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Group Suggests Bond Project for 2013-2014 Priority Guidance List.

Michael Deane of the National Association of Water Companies has asked Treasury and the IRS to include on the 2013-2014 priority guidance list (Notice 2013-22) guidance on the rules relating to remedial actions for tax-exempt bonds under reg. section 1.141-12, asserting that the defeasance requirement imposes a major burden on issuers seeking to take advantage of public-private partnerships.

July 19, 2013

Internal Revenue Service

Attn: CC:PA:LPD:PR (Notice 2013-22)

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Subject: Request for priority guidance under Notice 2013-22

Ladies and gentlemen:

This is to request that the Treasury Department and IRS provide guidance as described below on the rules related to remedial actions for tax-exempt bonds under section 1.141-12 of the Treasury Regulations. We also request that you include this issue in the 2013-2014 Guidance Priority List.

The remedial action requirements apply when an issuer of outstanding tax-exempt bonds takes an action that causes the bonds to no longer satisfy the private activity bond restrictions under section 141 of the Code. For example, a city or county may arrange for a private-sector business to assume the ownership or management of public facilities that were financed with tax-exempt bonds and that are used to provide services to residents. Such arrangements — often termed public-private

partnerships (PPPs) — let public bodies tap into the expertise, experience, and efficiency of the private sector. Where the public facilities were financed with tax-exempt debt previously issued by the public body, Treasury regulations require that one of three remedial actions be taken in connection with the transfer of the facilities to the private sector to avoid triggering tax on the bond interest for the holders of those bonds.

In a letter last year (attached) to then-Acting Assistant Secretary of the Treasury for Tax Policy Emily McMahon, we outlined reasons why the existing remedial alternatives are inadequate. In particular, we explained that the first alternative — defeasance — is impractical and extremely costly in the current interest-rate environment. To defease bonds bearing an interest rate of, for example, five percent, requires capital outlays far exceeding the face amount of the bonds. A second alternative — a deemed reissuance of the bonds — requires the state to apply its annual volume cap to the reissuance in the case of water and wastewater treatment facilities. This requirement makes the deemed reissuance impractical. The third alternative is for the public body to agree to use the proceeds from the disposition of the public facilities for governmental purposes (i.e., for purposes that do not cause the bonds to be considered private activity bonds). The precise application of this rule to long-term concession arrangements is unclear in the regulations.

We believe the IRS and Treasury have multiple options for modifying one or more of the remedial action rules to reduce hindrances to public-private partnerships due to outstanding tax-exempt bonds. Perhaps the simplest approach would be for the IRS and Treasury to clarify that an issuer's expenditure of lease payments, or ongoing payments under a concession arrangement, for governmental purposes satisfies the remedial action rules for alternative uses of disposition proceeds. This change would clarify that leases and concession arrangements are eligible for the same remedial action relief as outright sales of facilities. Under the existing regulations, the issuer must reasonably expect to expend the disposition proceeds for governmental purposes within two years of the disposition. Where the issuer receives the proceeds from a lease or concession arrangement over time, rather than up front, the policy behind the existing requirement should logically be considered as satisfied if the issuer were required to expend those proceeds within a time certain following their receipt. We are not aware of a policy basis for a different result.

An alternative approach for the IRS and Treasury to take would be to waive the defeasance requirement where the concessionaire does not receive the benefit of the tax-exempt bonds through an assumption of the debt service. A third approach would be for the IRS and Treasury to waive the requirement that the state allocate volume cap to the bonds at the time of the concession arrangement.

As you know, the President has proposed removing the issuances of tax-exempt bonds for water infrastructure from state private activity bond volume caps. That proposal reflects a policy decision to promote PPPs for development of water infrastructure. The President's budget contains a number of other proposals that would foster PPPs. Any regulatory adjustments by the IRS and Treasury that remove hindrances to the use of such partnerships in cases where there is outstanding tax-exempt debt would be fully consistent with the President's proposals.

Under current economic conditions it is clear that the defeasance requirement imposes a major burden on issuers that desire to take advantage of public-private partnerships. That burden, together with the administration policy favoring expanded use of such partnerships, should satisfy the requirements of Notice 2013-22 for inclusion of this issue on the 2013-2014 Guidance Priority List. We are confident the IRS and Treasury can eliminate or reduce the burden through clarifications in the regulatory requirements for remedial actions.

We appreciate your attention to this matter. Please let us know if you have any questions about this.

Sincerely,

Michael Deane

National Association of Water

Companies

Washington, DC

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