underwriter” is defined to mean:

A. Any person that agrees to participate in the initial sale of the bonds to the public by entering into a contract with the issuer or with a lead underwriter to form an underwriting syndicate; and

B. Any person that, on or before the sale date, directly or indirectly enters into a contract with any of the foregoing to sell the bonds.

### **5. Standard for Reliance on Certifications and Consequences of Violations**

The Existing Regulations treat an issuer's expectations or actions as reasonable only if a prudent person in the same circumstances as the issuer would have those same expectations or take those same actions, based on all the objective facts and circumstances. The Preamble to the Final Regulations states that the existing due diligence standard under the Existing Regulations will apply to any certificate under the Final Regulations and that a certificate from the underwriter of the first price at which 10% of a maturity of bonds were sold to the public is an example of reasonable supporting documentation for establishing the issue price of the bonds of any maturity under the general rule in the Final Regulations.

If the issuer selects a rule for determining issue price but a specific eligibility requirement of that rule is not met, issue price may not be determined under that rule and a redetermination of issue price under a different rule will occur. An example of failing to meet a specific eligibility requirement is an underwriter's breach of its hold-the-offering-price agreement under the special reasonable expectations rule.

A false statement by an underwriter in a certification or in the agreement among underwriters under one of these special rules may result in a penalty against the underwriter under section 6700, depending on the facts and circumstances.

### **Effective Date**

These regulations are effective for bonds sold on or after June 7, 2017.

### **History of Issue Price Regulations**

On June 18, 1993, the Department of the Treasury (Treasury Department) and the IRS published comprehensive final regulations in the Federal Register (TD 8476, 58 FR 33510) on the arbitrage investment restrictions and related provisions for tax-exempt bonds under sections 103, 148, 149, and 150. Since that time, those final regulations have been amended in various limited respects, including most recently in final regulations published in the Federal Register (TD 9777, 81 FR 46582) on July 18, 2016 (the regulations issued in 1993 and the various amendments thereto are collectively referred to as the Existing Regulations).

A notice of proposed rulemaking was published in the Federal Register (78 FR 56842; REG-14865-07) on September 16, 2013 (the 2013 Proposed Regulations), which, among other things, proposed to amend the definition of "issue price."

Subsequently, the Treasury Department and the IRS withdrew §1.148-1(f) of the 2013 Proposed Regulations regarding the definition of issue price and published another notice of proposed rulemaking in the Federal Register (80 FR 36301; REG-138526-14) on June 24, 2015, which re-proposed a definition of issue price (the 2015 Proposed Regulations).

### **National Law Review**

by Cathleen Chang, Robert M. Collie, Jr., Gregg Jones, Barbara Jane League

### **Andrews Kurth Kenyon Law Firm**

Tuesday, December 13, 2016