

Bond Case Briefs

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Taxable Advance Refunding Bonds and the World's Most Boring Ice Cream Cone: Squire Patton Boggs

Taxable debt tempts us to put the Internal Revenue Code back on the library shelf and the tax lawyers back into their pen. But if you use taxable debt to refund tax-exempt debt, or if you might ever refund that taxable debt with tax-exempt debt, then we regret to inform you that we ought to be involved. In a series of posts, we're going to take a look at some of the questions and complications that arise when issuers and borrowers incorporate straight taxable debt into the same lineage as tax-exempt debt. First up: a taxable advance refunding of tax-exempt bonds.

It might seem odd that an issuer would consider issuing taxable debt, which generally has a higher interest rate than tax-exempt debt, to fund a long-term escrow at the low reinvestment rates that have prevailed for the past 15 years (what fancy folks call "negative arbitrage") to retire tax-exempt debt. In certain rate environments, such as the present, where shorter-term interest rates applicable to refunding escrow securities are almost equal to the longer-term interest rates that apply to the refunding bonds, it can make sense. [The prohibition against the issuance of tax-exempt debt to advance refund tax-exempt bonds](#) enhances the incentive to issue taxable advance refunding bonds in this type of interest rate market.

When you're assembling the working group to issue the taxable advance refunding bonds, you might be tempted to ignore the tax-exempt bond rules and the public finance tax lawyers on your team. Don't. Let's discuss why.[1]

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By Johnny Hutchinson and Michael Cullers on September 25, 2019

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