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Proposed Rules Addressing LIBOR Phase-out Help Ease Reissuance Concerns.

Since the 2017 announcement that the London interbank offered rate ("LIBOR") may be phased out after the end of 2021, the municipal finance industry has been concerned that changes to debt obligations and related financial products necessary to address the phase out could cause an unexpected "reissuance" of the debt for federal tax purposes, which could result in negative consequences for issuers and debtholders. In response to these concerns, on October 9, 2019, the Department of the Treasury released Proposed Regulations addressing, among other things, whether changes arising out of the end of LIBOR will result in a reissuance for federal tax purposes (the "Proposed Regulations").

In general, the Proposed Regulations provide favorable guidance that should help avoid a reissuance in most instances. In particular, the Proposed Regulations provide that, if the terms of a debt instrument or non-debt contract (e.g., a swap) are changed to reference a "qualified rate" in lieu of (or as a fallback to) LIBOR and the change does not change the fair market value of the debt instrument or non-debt contract or the currency of the reference rate, then such change will not result in a reissuance for federal tax purposes. For example, if the terms of a variable rate bond that has an interest rate based on USD-LIBOR are changed to provide an interest rate based on the Secured Overnight Financing Rate published by the Federal Reserve Bank of New York (commonly referred to as "SOFR"), such change typically will not trigger a reissuance of the bond, so long as the fair market value of the bond remains the same.

The Proposed Regulations name certain existing rates that are "qualified rates," but also provide for flexibility to accommodate other rates. Further, to assist in addressing the fair market value requirement, the Proposed Regulations provide two safe harbors – one based on historic average of rates and the other on arm's length negotiations – that, if met, will result in the requirements to be deemed satisfied.

It is expected that, in some instances, changes to address the LIBOR phase out will include "associated alterations" that are reasonably necessary to implement the change. For example, a party may be required to make a one-time payment to offset the change in value of the debt-instrument that results from the replacement of LIBOR with a qualified rate. The Proposed Regulations provide that changes that fall within the definition of "associated alterations" will not result in a reissuance. However, other contemporaneous changes (e.g., an increase in the rate to address deterioration of an issuer's credit) must be analyzed separately and may trigger a reissuance.

The final version of Regulation will likely see changes as Treasury responds to comments on the Proposed Regulations, but the Proposed Regulations evidence a willingness to provide guidance setting a path forward that does not involve widespread reissuances and should help ease some of the concerns caused by the phase out of LIBOR. A taxpayer may choose to apply the Proposed Regulations to changes occurring on or after October 9, 2019, as long as the taxpayer and its related parties do so consistently.

Friday, October 18, 2019