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Muni Industry Awaits Final Reg on Libor Transition in 2020.

Municipal bond market leaders say their top wish for tax regulation in 2020 is for Treasury and the Internal Revenue Service to finalize their proposed transition rules for replacing Libor.

“Our organization has been in general support of the regulations,” said Emily Brock, director of the federal liaison center for the Government Finance Officers Association, noting her group’s comment letter to Treasury emphasized that issuers should be allowed to choose their new benchmark and make a safe transition.

In GFOA’s official comment letter, the group is seeking an additional safe harbor to the substantial equivalence test.

“That’s generally our top regulatory issue,” Brock said.

It’s also the top regulatory issue for the National Association of Bond Lawyers, according to NABL President Richard Moore, a tax partner at Orrick Herrington & Sutcliffe in San Francisco.

NABL submitted a 22-page comment letter to Treasury to ensure that the tax-exempt bond market receives consideration.

Libor, an acronym for the London Inter Bank Offered Rate, is being phased out at the recommendation of the Alternative Reference Rates Committee created by the U.S. Federal Reserve Board and the Federal Reserve Bank of New York.

The new alternative reference rates cited by Treasury and the IRS include the Secured Overnight Financing Rate (SOFR) published by the Federal Reserve Bank of New York and the Federal Funds Rate.

Treasury is including all other interbank offered rates, or IBORs in other countries, including Switzerland, Japan and the European Union.

All other tax-related regulatory initiatives are expected to remain on hold until a successor is hired to replace John Cross as the Treasury Department official involved in tax exempt bonds. His former position as associate tax legislative counsel at the Office of Tax Policy is not a political appointment, but there’s no public word yet on when it will be filled.

Once a successor to Cross is appointed, NABL is hoping Treasury and the IRS can finalize a reissuance regulation.

NABL also has submitted comments on Revenue Procedure 2018-26 to clarify and simplify the remedial action rules.

Another item on NABL’s wishlist is tweaks to Treasury Regulation 1.141-6 on allocation in accounting which was adopted in 2015. NABL submitted a comment letter to make it easier for issuers to navigate that framework.

And NABL is hoping the IRS responds to its letter seeking a reduction in the fees charged for private letter rulings. The number of PLRs has dropped as the fees have climbed. There were only four of the rulings in 2018 when the fee rose to $28,300 from 16 in 2008 when it was only $11,500.

“We haven’t gotten any feedback on that yet,” said Moore. “We would be supportive of anything that would lessen the cost of giving state and local issuers to the private letter ruling process.”

On the enforcement front, the Internal Revenue Service has announced its 2020 fiscal year compliance strategy will focus on three areas.

One will be jail bonds in respect to whether federal government use of locally built facilities or management contracts with localities cause excessive private business use.

The second is whether sinking fund over-funding causes the tax credit bonds to be arbitrage bonds.

And last area is whether variable rate bonds comply with the rebate and yield restriction rules under Internal Revenue Code Section 148.

NABL’s president said, “We appreciate the targeted nature of their audit initiatives and hope that when they audit bonds, they keep the audits focused on those points as possible in order to minimize the issuer’s burden and expense.”

The Oct. 16 IRS announcement of its audit priorities marked the second consecutive year it has published its compliance strategy online early in the fiscal year.

This has allowed bond attorneys to advise their clients whether a new audit notice is part of a wider initiative.

The IRS planned to close 500 audits in its Tax Exempt Bonds office 2019 fiscal year that ended Sept. 30 and is expected to conduct roughly that number in the current fiscal year.

In November, longtime IRS employee Allyson Belsome began serving as senior manager overseeing the Office of Tax Exempt Bonds after it was separated from the Office of Indian Tribal Government. The two offices had been combined in 2017.

Belsome, who is based in the suburbs of Chicago, most recently served as senior manager of ITG/TEB Technical which generates computer-driven guidance for selecting priorities for field audits.

Belsome already oversaw the Voluntary Closing Agreement Program, compliance reviews, technical assistance to agents, direct pay bonds and an internal computer system known as K-Net.

The VCAP program could be the subject of an overhaul in the coming year. The IRS priority guidance for 2019-2020 includes making improvements in the self-correction program for tax advantaged bonds and the IRS Advisory Council released a report in November suggesting an expansion of VCAP to provide two simpler options.

The VCAP program has seen a dramatic drop in filings over the last several years falling to 27 cases in fiscal 2018 from 44 in 2017, 67 in 2016 and 122 in 2015.

“The written VCAP program can necessitate an issuer spending between $20,000 and $60,000 or more on attorney’s fees,” the IRS Advisory Council said in its report. “Over 49% of VCAP cases over the last five years took longer than 180 days to resolve and over 75% of cases took 90 days or more

for resolution."

The new level 1 self-correction suggested in the report wouldn't require IRS approval for certain insubstantial and unintentional violations provided a written notice is provided.

"The notice should be simple, briefly identifying the applicable bond issue, the error type, the remediation taken, and the existence of issuer corrective actions to monitor and prevent reoccurrence of the error," the report said. "We strongly suggest that the IRS provide the form to be filed for the notice."

A level 1 response would be made by the IRS within two weeks.

The council gave as an example of a level 1 filing the failure by an issuer to invest in zero interest State and Local Government Securities known as SLGS to reduce the yield on an escrow investment. The council said the remediation "might be the appropriate yield reduction payment."

A level 2 self-correction also would involve a streamlined process with a "normally automatic IRS confirmation letter, without necessarily an IRS review, that the violation is considered corrected if the issuer has satisfied specified criteria," the report said.

"We recommend that the submission for level 2 be simple, utilizing a form that is, although streamlined, more lengthy than the level 1 postcard-type notice suggested," said the report.

If there is a level 2 review, the council recommends it be conducted by a Tax Exempt Bonds specialist without other layers of review under normal circumstances.

Confirmation letters should ordinarily be received within two weeks, but it should not be considered a voluntary closing agreement.

"We recommend that level 3 self-correction be through the negotiated VCAP to address less common fact patterns or more egregious situations," the report said. "Because an issuer might want or require a binding closing agreement, we suggest that issuers have the option to utilize level 3 despite potential applicability of levels 1 or 2."

The council recommended that all three levels should encourage issuers to identify and correct violations early.

Moore, the NABL president, thinks the IRS will give an overhaul of the VCAP program serious consideration "largely because it's a sound idea on the policy side and I think the IRS is motivated to consider ideas that will free up resources."

By Brian Tumulty

BY SOURCEMEDIA | ECONOMIC | 12/27/19 08:35 AM EST

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