

# **Bond Case Briefs**

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## **How Municipal Issuers Can Advance Refund Taxable or Tax-Advantaged Debt.**

PHOENIX – Municipal issuers can issue tax-exempt bonds and use the proceeds to advance refund either taxable bonds or tax-advantaged bonds like Build America Bonds, as long as the federal subsidy payments are “turned off” in the case of the BABs, a Treasury official told lawyers meeting here late last week.

Some bond attorneys attending sessions at the National Association of Bond Lawyers’ Tax and Securities Law Institute questioned whether the new tax law enacted in December that prohibits advance refundings bans tax-exempt advance refundings of taxable debt. They asked for guidance on this issue.

Treasury Department Associate Tax Legislative Counsel John Cross told the lawyers who raised the questions that he was surprised that they would think an issuer couldn’t issue tax-exempt bonds to refund taxable bonds.

Cross said that existing tax rules make clear that municipal issuers can issue tax-exempt bonds to advance refund taxable bonds because the refunding would not result in two sets of tax-exempt bonds outstanding — the basic problem with a tax-exempt advance refunding of tax-exempt bonds.

“You don’t need any more guidance,” Cross said during a session on hot tax topics in which he focused his presentation on the Trump administration’s infrastructure proposal for a new category of private activity bonds. None of the audience questions were on Cross’s preferred topic of the proposed PABs for infrastructure financing.

Lawyers also wanted to know if they could issue tax-exempt bonds to advance refund tax-advantaged bonds such as Build America Bonds. BABs are taxable but they are called tax-advantaged because the issuers of these and other direct-pay bonds receive federal subsidy payments from the Treasury equal to a percentage of their interest costs.

Cross said, “If you turn off the subsidy, I think you are fine. If the subsidy stays then I think you’ve got problems.” Cross predicted Treasury will issue a guidance in this area “reasonably soon.”

Cross said later that he thinks the source of confusion, in part, is that the federal tax code doesn’t generally use the word “tax-exempt.” The new tax law also does not say “tax exempt,” it just says advance refundings are prohibited.

But Section 1.149(d)-1(e) of the tax rules make clear that the only time an advance refunding is a problem is if it results in “two tax-exempt issues being outstanding concurrently for more than 90 days,” Cross said, adding, “That section of the rules is a road map on how to treat taxable debt for restrictions on advance refundings.”

Issuers would not have this problem with a taxable advance refunding of a tax-exempt bond or a tax-advantaged bond that no longer received federal subsidy payments, he said.

In the case of a BAB, once the taxable bond proceeds are put into an escrow to defease the BAB, the BAB no longer exists and doesn't continue to receive federal subsidy payments, lawyers said. Once defeased, the BAB is considered to be reissued, which means it becomes a new taxable bond, not a BAB. Issuers haven't been able to issue BABS since 2010, the bond can no longer be a BAB.

But Cross said issuers can also "turn off" the subsidy payments for their BABs without doing a refunding. They can inform Treasury they no longer want to receive the payments.

Despite the reassurance from Cross, only some of the attorneys who attended a Friday session on refundings and reissuance raised their hands when asked by if they felt confident taking out taxable debt to advance refund tax-exempt debt.

One member of the panel suggested that the NABL board might send a letter to Treasury making a request for guidance.

Jessica Giroux, NABL's director of governmental affairs, said Friday she planned to query the board.

Tom Vander Molen, who chaired the Friday session, told The Bond Buyer he understood the concern about the language in the new tax law.

"There's still concern about the literal language," said Vander Molen, partner in public finance and tax groups at Dorsey & Whitney in Minneapolis. "Literally you cannot use a bond to advance refund another bond. It doesn't say taxable or tax exempt."

"They are saying and it's my position, but not necessarily everybody is comfortable with that, that's okay so long as you don't have two exempt bonds issues for the same purpose outstanding simultaneously more than 90 days," Vander Molen said. "So if the original tax exempt bonds that were refunded taxable are gone you should be able to refund the taxable bonds with tax exempt bonds."

Elizabeth Walker, who joined Vander Molen of the panel, came away with the same message.

"The concern I heard from the audience, there are people who are concerned that the new tax law does not unequivocally allow taking out taxable debt on an advance refunding basis of tax exempt," said Walker, an attorney at Hall Render Killian, Heath & Lyman in Indianapolis.

Vander Molen and Walker each said they agreed with Cross that the new tax law did not terminate taxable refundings.

Vander Molen said he agreed with Treasury's Cross that the advance refunding regulations under Section 1.149 never covered taxable bonds unless the bonds were subject to the anti-abuse rule. "The anti-abuse rule is why we are concerned about BABs," Vander Molen said.

Walker said, "I don't think there's ever any harm in additional guidance. As with anything, it will depend on the facts and circumstances whether you would need additional guidance or not."

But Walker has not encountered any situations yet where additional Treasury guidance was needed. "I think there are many scenarios in which you take out taxable debt with tax exempt debt but frankly I have not encountered a lot of those that would be an advance refunding because usually it is a contemplated integrated transaction where the taxable debt is easily callable," she said.

Kimberly Min, a partner at Whiteford Taylor Preston in Baltimore, also attended the Thursday session with Cross and Tsilas and the Friday discussion on refundings.

“As to whether a taxable advance refunding can be accomplished, I agree that there doesn’t necessarily need to be guidance on that front,” Min said in an interview. “But there were other comments that they made, I think, that will necessitate some guidance.”

Min said the issues guidance could address include “how you treat a forward pricing on a Cinderella type structure and the concerns that they mentioned relating to artificially pushing the yield back into the tax exempt price versus at the taxable price when there really are different interest rate risks associated with each component of the financing.”

Cliff Gerber, the immediate past president of NABL and a partner at Norton Rose Fulbright in San Francisco, said attorneys were “keenly awaiting” the comments from the Treasury and IRS attorneys at Thursday’s meeting.

“A number of us... are going to caucus with our partners and consider the statements and figure out their relative comfort levels,” Gerber said in an interview.

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