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IRS Tells Arizona City Its BABs Don't Qualify for Subsidy Payments.

WASHINGTON — The Internal Revenue Service has told Avondale, Ariz. that it believes $29.8 million of Build America Bonds it issued in 2009 do not qualify for subsidy payments because of tax law violations.

Avondale, which disclosed the IRS' Nov. 12 proposed adverse determination letter in an event notice posted on the Municipal Securities Rulemaking Board's EMMA system this week, said the subsidy payments for the BABs are estimated to be between $675,000 and $54,000 per year for 25 years. It said the loss of the subsidy payments, if retroactive, could total about $10.83 million from issuance through maturity.

The IRS claims the bonds don't qualify for the subsidy payment because the BABs are private-activity bonds and because of alleged issue price problems, according to the event notice.

But Avondale is disputing the IRS' proposed determination. "The city does not agree with the positions taken by the service in the notice and plans to exercise appeal rights," the city said in its event notice.

The BAB program was created under the American Recovery and Reinvestment Act and allowed state and local governments to issue taxable bonds in 2009 and 2010 and receive subsidy payments from the Treasury Department equal to 35% of the interest costs.

The BABs were issued to finance street improvements, sewer improvements and a multi-purpose recreation center, according to their official statement. Kevin Artz, Avondale's finance and budget director, said that under a lease agreement, a private company operates the recreational center and shares some of the profits with the city.

Under federal tax law, BABs cannot be private activity bonds. Bonds are private activity bonds if more than 10% of a project is used by private parties and more than 10% of the debt service is paid for or secured by private parties.

Artz also said the IRS thinks the BABs were issued with more than a de minimis amount of premium, generally defined as 0.25% of the stated redemption price at maturity multiplied by the number of complete years from the bond's issue date to its maturity date.

The IRS' letter does not affect the ad valorem tax levy required on taxable property in Avondale to pay debt service on the bonds, the city said in its event notice.

Greenberg Traurig LLP served as bond counsel for the deal and Robert W. Baird & Co. served as underwriter, according to the official statement. Stone & Youngberg, now a division of Stifel Nicolaus & Co., served as financial advisor.

At least two other issuers have settled tax disputes over BABs with the IRS.

In 2012, Half Moon Bay, Calif. agreed to reduce its subsidy payments to 29% for $10.2 million of BABs it issued in 2009 after the IRS claimed the bonds violated the tax law because they were not used for capital expenditures.

A few months ago, the Nebraska Public Power District agreed to pay $350,000 to settle IRS charges that some of the bonds were sold at a price greater than the de minimis amount of premium.

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