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ABA Tax Section Recommends Withdrawal of Proposed Arbitrage Bond Regs.

Summary by Tax Analysts

The American Bar Association Section of Taxation has suggested the withdrawal of proposed regulations (REG-117298-21) on arbitrage bonds under section 148, which clarify the legality of short-term debt in debt limit situations and rectify situations in which redeeming bonds backed by student and mortgage loans inadvertently makes the bonds taxable.

The tax section contends that the proposed regs are not a clarification but rather constitute a new rule that is inconsistent with the original intent underlying the existing rule. Members maintain that the proposed regs will also adversely affect the operation of other code sections that rely on the rules of reg. section 1.148-6(d) and will impose significant burdens on issuers and conduit borrowers with little benefit to regulation and enforcement.

According to section members, tax professionals, issuers, and conduit borrowers have not found the existing regulation confusing and have been using it without incident for three decades. Moreover, its regulatory history does not suggest that the cash outlay was ever tied to a particular source from a particular time, members say. Rather, the regulatory history clarifies that the cash outlay rule was intended to ensure that a preliminary allocation of bond proceeds not tied to a then-existing cash outlay was not an effective allocation. The tax section contends that the existing rule was not intended to restrict the ability to reallocate expenditures to other sources available at a later date.

Section members argue that the proposed regs constitute a restrictive new limitation on the ability of issuers and conduit borrowers to fund projects, particularly affecting complex projects involving multiple sources of funding, often with longer development timelines. “It also unnecessarily disadvantages issuers and borrowers who have limited available funds at any given time to apply to project costs, but who anticipate the receipt of additional long-term funding, such as state or federal grants,” members say, adding that the proposed regs overlook core conceptual tools regularly used in fund accounting: temporarily using funds on hand to pay for current costs and replenishing those funds with an expected permanent source of funding.

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Tax Analysts

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