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IRS: Unspent Proceeds, Refunding Will Not Cause Loss of BABs' Subsidy.

WASHINGTON – Unspent proceeds at the time of a current refunding will not cause Build America Bonds to lose their qualified status for Treasury subsidy payments, the Internal Revenue Service recently found in a recent private letter ruling.

The private letter ruling (PLR) was written in response to a BAB issuer that sought a ruling on whether a proposed current refunding would cause the bonds to fail to meet a requirement that 100% of the proceeds, beyond those put into a reasonably required reserve, be used for capital expenditures.

In a current refunding, the issuer refunds previously issued bonds within 90 days from the issuance of the refunding bonds. The IRS concluded in the ruling that, based on the issuer's representations, "the existence of the unspent proceeds on the redemption date of the bonds will not retroactively cause the bonds to lose their status as 'qualified bonds.'"

Because of this, the IRS said, the issuer would not lose any credit under Section 6431 of the Internal Revenue Code for the bonds for the period prior to the date of redemption. IRS officials said the ruling is contingent on the issuer not spending any of the unspent proceeds for anything other than capital expenditures.

The four-page PLR, signed by IRS senior counsel Timothy Jones, states that the bonds in question were used to finance certain capital projects for an unidentified city. The bonds were to be treated as direct-pay BABs, and the issuer agreed to spend 100% of project proceeds of the bonds for capital expenditures. By an unspecified date, a percentage of the available project proceeds of the bonds remained unspent.

The names of all parties involved in the issuance were withheld in the PLR, which was released on Jan. 13. Both the issuer and city intended to refinance the BABs by issuing tax-exempt bonds.

The IRS also stated in the PLR that it was not expressing any opinion about whether the BABs could be considered reissued upon the deposit of the refunding bond proceeds into an escrow fund to pay principal and interest on the bonds at redemption.

Linda Schakel, a partner with Ballard Spahr in Washington, said she agrees with the ruling, especially considering that the BAB legislation was different than other tax credit subsidy bonds, which required proceeds be spent within three years of the issue date on permitted costs.

"I think this is definitely a very reasonable approach to the question of what happens when you have unspent proceeds at the time you do a refunding, particularly unspent proceeds more than three years after the bonds are issued," she said.

However, Schakel said the ruling does not provide details regarding what might have delayed expenditure or what factors confirm the issuer still expects to expend proceeds.

“I take [this] to mean that the ruling is not conditioned as being extraordinary circumstances justifying the outcome,” Schakel said.

Tom Vander Molen, a partner at Dorsey and Whitney in Minneapolis, said he believes that the ruling is correct. He said that although he is not aware of this particular request for a PLR, this issue has come up in different contexts.

“Sometimes in audits, the IRS says maybe it’s a problem if you don’t spend proceeds before you refund,” Vander Molen said. “My position has always been it doesn’t matter as long as you use the proceeds you were going to in the time you were going to.”

“I think this is very consistent with that,” he said. “I think this ruling is exactly right.”

Created under the American Recovery and Reinvestment Act, roughly $181 million of BABs were issued to finance infrastructure during 2009 and 2010 before the program expired for new issuances.

The Bond Buyer

By Evan Fallor

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