
NASACT: Treasury/IRS Seek Comment on Potential Tax Consequences of LIBOR Transition

In the summer of 2017, the United Kingdom Financial Conduct Authority announced that all currency and term variants of the London Interbank Offered Rate (LIBOR), including U.S.-dollar LIBOR (USD LIBOR), may be phased out after the end of 2021. LIBOR is used globally as a "benchmark" or "reference rate" for various commercial and financial contracts, including floating rate mortgages, corporate and municipal bonds, asset-backed securities, consumer loans, swaps and other derivatives.

As a result of this announcement, several work groups were formed to recommend an alternative rate to LIBOR. In the U.S., the Alternative Reference Rates Committee (ARRC) was formed and identified the Secured Overnight Financing Rate (SOFR) as the alternative rate for USD LIBOR. SOFR is a broad measure of the cost of borrowing cash overnight and collateralized by Treasury securities.

Earlier this year, the ARRC submitted to the Treasury Department and the Internal Revenue Service documents identifying various potential tax issues associated with the elimination of Interbank Offered Rates (IBOR). ARRC further requested that tax guidance be issued to address potential tax consequences so that an orderly transition may occur. The ARRC stated that existing debt instruments and derivatives providing for IBOR-based payments must be amended to address the transition.

The Treasury Department and the IRS have issued guidance to minimize potential market disruption and to facilitate an orderly transition. Specifically, the guidance would address concerns about whether the replacement rate in a debt instrument or non-debt contract would result in a taxable exchange of the debt instrument or contract.

Generally, the proposed regulations provide that alteration of the terms of existing financial instruments that switch from LIBOR to another alternative rate will not be treated as a modification resulting in the realization of income, deduction, gain, or loss for purposes of section 1001 of the Tax Code. However, the proposed regulations provide more fully the circumstances in which the modification could result in a taxable exchange.

The Treasury and IRS are specifically seeking comment on any complications under any section of the Code or existing regulations that may arise from the replacement of an IBOR with a qualified rate and that are not resolved in the proposed regulations.

NASACT members are urged to provide comments, which may be sent to Cornelia Chebinou no later than COB on Friday, November 15. Should enough comments be received, NASACT will prepare an association response. You may also comment directly to Treasury and IRS no later than November 25, 2019.