Bond Case Briefs

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IRS Releases Guidance on the Transition From LIBOR: Ballard Spahr

The IRS recently released helpful guidance in Revenue Procedure 2020-44 to assist the market's transition from the London Interbank Offered Rate (LIBOR) and other interbank offered rates (IBORs) to alternative reference rates. LIBOR is set to be phased out after the end of 2021.

The Upshot

- The Revenue Procedure provides that the adoption of certain fallback language recommended by the Alternative Reference Rates Commission (ARRC) and the International Swaps and Derivatives Association (ISDA) for contracts with terms referencing an IBOR will not result in a reissuance. The guidance further provides that such modifications will also not be treated as a termination of a qualified hedge or as a disposition or termination of either leg of a hedge transaction. The relief provided by the Revenue Procedure is effective for modifications to contracts occurring on or after October 9, 2020, and before January 1, 2023, but may be relied on for modifications to contracts occurring before October 9, 2020.
- The guidance applies to any of the following modifications:
- The contract is modified to incorporate ISDA Fallback (as that term is defined in Rev. Proc. 2020-44, section 3.02), regardless of whether that modification results from adherence to the anticipated ISDA Protocol to be posted by ISDA on its website or a bilateral agreement between the parties to the contract.
- The contract is modified to incorporate an ARRC Fallback (as that term is defined in Rev. Proc. 2020-44, section 3.01).
- The contract is modified to incorporate the terms of either an ARRC Fallback or an ISDA Fallback with certain deviations that fall into one or more of the following categories: deviations that are necessary to make the terms incorporated into the contract legally enforceable in a relevant jurisdiction; deviations from the terms of an ISDA Fallback that are necessary to incorporate the ISDA Fallback into a contract that is not a Protocol Covered Document (as defined in the ISDA Protocol); deviations to omit terms of an ARRC Fallback or an ISDA Fallback that do not affect the way the contract works; and deviations to add, revise, or remove technical, administrative, or operational terms provided the changes are reasonably necessary to adopt the ARRC Fallback or the ISDA Fallback.
- This additional guidance was published approximately a year after the IRS published proposed regulations on the tax consequences of the transition to the use of reference rates other than IBORs in debt instruments and non-debt contracts. (REG-118784-18; 84 F.R. 54068; October 9, 2019).
- The Revenue Procedure states that Treasury and the IRS concluded that interim guidance in advance of finalizing the proposed regulations was needed to support the adoption of the ARRC Fallback language that had been provided over the last year and the ISDA Protocol.

The Bottom Line

The bond community should expect to see additional guidance in the next year. The recently released guidance signals that the IRS and Treasury may provide additional relief as necessary to address continuing developments in the transition from LIBOR. The IRS has requested comments. Comments should be submitted in writing on or before December 31, 2022.

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