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Abusive Arbitrage Devices – It's Time to Get Reacquainted Pt. II - Squire Patton Boggs

(Episode 2 – Overburdening (Generally) Not Allowed)

As you may remember, in the first episode, we discussed how the federal government's primary goal in subsidizing tax-exempt bonds is to encourage investment by issuers in long-lived, tangible assets. We also discussed how the federal government has tried to keep issuers on the intended path by preventing them from exploiting the difference between the tax-exempt and taxable markets. Finally, we noted that bonds will generally be taxable arbitrage bonds if the issuer has successfully exploited the difference between tax-exempt and taxable interest rates and has also overburdened the tax-exempt bond market.

This episode will discuss the three rules intended to prevent the overburdening of the tax-exempt bond market – (1) You shall not issue too early; (2) You shall not issue too much; and (3) You shall not issue for too long.

Why would you issue too early? To take advantage of a low interest rate environment. For example, an issuer might not have a capital project for Year 1 when interest rates are low, but anticipates having a capital project in Year 3 when interest rates might be higher. The rule imposed by the federal government to prevent the issuer from issuing tax-exempt bonds too early is a requirement that the issuer reasonably expect on the issuance date of the tax-exempt bonds that it will spend at least 85% of the spendable proceeds within three years of the issuance date. Even though the test involves "reasonable expectations," remember that hindsight is always 20/20, and thus issuers should strive to actually meet this goal.

Continue reading.

By Cynthia Mog on February 26, 2023

The Public Finance Tax Blog

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