January 4, 2016

The Honorable John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Proposed Issue Price Regulations

Dear Commissioner Koskinen:

Enclosed please find comments on the proposed regulations relating to the determination of “issue price” under section 148, applicable to tax-exempt bonds and other tax-advantaged bonds (“Comments”). These Comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss the Comments with you or your staff if that would be helpful.

Sincerely,

George C. Howell, III
Chair, Section of Taxation

Enclosure

CCs: William Wilkins, Chief Counsel, Internal Revenue Service
Erik Corwin, Deputy Chief Counsel (Technical), Internal Revenue Service
Helen Hubbard, Associate Chief Counsel (Financial Institutions & Products), Internal Revenue Service
Rebecca Harrigal, Director, Office of Tax Exempt Bonds, Internal Revenue Service
Mark Mazur, Assistant Secretary (Tax Policy), Department of the Treasury
Emily McMahon, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Thomas West, Tax Legislative Counsel, Department of the Treasury
John Cross, Associate Tax Legislative Counsel, Department of the Treasury
These comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Darren C. McHugh of the Section’s Tax-Exempt Financing Committee (the “Committee”). Substantive contributions were made by Arthur E. Anderson, II, David J. Cholst, Margaret C. “Peg” Henry, Nancy M. Lashnits, Rene A. Moore, Mark O. Norell and John F. Stanley. The Comments were reviewed by Stefano Taverna, Chair of the Committee. The Comments were further reviewed by Clifford M. Gerber of the Section’s Committee on Government Submissions, and by Peter H. Blessing, the Section’s Vice Chair (Government Relations).

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member of the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

Contact: Darren C. McHugh
Phone: 720-616-6980
Facsimile: 720-616-6975
dmchugh@sycr.com

Date: January 4, 2016
EXECUTIVE SUMMARY

On June 24, 2015, the Internal Revenue Service (the “Service”) and the United States Department of the Treasury (“Treasury”) published proposed regulations (the “Proposed Regulations”) in the Federal Register relating to the determination of “issue price” under section 148 applicable to tax-exempt bonds and other tax-advantaged bonds. The Proposed Regulations would create a new definition of the term “issue price” to apply to tax-advantaged bonds that would replace the definition of issue price in Treas. Reg. § 1.148-1(b) (the “Existing Regulations”). The Committee on Tax-Exempt Financing of the Section of Taxation of the American Bar Association (the “Committee”) is submitting these comments (the “Comments”) in response to the issuance of the Proposed Regulations and Treasury and the Service’s solicitation of public comments regarding the Proposed Regulations.

On September 16, 2013, Treasury and the Service published proposed regulations (the “2013 Regulations”) in the Federal Register relating to, inter alia, issue price determinations made under the Existing Regulations. Treasury and the Service withdrew the 2013 Regulations at the time that the Proposed Regulations were published in the Federal Register.

The Committee commends Treasury and the Service on the development of the Proposed Regulations and the responsiveness of Treasury and the Service to comments received relating to the 2013 Regulations. The Committee believes that the Proposed Regulations set forth a practical, administrable and theoretically sound approach to issue price determinations made under section 148. The Committee recommends, however, that certain technical amendments be made to the Proposed Regulations, which are described in these Comments and set forth in Appendix A hereto.

The Committee has previously provided Treasury and the Service substantive technical and policy-related comments relating to the determination of issue price. For Treasury and the Service’s convenience, those prior comments are attached as Appendices B and C to these Comments.

References in these Comments to the “Final Regulations” refer to any final version of the Proposed Regulations.

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1 References to “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.
2 As used herein, the term “tax-advantaged bonds” has the meaning set forth in Prop. Treas. Reg. § 1.150-1(b), 78 Fed. Reg. 56,842 (2013), which defines the term “tax-advantaged bond” to mean:

   a tax-exempt bond, a taxable bond that provides a Federal tax credit to the investor with respect to the issuer’s borrowing costs, a taxable bond that provides a refundable Federal tax credit payable directly to the issuer of the bond for its borrowing costs under section 6431, or any future similar bond that provides a Federal subsidy for any portion of the borrowing costs. Examples of tax-advantaged bonds include qualified tax credit bonds under section 54A(d)(1) and build America bonds under section 54AA.

DISCUSSION

A. Introduction

The issue price of an issue of tax-advantaged bonds is a critical metric for determining compliance with a variety of federal tax law requirements applicable to an issue, most notably the arbitrage requirements and limitations of section 148, but also requirements relating to the private activity bond tests of section 141, the proceeds expenditure requirements of sections 142-145, the volume cap requirements of section 146, and certain miscellaneous requirements and limitations under sections 147 and 149. Additionally, for tax-advantaged bonds that provide direct-payment subsidies to the issuers of such bonds, the issue price is used to determine whether the bonds comply with limitations on the amount of premium at which the bonds may be issued. While certain of these definitions and compliance requirements define or rely upon a specific concept of “proceeds” that may include certain investment earnings or exclude amounts used for certain purposes (such as reasonably required reserve funds), all of them rely upon issue price as a material component of the definition or compliance requirement, as applicable.

Section 148(h) provides that the “yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274).” While sections 1273 and 1274 provide substantial rules relating to issue price determinations, the Existing Regulations amplify those provisions in the context of tax-advantaged bonds issued for money and offered to the public. The Existing Regulations define the term “issue price” generally as follows:

Issue price means, except as otherwise provided, issue price as defined in sections 1273 and 1274. Generally, the issue price of bonds that are publicly offered is the first price at which a substantial amount of the bonds is sold to the public. Ten percent is a substantial amount. The public does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers. The issue price does not change if part of the issue is later sold at a different price. The issue price of bonds that are not substantially identical is determined separately. The issue price of bonds for which a bona fide public offering is made is determined as of the

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5 See I.R.C. § 141(b)(1)-(2) (private business tests); I.R.C. § 141(c) (private loan financing test).
6 I.R.C. § 142(a); I.R.C. § 143(a)(2)(A)(i); I.R.C. § 144(a)(1); I.R.C. § 145(a)(1)-(2); see also I.R.C. § 150(a)(3) (definition of “net proceeds”).
8 See, e.g., I.R.C. § 147(b)(2)(A) (determination of weighted average maturity of an issue “... determined by taking into account the respective issue prices of bonds issued as part of such issue”).
9 See, e.g., I.R.C. § 149(b)(2)(B) (determination of whether certain tax-advantaged bonds are federally guaranteed based, in part, upon amount of “proceeds” of the issue of which the bond is a part used to make federally guaranteed loans or invested in federally insured deposits or accounts).
10 See, e.g., I.R.C. § 54AA(d)(2)(C) (build America bonds); I.R.S. Notice 2010-35, 2010-19 I.R.B. 660 (April 26, 2010) (applying I.R.C. § 54AA(d)(2)(C) to certain qualified tax credit bonds for which an election is made under I.R.C. § 6431(f)). The examples cited in the preceding footnotes are intended to be illustrative of the multitude of provisions that rely upon conclusive determinations of the issue price of an issue to analyze compliance with federal tax law, but is not intended to be an exclusive or exhaustive list of such provisions.
sale date based on reasonable expectations regarding the initial public offering price. If a bond is issued for property, the applicable Federal tax-exempt rate is used in lieu of the Federal rate in determining the issue price under section 1274. The issue price of bonds may not exceed their fair market value as of the sale date.\(^{12}\)

Accordingly, under the Existing Regulations, the issue price of a tax-advantaged bond (and, accordingly, an issue composed of tax-advantaged bonds) that are offered to the public in exchange for money is either (a) the first price at which at least ten percent of the bond was actually sold to persons who are members of the public,\(^{13}\) or (b) for bonds for which there is a bona fide public offering at the initial offering price, the first price at which the underwriter reasonably expected that the bonds would be sold to persons who are members of the public.\(^{14}\) Because the reasonable expectations standard does not rely upon actual sales of bonds, the standard does not require issuers and their counsel to attempt to ascertain whether a purchaser intends to resell a bond or hold it for investment purposes.

One consequence of the reasonable expectations standard under the Existing Regulations has been to encourage competitive bond pricing, because underwriters are able to price bonds aggressively, and, to the extent that bonds remain unsold, can take a financial position in the bonds that is consistent with underwriting and capital risk, while still allowing issue price determinations to be made and the transaction to move forward. One of the primary policy considerations that must be taken into account in finalizing the Proposed Regulations is the extent to which the Final Regulations encourage (or at least do not inhibit) pricing bonds to achieve the lowest cost of funds to issuers, as opposed to creating a regulatory regime whereby underwriters price bonds at such low prices (and correspondingly high yields) that issue price can always be established on the basis of actual sales.

Additionally, as Treasury and the Service are aware, tax-exempt and certain types of tax credit bonds are sold with the expectation that bond or tax counsel will deliver a “will” opinion on the date of delivery of the bonds. Because such determinations are heavily dependent upon the issue price of the bonds, it is critical that the issue price of the bonds be established on the sale date with absolute certainty.

Because the Proposed Regulations are a welcome regulatory compromise that could strike an appropriate balance between regulatory goals, fairness and the practical methods and timing within which public financing transactions are executed, the Committee recommends that they be finalized with some amendments and amplifications that are further described in these Comments.

These Comments focus on four primary points of revision and/or clarification and a number of related recommendations. First, the definition of the term “underwriter” should be revised slightly to limit the risk of misapplication of the definition in enforcement proceedings and provide greater certainty to market participants, consistent with the stated purposes of the Proposed Regulations.\(^ {15}\) Second, diligence and documentation issues relating to the requirements of the Proposed Regulations

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\(^{12}\) Treas. Reg. § 1.148-1(b).

\(^{13}\) Id.

\(^{14}\) Id.

\(^{15}\) See Issue Price Definition for Tax-Exempt Bonds, 80 Fed. Reg. 36,301, 36,303 (proposed June 24, 2015) (to be codified at 26 C.F.R. pt. 1) (noting that the Proposed Regulations were issued, and withdrawing the 2013 Regulations, in part in response to comments received suggesting that the definition of the term “underwriter” in the 2013 Regulations was “unduly broad and ambiguous.”)
need to be refined and clarified to create an administrable platform for issuers, tax practitioners and the Service’s enforcement personnel. Third, revisions should be made to achieve workable solutions to potential yield restriction issues that may arise under the alternative method in connection with advance refunding transactions as discussed in Section H of these Comments. Finally, the Committee requests that the Proposed Regulations be adjusted in order to allow for more definite issue price determinations at more certain dates and times.

Attached to these Comments as Appendix A is a blackline of the Proposed Regulations showing suggested revisions that the Committee believes would implement the recommendations made in these Comments (the “Appendix A Comparison”).

B. **Clarify the Scope of Application of the Definition of Issue Price and the Use of Issue Price for Non-Arbitrage Related Measures**

As noted in the Introduction to these Comments, issue price has substantial non-arbitrage-related usage in sections 103, 141-150, 54A-54AA and 6431, and the reasonable expectations standard of the Existing Regulations relating to issue price determinations historically has been reflected in non-arbitrage-related contexts. For both policy and practical reasons, this consistency makes sense because in both cases compliance is measured by reference to the amount actually borrowed. For example, the legislative history that describes the costs of issuance limitation applicable to private activity bonds describes underwriters’ spread as “[the purchase price of bonds reflecting a] . . . discount below the price at which [the bonds] are expected to be sold to the public” (emphasis added).

Therefore, the Committee respectfully requests Treasury and the Service to clarify that issue price determinations made under section 148 also apply to other requirements and provisions under sections 103, 141-150, 54A-54AA and 6431 that rely on measures of issue price and/or sale proceeds. Providing such clarification would ensure that issue price determinations under section 148 continue to be consistent with what the Committee believes that Congress, Treasury and the Service intend (that is, that non-arbitrage requirements and limitations under the Code and the Treasury Regulations that rely on issue price, either expressly or impliedly, use the same measure of issue price as is used for arbitrage purposes). The Committee does not believe that there is any policy or technical reason for using different issue price determinations in such contexts, and notes that any attempt to use different measures, other than issue price determinations made under section 148, would impose substantial, unjustified burdens on issuers and runs contrary to the goal of simplification. Additionally, the Committee believes that the Proposed Regulations should clarify that issue price is the measure used to assess compliance with all requirements and limitations applicable to tax-advantaged bonds in instances where measures of compliance are tested against the

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16 See part A, supra.
17 The Committee notes that certain arbitrage-related definitions do not expressly incorporate the definition of issue price under the Existing Regulations and would not expressly incorporate the definition of issue price under the Proposed Regulations, but would instead rely upon I.R.C. §§ 1273 and 1274. See, e.g., Treas. Reg. § 1.148-1(b) (definition of de minimis).
18 See, e.g., Treas. Reg. § 1.141-2(d)(2)(i) (definition of reasonable expectations for purposes of applying the private activity bond tests).
19 I.R.C. § 147(g).
amount of bonds issued or outstanding.\textsuperscript{21} This clarification could be accomplished either by providing the clarification in the Final Regulations or by providing a clarifying statement in the preamble to the Final Regulations.

C. \textit{Clarify the Definition of “Underwriter” and the Ability of Issuers and Underwriters to Rely on Information Provided by Underwriters}

The term “underwriter” is defined in paragraph (f)(3)(ii) of the Proposed Regulations to include “(A) [a]ny person (as defined in section 7701(a)(1)) that contractually agrees to participate in the initial sale of the bonds to the public by entering into a contract with the issuer (or with the lead underwriter to form an underwriting syndicate); and (B) [a]ny person that, on or before the sale date, directly or indirectly enters into a contract or other arrangement with a person described in paragraph [(A) above] to sell the bonds.”\textsuperscript{22} This is a significant improvement over the current definition, and should help mitigate some of the uncertainty that will potentially arise as the result of the Final Regulations’ elimination of the reasonable expectations standard. In an effort to further reduce uncertainty that may arise in practice from the application of the definition of underwriter in the Proposed Regulations, the Committee recommends that the definition be clarified and amplified in the following respects.

(i) \textit{Use Limiting Language in the Definition of Underwriter}

Paragraph (f)(3)(ii) of the Proposed Regulations reads, in part, “[t]he term underwriter include. . .”\textsuperscript{23} To ensure that the term is applied in a consistent manner and to mitigate the potential for ambiguity, the word “include” in paragraph (f)(3)(ii) of the Proposed Regulations should be replaced with the word “means,” as reflected in the Appendix A Comparison.

(ii) \textit{Clarify the Types of Arrangements That Result in a Person Being an Underwriter - General}

The first part of the definition of the term underwriter in paragraph (f)(3)(ii)(A) of the Proposed Regulations is clear and contemplates normal commercial transactions between issuers and investment banks that are unquestionably serving as underwriters with respect to an issue of bonds in a negotiated or competitive sale. However, the second part of the definition of underwriter in paragraph (f)(3)(ii)(B) of the Proposed Regulations could be interpreted in ways that would diminish underwriters’ and issuers’ abilities to make certain determinations about whether a person is an underwriter or a member of the public. To limit the potential for uncertainty in transaction planning and enforcement in identifying persons who are underwriters, the Committee recommends that paragraph (f)(3)(ii)(B) of the Proposed Regulations be amended in the manner set forth in the Appendix A Comparison and as described below.

\textsuperscript{21} Such a provision or clarification would be consistent with the intent of Congress, Treasury and the Service relating to such measures in any event. \textit{See} Rev. Rul. 83-154, 1983-2 C.B. 33 (amount of volume cap allocated to an issue determined on the basis of issue price of the issue); I.R.S. Priv. Ltr. Rul. 9431007 (April 26, 1994) (same conclusion where I.R.C. § 146(a) uses the term “aggregate face amount”). The Committee also notes that it may be the case that in instances where compliance is measured by reference to the amount of bonds outstanding (as opposed to issued), using the issue price as a beginning value may require using the amortized or accreted value of bonds subsequent to the issue date of the bonds. \textit{See, e.g.}, Treas. Reg. § 1.148-4(e)(2) (value of a bond that is not a plain par bond is the present value of the bond on a given date).


\textsuperscript{23} \textit{Id.}
As drafted, paragraph (f)(3)(ii)(B) of the Proposed Regulations treats “[a]ny person that . . . directly or indirectly enters into a contract or other arrangement with [a person who is an underwriter under paragraph (f)(3)(ii)(A) of the Proposed Regulations] to sell the bonds” (emphasis added).\(^{24}\) For the reasons set forth above and in the succeeding paragraphs, the Final Regulations should eliminate the phrase “other arrangement” in paragraph (f)(3)(ii)(B) of the Proposed Regulations in favor of the language used in the Appendix A Comparison, which would provide that a person is treated as an underwriter under the concept set forth in paragraph (f)(3)(ii)(B) of the Proposed Regulations if such person “directly or indirectly enters into a written contract with a person described in paragraph (f)(3)(iv)(A) of this section [as proposed in these Comments] to participate in the initial sale of the bonds to the public.”\(^{25}\)

In contrast with paragraph (f)(3)(ii)(B) of the Proposed Regulations, paragraph (f)(3)(ii)(A) of the Proposed Regulations rightfully places significant focus on identifying arrangements that are related to the initial sale of bonds to the public in characterizing a person as an underwriter. The importance of this focus cannot be overstated, as it helps narrow the inquiry into whether a purchaser is an underwriter or a member of the public, and as a corollary helps resolve long-standing questions among issuers, underwriters and their counsel as to whether purchasers who purchase bonds for resale in the ordinary course of their businesses (such as broker-dealers) will be treated as underwriters for purposes of establishing the issue price of bonds. This relative clarity is lessened by the broad nature of the term “other arrangement” in paragraph (f)(3)(ii)(B) of the Proposed Regulations and the lack of any language in that paragraph limiting those arrangements to arrangements that are associated with the initial sale or distribution of bonds to the public.

The term “contract” when used in paragraph (f)(3)(ii)(B) of the Proposed Regulations sufficiently captures the types of relationships between underwriters and other persons involved (and intended to be involved) in the initial distribution or offering of bonds to the public. The proposed amendments in the Appendix A Comparison result in a significant alteration that ought to make underwriter identification under paragraph (f)(3)(ii)(B) of the Proposed Regulations more consistent with underwriter identification made under paragraph (f)(3)(ii)(A) of the Proposed Regulations. Most importantly, the use of the words “contract” and “other arrangement” in paragraph (f)(3)(ii)(A)-(B) of the Proposed Regulations should be revised and clarified to include only contractually enforceable written arrangements associated with the initial sale of the bonds to the public, creating a consistency between contracts that result in a person being an underwriter and contracts that result in a sale of bonds for purposes of establishing the sale date of the bonds under Treas. Reg. § 1.150-1(c)(6).\(^{26}\)

It is customary, commercially reasonable and not inconsistent with the purposes of sections 103 and 141-150 and the Treasury Regulations thereunder that underwriters may develop institutional knowledge and/or relationships with brokerages or other purchasers relating to the capacity and willingness of those purchasers to purchase bonds at reasonably predictable prices relative to the initial offering price. These types of relationships generally do not exist primarily to facilitate the initial distribution of bonds to the public, as is evidenced by the purchaser’s lack of underwriting or capital risk with respect to the offering. To emphasize the additional clarity and amplification suggested in these Comments, we recommend that an example of the operation of the definition of “underwriter” be incorporated into the Final Regulations.

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\(^{26}\) Treas. Reg. § 1.150-1(c)(6) (definition of sale date).
Providing the clarifications suggested above is critical for certainty in closing transactions and acknowledging informal “downstream” relationships that an underwriter may have that possess only a tangential nexus to the initial offering and distribution of bonds to the public, but are necessary for the operation of the marketplace. Additionally, amending the definition of the term underwriter will help tax-advantaged bond underwriting firms develop compliance systems that can be as accurate and reliable as possible.

(iii) **Clarification Regarding Private/Direct Placement Transactions**

Some concern has been expressed that the Proposed Regulations are ambiguous as to whether a person who purchases bonds in a private placement or “direct placement” transaction will be treated as an underwriter of purchased bonds as opposed to a member of the public.

While private placements are not unique or new types of transaction, a combination of non-tax regulatory requirements and macroeconomic developments that began around calendar years 2008-2009 have made direct placement transactions a more prevalent component of the municipal finance market. In a typical direct placement transaction, a commercial bank purchases bonds for its own account for investment. The purchase of the bonds may be pursuant to a formal purchase agreement, a (relatively) informal term sheet or a variety of documents that are executed close to (or at the time of) the issuance of the bonds, such as a financing or loan agreement. Direct placement transactions have some advantages over public bond sales for some types of issuers or transactions, such as the absence of a requirement to obtain a rating or prepare a disclosure document (in reliance on applicable securities law exceptions). Accordingly, it is consistent with the stated intent to treat any person who enters into a contract with an issuer to purchase bonds for investment as a member of the public for purposes of establishing the issue prices of those bonds. The preamble to the Proposed Regulations contains a statement that “[a] person that holds bonds for investment is not an underwriter with respect to those bonds.”

Due to the substantial importance of direct placement transactions to the municipal bond market, we recommend that the Final Regulations include a clear statement that any person who purchase bonds for investment will not be treated as an “underwriter” irrespective of its status as a bank or financial institution. Additionally, we recommend that Treasury and the Service provide examples in the Final Regulations clarifying the application of the provision to common transactions involving financial institutions. Some suggested examples are included in the Appendix A Comparison.

(iv) **Clarify the Standards Applicable to Reliance on Information Provided by Underwriters to Issuers and to Other Underwriters**

The Existing Regulations allow an issuer to rely on information provided by an underwriter if the reliance on the information is reasonable. Typically, the reasonableness standard is satisfied if

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28 Id. at 2-3 (citing Moody’s Investors Service, Special Comment, *Direct Bank Loans Carry Credit Risks Similar to Variable Rate Demand Bonds for Public Finance Issuers* (2011)). The Committee does not express an opinion or take a position on the relative suitability or desirability of direct or private placement transactions or publicly offered debt transactions.  
30 See Treas. Reg. § 1.148-2(b)(1)-(2); Treas. Reg. § 1.148-1(b). Treas. Reg. § 1.148-1(b) defines “reasonable expectations or reasonableness” as follows:
the issuer (or an officer or agent of the issuer) makes reasonable inquiry into and/or obtains reasonable certifications from the underwriter relating to information to be relied upon, and has no reason to believe that such information is false. The reasonableness standard under the Existing Regulations has not, to the knowledge of the Committee, been interpreted in a manner that would require auditing or independent verification of information provided to issuers, which they have no reason to believe is false.

While the Proposed Regulations clearly place some level of active due diligence requirements upon issuers and underwriters, it is best to address and clarify the required level of diligence relating to these determinations in the Final Regulations. Although the required level of diligence could be developed through industry custom or enforcement actions, neither of these two alternatives is particularly appealing. The former approach could create vast differences in diligence standards among states, issuers and market participants, and the latter is undesirable from both an equitable and a tax administration perspective.

First, the Final Regulations should contain a provision expressly allowing issuers to rely conclusively upon information provided by underwriters relating to issue price determinations so long as that reliance is reasonable under Treas. Reg. § 1.148-1(b). Issuers have a very limited amount of control over to whom and in what manner bonds are transferred subsequent to the initial transfer under the typical bond purchase agreement, regardless of whether the sale is made through a competitive or a negotiated underwriting. The amount of proceeds received by the issuer (and, as a corollary, the issuer’s real cost of funds with respect to the issue) is not affected by sales of the bonds by the underwriter at prices other than those that correspond to the purchase price of the bonds from the issuer. Therefore, issuers have no practical reason to participate in actions that would understate the issue price of bonds and increase their yield. Most importantly, issuers have very limited access to information that would enable them to audit or otherwise verify information provided by underwriters relating to the prices at which they sold the bonds to the public, or whether the persons to whom an underwriter sold bonds are members of the public. Issuers and their counsel have previously objected to any suggestion that they develop or acquire technology and expertise that would enable them to independently verify pricing information provided to them by underwriters.

Principles of equity and fairness in tax administration dictate that issuers be able to rely conclusively upon information provided by underwriters where issuers have exercised reasonable diligence with respect to such information. It belies common sense to impose on state and local governments an obligation to develop expertise in the intricacies of distribution systems for municipal bonds subsequent to the initial sale of bonds to one or more underwriters.

An issuer’s expectations or actions are reasonable only if a prudent person in the same circumstances as the issuer would have those same expectations or take those same actions, based on all the objective facts and circumstances. Factors relevant to a determination of reasonableness include the issuer’s history of conduct concerning stated expectations made in connection with the issuance of obligations, the level of inquiry by the issuer into factual matters, and the existence of covenants, enforceable by bondholders, that require implementation of specific expectations. For a conduit financing issue, factors relevant to a determination of reasonableness include the reasonable expectations of the conduit borrower, but only if, under the circumstances, it is reasonable and prudent for the issuer to rely on those expectations.

31 Id.
32 Id.
33 See, e.g., AMERICAN BAR ASSOCIATION, SECTION OF TAXATION, COMMENTS CONCERNING THE DEFINITION OF ISSUE PRICE FOR TAX-EXEMPT BONDS AND OTHER TAX-ADVANTAGED BONDS, 6, 10 (January 23, 2014).
Treasury and the Service should also specifically provide guidance regarding the application of the reasonableness standard noted above to instances where (A) an underwriter provides an inaccurate representation as to facts bearing on an issue price determination (such as the actual sale price, initial offering price or amount of actual sales), and (B) where an underwriter breaches a representation or covenant provided to an issuer relating to an issue price determination. In both of these cases, issuers should not make any subsequent redeterminations of issue price or any related determinations (such as arbitrage yield) so long as they reasonably rely upon the information provided by an underwriter.

Second, the Final Regulations should contain a provision expressly allowing underwriters to rely on information provided by other underwriters. It is commercially impractical for underwriters to audit or otherwise attempt to independently verify information provided by other underwriters relating to sales of bonds. Additionally, underwriters are not likely going to share proprietary information with competitors (such as information that would reasonably result in the identification of specific customers) that might allow other underwriters in a syndicate to verify whether a purchaser was a member of the public (or, conversely, an underwriter). Allowing underwriters to rely upon information provided by one another recognizes the relative sophistication of parties involved in municipal financing transactions and the need of such parties to protect proprietary customer information.

While issuers and underwriters should be able to rely upon information provided by underwriters where such reliance is reasonable, reasonableness should be determined under the current standard set forth in the Existing Regulations.\(^{34}\) In the context of reliance on information provided by underwriters to both issuers and other underwriters, incorporating an existing standard of reasonableness into these proposed reliance provisions helps ensure that issuers, underwriters and their counsel will be able to plan and execute transactions under a familiar legal standard, which in turn will enhance predictability and standardization of practices in the municipal finance market, as well as providing a familiar framework within which enforcement activities could be conducted.

\(\text{(v) } \text{Anti-Abuse}\)

To the extent that Treasury and the Service are concerned that amending the definition of the term underwriter in the manner recommended in these Comments would limit the ability of the Service to properly enforce the provisions of sections 103 and 141-150, the Committee suggests that existing provisions of the Code and the Treasury Regulations provide more appropriate avenues for deterring, and taking enforcement actions against, abusive transactions.\(^{35}\) Additionally, the Committee notes that underwriters can also be subject to securities law enforcement actions for misconduct in pricing primary market bond offerings.

D. **Clarify the Application of the Definition of Issue Price in General**

(i) **Confirm That Issue Price is Determined on a Bond-by-Bond Basis**

The Proposed Regulations require issue price determinations to be made on a maturity-by-maturity basis.\(^{36}\) This is consistent with existing practice, insofar as issuers may establish the issue

\(^{34}\) Treas. Reg. § 1.148-1(b) (definition of reasonable expectations and reasonableness).

\(^{35}\) See, e.g., Treas. Reg. § 1.148-10(e); I.R.C. § 6700.

prices of separate bonds in an issue using either actual sales or reasonable expectations.\textsuperscript{37} Treasury should confirm that the issue prices of separate maturities may be established using either the actual sales method or the alternative method in the Final Regulations, either through a clarifying provision in the Final Regulations or a statement to such effect in the preamble to the Final Regulations. A suggested clarifying amendment is provided in the Appendix A Comparison, which would confirm that the issue price may be established using either the actual sales method or the alternative method.

(ii) \textit{Confirm the Finality of Issue Price Determinations Made Under the Alternative Method}

The Proposed Regulations accomplish the regulatory goal of finality of issue price determinations on the sale date primarily through the incorporation of the alternative method under paragraph (f)(2)(iii) of the Proposed Regulations.\textsuperscript{38} The alternative method allows for the issue price of a bond to be determined by reference to the initial offering price of the bond to the public, as opposed to the actual sale price of a substantial amount of the bond, provided that certain requirements are satisfied, which primarily relate to underwriter certifications and limitations on the ability to sell unsold portions of the bond at prices higher than the initial offering price subsequent to the sale date and prior to the issue date.\textsuperscript{39}

To further clarify the extent to which the alternative method may serve to conclusively establish the issue price of bonds as of the sale date, the Proposed Regulations should make clear that once an issuer has used the alternative method of establishing the issue price of a maturity, subsequent sales of bonds of that maturity do not affect that determination of the issue price, even if the amount of those subsequent sales occurs at different prices (and corresponding yields) and the amount of bonds sold at such price is a substantial amount. However, the Final Regulations should also make clear that an issuer may use the actual sales method to establish the issue price of a bond where subsequent sales are sufficient to meet the rule set forth in paragraph (f)(2)(i) of the Proposed Regulations (or its corresponding provision in the Final Regulations).\textsuperscript{40} Such clarification could be accomplished through a statement in the preamble to the Final Regulations that the issue price of a bond that is properly established under the alternative method is not required to reflect subsequent sales of the bond at different prices, but that the issue price of the bond may reflect subsequent sales of the bond where such sales would result in satisfying the actual sales method.

(iii) \textit{Create an Option Allowing Issuers to Treat Non-Publicly Traded Bonds Issued in Debt-for-Debt Exchanges as Issued at Par}

The Proposed Regulations rely on rules set forth in sections 1273 and 1274 to determine the issue price of non-publicly traded bonds that are issued in exchange for property.\textsuperscript{41} In the tax-

\textsuperscript{37} Treas. Reg. § 1.148-1(b) (definition of issue price).
\textsuperscript{40} This would make clear that an issuer may, for instance, begin using the alternative method after the sale date for a bond because there have been insufficient sales of the bond to that point to use the actual sales method, but, if subsequent to the sale date a substantial amount of the bond is actually sold at a price that is lower than the initial offering price, an issuer could use the lower price under the actual sales method (and correspondingly higher yield) in order to reduce or eliminate an expected rebate or yield reduction payment liability. Alternatively, the issuer could choose to continue using the alternative method and establish the issue price of the bond as the higher price (and correspondingly lower yield).
advantaged bond market, most bonds are originally issued for money, within the meaning of Treas. Reg. § 1.1273-2(a)(1). However, where significant modifications are made to a bond, the bond is treated as exchanged for the modified bond under Treas. Reg. § 1.1001-3.\(^{42}\)

Establishing the issue price of bonds issued in a debt-for-debt exchange is primarily addressed in Treas. Reg. § 1.1273-2, and is summarized below:

- Where the bonds are “publicly traded,” the issue price of the bonds is the fair market value of the bonds on the date of the exchange;\(^{43}\)
- Where the bonds are not publicly traded, but the property exchanged for the bonds (i.e., the original or pre-modification bond) is publicly traded, the issue price of the bonds is the fair market value of the property on the date of the exchange;\(^{44}\) and
- If neither the bonds nor the property are publicly traded, then the issue price is generally determined under section 1274.\(^{45}\)

To establish the issue price of a bond under section 1274, an issuer must determine whether a bond bears adequate stated interest by comparing the stated interest rate on the bond to the adjusted applicable federal tax-exempt rate (the “AAFR”). If the stated interest rate on the bond is equal to or greater than the AAFR, then the issue price of the bond will be the outstanding stated principal amount of the bond prior to the modification.\(^{46}\) If the stated interest rate on the bond is less than the AAFR, then the bond will be treated as having original issue discount equal to the difference between the outstanding stated principal amount of the bond and the imputed principal amount of the bond.\(^{47}\)

As a general matter, most tax-advantaged bonds issued in debt-for-debt exchanges will not be treated as publicly traded, oftentimes by operation of Treas. Reg. § 1.1273-2(f)(6) (the “Small Issue Rule”). The Small Issue Rule treats bonds issued as part of an issue the outstanding stated principal amount of which is $100 million or less as per se not publicly traded. Under section 1274, the issue price of such bonds would be either the outstanding stated principal amount of the issue on the date of the exchange or the “imputed principal amount” of the bonds on the date of the exchange, depending on the stated interest rate of the bonds.\(^{48}\)

The experience of members of the Committee suggests that the AAFR is oftentimes higher than the stated interest rate on the bonds, resulting (among other consequences) in (A) an issue having a lower issue price than the outstanding stated principal amount of the issue on the exchange date, and (B) an arbitrage yield that is higher than it would otherwise be if the bonds were treated as issued for an amount equal to the outstanding stated principal amount.

Solely for purposes of determining the issue price of tax-advantaged bonds issued in debt-for-debt exchanges for purposes of determining compliance with sections 103 and 141-150, 54A-54AA and 6431, we recommend that Treasury and the Service include a provision in the Final Regulations that allows issuers the option to treat bonds issued in a debt-for-debt exchange (in both publicly offered and privately placed transactions) as having an issue price equal to the outstanding

\(^{42}\) Treas. Reg. § 1.1001-3.
\(^{43}\) I.R.C. § 1273(b)(3).
\(^{44}\) Id.
\(^{45}\) Id.
\(^{46}\) I.R.C. § 1273(b)(4)(B).
\(^{47}\) I.R.C. § 1274(a)(1).
\(^{48}\) See I.R.C. § 1274(a).
stated principal amount of such bonds. Such a provision could provide practical flexibility for issuers and their counsel, particularly in instances where the arbitrage yield or other quantitative metrics dependent upon issue price are immaterial to the financing, and in most cases would not result in any foregone revenue to Treasury for financings having gross proceeds that are subject to arbitrage rebate or yield restriction requirements (because issuers would be opting to have a lower arbitrage yield on the issue). Furthermore, because any such provision would only apply to determinations made under sections 103 and 141-150, bondholders could not use the provision to otherwise defer recognition of income or to treat payments as returns of capital as opposed to interest for purposes of their federal income tax returns. The relative simplicity afforded by such a provision would also further the interests of tax administration. Finally, for the foregoing practical and policy reasons, any such provision should be made applicable to tax-advantaged bonds that would not otherwise be governed by the Small Issue Rule. Included in the Appendix A Comparison is a suggested provision that captures this concept.

E. Allow Issue Price Determinations to be made on the Sale Date at a Specific Time and Make Conforming and Corresponding Adjustments to the Definition of Sale Date

The Proposed Regulations make issue price determinations (under both the alternative method and the actual sales method) dependent upon all transactions and facts transpiring over the entirety of the sale date.\(^49\) Sale date is currently defined as “the first day on which there is a binding contract in writing for the sale or exchange of [a] bond.”\(^50\) Tax-advantaged bonds are often sold (pursuant to a bond purchase agreement or similar contract) relatively early in the day on the sale date, so that transaction participants have final pricing numbers to work with by early in the afternoon on the sale date. It is common practice in smaller transactions for bond pricing to be completed over a full day or two before the bond issuer approves the bond sale. In such instances, the underwriter assumes the risk that the sale might not be approved by the bond issuer’s board but commits to purchase the bonds at a specified price (and with specified interest rates). While there is no legally enforceable contract for the sale of the bonds on such date, there are substantial practical sanctions that would apply to an underwriter that did not follow through with its purchase offer, and in fact there is little practical risk that the bond issuer will not approve the transaction. This sale timing sequence allows legal counsel to the various participants to draft agreements (such as bond purchase agreements) that must be executed on the sale date, and review the bond sale to ensure that state, securities and tax law requirements and limitations are satisfied with respect to the transaction. In the case of advance refunding transactions,\(^51\) escrow securities are usually purchased at the time of bond pricing, even if bond pricing occurs prior to the actual sale date.

Due to the need of transaction participants to make substantive, detailed evaluations of pricing data on the sale date, the Committee recommends that the Proposed Regulations replace the use of the full sale date with a pricing time, which may occur before the sale date. The Committee recommends that transaction participants be given the ability to use a particular “cutoff” time on or


\(^{50}\) Treas. Reg. § 1.150-1(d)(6).

\(^{51}\) Advance refunding transactions are transactions where the last expenditure of any proceeds of the issue for the payment of principal or interest on the refunded issue occurs more than 90 days after the issue date of the issue. Treas. Reg. § 1.150-1(d)(3)-(4). While escrow securities may be used in connection with current refunding transactions, advance refunding transactions almost always involve the purchase of escrow securities due to certain requirements and limitations that are specific to advance refunding transactions. See, e.g., Treas. Reg. § 1.148-10(c)(1)-(2) (excess gross proceeds limitation); Treas. Reg. § 1.148-10(c)(5) (limited exception to excess gross proceeds limitation for certain gross advance refunding transactions).
before the sale date to make issue price determinations under the alternative method, so that final
pricing data can be meaningfully analyzed on the sale date with a sufficient amount of time to allow
for any adjustments that may need to be made and ensure that sufficient time is allowed on the sale
date to finalize sale date transaction documents and, in the context of advance refunding transactions,
receive bids for escrow securities. The Committee notes that a rule allowing transaction
participants to use a pricing time would align federal tax rules relating to issue price determinations
to corresponding securities law provisions that require underwriters to provide information relating to
new issue pricing within a prescribed period of time after a purchase agreement is executed and
before the underwriters may trade bonds.

To ensure that the proposed use of a pricing time is used in a manner that would facilitate
bona fide issue price determinations for non-abusive purposes, the selection of a pricing time should
be subject to the following requirements and limitations:

- The pricing time must not be earlier than the time that the underwriter commits to
  purchase the bonds at a specified purchase price and with the interest rate and
  other payment terms set, subject only to reasonable variations in the par amount
  by up to 10%.
- The pricing time must not be later than the end of the sale date.
- The pricing time must be memorialized within one hour in a written document signed
  by an underwriter.
- The underwriter must, no later than the issue date, certify that the pricing time meets
  the above requirements.
- The issuer must have no reason to believe that such certification of the underwriter is
  not true.

By way of example, times that could be selected as the pricing time (whether or not occurring
on the sale date) include the time that a bond purchase agreement or similar document is signed or an
award of bonds purchased pursuant to a competitive bid is formally made or the close of business on
the sale date.

From a tax administration perspective, the Committee believes that the concept of a pricing
time should not be any more complex to document and review in the context of enforcement
proceedings if the change is accompanied by a provision in the Final Regulations requiring
transaction participants to document the selected pricing time. Because the Existing Regulations
require that issuers execute a document establishing their reasonable expectations relating to federal

52 While issue price finality may have consequences or specific considerations which potential purchasers may take
into account in debt capital markets other than the tax-exempt bond market, the tax compliance requirements
applicable to tax-exempt bonds pose unique transaction execution considerations that we believe warrants this
specific treatment.
54 We anticipate that the “reasonableness” requirement in this element would serve in part as an anti-abuse limitation
that would require a non-arbitrage related governmental purpose for adjusting the par amount of the bonds where
principal amounts were proposed to be adjusted upwards. The 10% variance limitation in this element would also
serve to allow various funds or accounts to be sized in a manner that satisfies the bona fide governmental purposes
of the bond issue, as well as bond authorization requirements and limitations, and would also allow the issue to be
sized in a manner that accommodates federal tax compliance (such as by downsizing par amounts where premiums
generated are higher than originally anticipated).
tax law compliance on the issue date,\textsuperscript{55} documenting the pricing time not only would impose little burden upon issuers, it would also be subject to relatively simple confirmation by the Service in the context of an enforcement proceeding.

F. \textit{Confirm That the Proposed Regulations do not Seek Proprietary Information from Underwriters}

The Committee understands that the Proposed Regulations are not intended to require underwriters to provide proprietary information in the normal course of executing transactions. The Final Regulations should be clear that certifications provided by underwriters to establish the issue prices of bonds under the general rule or the alternative method need not include information that would identify (or reasonably enable identification of) persons to whom an underwriter sells bonds. This confirmation could be provided in a statement to this effect in the preamble to the Final Regulations. Other provisions of the federal tax law currently protect proprietary information of taxpayers in a similar manner.\textsuperscript{56}

G. \textit{Clarify and Amplify the Requirements Applicable to the Alternative Method}

The Proposed Regulations’ inclusion of the alternative method for establishing the issue price should help lessen the uncertainty that results from removing the ability to establish issue price based upon reasonable expectations by allowing conclusive issue price determinations on the sale date on a basis other than actual sales. The alternative method will serve as an important method for establishing the issue price of bonds where the underwriters have priced bonds at a lower cost of funds to issuers and Treasury. The alternative method could also allow underwriters to take a temporary aggressive pricing position but still allow the bond issue to close.\textsuperscript{57}

(i) \textit{Incorporate the Concept of an Offering Period into the Alternative Method}

The Proposed Regulations recognize that part of assuming underwriting risk is the risk that bonds may not sell on the sale date at the prices that such bonds were originally expected to be sold.\textsuperscript{58} They also recognize that underwriters may subsequently sell unsold bonds, even before the issue date, at prices higher than those initially expected due to changes in financial markets. Additionally, the Proposed Regulations rightfully recognize, albeit impliedly, that the speed and sophistication of modern capital markets and trading strategies create a practical dynamic whereby market changes are almost certain to occur between the sale date and issue date of bonds.\textsuperscript{59} It is not uncommon for market interest rates, most commonly measured by reference to the prevailing 10-year Treasury note rate, to swing in both directions between sale and closing, and potentially multiple times.

\textsuperscript{55} Treas. Reg. § 1.148-2(b)(2).
\textsuperscript{56} See, e.g., I.R.M. 30.6.1.2(3), Security of Confidential Information, Official Documents and Tax Data (April 29, 2009) (extending “sensitive but unclassified” information status to, among other types of information, “proprietary information (e.g., contracts, solicitations, information covered by the Trade Secrets Act, the Procurement Integrity Act, and similar statutes”).
\textsuperscript{57} See part A, supra.
\textsuperscript{59} Id. As noted above, changes occur intraday as well. The concept of “pricing time” discussed above in part E is consistent with these market realities.
For tax-advantaged bonds, the period between the sale date and the issue date of bonds is typically between 10 and 15 days. Additionally, it is the experience of members of the Committee that some state laws require a minimum period between the sale date and the closing date. It is virtually certain that over this period of time there will be market changes that are favorable or adverse to an underwriter that holds a temporary position in unsold bonds. Additionally, the period between the sale date and the issue date is a critical period for transaction diligence and diligence memorialization, and completion of bond documents and legal and accounting opinions and letters. This period enables the parties to review finalized versions of transaction documents, conduct diligence relating to signatories and authentication of those documents, and finalize and affirm conclusions relating to the federal tax analysis.

Due to the nature of tax-advantaged bond transactions and the type and extent of documentation that is dependent upon final pricing information, transaction participants need time and certainty to close transactions in a diligent, efficient and orderly manner. Where an underwriter engages in permitted sales at higher prices between the sale date and the issue date, the requirement to document the intervening market change under the alternative method could complicate the closing process by adding required documentation, the contents and extent of which may have to be negotiated, very close to the closing date (perhaps as late as the day prior to closing). For this reason, the alternative method should incorporate the concept of an offering period, after which the issue price of a bond (determined under the alternative method) would “settle,” and that any such offering period end at a time prior to the closing date. At the end of such offering period, underwriters would be able to sell bonds at higher prices without further documentation and without affecting the issuers’ compliance with the determination of the issue price of the bonds under the alternative method. This proposal does not alter the manner in which the alternative method would function, other than shortening the “lock-up” period following the sale date during which bonds could sell at prices higher than the initial offering prices without providing additional documentation relating to the sale, as currently contemplated under the alternative method.

Similar to what the Committee recommended in its comments on the 2013 Regulations, the Committee recommends that such an offering period begin on the sale date and end six business days after the sale date. As described in those comments, a six business days period ensures that an offering price or position in unsold maturities would be held over a weekend, and it would be sufficiently brief to ensure that issuers could meet their obligations to deliver a final official statement relating to a bond sale under SEC Rule 15c2-12 within seven business days after the sale date.

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62 Because the 2013 Regulations were not finalized, we have no reason to believe that the proposal made by the Committee in its comments on the 2013 Regulations was considered and disregarded by Treasury or the Service.
63 Id.
64 17 C.F.R. 240.15c2-12(b)(3) (requirement that issuer contract with underwriter to deliver final official statement within seven business days after the sale date).
(ii) Clarify That Market Changes Need Not be Limited to Interest Rate Changes and the Scope of the Market Change Concept

Current market realities and the frequency of changes in the capital markets are reflected in the provisions of the alternative method that allow sales of bonds by underwriters at higher prices between the sale date and the issue date.\(^{65}\) While the concept of “market change” is broader than just declines in interest rates (the example used in the Proposed Regulations)\(^{66}\) it is possible that the Proposed Regulations could be read to suggest that the term “market change” is limited to declines in interest rates (e.g., the 10-year Treasury note rate) and interest rate indices that would be used to price tax-advantaged bonds. Accordingly, the Final Regulations should contain a broader concept of “market change” that is consistent with the status of current public finance markets and the number and type of different credits that raise capital in the public finance markets.\(^{67}\)

Additionally, because it is possible that there could be *bona fide* reasons that bonds are sold at higher prices subsequent to the sale date in a manner that is inconsistent with benchmark market measures, the “market change” concept in the Final Regulations should be broadened. Even political factors that are perceived by market participants to be positive or adverse to a specific obligor could create instances where market prices for bonds could move in a manner that is inconsistent with indicative prices derived solely from benchmark indices (or movements in benchmark indices).

Examples of circumstances that could change markets, in addition to interest rate changes, are currency devaluations of major world economies, Federal Open Market Committee announcements and credit quality changes. Included in the Appendix A Comparison is language that the Committee believes would sufficiently clarify the scope of the term “market change.”

(iii) Clarify the Issuer Diligence Requirement under the Alternative Method

The alternative method requires that issuers exercise due diligence in relying upon the certifications provided by underwriters made pursuant to the requirements of the alternative method. As stated elsewhere in these Comments,\(^{68}\) issuers have limited control over underwriters, and very limited (if any) meaningful methods by which to independently verify information provided by underwriters relating to bond pricing. Meaningful due diligence relating to bond pricing is expected to be obtained either through dialogue with underwriters and/or consultation with a municipal advisor relating to bond pricing. Because of issuers’ relative lack of access to data that would allow meaningful independent analysis of bond pricing data, the Proposed Regulations should be amended to provide a safe harbor specifying circumstances under which the due diligence requirement under the alternative method will be treated as having been satisfied if (1) the bonds were sold pursuant to a competitive sale process where the issuer received at least three offers to purchase the bonds, (2) the issuer conducts a post-pricing consultation with the underwriter relating to the bond pricing, the occurrence of which is documented in the tax document relating to the issue, or (3) the issuer engages the services of an independent municipal advisor to provide a certification to the issuer to

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\(^{66}\) The Committee notes that changes in interest rates are used as an example of the type of market change that could serve as an acceptable basis for selling bonds at higher prices than the initial offering prices between the sale date and the issue date of bonds under the alternative method. Issue Price Definition for Tax-Exempt Bonds, 80 Fed. Reg. 36,301, 36,303 (proposed on June 24, 2015) (to be codified at 26 C.F.R. pt. 1).


\(^{68}\) Supra part C(iv), at p.4.
the effect that the municipal advisor has reviewed the pricing of the bonds and that, in the opinion of the municipal advisor, the initial offering prices of the bonds represent fair market value prices for the bonds as of the sale date.

Any of the three of the proposed safe harbor methods for satisfying the due diligence requirement under the alternative method represent active, meaningful methods for the issuer to be engaged in the bond sale process and to satisfy itself that underwriters are accurately representing the pricing process and results to the issuer, without requiring independent verification of bond price. First, competitive bond sales have long been perceived as being more likely to result in clearer, more transparent bond pricing than negotiated sale transactions. While the Committee does not take any position on the desirability of competitive sales over negotiated sales (or vice versa), the nature of a competitive sale is that an issuer is presented with proposals for the purchase of the bonds and chooses the bid that represents the lowest cost of funds to the issuer. Using a competitive sale process as a means of satisfying a safe harbor for establishing fair market value has proved workable in the context of purchasing guaranteed investment contracts and investments for yield restricted defeasance escrows. A similar process should be sufficient evidence of an issuer’s due diligence relating to underwriter certifications under the alternative method. Second, where an issuer does not engage an independent municipal advisor with respect to a bond sale, pre- and post-pricing dialogue with underwriters is a recognized best practice in municipal finance. This method would closely align with existing practice relating to reviewing bond pricing and completing the tax analysis relating to an issue. Finally, where an issuer incurs the costs of engaging an independent municipal advisor in connection with a bond sale, it is reasonable to infer that one role of the advisor is to provide a continuing education and an analytical function to the issuer, and that the issuer ought to be able to satisfy its primary due diligence function relating to bond pricing by relying on consultations with such an advisor.

(iv) **Technical Correction to Alternative Method**

As drafted, paragraph (f)(2)(ii)(A) of the Proposed Regulations reads “[t]he underwriters fill all orders at the initial offering price placed by the public and received by the underwriters on or before the sale date (to the extent the orders do not exceed the amount of bonds to be sold) . . .” (emphasis added). The language in italics in the immediately preceding sentence should be deleted in the Final Regulations. If the issuer is using the alternative method to establish the issue price of bonds, by definition there have not been orders or sales of those bonds equaling or exceeding 10% of the amount of the bond to be sold.

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71 See Government Finance Officers Association, Selecting and Managing Municipal Advisors (February, 2014), http://www.gfoa.org/sites/default/files/DEBT_SELECTING_AND_MANAGING_MUNICIPAL_ADVISORS.pdf. The Committee also notes that delegating specialized professional functions to outside consultants is expressly permitted under the current arbitrage regulations in the context of the five-year temporary period of Treas. Reg. 1.148-2(e)(2)(ii) (allowing issuers to rely on the certification of an architect or engineer in determining that a five-year period is necessary to complete the capital project financed).


73 See Prop. Treas. Reg. § 1.148-1(f)(2)(i) (“issue price of bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public”); Prop. Treas. Reg. § 1.148-1(f)(2)(ii) (“[a]s an alternative to the general rule in paragraph (f)(2)(i) of this section, if the underwriters have not received orders placed by the
H. Provide for Yield Reduction Payment Ability When SLGs are Unavailable

The Proposed Regulations, as drafted, present some potential administrative difficulties that are unique to advance refunding transactions, particularly when United States Treasury, State and Local Government Series Securities (“SLGs”), are unavailable because SLGs sales have been suspended. Advance refunding transactions involve balancing several major, time-sensitive processes that depend, in significant part, upon knowing the issue price and the yield of the refunding issue for purposes of analyzing compliance with section 148 and the Treasury Regulations thereunder. Advance refunding transactions involve purchasing securities (“escrow securities”) that generate cash flows that are sufficient to defease the refunded issue. Due in large part to existing federal tax law restrictions relating to advance refunding issues, escrow securities cannot be purchased prior to the time that the financing group knows the issue price and yield of the advance refunding issue, to ensure that (a) the issue generates sufficient sale proceeds to purchase the escrow securities, and (b) the yield on the escrow securities does not exceed the yield on the advance refunding issue.

Because, under the Existing Regulations, the issue price of tax-advantaged bonds may be established based upon reasonable expectations on the sale date of the bonds, the issue price of an advance refunding issue is typically established relatively early on the sale date. Once the issue price is established and, in the absence of the availability of SLGs (or where SLGs are available, but open-market securities may provide a more efficient escrow), a bidding agent will receive bids from potential providers of the escrow securities. Under the Existing Regulations, the time between the establishment of the issue price and the yield of the refunding issue and the purchase of escrow securities is relatively short. This short period significantly mitigates the risk of market changes that could result in receiving bids for escrow securities with a market value significantly higher or lower than what is expected at the time that the refunding bonds are sized and sold. Accordingly, advance refunding issues can be sized fairly accurately, and interactions between bidding agents, verification agents, financial advisors and underwriters can occur at a speed and with an accuracy that ensures that the transaction can proceed smoothly to closing. This timing sequence, coupled with modern bond issue and escrow sizing and verification software, allows issuers, their counsel and financial professionals to execute advance refunding transactions that are non-abusive and efficient.

If finalized in the current format, the Proposed Regulations could potentially upset the delicate timing intricacies unique to advance refunding issues. The alternative method is used only where the actual sales method is not satisfied. Because actual sales that occur at a level sufficient to satisfy the actual sales method could, in theory, originate from orders placed to an underwriter at any

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74 See generally Treas. Reg. § 1.150-1(d)(4) (definition of advance refunding issue).
75 Since SLG sales were suspended in 1995, sales of SLGs have been suspended nine times, not including the suspension that took effect on March 13, 2015. Robert J. Eidnier, Here We Go Again — SLGs Window Likely to Close (U.S. Treasury – State and Local Government Series), The National Law Review (March 4, 2015), http://www.natlawreview.com/article/here-we-go-again-slg-window-likely-to-close-us-treasury-state-and-local-government. These suspensions have at times lasted several months, with the most recent suspension lasting approximately eight months. Id.; Naomi Jagoda, SLGs Sales Halt May Pose Challenge for Small Issues, The Bond Buyer, March 18, 2015, at 1.
76 See, e.g., Treas. Reg. § 1.148-9(d)(2)(i) (30 day temporary period for proceeds (other than transferred proceeds) of advance refunding issues); Treas. Reg. § 1.148-9(d)(2)(ii)(B) (termination of temporary period allowed for proceeds of a prior issue on issue date of advance refunding issue); Treas. Reg. § 1.148-10(c)(1) (excess gross proceeds limitation for advance refunding issues).
77 Id.
78 Id.
time on the sale date, and because intraday market activity could make bonds offered at a given price early in the day more attractive later in the day on the sale date, there is a potential inability to conclusively establish the issue price of an issue (and, accordingly, the yield of the issue) until the end of the day on the sale date. Practically, this means that issuers may not be able to receive bids for escrow securities until the business day following the sale date.

Due to the timing issues described above, issuers will need regulatory guidance under the Proposed Regulations to address pricing discrepancies that could arise in advance refunding transactions. If market changes overnight cause the purchase of escrow securities at a market value that is lower than financing group participants expected when the bonds were sized and sold, the issuer would pay less than expected for the escrow securities, increasing the yield of the escrow securities and potentially resulting in a violation of the yield restriction rules under section 148.79

To mitigate the potential compliance issue described above, the Proposed Regulations should reflect the authority of issuers under existing non-regulatory published guidance to make yield reduction payments on nonpurpose investments held in an advance refunding escrow when SLGs are unavailable for purchase.80 Including this provision in the Final Regulations would help issuers engage in advance refunding transactions in an economically efficient manner, using escrow securities purchased at fair market value. Treasury and the Service recognized in the 2013 Regulations the possibility that regulatory changes relating to issue price determinations could result in discrepancies between the amount of sale proceeds received from the sale of an issue and the cost of escrow securities.81 Accordingly the Committee recommends that Treasury and the Service include this concept in the Final Regulations.82

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APPENDIX A

COMPARISON OF PROPOSED REGULATIONS AS AMENDED TO INCORPORATE CERTAIN ELEMENTS OF THE COMMENTS

(Attached)
Section 1.148-1:

(b) *** Issue price means issue price as defined in paragraph (f) of this section.

(f) Definition of issue price.

(1) In general. Except as otherwise provided in this paragraph (f), issue price is defined in sections 1273 and 1274 and the regulations under those sections.

(2) Bonds issued for money.

(i) In general. The issue price of bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public.

(ii) Alternative method based on initial offering price. As an alternative to the general rule in paragraph (f)(2)(i) of this section, if the underwriters have not received orders placed by the public for a substantial amount of tax-exempt bonds on or before the sale date pricing time, the issuer may treat the initial offering price to the public as the issue price of the bonds if all of the following requirements are met:

(A) The underwriters fill all orders at the initial offering price placed by the public and received by the underwriters on or before the sale date pricing time, and no underwriter fills an order placed by the public and received by the underwriters on or before the sale date pricing time at a price higher than the initial offering price.

(B) The issuer obtains from the lead underwriter in the underwriting syndicate or selling group (or, if applicable, the sole underwriter) certification of the following:

(1) The initial offering price;

(2) That the underwriters met the requirements of paragraph (f)(2)(ii)(A) of this section;

(3) That no underwriter will fill an order placed by the public and received after the sale date and before the issue date during the offering period at a price higher than the initial offering price, except if the higher price is the result of a market change
(such as a decline in interest rates) for those bonds after the sale date pricing time; and

(4) That the lead (or sole) underwriter will provide the issuer supporting documentation for the matters covered by the certifications in paragraphs (f)(2)(ii)(B)(1) and (2) of this section and, with regard to paragraph (f)(2)(ii)(B)(3) of this section, either documentation regarding any bonds for which an underwriter filled an order placed by the public and received after the sale date pricing time and before the issue date end of the offering period at a price higher than the initial offering price and the corresponding market change for those bonds, or a certification that no underwriter filled such orders at a price higher than the initial offering price during the offering period.

(C) The issuer does not know or have reason to know, after exercising due diligence, that the certifications described in paragraph (f)(2)(ii)(B) of this section are false. (3) An issuer shall be treated as having exercised due diligence under this paragraph (C) if:

(1) the issuer conducts a consultation with the underwriter (or, in the case of a syndicated underwriting, the lead underwriter) relating to the sale of the bonds the occurrence of which is documented in the bond documents relating to such bonds;

(2) the issuer obtains a certification from a municipal advisor (within the meaning of 17 C.F.R. § 240.15Ba1-1(d)(1)(i)) to the effect that the municipal advisor has reviewed bond sale pricing data and contemporaneous market data and that, in the opinion of the municipal advisor, the initial offering prices of the bonds represent fair market value prices for the bonds as of the pricing time; or

(3) the bonds are sold pursuant to a qualified competitive sale.

(3) Definitions. For purposes of this paragraph (f), the following definitions apply:

(i) Offering period. Offering period means the period beginning at the pricing time and ending at the close of business on the sixth business day following the pricing time.

(ii) Public. Public means any person (as defined in section 7701(a)(1)) other than an underwriter or a related party (as defined in §1.150-1(b)) to an underwriter.
(ii) iii) Qualified competitive sale. The term qualified competitive sale means any sale where the issuer receives at least three bona fide offers to purchase the bonds pursuant to a published notice of sale or similar document.

(iv) Underwriter. The term underwriter includes-

(A) Any person (as defined in section 7701(a)(1)) that contractually agrees to participate in the initial sale of the bonds to the public by entering into a written contract with the issuer (or with the lead underwriter to form an underwriting syndicate) to participate in the initial sale of the bonds to the public; and

(B) Any person that, on or before the sale date, directly or indirectly enters into a written contract or other arrangement with a person described in paragraph (f)(3)(ii)iv(A) of this section to sell the bonds to the public.

A person who holds bonds for investment is not an underwriter with respect to those bonds.

Examples. The following examples illustrate the application of paragraph (iv) of this section.

Retail brokerage. Issuer A enters into a bond purchase agreement with bond underwriting firm B, pursuant to which B will sell A’s general obligation bond issue. B offers a serial maturity having a principal amount of $100,000 of the bonds to the public on the sale date at a price of $103,000. B sells the maturity to a brokerage firm, C, at a price of $103,000. B has sold tax-exempt bonds of other issues to C in the ordinary course of its underwriting business, and has institutional knowledge that C’s business is as a brokerage firm to sell bonds that it purchases for customers at a higher price than C purchases those bonds from sellers, rather than holding bonds for C’s own account. C sells the maturity to customer D for $104,000. D purchases the maturity intending to hold the bond as an investment. C does not have a contract with A to sell the bond. and C did not, directly or indirectly, enter into a contract with B on or before the sale date to sell the bonds to its customers as part of the initial sale of the bonds to the public. C is not an underwriter for purposes of paragraph (f), and the issue price of the bond is $103,000.
Bonds held in investment funds. Issuer A sells tax-exempt bonds to underwriter B as part of the initial sale of A’s tax-exempt bond issue. B offers the bonds to the public, and the bonds are purchased by Company C at a price of 101 percent of the stated redemption price at maturity of the bonds. C is an investment management company that is a related party to B, and purchases individual debt and equity investments that it holds in funds with specific investment goals for customers. Interests in the investment funds are sold to investors. The investors’ return on their investments reflects the return on all investments in a fund. Investors own interests in the fund, but do not own any of the individual investments or have the right to exercise investment discretion with respect to the fund’s investments. The issue price of the bonds is 101 percent of the stated redemption price at maturity of the bonds. The result is the same regardless of whether the interests in the fund are widely available for purchase or offered to a limited number of potential investors.

(4) Special rules. For purposes of this paragraph (f), the following special rules apply:

(i) Separate determinations. The issue price of bonds in an issue that do not have the same credit and payment terms is determined separately. The issue prices of bonds of an issue that are not substantially identical may be established using either method set forth in paragraph (2) to the extent the requirements of each such method are otherwise satisfied.

(ii) Substantial amount. Ten percent is a substantial amount.

(iii) Bonds issued for property. If a bond is issued for property, the adjusted applicable Federal rate, as determined under section 1288, is used in lieu of the applicable Federal rate to determine the bond’s issue price under section 1274.

(iv) Reliance on information provided by underwriters.

(A) An issuer is entitled to rely conclusively upon information provided by an underwriter relating to issue price determinations made under paragraph (f) with respect to bonds sold by such underwriter if such reliance is reasonable. An issuer’s issue price determinations made upon information provided by an underwriter are conclusive with respect to only such issuer so long as the issuer does not have actual knowledge that such information is inaccurate.
(B) An underwriter may rely upon information provided by another underwriter with respect to issue price determinations under paragraph (f) provided such information is reasonable.

(v) Pricing time. Pricing time means the time selected by the issuer, provided that the pricing time:

(A) must be not earlier than the time that the underwriter commits to purchase bonds at determined interest rates and other payment terms and a determined purchase price, subject to reasonable deviations in the par amount of a bond to be sold not exceeding 10% of the par amount of the bond;

(B) must not be later than the end of the sale date;

(C) must be memorialized within one hour in a written document or certificate signed by an underwriter; and

(D) must be covered by an underwriter certification, provided no later than the issue date of the bonds, that the selected pricing time meets the requirements set forth above, which certification the issuer does not have any reason to believe is not true.

(vi) Market change. The term market change means any qualitative or quantitative variation in considerations that may reasonably result in the change of a price of a bond, and includes (but is not limited to) changes in interest rates and interest rate indices, economic factors that affect (or may reasonably be expected to affect) the credit quality of an obligor, and political factors that may affect an obligor, as certified by an underwriter or a municipal advisor (within the meaning of 17 C.F.R. § 240.15Ba1-1(d)(1)(i)).

Section 1.150-1:

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(b)*** Issue price means issue price as defined in section 1.148-1(f).

****

(f) Measurement of Amount of Bonds. With respect to the original issuance of bonds, references to anticipated amount of bonds, aggregate face amount of bonds and stated principal amount of bonds shall be treated as referring to issue price, unless the context clearly indicates otherwise.

****

Section 1.1273-2(d)(3):
**** (3) **Tax-Advantaged Bonds.** Solely for purposes of sections 103 and 141-150, an issuer may elect to treat the issue price of a debt instrument issued in a debt-for-debt exchange as its stated redemption price at maturity. Such election must be in writing on or before the issue date of the exchanged instrument.
APPENDIX B

COMMITTEE COMMENTS ON 2013 WITHDRAWN REGULATIONS

(Attached)
January 23, 2014

Hon. John Koskinen  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20024

Re: Comments Concerning the Definition of Issue Price for Tax-Exempt Bonds and Other Tax-Advantaged Bonds

Dear Commissioner Koskinen:

Enclosed are comments concerning the definition of issue price for tax-exempt bonds and other tax-advantaged bonds. These comments represent the view of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Michael Hirschfeld  
Chair, Section of Taxation

Enclosure

cc: Mark J. Mazur, Assistant Secretary (Tax Policy), Department of the Treasury  
William J. Wilkins, Chief Counsel, Internal Revenue Service  
Emily S. McMahon, Deputy Assistant Secretary (Tax Policy), Department of Treasury
These comments (the "Comments") on certain portions of Proposed Treasury Regulation section 1.148-1 are submitted on behalf of the American Bar Association Section of Taxation (the "Section") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Arthur Anderson of the Committee on Tax-Exempt Financing (the "Committee"). Substantive contributions were made by Faust Bowerman, Stefano Taverna, Christie Martin, Robert Kaplan and Mark Norell. The Comments were reviewed by Nancy M. Lashnits, Chair of the Committee, and by Frederic L. Ballard, Jr., reviewer for the Committee on Government Submissions, and Bahar Schippel, Council Director for the Committee.

Although the members of the Section who participated in preparing these Comments have clients who might be affected by the Federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact: Arthur E. Anderson II
Phone: (804) 775-4366
Email: aanderson@mcguirewoods.com
Date: January 23, 2014
EXECUTIVE SUMMARY

On September 16, 2013, the Internal Revenue Service (the "Service") and the United States Treasury (the "Treasury") published in the Federal Register proposed regulations1 on the arbitrage restrictions under section 1482 applicable to tax-exempt bonds and other tax-advantaged bonds. These Comments relate only to the portions of the proposed regulations related to the changes to the current definition of issue price, which is found in Regulations section 1.148-1 (the "Existing Regulations").3 Hereinafter such portions of the proposed regulations will be referred to as the "Proposed Regulations." The Section is submitting separate comments on other aspects of the proposed regulations, including provisions relating to working capital expenditures, grants and treatment of qualified hedges.

As used herein, the terms "tax-advantaged bonds" and "bonds" encompass all of the tax-exempt and other tax-advantaged bonds to which the Proposed Regulations will apply, if finalized.4

For the following reasons, the Committee respectfully requests that the Proposed Regulations be withdrawn and that any other changes to the Existing Regulations be re-proposed. The Proposed Regulations do not properly assess the significance of the perceived problems with the Existing Regulations nor do they reflect a cost-benefit analysis of replacing the "reasonable expectations" provision of the Existing Regulations with the "actual facts" approach of the Proposed Regulations. The Committee believes that the changes to long-established market practices will harm intergovernmental comity and will increase rather than diminish uncertainty for issuers and other market participants. Therefore, the Existing Regulations should not be replaced by the Proposed Regulations. However, the Existing Regulations could be improved as recommended in comments submitted by the Section in 2010 and attached hereto as Appendix A.

If the Service and Treasury decide to adhere to an actual facts approach, the Committee suggests a number of changes and additions to be made to the Proposed Regulations to retain certain critical benefits of the Existing Regulations.

2 References to a "section" are to a section of the Internal Revenue Code of 1986, as amended, unless otherwise indicated.
3 Reg. § 1.148-1.
4 Prop. Reg. § 1.150-1(b), 78 Fed. Reg. 56,842 (2013), defines a "tax-advantaged bond" to mean:

[A] tax-exempt bond, a taxable bond that provides a Federal tax credit to the investor with respect to the issuer's borrowing costs, a taxable bond that provides a refundable Federal tax credit payable directly to the issuer of the bond for its borrowing costs under section 6431, or any future similar bond that provides a Federal subsidy for any portion of the borrowing costs. Examples of tax-advantaged bonds include qualified tax-credit bonds under section 54A(d)(1) and build America bonds under section 54AA.
I. RETAIN THE EXISTING REGULATIONS

A. Introduction.

For all types of tax-advantaged bonds, the issue price is the starting point for determining compliance with all arbitrage-related matters. It is also the starting point for determining compliance with other key requirements applicable to certain types of tax-advantaged bonds, including those relating to volume cap, private business use limitations and the restrictions on bond-financed costs of issuance. For "direct pay" tax-advantaged bonds such as "build America bonds" issued under section 54AA and section 6431, issue price determines whether an issuer has complied with the premium limit and, thus, along with other provisions, whether the issuer is entitled to receive the subsidy from the U.S. Treasury. 5

Section 148(h) provides that the "yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274)." The Existing Regulations define issue price as follows:

Issue price means, except as otherwise provided, issue price defined in section 1273 and 1274. Generally, issue price of bonds that are publicly offered is the first price at which a substantial amount of bonds is sold to the public. Ten percent is a substantial amount. The public does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers. The issue price does not change if part of the issue is later sold at a different price. The issue price of bonds that are not substantially identical is determined separately. The issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price. If a bond is issued for property, the applicable Federal tax-exempt rate is used in lieu of the Federal rate in determining the issue price under section 1274. The issue price of bonds may not exceed the fair market value as of the sale date. 6

The "reasonable expectations" provision of Existing Regulations allows the final determination of the issue price of an issue of tax-advantaged bonds on the sale date. Thus, the issuer will know, on the sale date, whether the tax-advantaged bonds will satisfy the many requirements that depend on the issue price. Having a final issue price on the sale date also enables the issuer to make many calculations required for compliance with tax law (such as the yield on the bonds), which can be critical if yield-restricted investments are being purchased.

The Proposed Regulations would amend the issue price definition in a number of significant respects. Most importantly, the Proposed Regulations would base the determination of issue price on actual sale prices to the public instead of on reasonably expected sale prices. The Proposed Regulations would also remove the definition of "substantial amount" as ten percent. Instead, the Proposed Regulations would provide a safe

6 Reg. § 1.148-1(b).
harbor under which an issuer may treat the first price at which a minimum of 25 percent of the bonds of a maturity is actually sold to the public as the issue price, so long as all orders at this price received from the public during the offering period are filled (to the extent that the public orders at such price do not exceed the amount of bonds sold). The actual facts approach would eliminate, for a standard publicly-offered, tax-advantaged bond issue, the ability to determine with certainty whether the issue complies with tax provisions dependent on the issue price until after the sale date.

The "reasonable expectations" standard of the Existing Regulations does not require an issuer to delve into the intent of any particular purchaser of its tax-advantaged bonds. Issuers can form and rely on reasonable expectations about both the price at which the bonds will be sold and the identity and intent of the potential bond purchasers. In apparent recognition of this problem, in the Proposed Regulations the Service and Treasury attempt to clarify and simplify the distinction between a purchaser who is a member of the public and a purchaser who is not. The Proposed Regulations define the term "public" to mean any person other than an "underwriter." "Underwriter" is defined to mean any person that purchases bonds from the issuer for the purpose of effecting the original distribution of the bonds, or otherwise participates directly or indirectly in the original distribution. An issuer will find it fairly easy to identify as underwriters the financial firms with which it has a contractual relationship, such as, for example, through a bond purchase agreement. Under the Proposed Regulations, however, issuers would be required to determine intent in assessing purchases by security dealers and others who are not part of the underwriting syndicate, who may be acting "for the purpose of effecting the original distribution of the bonds."

B. Identifying the Problems and Assessing Their Significance.

The legislative history of Section 148(h) is clear. In enacting the provision as part of the Tax Reform Act of 1986, Congress intentionally overturned State of Washington v. Commissioner, 692 F.2d 128 (D.C. Cir. 1982), which held that an issuer's calculation of arbitrage yield should reflect the "all-in" costs of its borrowing, including the underwriter's compensation and the other costs of issuance. The underwriter's discount or commission is a major component of the costs of issuance for the issuer of any publicly-offered, tax-advantaged bond issue. Including costs of issuance in the issue price raises the issue price, and a higher issue price for a given principal amount of tax-advantaged bonds lowers the arbitrage yield thereon. Section 148(h) in effect prohibits an issuer from increasing the arbitrage yield on its bonds to recover the costs of issuance through the investment of bond proceeds at the higher yield.

The preamble to the Proposed Regulations identifies the problems the Service and Treasury see with the Existing Regulations. First, the preamble asserts that the ten percent standard does not always produce a representative price for tax-advantaged bonds due to the execution by underwriters of the first ten percent of the sale of a maturity of the bonds at the lowest price (and thus the highest yield) of the range of prices being offered. In other words, there is not a "bona fide public offering" of all of the bonds of the maturity at the stated issue price. Second, the public availability of certain actual pricing information on the Internet—most importantly through the Electronic Municipal Market Access ("EMMA") platform
developed by the Municipal Securities Rulemaking Board (the "MSRB")—has led the Service and Treasury to question the ability of the reasonable expectations standard of the Existing Regulations to produce a representative issue price. The reported trade data has shown, in certain instances, actual sales to the public that differ significantly from the reasonably expected issue price. Third, the reported trade data has also shown sales to underwriters and security dealers being counted as sales to the public. Essentially, the Service and Treasury believe that the Existing Regulations are facilitating the understatement of the issue price of tax-advantaged bonds and the underwriter's compensation, producing an arbitrage yield higher than Section 148(h) permits.

Although the problems are adequately identified, the preamble fails to assess the significance of the problems. For example, it does not assess the loss to the Federal government resulting from lower rebate payments or higher subsidy levels. An underwriter who is holding back a portion of a maturity of tax-advantaged bonds may be faced with selling at a loss if the market moves away from it. An intermediary purchasing bonds on the sale date with the intent to "flip" them before the issue date may be in the same position. The reality is that markets go down as well as up.

Compounding the failure to assess the significance of the problems is the mislaying of the burden of fixing the problems. All three of the problems identified in the preamble – not making a bona fide public offering of all of the bonds of a maturity at their stated issue price, significantly different actual sale prices, and sales to "flippers" being counted as sales to the public — stem from the actions of underwriters and securities dealers. Issuers have little incentive or ability to control or alter the actions of these other market participants. The Existing Regulations should not be abandoned without a complete consideration of whether there are other tools available (such as MSRB or SEC rules) to address the problems without placing the burden on issuers.

C. Cost/Benefit Analysis.

The Service and Treasury should ascertain whether the benefits of the Proposed Regulations would be greater than the costs. If an issuer decides to eliminate the possibility of unsold maturities on the sale date, it will be forced to accept lower prices and higher yields

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7 The Committee will make several references to Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (October 4, 1993) ("EO 12866"). In EO 12866 President Clinton set forth the principles to which Federal agencies are to adhere in promulgating regulations. One of these principles requires Federal agencies not only to identify the problem intended to be addressed by a regulation, but also to assess the significance of that problem. On January 18, 2011, President Obama issued Exec. Order No. 13,563, 76 Fed. Reg. 3821 (January 21, 2011), to reaffirm and supplement EO 12866. President Obama made no substantive changes to any of the regulatory principles of EO 12866.

8 In developing a regulation, EO 12866 requires a Federal agency to: [continued on next page]

[A]ssess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs….
in negotiated underwritings. In order to ensure that no unsold maturities exist, underwriters will have less incentive to market bonds aggressively. They will instead accept lower prices and higher yields just so bonds can be "put away" on the sale date. Due to the nature of competitive sales, it is virtually impossible to eliminate the possibility of unsold maturities. Underwriters in competitive sales cannot know whether they will have the opportunity to purchase bonds until the sale date, which discourages pre-sale marketing of those bonds. Alternatively, if the issuer determines to continue to sell its bonds as such sales occur in the current market, where the possibility of unsold maturities exists, the issuer will be forced to incur additional legal and financial advisory costs in attempting to determine issue price based on actual sales to the public. Additional bonds are likely to be issued to cover the higher costs. The Service and Treasury should determine whether the benefits of ascertaining what they believe to be a more accurate representative price of bonds may be offset by (i) the higher bond interest rates produced by discouragement of market pricing through competitive sales and the other ways in which the Proposed Regulations may narrow the market, and (ii) the higher fees paid to financial advisors and legal counsel because of the additional analyses that will need to be performed under the Proposed Regulations.

D. Effects on State and Local Governments.

Recent years have been difficult for State and local governments. Their finance staffs are currently thin and suffer from high rates of turnover. The Service and Treasury should consider the administrative burden that would be imposed on State and local finance officials if they are required to obtain, evaluate and apply the information about the identity of bond purchasers and pricing necessary to satisfy the actual sales standard in the Proposed Regulations.9

The burden could be particularly acute, and compliance may be impossible in the short-term, if issuers are required to determine the intent of a market participant (including participants with whom there is no privity of contract) in purchasing bonds—in other words, whether the purchaser is purchasing bonds for the purpose of effecting the original distribution of the issue. Although EMMMA has clearly made pricing in the tax-advantaged bond market more transparent, it is not possible to ascertain a purchaser's intent through EMMMA. The Committee's understanding is that EMMMA was designed to provide general market transparency and that it was not designed to serve as a tool to establish issue price. The use of EMMMA to gauge issue price can lead to erroneous conclusions. Therefore, State and local governments will likely be forced to add personnel or spend more money on lawyers and financial advisors to perform the due diligence needed to make the determinations of intent. These issues must be viewed in light of the fact that for governmental bond issues,

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9 EO 12866 requires Federal agencies to be sensitive to the views of State, local and tribal governmental entities. In developing a regulation, an agency must:

[A]ssess the effects of Federal regulations on State, local, and tribal governments, including specifically the availability of resources to carry out those mandates, and seek to minimize those burdens that uniquely or significantly affect such governmental entities, consistent with achieving regulatory objectives. In addition, as appropriate, agencies shall seek to harmonize Federal regulatory actions with related State, local, and tribal regulatory and other governmental functions....
only the yield would change as a result of the application of the Proposed Regulations. Neither the amount nor the timing of the debt service to be paid by the issuer nor the net proceeds to be received by the issuer at issuance would be affected by assigning bonds a higher issue price and thus a lower arbitrage yield for events occurring after the sale date.

In addition, the Committee believes that competitive sales will be difficult under the Proposed Regulations. Competitive sales generally ensure the lowest cost of capital for issuers (and hence minimize the arbitrage yield). Competitive sales are also required by the law of a significant number of States.\textsuperscript{10}

The actual facts regime of the Proposed Regulations requires a protracted and continual tracking of actual sales of bonds and the determination of which purchasers are or are not underwriters. The possibility that the arbitrage yield on an issue could change after the sale date will require issuers to put additional cushion in the savings and other parameters in their authorizing resolutions if they are so permitted by State law. Furthermore, while the Proposed Regulations permit issuers to make a yield reduction payment in connection with advance refunding escrows the yield of which would exceed the yield on the bonds, issuers will certainly face additional costs in computing the yield reduction payments and many issuers may not have the funds to make any such payments. Overburdening State and local governments with the actual facts regime of the Proposed Regulations would be harmful to intergovernmental comity.

E. Reducing Uncertainty.

The greatest virtue of the Existing Regulations is certainty. Issuers are able to calculate the issue price and arbitrage yield on the sale date. Advance refunding issues can be verified, and refunding escrow securities can be locked in well before the closing date. Practitioners have also relied on the Existing Regulations to test compliance with many other tax and structuring requirements, such as whether the issuer has sufficient volume cap or has properly sized a debt service reserve fund. Official statements can be finalized in a timely manner. Furthermore, the certainty provided by the Existing Regulations allows issuers to proceed to closing with the knowledge that the sale date number runs would conclusively show compliance with the bond authorization parameters. For example, under the Existing Regulations an issuer can award bonds and purchase a refunding escrow on the sale date with the certainty of compliance with an authorizing resolution that requires a showing of a three percent present value debt service savings. The Proposed Regulations do not provide such level of certainty, and the Committee does not believe that the Service and Treasury have made the case that the savings either to the Federal government or to issuers will be sufficient to justify the loss of certainty.

F. Section II Conclusion: Retain the Existing Regulations.

The Committee believes that the Proposed Regulations should not be adopted.

The Committee acknowledges that the Existing Regulations would benefit from additional guidance to make them work more effectively. In this regard, the Committee references the comments on the definition of issue price submitted by the Section in 2010, a copy of which is attached as Appendix A. The Committee would welcome the inclusion in a re-proposed issue price definition of any or all of the suggestions set forth in the 2010 comments.

II. COMMENTS ON THE PROPOSED REGULATIONS

A. Introduction.

If the Service and Treasury decide to abandon the Existing Regulations, the Committee proposes the changes to the Proposed Regulations set forth below. The Committee respectfully requests that the market be given an opportunity to comment on any of these changes the Service and Treasury may determine to make and that such changes, along with the Proposed Regulations modified thereby, be re-proposed.

B. Twenty-Five Percent versus Ten Percent.

The 25 percent "substantial amount" safe harbor threshold is too high. Issuers will strive to achieve as much finality on the sale dates of their bonds as they can. The actual facts regime of the Proposed Regulations will result in issuers insisting on a demonstration by the underwriters that 25 percent of each maturity of an issue is actually sold to the public on the sale date. At times in the current market, the underwriter will not have actual sales of ten percent of each maturity on the sale date, much less 25 percent. The Committee believes that the narrowing of the market will result from the higher threshold, particularly when combined with the requirement to fill all orders for bonds at the safe harbor threshold price, and will drive up yields. The ten percent figure has been used for more than two decades by practitioners and market participants in the taxable market as well as by the tax-exempt market to establish how much of a particular maturity is a "substantial amount." 11 The removal of the substantial amount definition, therefore, affects not just the tax-exempt bond market, but also the taxable market. The Committee urges that the threshold remain at ten percent.

When a large number of substantially similar products, commodities or financial instruments (for example, multiple bonds of the same maturity) are offered for sale, there are likely to be multiple prices for such products, commodities or financial instruments. An increase in the substantial amount threshold from ten percent to 25 percent exacerbates this problem. If the Service and Treasury settle on the higher threshold, then it will be critically necessary to provide guidance on how issue price for a maturity is to be determined when multiple prices occur and less than 25 percent is actually sold at one price.

C. Competitive Sale Safe Harbor.

The Proposed Regulations surprisingly lack accommodation for competitive sales. Many issuers are required by the laws of their states to sell bonds competitively, and many others prefer competitive sales because they are believed to result in better bond pricing and streamlined procurement. Moreover, in competitive sales the issuer and the purchasers of the bonds do not have the same privity and contractual relationship that issuers enjoy in negotiated underwritings. This lack of accommodation is particularly surprising in light of past indications from the Service that the abuses observed in the determination of issue price, which were perceived occurring in negotiated transactions, were not apparent with competitive sales.

Given the compressed time periods and lower underwriting spreads in the competitive sale arena, the Committee believes that few competitive sales as currently configured will be able to satisfy the 25 percent safe harbor on the sale date. This may encourage issuers to choose the negotiated sale or private placement routes, if possible. This may have the unfortunate effect of raising tax-advantaged bond yields, harming both the Federal government and issuers.

The Committee urges the Service and Treasury to retain the basic reasonable expectations rules under the Existing Regulations for bond issues sold in competitive sales that meet requirements analogous to those for the establishment of fair market value prices for yield-restricted escrows and guaranteed investment contracts.

The Committee also urges the Service and Treasury to set the "substantial amount" threshold in competitive sales at the current market expectation — that is, ten percent — and to eliminate the requirement that all orders be filled at the stated offering price during the offering period. The nature of competitive sales simply does not permit the kind of pre-sale market testing that would encourage a bidder to take risks with the initial offering prices. Again, the Committee fears that yields will go up and harm both the Federal government and issuers.

D. Authorize Reliance on Certain Certificates.

The goal of an issuer in selling tax-advantaged bonds is to obtain the best possible pricing of debt instruments to finance a school, a municipal building or a road system. The issuer sells its bonds through underwriters and securities dealers because these intermediaries are in the business of finding bond purchasers and dealing with them. The Committee urges the Service and Treasury to add a provision to the Proposed Regulations, if finalized in their current form, authorizing an issuer to rely in good faith on a certificate from the managing underwriter or successful bidder regarding (i) the first price at which 25 percent of a maturity of tax-advantaged bonds is sold, (ii) the filling of all orders from the public at the first price during the offering period, and (iii) the identity of each underwriter of the bonds (including each "related party" underwriter). "Good faith" would mean the absence of abuse (for example, bid rigging, pay-to-play, or price-fixing) or actual contrary knowledge by the issuer.

In fact, underwriters, who are best positioned to know the facts surrounding any particular pricing, are already bound by MSRB standards dealing with factual representations.
The standards provide that "all representations made by underwriters to issuers of municipal securities in connection with municipal securities underwritings (e.g., issue price certificates and responses to requests for proposals), whether written or oral, must be truthful and accurate and may not misrepresent or omit material facts." Obtaining issue price representations, mostly written, is part of a well-established practice of bond tax counsel. In addition, the Committee supports specific identification rules, similar to those of section 1236(b) relating to dealer's identification of securities held for investment, so long as the responsibility for making the specific identification resides with the underwriters and securities dealers. Those identification requirements should remain with the market participants and can be used as evidence of truthfulness about the underwriter's representations.

The underwriters of a tax-advantaged bond issue have, or can cost-effectively obtain, the background needed to make the certifications necessary to satisfy the safe harbor issue price rule. Policing mechanisms exist to assure the veracity of the certifications. The Committee urges the Service and Treasury to make it clear that an issuer can satisfy the safe harbor issue price rules through good faith reliance on an underwriter's certificate.

E. Need for Actual Sales Price Data.

Although technological improvements (such as EMMA) are mentioned in the preamble to the Proposed Regulations, the text of the Proposed Regulations does not specify where an issuer is to obtain the information about the actual sales of its bonds. EMMA in its current form does not provide a viable solution, because of its various timing and misidentification problems, which have been mentioned above and discussed with the Service and Treasury in other contexts. EMMA can only serve as a tool to verify in some, but not all, cases, the certifications provided by paid professionals that are supposed to comply with securities laws. If the Service and Treasury require that the issue price of sales be based on actual facts, they should first make sure that issuers have access to the necessary data to comply or to verify the certifications of the underwriters. Prior to requiring that prices be based on actual sales prices, the Committee recommends that significant lead time be provided so as to ensure that databases (whether from EMMA, from underwriters or by other means) exist to ensure transparent and accurate information for compliance with the tax law. Additionally, the Committee recommends that prior to effectiveness of the Proposed Regulations, the Service review those databases to ensure that it is satisfied with the quality and sufficiency of the data.

F. Defined Safe-Harbor Offering Period.

The Proposed Regulations have the potential to create enormous uncertainty by the requirement to track — possibly long after the closing date of a bond issue — the actual sale prices of the bonds. This tracking may be necessitated by (i) the need to assure that even if

13 Reg. § 1.1236-1 clearly imposes the responsibility for identification of a security as "held for investment" on the securities dealer.
the required portion of a maturity of bonds is actually sold at the initial offering price, all orders for bonds of the maturity at the initial offering price during the "offering period" are filled, and (ii) situations in which less than the required threshold of the maturity is sold at the initial offering price. The Proposed Regulations do not define "offering period," but most market participants assume that it has the same meaning as under the securities laws. This means, for a particular maturity of bonds, a period ending on the date the underwriters no longer retain an unsold balance of the bonds for sale to the public. The end date need not correspond to the closing date of the issue.

In order to provide issuers some finality and certainty in the process of determining issue price, the Committee urges the Service and Treasury to include the concept of a defined safe-harbor offering period. This is, admittedly, a rough-justice approach, but it reflects the undeniable fact that markets go down as well as up in the two-week to four-week period between the sale date and the closing date of a typical governmental bond issue and certainly fluctuate after the closing date. The Service and Treasury should consider whether any net loss in terms of overstated yields will be negated by the cost of the bonds that will have to be issued to cover the additional issuance costs.

The Committee recommends that the offering period end six business days after the sale date. The six-day period is chosen for two reasons. First, six business days would always require the holding of the initial offering price or a position in the to-be-issued bonds over a weekend. Second, six business days would allow the final determination of issue price in time for the issuer to meet its obligation under SEC Rule 15c2-12 to deliver the final official statement within seven business days after the sale date. Such a rule would not only promote certainty but would also reflect that tax laws related to issue price do not operate in a vacuum. It would promote intergovernmental comity by dovetailing with the other regulatory guidelines with which issuers and underwriters must comply.

The Service and Treasury could alternatively consider defining the offering period by reference to the 13-day or 15-day periods established under Regulations Section 1.1275-1(f) or 1.150-1, even though this approach would not work as well with existing market requirements and practices as the six business day offering period. If two bond issues that are sold 15 days apart from each other are deemed to be separate issues, the Service and Treasury should view the sale of the second bond of a maturity 15 days after the sale of the first bond of the same maturity as not affecting each other.

The concept of a definite safe harbor offering period would also facilitate addressing the situation in which less than 25 percent (or ten percent) of a maturity can be sold at the initial offering price (or at the "first price," if different). If by the end of the safe-harbor period less than 25 percent (or ten percent) of a maturity is actually sold to the public, the issue price of that maturity should be the initial offering price at which that maturity was marketed to the public on the sale date in a bona fide public offering.
G. Bifurcated Rule.

If the concern of the Service and Treasury is that the yield on new money financings is too high based on the Existing Regulations, then they should consider finalizing the Proposed Regulations with a bifurcated rule under which refunding escrows would be subject to one rule and new money transactions, which include longer term investments in construction and acquisition funds, as well as reserve funds, would be subject to a different rule.

H. Non-Yield-Related Consequences of the Actual Facts Regime.

The Committee does not believe that issuers can adequately assess the potential consequences of the Proposed Regulations without knowing how the Service and Treasury intend to address the many other provisions of the Code the compliance with which is determined based on the issue price of the bonds. For example, the actual facts regime may not allow an issuer to secure adequate volume cap. In addition, the limits on costs of issuance may also be violated if the issue price becomes less than originally anticipated. This is the most important reason for the Committee's request that any change in the issue price definition be re-proposed.
APPENDIX A

(See Attached)
November 9, 2010

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Issue Price

Dear Commissioner Shulman:

Enclosed are comments on the determination of issue price applicable to tax-exempt bonds and tax credit and Build America bonds. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Charles H. Egerton
Chair, Section of Taxation

Enclosure

cc: Michael F. Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
William J. Wilkins, Chief Counsel, Internal Revenue Service
Jeffrey Van Hove, Acting Tax Legislative Counsel, Department of the Treasury
Bryon Christensen, Deputy Tax Legislative Counsel, Department of the Treasury
John J. Cross III, Associate Tax Legislative Counsel, Department of the Treasury
Clifford J. Gannett, Director, Office of Tax Exempt Bonds, Internal Revenue Service
Stephen R. Larson, Associate Chief Counsel, Financial Institutions & Products, Internal Revenue Service
James A. Polfer, Branch Chief, Branch 5, Financial Institutions & Products, Internal Revenue Service
ABA SECTION OF TAXATION
COMMENTS ON ISSUE PRICE

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Winnie Tsien of the Committee on Tax Exempt Financing of the Section of Taxation. Substantive contributions were made by Frederic L. Ballard, Jr.; David J. Cholst; Maxwell D. Solet; Jeremy A. Spector; Stefano Taverna; and Lorraine Tyson. The Comments were reviewed by John Swendseid, Vice-Chair of the Committee. The Comments were further reviewed by Clifford M. Gerber and David C. Garlock of the Section’s Committee on Government Submissions and by Andrew J. Dubroff, Council Director for the Tax Exempt Financing Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact: Winnie Tsien
Phone: (213) 612-2336
Email: wtsien@orrick.com

Date: November 9, 2010
Executive Summary

These Comments recommend that the determination of issue price under Regulation section 1.148-1(b) (the “Regulation”) be made permanently applicable to tax-exempt bonds and all tax credit and Build America Bonds.\(^1\) Making the Regulation permanent, and clarifying several of its aspects, would facilitate the determination of issue price for all such bonds, which would enhance compliance with the various Code requirements that depend in whole or in part on the issue price of bonds. Two important themes discussed in these comments are that (i) the Regulation allows for issue price to be determined on the sale date, and (ii) the Regulation provides that issue price can be determined under a reasonable expectations standard or by the first price at which ten percent of each maturity is sold.\(^2\)

These Comments recommend that issue price be established using the reasonable expectations of the managing underwriter in a negotiated sale (or of the successful bidder in a competitive sale) as of the time the prices of the bonds are agreed to by the issuer and the managing underwriter (or successful bidder). Those prices are appropriate because they best reflect the underwriter’s (or the successful bidder’s) expectations for the initial prices at which the bonds will be offered to the public and at which a substantial amount of each maturity of the bonds will be sold to the public. For this purpose, the expectations should relate to the sale price of the first ten percent of each maturity of the bonds.

The underwriting team is the most appropriate entity to determine the first price at which ten percent of each maturity of the bonds is actually sold to the public. The issuer has no contact with the buying public, and data that is available on public websites cannot be easily interpreted to identify the status of the buyers. Thus, these Comments recommend that the Regulation be interpreted to permit good-faith reliance on the certificate of the underwriting team as to first price at which ten percent of each maturity of the bonds was sold, or reasonably expected to be sold, to the public.

The process involved in a negotiated underwriting (or a competitive sale) supports a presumption that it reflects a bona fide public offering, absent actual knowledge by the issuer that a bona fide public offering was not made, or that clear abuse such as bid-rigging, pay-to-play, or price-fixing, occurred. Efforts by the issuer or underwriter to alter a bona fide process, by limiting its offering to only particular types of buyers, or by otherwise controlling the subsequent sales of bonds by the initial buyers, will increase inefficiencies and interest rates and likely harm taxpayers as much as the government. Thus, these Comments recommend that the Regulation support the presumption.

Financial institutions frequently buy bonds in a primary offering, and it is very difficult for the issuer to know whether those institutions (other than the members of the underwriting team with whom the issuer has a contract) are purchasing “in the capacity of underwriters or

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\(^1\) References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

\(^2\) References to a “maturity” of bonds means the portion of a bond issue that consists of “substantially identical” bonds within the meaning of the Regulation.
wholesalers” within the meaning of the Regulation, or as investors on their own behalf. Thus, these Comments recommend that the Regulation permit financial institutions to be treated as public buyers (i.e., not as underwriters or wholesalers) unless the underwriting team that has contracted with the issuer knows, based on a written contract or other agreement with the purchaser, that the purchaser is acting in the role as underwriter or wholesaler, and not as investor.
Issue Price

I. Introduction.

The issue price for tax-exempt bonds is determined pursuant to the Regulation. In 2009, Congress enacted legislation authorizing the issuance of Build America Bonds ("BABs"), of which certain BABs ("Direct Pay BABs") are eligible to receive a subsidy payment from the U.S. Government pursuant to section 6431. In 2010, Congress extended the same type of subsidy to "specified tax credit bonds" (collectively, with Direct Pay BABs, the "Direct Pay Bonds"). In response to questions regarding the rules applicable to determine the issue price of the Direct Pay Bonds, the Internal Revenue Service (the "Service") issued Notice 2010-35 (the "Notice"), stating, in part, that the Regulation will be used to determine the issue price of all Direct Pay Bonds until further notice. These Comments urge that the Regulation be permanently applied to determine the issue price of all Direct Pay Bonds as well as tax-exempt bonds. These Comments also recommend that the interpretation of certain components of the Regulation be confirmed.

II. Establishing Issue Price under Regulation section1.148-1.

A. Permanent Application of the Regulation to Establish Issue Price for All Bonds.

Section 148(h) provides that “yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274).” The Regulation further defines issue price as follows:

Issue price means, except as otherwise provided, issue price defined in section 1273 and 1274. Generally, issue price of bonds that are publicly offered is the first price at which a substantial amount of bonds is sold to the public. Ten percent is a substantial amount. The public does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers. The issue price does not change if part of the issue is later sold at a different price. The issue price of bonds that are not substantially identical is determined separately. The issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price. If a bond is issued for property, the applicable Federal tax-exempt rate is used in lieu of the Federal rate in determining

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4 Pub. L. No. 111-147, 124 Stat. 1029 (Hiring Incentives to Restore Employment Act of 2010). Such bonds include new clean renewable energy bonds defined in section 54C, qualified energy conservation bonds defined in section 54D, qualified zone academy bonds defined in section 54E and qualified school construction bonds defined in section 54F.
the issue price under section 1274. The issue price of bonds may not exceed the fair market value as of the sale date.\(^6\)

The Notice states that the Regulation will apply to Direct Pay Bonds for purposes of determining issue price. The Notice, however, also states that the Department of Treasury (the “Treasury”) and the Service continue to review the definition and may issue prospective guidance or changes to the definition. These Comments urge that the Regulation be permanently applied to determine the issue price of tax-exempt bonds and Direct Pay Bonds. In addition, if there are to be changes to the Regulation, tax-exempt bonds and Direct Pay Bonds should be subject to the same rules and the same changes.

Because issuers of Direct Pay Bonds and tax-exempt bonds are generally the same entities, providing the same issue price rule for them would enhance certainty and administrability. They are often issued at or about the same time to finance different portions of the same overall project and uniform rules will enhance compliance.

For tax-exempt bonds and Direct Pay Bonds, the issue price is the starting point for determining compliance with all arbitrage-related matters. It is also the starting point for certain other key requirements applicable to tax-exempt bonds, including those relating to volume cap, limitations on “private business use” and the limitation on costs of issuance with respect to private activity bonds (including qualified section 501(c)(3) bonds). For Direct Pay Bonds, the issue price determines whether an issuer is entitled to receive the subsidy from the U.S. Treasury by virtue of several additional requirements. Similar to tax-exempt private activity bonds, section 54A incorporates a limit on costs of issuance that may be financed with proceeds from the sale of an issue of Direct Pay Bonds.\(^7\) While issue price is not specifically mentioned, most practitioners apply the section 54A limit by reference to issue price. The Act further imposes a premium limit on BABs\(^8\) (and, under the Notice, to all Direct Pay Bonds), and this limit also applies by reference to issue price. Further, most practitioners use the issue price for measuring compliance with the volume cap limits applicable to Direct Pay Bonds other than BABs.

The Regulation provides a method of determining the issue price as of the sale date of bonds. This methodology is very important for issuers of tax-exempt bonds and Direct Pay Bonds as well as their advisors. It enables the parties to know, on the sale date, whether the sale of bonds will satisfy the many requirements for Direct Pay Bonds that depend on the issue price. Finality regarding issue price on the sale date also enables the issuer to make many calculations required for compliance with tax law (e.g., the yield on the bonds), which can be critical if yield-restricted investments are being purchased.

Allowing the long-established issue price rule under the Regulation to be used for all bonds would be consistent with the stated Congressional intent of assisting municipal issuers in their financial planning and operations. It would also avoid the market uncertainty that would

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6 Reg. § 1.148-1(b).
8 I.R.C. § 54AA(d)(2)(C).
result from a different rule for Direct Pay Bonds that would perhaps threaten the continued viability of such bonds in some situations, even if based on an existing rule under another Code provision.

B. Reasonable Expectations Regarding the Initial Public Offering Price.

In addition to providing a general framework for establishing issue price, the Regulation provides a narrow, specific safe harbor through a series of declaratory rules. One such safe harbor in the Regulation, but not in section 1273, is that “the issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price.”

“Reasonable expectation” is provided as an alternative to the actual sales price rule set out in the second sentence of the Regulation. The use of reasonable expectations in establishing the issue price of tax-exempt bonds has been vital in many instances. Reasonable expectations are especially important where the actual sale price of the bonds cannot be obtained or accurately determined on the sale date (e.g., if ten percent of a maturity of the bonds was not sold on the sale date).

1. Reasonable Expectations Are Established at the Time of Offering.

While the Regulation permits the use of reasonable expectations to establish the issue price of publicly offered bonds, it does not provide further guidance or limits on which expectations are the most reasonable. Underwriting or selling the bonds is a fluid process. An underwriter or a bidder in a competitive sale—which is the entity on whose expectations an issuer will be relying—may change its expectations as to the offering prices of bonds throughout the process, and all of the different expectations may be reasonable. These Comments recommend that the proper time to measure one’s reasonable expectations as to the initial offering price for purposes of establishing the issue price of bonds is when the issuer’s representative and the managing underwriter agree to a price in a negotiated sale (or when the issuer’s representative in a competitive offering has agreed to the prices in the successful bid), rather than any other time (e.g., the time of execution of a bond purchase agreement, the formal award of bonds at a competitive sale, or the end of the day of sale).

As part of the typical underwriting process in a negotiated sale, an underwriter conducts its due diligence on the market in which the bonds will be offered, in large part through conversations with potential buyers. This “pre-sale” period can vary in time and scope, depending on the bonds to be sold, the timing and any factors unique to the issuer or the underwriter. Practitioners generally understand that the following events occur on the sale date (albeit, not always in this order): (i) the bond offering prices are established, sometimes as adjusted from the prices previously considered during the pre-sale period, and at other times by confirming expected trades between the underwriter and buyers; (ii) the issuer and the underwriter execute a bond purchase agreement (“BPA”), agreeing to the prices at which the underwriter will acquire the bonds from the issuer; and (iii) sales are “ticketed” (i.e., bonds are promised to be delivered to the buyers). In the typical series of events, the public offering could be viewed as occurring as early as the beginning of the sale date, and any subsequent period prior to the execution of the BPA.
Potential purchasers in a typical competitive sale will bid individually or as part of a syndicate. There are often no pre-sale orders because there is no assurance any one bidder will win the bid. Bidders put forth their best bid, usually in the form of the lowest interest cost, and the issuer selects the winner based on the lowest cost, taking into account premium credited to, or discount charged to, the issuer. There is no requirement that compensation be disclosed before the winning bid is awarded. A purchaser will normally bid the lowest cost possible to win the bid and still resell the bonds to the public at a reasonable profit.

Potential bidders undergo a process similar to a negotiated sale, although it may involve less effort because no bidder knows whether it will be the actual underwriter until the bids are opened and the bonds are awarded. Each bidder formulates a bid based on its own reasonable expectations regarding the initial public offering price at which it expects to sell the bonds. The bidder hopes to make a profit by buying from the issuer and selling at a higher price in the market. The bid, if accepted, establishes the prices at which the bidder will buy the bonds from the issuer. Once the bids are opened, the successful bidder is notified that the formal award has been made to that bidder, and that bidder can formally offer the bonds in the market (i.e., sales can be “ticketed”).

Both underwriters in negotiated sales and purchasers in competitive sales typically re-offer bonds to investors pursuant to procedures that are transparent and intended to comply with securities laws. They establish the reoffering prices of the bonds based on their reasonable expectations as to the sale prices. Purchasing through a competitive process ensures that bonds are sold at the lowest cost to the issuer, hence reducing yield to the most competitive level.

The foregoing underwriting and competitive sale processes imply that reasonable expectations as to the issue price are the prices incorporated into the BPA or accepted in a competitive sale. The time to measure whether those prices reflect reasonable expectations should not be the end of the sale date, as that can be many hours after the underwriter or the bidder has established the initial offering prices. The time of actual execution of a BPA is also an inappropriate measure of reasonable expectations because execution is usually driven by the availability of someone authorized to sign the contract, and this timing has no connection to expectations regarding how the bonds will be sold to the public.

These Comments recommend that the Regulation be interpreted to provide that the issue price is established using the reasonable expectations of the managing underwriter in a negotiated sale, or of the successful bidder in a competitive sale, as of the time the prices of the bonds are agreed to by the issuer’s representative and the managing underwriter or successful bidder.

2. Reasonable Expectations to Sell First Ten Percent of Each Maturity.

The Regulation, which permits the use of reasonable expectations of an underwriter (or a bidder) for purposes of establishing issue price of a publicly offered debt instrument, does not provide guidance on the scope of applicability of the expectations. Based on the entire context of the Regulation, the issue price should be established using the price at which an underwriter (or a successful bidder) reasonably expects to sell a substantial amount (i.e., at least ten percent) of each substantially identical group (or each maturity) of bonds to the public.
C. The First Ten Percent Sale Price to Establish Issue Price.

The Regulation also provides that issue price may be established using the first price at which a substantial amount of each maturity of the bonds is sold to the public. While not addressed in section 1273, the Regulation affirmatively states that a “substantial amount” is ten percent. Therefore the bright line of ten percent is available to unequivocally establish the issue price of bonds that are eligible for this rule. Indeed, the Regulation states that, once the issue price is established, a subsequent sale at a different price does not affect the issue price.

Publicly available trade data is imperfect. In addition to the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access System (“EMMA”) website, which is specifically referenced in IRS Form 14127, the “investinginbonds” website is a source of trading data and financial professionals also often subscribe to the Bloomberg wire services for trade information on bonds. Each website has its own independent reporting and posting rules, but each depends on financial institutions to timely supply complete and accurate trade information. In addition, different websites provide different and limited information. For example, EMMA only identifies whether a sale is one made to a “customer” or is an “inter-dealer trade.” Inter-dealer trades on EMMA do not distinguish between trades with the intention to hold for investment purposes and trades for immediate resale. In some cases, trades recorded as “inter-dealer” trades are, in fact, trades to the “public” because the dealer-purchaser is purchasing on behalf of a true investor that is not a bond house. Sales to the public are complicated because they may have varying, embedded commissions, and the failure of the fixed income bond market to require separate reporting of commissions adds to the complexity and lack of transparency. Therefore, interpretational leaps are required for a user to draw conclusions from the publicly available data.

Only the underwriting team knows if at least ten percent of a maturity has been first sold at a specific price, because some informational websites do not track sales of specific bonds within each maturity, and some sites (including EMMA) only report trades of bonds by date, amount and type of transaction. Therefore, only the underwriter, as the initial seller of the bonds to the marketplace, knows the identities of the purchasers and the first price at which at least ten percent of a maturity is sold. Given the underwriter’s access to information and control over the process, a certification by the underwriter regarding the first ten percent sale price should establish the issue price of bonds that are publicly offered, absent abuse, such as bid-rigging. While a review of public trade data may lead to further conversations with an underwriter, that data alone should not overcome the presumption of the underwriter’s certification. These Comments recommend that the Regulation be interpreted to allow the issuer to rely on a certificate of the underwriter as to its reasonable expectation to sell at least ten percent of each maturity of the bonds to the public at its initial offering price, absent abuse such as bid rigging or lack of a bona-fide, public offering (discussed below).

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9 This site can be found at [http://www.emma.msrb.org](http://www.emma.msrb.org).

10 This site can be found at [http://www.investinginbonds.com](http://www.investinginbonds.com).

11 Trades posted at the same time on EMMA are sometimes re-ordered when reviewed at a later time or date.
D. Definition of “Public” in Public Offering and Sale

The recommendations regarding reliance on the issue price rules in the Regulation and section 1273 are premised on the bonds being “publicly offered.” The sale process, as previously described, encourages a public offering, and a public offering is commonly required in the BPA between the issuer and an underwriter, or as a term in the notice of sale for a competitive sale. An issuer may be unable to do anything further to ensure a public offering.

1. Presumed Public Offering Absent Abuse or Knowledge.

An underwriter (or the winning bidder in a competitive sale) commonly is subject to an obligation or covenant to publicly offer the bonds it purchases from the issuer. Given the transparency of the process, a sale of bonds by an issuer through a negotiated underwriting (or a competitive bid) should be presumed to be a bona-fide public offering, absent clear abuse or actual contrary knowledge by the issuer. For example, practices such as bid-rigging, pay-to-play, or price-fixing would overcome the presumption, as would the issuer’s actual knowledge that a public offering did not occur (e.g., where the cover page of the Official Statement lists one or more maturities as “not re-offered” (or “NRO”)), but the mere sale of a bond at a price different from the offering price should not be viewed as evidencing the absence of a bona-fide public offering.

One indicator of a public offering is whether the public was actually able to purchase the bonds at the offering prices. Actual sales of bonds to the public would confirm that bonds were indeed offered to the public. It is customary for underwriters to send out an “offering wire” to the market, offering bonds at stated prices for anyone to buy at those prices. But offering the bonds for sale is not the same as actually selling the bonds. A public offering can occur without regard to the actual results. Public buyers can acquire and resell bonds on the sale date or other dates; financial institutions can acquire bonds for their own investment purposes for a short, intermediate or long timeframe; and, financial institutions can also buy for resale. It is important to re-emphasize that trades at different prices, alone, do not evidence lack of a public offering.

Absent a contractual agreement or understanding with the buyer, the underwriter cannot control the resale prices. The issuer has no control over the prices at which anyone other than the underwriter sells the bonds, because it only has a contract with the underwriter. The underwriter may be able to control the prices at which others in the underwriting syndicate or distribution group sell the bonds for a relatively short period of time. But, after the bonds leave the underwriter (and any syndicate or distribution group), even the underwriter loses control over prices, and market conditions thereafter dictate price increases or decreases. Bond prices can also be influenced by a particular seller’s need to sell quickly, a particular buyer’s need to purchase at a particular price or on a particular date, and a variety of other factors.

The Treasury and the Service might be concerned that an underwriter will intentionally withhold bonds from the initial sale, or sell them to select wholesaler buyers that will resell them (perhaps immediately) at higher prices. An issuer’s only recourse is based on its BPA with the

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12 The meaning of the term “public” is discussed further in the “Definition of the Public” discussion, below.
underwriter (or agreement with a bidder in a competitive sale—through contract or through the notice of sale) in which the underwriter (or the winning bidder) commits to publicly offer the bonds. The issuer’s lack of control necessitates its reliance on the underwriter’s certification and the prices shown on the official statement or other publically disseminated offering documents for the bonds. We understand that organizations such as the Municipal Securities Rulemaking Board (the “MSRB”) and the Financial Industry Regulatory Authority have jurisdiction to monitor fairness of pricing of underwriters.13

Indeed, the MSRB has recently promulgated new amendments to MSRB Rules G-8 and G-11 to assist in assuring public access to bonds in initial offerings and fairness in the public offering process.14 According to the release (the “Release”) by the Securities and Exchange Commission (the “SEC”) approving the amendments, the “proposed amendments to Rule G-11 would: (1) apply the rule to all primary offerings, not just those for which a syndicate is formed; (2) require that all dealers (not just syndicate members) disclose whether their orders are for their own account or a related account; and (3) require that priority be given to orders from customers over orders from syndicate members for their own accounts or orders from their respective related accounts, to the extent feasible and consistent with the orderly distribution of securities in the offering, unless the issuer otherwise agrees or it is in the best interests of the syndicate not to follow that order of priority.”15 Moreover, “[t]he Commission believes the proposal will help achieve a broader distribution of municipal securities while still providing sufficient flexibility to syndicate managers and sole underwriters, and further believes that investors would benefit from a broader distribution of securities that is fair and reasonable and consistent with principles of fair dealing.”16

In addition, a competitive sale that meets all of the state law and securities law requirements for competitive bidding should by itself establish a “public offering” of all of the bonds, at least in the absence of a clear abuse (e.g., bid-rigging, pay-to-play, or price-fixing) or actual contrary knowledge by the issuer. A competitive sale should eliminate a possible Service concern that, in a negotiated sale, bonds may be held back by the underwriter for later resale or for sale to preferred customers who might be brokers.17 The bidder in a competitive sale has no assurance that it will be able to buy the bonds from the issuer. This uncertainty reduces the likelihood that a bidder will have side arrangements that are contingent upon winning the bid when any other broker or wholesaler can also bid on the issuer’s sale. Accordingly, these

13 Also, section 6700 provides that penalties may be imposed on any person who participates in, among other things, an investment plan or arrangement and makes a “statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter. . . .”

14 See File No. SR-MSRB-2009-17 (November 8, 2009), as amended by Amendment 1 to File No. SR-MSRB-2009-17 (August 4, 2010). Both documents were approved by the Securities and Exchange Commission August 16, 2010, and are effective October 12, 2010.


16 Id.

17 See Proposed Internal Revenue Service Form 14127, Question 4.
Comments recommend that, absent clear abuse or actual contrary knowledge by the issuer, a competitive sale be treated as a bona-fide public offering, with the reasonable expectations of the winner of the competitive bid to sell at least ten percent of each maturity of the bonds it was awarded establishing the issue price.

2. Public Offering Should Not Exclude Anyone.

Neither the Regulation, nor the issue price rule in section 1273 and its underlying Regulations, requires that a public offering exclude bonds houses, brokers or others that are not considered part of the public. While the only sales that establish issue price are sales to the public, the offering should be open to all buyers. The issue price can still be properly established under the Regulation in such a public offering.

An issuer has limited options to control the underwriting and selling process, and any controls might disrupt the market and result in unintended consequences. If an issuer narrowed its pool of purchasers to those covenanting not to resell their bonds for a specified time period, the issuer’s cost (and the corresponding subsidy paid by the Treasury with respect to the Direct Pay Bonds) would increase. Alternatively, if an issuer limited the prices at which the underwriter or the initial purchaser may sell or resell their bonds, again, the issuer’s cost (and the corresponding subsidy paid by the Treasury) would increase. These limitations would create further inefficiencies by being less “public,” due to participation being restricted to only select or pre-screened parties. Moreover, state law often requires the issuer in a competitive sale to accept the lowest interest-rate bid, thereby depriving the issuer of legal authority to impose conditions on the bond purchasers.

3. Definition of Public.

There has historically been some uncertainty about what constitutes the public in the context of a public offering. The term “public” is explained in the Regulation by reference to what is not the public. The Regulation excludes “bond houses, brokers, or similar persons or organizations acting in the capacity as underwriters, or wholesalers.”

The “acting in the capacity” requirement in the Regulation can be interpreted either (i) to apply to bond houses, brokers and all other persons or organizations similar to bond houses or brokers that have the capacity to act as underwriters or wholesalers, or (ii) to apply only to entities (bond houses, brokers or “other persons or organizations”) actually acting in the capacity of underwriters or wholesalers in a particular bond sale (and, presumably, other bond houses and brokers are not excluded from the “public” in that transaction). These Comments recommend that the phrase “acting in the capacity of an underwriter, or wholesaler” be interpreted as modifying “bond houses”, “brokers,” and “other persons or organizations” so that a sale to a bond house or broker is disregarded only if the bond house or broker is actually acting in such capacity or it is acting as a member of the underwriting syndicate or distribution group. A

18 (Emphasis added.)

19 For example, a bond house can be both an investor and an intermediary, and its role, from the time of bond sale, may not be clear and also may change quickly thereafter.
contrary reading would exclude all financial institutions that have trading capacity, even if the
buyer intends to hold the bonds for investment rather than resale. But as described above
regarding publicly available information on actual trades, an issuer generally cannot distinguish
between bond houses that are holding bonds for investment or for resale, because services such
as EMMA only identify sales to a bond house as an “inter-dealer” trade.

Even the underwriter’s opportunity to assess the identity of the buyer and the buyer’s
intent is limited to the initial offering. Without a written agreement or direct knowledge, the
underwriter cannot be certain about whether a trade executed, likely by computer, with another
dealer is for the dealer’s investment or resale. In our experience, investment banking firms often
purchase debt instruments for their own account; in such cases, disregarding these original sales
in calculating issue price could lead to an inconclusive result.

The Service has publicly asked about trades to affiliates of the underwriter or their
“affiliated accounts,” with no guidance provided for how the scope of “affiliate” is to be
determined.\(^\text{20}\) Members of an underwriting syndicate or distribution group are clearly acting in
concert during the term of the syndicate or group, but the extent of any remaining rights or
obligations between the members following dissolution of the syndicate or group is unclear. A
similar question arises for entities that submit a joint bid in a competitive sale, although the
rights or obligations between these entities may be even more informal.

The concept of the “public” is even more fluid when subjective considerations are taken
into account. For example, an initial buyer may view itself differently from time to time, or
disagree with how its role is being characterized by others. Moreover, a buyer’s intent might
shift over time, perhaps having an initial intention to sell the bonds but subsequently deciding to
retain the bonds for a period of time.

In light of the interpretative difficulties with respect to website information, the multiple
roles a financial institution could assume, and the fluid intention of participants, these Comments
recommend that the scope of the “public” should be presumed to include financial institutions
unless the underwriter knows, from a written contract or other agreement, that the financial
institution is acting in the capacity of underwriter or wholesaler.

III. Conclusions.

The concerns of the government, bond issuers, underwriters and bond lawyers over the
issue price of tax-exempt bonds and Direct Pay Bonds can be best addressed by making the
Regulation permanently applicable to tax-exempt bonds and Direct Pay Bonds, with certain
clarifications.

Specifically these Comments recommend that:

1. The Regulation be permanently applicable to tax-exempt bonds and Direct Pay Bonds.

\(^{20}\) See Proposed Internal Revenue Service Form 14127, Question 1, part 3.
2. The Regulation be interpreted in formal guidance (e.g., a Notice) as follows:

   a. Establish issue price using the reasonable expectations of the managing underwriter in a negotiated sale (or of the successful bidder in a competitive sale) as of the time the prices of the bonds are agreed to by the issuer’s representative and the managing underwriter (or successful bidder) and using expectations as to the price at which the first ten percent of each maturity is to be sold.

   b. Permit good-faith reliance on the certificate of the underwriting team as to first price at which ten percent of each maturity of the bonds was sold, or reasonably expected to be sold, to the public.

   c. Presume that a public negotiated offering or competitive bid that contractually requires a public offering of all of the bonds is a bona fide public offering, absent clear abuse (e.g., bid-rigging, pay-to-play, or price-fixing) or actual contrary knowledge by the issuer.

   d. Permit the “public” to include financial institutions, unless the underwriting team that has contracted with the issuer knows, based on a written contract or other agreement with the bond purchaser, that the bond purchaser is acting in the role as underwriter or wholesaler, and not as investor.
APPENDIX C

2010 COMMITTEE COMMENTS ON ISSUE PRICE

(Attached)
November 9, 2010

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Issue Price

Dear Commissioner Shulman:

Enclosed are comments on the determination of issue price applicable to tax-exempt bonds and tax credit and Build America bonds. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Charles H. Egerton
Chair, Section of Taxation

Enclosure

cc: Michael F. Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
    William J. Wilkins, Chief Counsel, Internal Revenue Service
    Jeffrey Van Hove, Acting Tax Legislative Counsel, Department of the Treasury
    Bryon Christensen, Deputy Tax Legislative Counsel, Department of the Treasury
    John J. Cross III, Associate Tax Legislative Counsel, Department of the Treasury
    Clifford J. Gannett, Director, Office of Tax Exempt Bonds, Internal Revenue Service
    Stephen R. Larson, Associate Chief Counsel, Financial Institutions & Products, Internal Revenue Service
    James A. Polfer, Branch Chief, Branch 5, Financial Institutions & Products, Internal Revenue Service
These comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Winnie Tsien of the Committee on Tax Exempt Financing of the Section of Taxation. Substantive contributions were made by Frederic L. Ballard, Jr.; David J. Cholst; Maxwell D. Solet; Jeremy A. Spector; Stefano Taverna; and Lorraine Tyson. The Comments were reviewed by John Swendseid, Vice-Chair of the Committee. The Comments were further reviewed by Clifford M. Gerber and David C. Garlock of the Section’s Committee on Government Submissions and by Andrew J. Dubroff, Council Director for the Tax Exempt Financing Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact: Winnie Tsien
Phone: (213) 612-2336
Email: wtsien@orrick.com

Date: November 9, 2010
Executive Summary

These Comments recommend that the determination of issue price under Regulation section 1.148-1(b) (the “Regulation”) be made permanently applicable to tax-exempt bonds and all tax credit and Build America Bonds. Making the Regulation permanent, and clarifying several of its aspects, would facilitate the determination of issue price for all such bonds, which would enhance compliance with the various Code requirements that depend in whole or in part on the issue price of bonds. Two important themes discussed in these comments are that (i) the Regulation allows for issue price to be determined on the sale date, and (ii) the Regulation provides that issue price can be determined under a reasonable expectations standard or by the first price at which ten percent of each maturity is sold.2

These Comments recommend that issue price be established using the reasonable expectations of the managing underwriter in a negotiated sale (or of the successful bidder in a competitive sale) as of the time the prices of the bonds are agreed to by the issuer and the managing underwriter (or successful bidder). Those prices are appropriate because they best reflect the underwriter’s (or the successful bidder’s) expectations for the initial prices at which the bonds will be offered to the public and at which a substantial amount of each maturity of the bonds will be sold to the public. For this purpose, the expectations should relate to the sale price of the first ten percent of each maturity of the bonds.

The underwriting team is the most appropriate entity to determine the first price at which ten percent of each maturity of the bonds is actually sold to the public. The issuer has no contact with the buying public, and data that is available on public websites cannot be easily interpreted to identify the status of the buyers. Thus, these Comments recommend that the Regulation be interpreted to permit good-faith reliance on the certificate of the underwriting team as to first price at which ten percent of each maturity of the bonds was sold, or reasonably expected to be sold, to the public.

The process involved in a negotiated underwriting (or a competitive sale) supports a presumption that it reflects a bona fide public offering, absent actual knowledge by the issuer that a bona fide public offering was not made, or that clear abuse such as bid-rigging, pay-to-play, or price-fixing, occurred. Efforts by the issuer or underwriter to alter a bona fide process, by limiting its offering to only particular types of buyers, or by otherwise controlling the subsequent sales of bonds by the initial buyers, will increase inefficiencies and interest rates and likely harm taxpayers as much as the government. Thus, these Comments recommend that the Regulation support the presumption.

Financial institutions frequently buy bonds in a primary offering, and it is very difficult for the issuer to know whether those institutions (other than the members of the underwriting team with whom the issuer has a contract) are purchasing “in the capacity of underwriters or

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1 References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

2 References to a “maturity” of bonds means the portion of a bond issue that consists of “substantially identical” bonds within the meaning of the Regulation.
wholesalers” within the meaning of the Regulation, or as investors on their own behalf. Thus, these Comments recommend that the Regulation permit financial institutions to be treated as public buyers (i.e., not as underwriters or wholesalers) unless the underwriting team that has contracted with the issuer knows, based on a written contract or other agreement with the purchaser, that the purchaser is acting in the role as underwriter or wholesaler, and not as investor.
**Issue Price**

I. Introduction.

The issue price for tax-exempt bonds is determined pursuant to the Regulation. In 2009, Congress enacted legislation authorizing the issuance of Build America Bonds (“BABs”), of which certain BABs (“Direct Pay BABs”) are eligible to receive a subsidy payment from the U.S. Government pursuant to section 6431. In 2010, Congress extended the same type of subsidy to “specified tax credit bonds” (collectively, with Direct Pay BABs, the “Direct Pay Bonds”). In response to questions regarding the rules applicable to determine the issue price of the Direct Pay Bonds, the Internal Revenue Service (the “Service”) issued Notice 2010-35 (the “Notice”), stating, in part, that the Regulation will be used to determine the issue price of all Direct Pay Bonds until further notice.

These Comments urge that the Regulation be permanently applied to determine the issue price of all Direct Pay Bonds as well as tax-exempt bonds. These Comments also recommend that the interpretation of certain components of the Regulation be confirmed.

II. Establishing Issue Price under Regulation section1.148-1.

A. Permanent Application of the Regulation to Establish Issue Price for All Bonds.

Section 148(h) provides that “yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274).” The Regulation further defines issue price as follows:

Issue price means, except as otherwise provided, issue price defined in section 1273 and 1274. Generally, issue price of bonds that are publicly offered is the first price at which a substantial amount of bonds is sold to the public. Ten percent is a substantial amount. The public does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers. The issue price does not change if part of the issue is later sold at a different price. The issue price of bonds that are not substantially identical is determined separately. The issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price. If a bond is issued for property, the applicable Federal tax-exempt rate is used in lieu of the Federal rate in determining

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4 Pub. L. No. 111-147, 124 Stat. 1029 (Hiring Incentives to Restore Employment Act of 2010). Such bonds include new clean renewable energy bonds defined in section 54C, qualified energy conservation bonds defined in section 54D, qualified zone academy bonds defined in section 54E and qualified school construction bonds defined in section 54F.

the issue price under section 1274. The issue price of bonds may not exceed the fair market value as of the sale date.\textsuperscript{5}

The Notice states that the Regulation will apply to Direct Pay Bonds for purposes of determining issue price. The Notice, however, also states that the Department of Treasury (the “Treasury”) and the Service continue to review the definition and may issue prospective guidance or changes to the definition. These Comments urge that the Regulation be permanently applied to determine the issue price of tax-exempt bonds and Direct Pay Bonds. In addition, if there are to be changes to the Regulation, tax-exempt bonds and Direct Pay Bonds should be subject to the same rules and the same changes.

Because issuers of Direct Pay Bonds and tax-exempt bonds are generally the same entities, providing the same issue price rule for them would enhance certainty and administrability. They are often issued at or about the same time to finance different portions of the same overall project and uniform rules will enhance compliance.

For tax-exempt bonds and Direct Pay Bonds, the issue price is the starting point for determining compliance with all arbitrage-related matters. It is also the starting point for certain other key requirements applicable to tax-exempt bonds, including those relating to volume cap, limitations on “private business use” and the limitation on costs of issuance with respect to private activity bonds (including qualified section 501(c)(3) bonds). For Direct Pay Bonds, the issue price determines whether an issuer is entitled to receive the subsidy from the U.S. Treasury by virtue of several additional requirements. Similar to tax-exempt private activity bonds, section 54A incorporates a limit on costs of issuance that may be financed with proceeds from the sale of an issue of Direct Pay Bonds.\textsuperscript{7} While issue price is not specifically mentioned, most practitioners apply the section 54A limit by reference to issue price. The Act further imposes a premium limit on BABs\textsuperscript{8} (and, under the Notice, to all Direct Pay Bonds), and this limit also applies by reference to issue price. Further, most practitioners use the issue price for measuring compliance with the volume cap limits applicable to Direct Pay Bonds other than BABs.

The Regulation provides a method of determining the issue price as of the sale date of bonds. This methodology is very important for issuers of tax-exempt bonds and Direct Pay Bonds as well as their advisors. It enables the parties to know, on the sale date, whether the sale of bonds will satisfy the many requirements for Direct Pay Bonds that depend on the issue price. Finality regarding issue price on the sale date also enables the issuer to make many calculations required for compliance with tax law (e.g., the yield on the bonds), which can be critical if yield-restricted investments are being purchased.

Allowing the long-established issue price rule under the Regulation to be used for all bonds would be consistent with the stated Congressional intent of assisting municipal issuers in their financial planning and operations. It would also avoid the market uncertainty that would

\textsuperscript{5} Reg. § 1.148-1(b).
\textsuperscript{7} I.R.C. § 54AA(a)(4)(A)(ii).
\textsuperscript{8} I.R.C. § 54AA(d)(2)(C).
result from a different rule for Direct Pay Bonds that would perhaps threaten the continued viability of such bonds in some situations, even if based on an existing rule under another Code provision.

B. Reasonable Expectations Regarding the Initial Public Offering Price.

In addition to providing a general framework for establishing issue price, the Regulation provides a narrow, specific safe harbor through a series of declaratory rules. One such safe harbor in the Regulation, but not in section 1273, is that “the issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price.”

“Reasonable expectation” is provided as an alternative to the actual sales price rule set out in the second sentence of the Regulation. The use of reasonable expectations in establishing the issue price of tax-exempt bonds has been vital in many instances. Reasonable expectations are especially important where the actual sale price of the bonds cannot be obtained or accurately determined on the sale date (e.g., if ten percent of a maturity of the bonds was not sold on the sale date).

1. Reasonable Expectations Are Established at the Time of Offering.

While the Regulation permits the use of reasonable expectations to establish the issue price of publicly offered bonds, it does not provide further guidance or limits on which expectations are the most reasonable. Underwriting or selling the bonds is a fluid process. An underwriter or a bidder in a competitive sale—which is the entity on whose expectations an issuer will be relying—may change its expectations as to the offering prices of bonds throughout the process, and all of the different expectations may be reasonable. These Comments recommend that the proper time to measure one’s reasonable expectations as to the initial offering price for purposes of establishing the issue price of bonds is when the issuer’s representative and the managing underwriter agree to a price in a negotiated sale (or when the issuer’s representative in a competitive offering has agreed to the prices in the successful bid), rather than any other time (e.g., the time of execution of a bond purchase agreement, the formal award of bonds at a competitive sale, or the end of the day of sale).

As part of the typical underwriting process in a negotiated sale, an underwriter conducts its due diligence on the market in which the bonds will be offered, in large part through conversations with potential buyers. This “pre-sale” period can vary in time and scope, depending on the bonds to be sold, the timing and any factors unique to the issuer or the underwriter. Practitioners generally understand that the following events occur on the sale date (albeit, not always in this order): (i) the bond offering prices are established, sometimes as adjusted from the prices previously considered during the pre-sale period, and at other times by confirming expected trades between the underwriter and buyers; (ii) the issuer and the underwriter execute a bond purchase agreement (“BPA”), agreeing to the prices at which the underwriter will acquire the bonds from the issuer; and (iii) sales are “ticketed” (i.e., bonds are promised to be delivered to the buyers). In the typical series of events, the public offering could be viewed as occurring as early as the beginning of the sale date, and any subsequent period prior to the execution of the BPA.
Potential purchasers in a typical competitive sale will bid individually or as part of a syndicate. There are often no pre-sale orders because there is no assurance any one bidder will win the bid. Bidders put forth their best bid, usually in the form of the lowest interest cost, and the issuer selects the winner based on the lowest cost, taking into account premium credited to, or discount charged to, the issuer. There is no requirement that compensation be disclosed before the winning bid is awarded. A purchaser will normally bid the lowest cost possible to win the bid and still resell the bonds to the public at a reasonable profit.

Potential bidders undergo a process similar to a negotiated sale, although it may involve less effort because no bidder knows whether it will be the actual underwriter until the bids are opened and the bonds are awarded. Each bidder formulates a bid based on its own reasonable expectations regarding the initial public offering price at which it expects to sell the bonds. The bidder hopes to make a profit by buying from the issuer and selling at a higher price in the market. The bid, if accepted, establishes the prices at which the bidder will buy the bonds from the issuer. Once the bids are opened, the successful bidder is notified that the formal award has been made to that bidder, and that bidder can formally offer the bonds in the market (i.e., sales can be “ticketed”).

Both underwriters in negotiated sales and purchasers in competitive sales typically re-offer bonds to investors pursuant to procedures that are transparent and intended to comply with securities laws. They establish the reoffering prices of the bonds based on their reasonable expectations as to the sale prices. Purchasing through a competitive process ensures that bonds are sold at the lowest cost to the issuer, hence reducing yield to the most competitive level.

The foregoing underwriting and competitive sale processes imply that reasonable expectations as to the issue price are the prices incorporated into the BPA or accepted in a competitive sale. The time to measure whether those prices reflect reasonable expectations should not be the end of the sale date, as that can be many hours after the underwriter or the bidder has established the initial offering prices. The time of actual execution of a BPA is also an inappropriate measure of reasonable expectations because execution is usually driven by the availability of someone authorized to sign the contract, and this timing has no connection to expectations regarding how the bonds will be sold to the public.

These Comments recommend that the Regulation be interpreted to provide that the issue price is established using the reasonable expectations of the managing underwriter in a negotiated sale, or of the successful bidder in a competitive sale, as of the time the prices of the bonds are agreed to by the issuer’s representative and the managing underwriter or successful bidder.

2. Reasonable Expectations to Sell First Ten Percent of Each Maturity.

The Regulation, which permits the use of reasonable expectations of an underwriter (or a bidder) for purposes of establishing issue price of a publicly offered debt instrument, does not provide guidance on the scope of applicability of the expectations. Based on the entire context of the Regulation, the issue price should be established using the price at which an underwriter (or a successful bidder) reasonably expects to sell a substantial amount (i.e., at least ten percent) of each substantially identical group (or each maturity) of bonds to the public.
C. The First Ten Percent Sale Price to Establish Issue Price.

The Regulation also provides that issue price may be established using the first price at which a substantial amount of each maturity of the bonds is sold to the public. While not addressed in section 1273, the Regulation affirmatively states that a “substantial amount” is ten percent. Therefore the bright line of ten percent is available to unequivocally establish the issue price of bonds that are eligible for this rule. Indeed, the Regulation states that, once the issue price is established, a subsequent sale at a different price does not affect the issue price.

Publicly available trade data is imperfect. In addition to the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access System (“EMMA”) website, which is specifically referenced in IRS Form 14127, the “investinginbonds” website is a source of trading data and financial professionals also often subscribe to the Bloomberg wire services for trade information on bonds. Each website has its own independent reporting and posting rules, but each depends on financial institutions to timely supply complete and accurate trade information. In addition, different websites provide different and limited information. For example, EMMA only identifies whether a sale is one made to a “customer” or is an “inter-dealer trade.” Inter-dealer trades on EMMA do not distinguish between trades with the intention to hold for investment purposes and trades for immediate resale. In some cases, trades recorded as “inter-dealer” trades are, in fact, trades to the “public” because the dealer-purchaser is purchasing on behalf of a true investor that is not a bond house. Sales to the public are complicated because they may have varying, embedded commissions, and the failure of the fixed income bond market to require separate reporting of commissions adds to the complexity and lack of transparency. Therefore, interpretational leaps are required for a user to draw conclusions from the publicly available data.

Only the underwriting team knows if at least ten percent of a maturity has been first sold at a specific price, because some informational websites do not track sales of specific bonds within each maturity, and some sites (including EMMA) only report trades of bonds by date, amount and type of transaction. Therefore, only the underwriter, as the initial seller of the bonds to the marketplace, knows the identities of the purchasers and the first price at which at least ten percent of a maturity is sold. Given the underwriter’s access to information and control over the process, a certification by the underwriter regarding the first ten percent sale price should establish the issue price of bonds that are publicly offered, absent abuse, such as bid-rigging. While a review of public trade data may lead to further conversations with an underwriter, that data alone should not overcome the presumption of the underwriter’s certification. These Comments recommend that the Regulation be interpreted to allow the issuer to rely on a certificate of the underwriter as to its reasonable expectation to sell at least ten percent of each maturity of the bonds to the public at its initial offering price, absent abuse such as bid rigging or lack of a bona-fide, public offering (discussed below).

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9 This site can be found at http://www.emma.msrb.org.
10 This site can be found at http://www.investinginbonds.com.
11 Trades posted at the same time on EMMA are sometimes re-ordered when reviewed at a later time or date.
D. Definition of “Public” in Public Offering and Sale

The recommendations regarding reliance on the issue price rules in the Regulation and section 1273 are premised on the bonds being “publicly offered.” The sale process, as previously described, encourages a public offering, and a public offering is commonly required in the BPA between the issuer and an underwriter, or as a term in the notice of sale for a competitive sale. An issuer may be unable to do anything further to ensure a public offering.

1. Presumed Public Offering Absent Abuse or Knowledge.

An underwriter (or the winning bidder in a competitive sale) commonly is subject to an obligation or covenant to publicly offer the bonds it purchases from the issuer. Given the transparency of the process, a sale of bonds by an issuer through a negotiated underwriting (or a competitive bid) should be presumed to be a bona-fide public offering, absent clear abuse or actual contrary knowledge by the issuer. For example, practices such as bid-rigging, pay-to-play, or price-fixing would overcome the presumption, as would the issuer’s actual knowledge that a public offering did not occur (e.g., where the cover page of the Official Statement lists one or more maturities as “not re-offered” (or “NRO”)), but the mere sale of a bond at a price different from the offering price should not be viewed as evidencing the absence of a bona-fide public offering.

One indicator of a public offering is whether the public was actually able to purchase the bonds at the offering prices. Actual sales of bonds to the public would confirm that bonds were indeed offered to the public. It is customary for underwriters to send out an “offering wire” to the market, offering bonds at stated prices for anyone to buy at those prices. But offering the bonds for sale is not the same as actually selling the bonds. A public offering can occur without regard to the actual results. Public buyers can acquire and resell bonds on the sale date or other dates; financial institutions can acquire bonds for their own investment purposes for a short, intermediate or long timeframe; and, financial institutions can also buy for resale. It is important to re-emphasize that trades at different prices, alone, do not evidence lack of a public offering.

Absent a contractual agreement or understanding with the buyer, the underwriter cannot control the resale prices. The issuer has no control over the prices at which anyone other than the underwriter sells the bonds, because it only has a contract with the underwriter. The underwriter may be able to control the prices at which others in the underwriting syndicate or distribution group sell the bonds for a relatively short period of time. But, after the bonds leave the underwriter (and any syndicate or distribution group), even the underwriter loses control over prices, and market conditions thereafter dictate price increases or decreases. Bond prices can also be influenced by a particular seller’s need to sell quickly, a particular buyer’s need to purchase at a particular price or on a particular date, and a variety of other factors.

The Treasury and the Service might be concerned that an underwriter will intentionally withhold bonds from the initial sale, or sell them to select wholesaler buyers that will resell them (perhaps immediately) at higher prices. An issuer’s only recourse is based on its BPA with the

12 The meaning of the term “public” is discussed further in the “Definition of the Public” discussion, below.
underwriter (or agreement with a bidder in a competitive sale—through contract or through the notice of sale) in which the underwriter (or the winning bidder) commits to publicly offer the bonds. The issuer’s lack of control necessitates its reliance on the underwriter’s certification and the prices shown on the official statement or other publically disseminated offering documents for the bonds. We understand that organizations such as the Municipal Securities Rulemaking Board (the “MSRB”) and the Financial Industry Regulatory Authority have jurisdiction to monitor fairness of pricing of underwriters.13

Indeed, the MSRB has recently promulgated new amendments to MSRB Rules G-8 and G-11 to assist in assuring public access to bonds in initial offerings and fairness in the public offering process.14 According to the release (the “Release”) by the Securities and Exchange Commission (the “SEC”) approving the amendments, the “proposed amendments to Rule G-11 would: (1) apply the rule to all primary offerings, not just those for which a syndicate is formed; (2) require that all dealers (not just syndicate members) disclose whether their orders are for their own account or a related account; and (3) require that priority be given to orders from customers over orders from syndicate members for their own accounts or orders from their respective related accounts, to the extent feasible and consistent with the orderly distribution of securities in the offering, unless the issuer otherwise agrees or it is in the best interests of the syndicate not to follow that order of priority.”15 Moreover, “[t]he Commission believes the proposal will help achieve a broader distribution of municipal securities while still providing sufficient flexibility to syndicate managers and sole underwriters, and further believes that investors would benefit from a broader distribution of securities that is fair and reasonable and consistent with principles of fair dealing.”16

In addition, a competitive sale that meets all of the state law and securities law requirements for competitive bidding should by itself establish a “public offering” of all of the bonds, at least in the absence of a clear abuse (e.g., bid-rigging, pay-to-play, or price-fixing) or actual contrary knowledge by the issuer. A competitive sale should eliminate a possible Service concern that, in a negotiated sale, bonds may be held back by the underwriter for later resale or for sale to preferred customers who might be brokers.17 The bidder in a competitive sale has no assurance that it will be able to buy the bonds from the issuer. This uncertainty reduces the likelihood that a bidder will have side arrangements that are contingent upon winning the bid when any other broker or wholesaler can also bid on the issuer’s sale. Accordingly, these

13 Also, section 6700 provides that penalties may be imposed on any person who participates in, among other things, an investment plan or arrangement and makes a “statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter. . . .”

14 See File No. SR-MSRB-2009-17 (November 8, 2009), as amended by Amendment 1 to File No. SR-MSRB-2009-17 (August 4, 2010). Both documents were approved by the Securities and Exchange Commission August 16, 2010, and are effective October 12, 2010.


16 Id.

17 See Proposed Internal Revenue Service Form 14127, Question 4.
Comments recommend that, absent clear abuse or actual contrary knowledge by the issuer, a competitive sale be treated as a bona-fide public offering, with the reasonable expectations of the winner of the competitive bid to sell at least ten percent of each maturity of the bonds it was awarded establishing the issue price.

2. Public Offering Should Not Exclude Anyone.

Neither the Regulation, nor the issue price rule in section 1273 and its underlying Regulations, requires that a public offering exclude bonds houses, brokers or others that are not considered part of the public. While the only sales that establish issue price are sales to the public, the offering should be open to all buyers. The issue price can still be properly established under the Regulation in such a public offering.

An issuer has limited options to control the underwriting and selling process, and any controls might disrupt the market and result in unintended consequences. If an issuer narrowed its pool of purchasers to those covenanting not to resell their bonds for a specified time period, the issuer’s cost (and the corresponding subsidy paid by the Treasury with respect to the Direct Pay Bonds) would increase. Alternatively, if an issuer limited the prices at which the underwriter or the initial purchaser may sell or resell their bonds, again, the issuer’s cost (and the corresponding subsidy paid by the Treasury) would increase. These limitations would create further inefficiencies by being less “public,” due to participation being restricted to only select or pre-screened parties. Moreover, state law often requires the issuer in a competitive sale to accept the lowest interest-rate bid, thereby depriving the issuer of legal authority to impose conditions on the bond purchasers.

3. Definition of Public.

There has historically been some uncertainty about what constitutes the public in the context of a public offering. The term “public” is explained in the Regulation by reference to what is not the public. The Regulation excludes “bond houses, brokers, or similar persons or organizations acting in the capacity as underwriters, or wholesalers.”

The “acting in the capacity” requirement in the Regulation can be interpreted either (i) to apply to bond houses, brokers and all other persons or organizations similar to bond houses or brokers that have the capacity to act as underwriters or wholesalers, or (ii) to apply only to entities (bond houses, brokers or “other persons or organizations”) actually acting in the capacity of underwriters or wholesalers in a particular bond sale (and, presumably, other bond houses and brokers are not excluded from the “public” in that transaction). These Comments recommend that the phrase “acting in the capacity of an underwriter, or wholesaler” be interpreted as modifying “bond houses”, “brokers,” and “other persons or organizations” so that a sale to a bond house or broker is disregarded only if the bond house or broker is actually acting in such capacity or it is acting as a member of the underwriting syndicate or distribution group.

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18 (Emphasis added.)

19 For example, a bond house can be both an investor and an intermediary, and its role, from the time of bond sale, may not be clear and also may change quickly thereafter.
contrary reading would exclude all financial institutions that have trading capacity, even if the buyer intends to hold the bonds for investment rather than resale. But as described above regarding publicly available information on actual trades, an issuer generally cannot distinguish between bond houses that are holding bonds for investment or for resale, because services such as EMMA only identify sales to a bond house as an “inter-dealer” trade.

Even the underwriter’s opportunity to assess the identity of the buyer and the buyer’s intent is limited to the initial offering. Without a written agreement or direct knowledge, the underwriter cannot be certain about whether a trade executed, likely by computer, with another dealer is for the dealer’s investment or resale. In our experience, investment banking firms often purchase debt instruments for their own account; in such cases, disregarding these original sales in calculating issue price could lead to an inconclusive result.

The Service has publicly asked about trades to affiliates of the underwriter or their “affiliated accounts,” with no guidance provided for how the scope of “affiliate” is to be determined.20 Members of an underwriting syndicate or distribution group are clearly acting in concert during the term of the syndicate or group, but the extent of any remaining rights or obligations between the members following dissolution of the syndicate or group is unclear. A similar question arises for entities that submit a joint bid in a competitive sale, although the rights or obligations between these entities may be even more informal.

The concept of the “public” is even more fluid when subjective considerations are taken into account. For example, an initial buyer may view itself differently from time to time, or disagree with how its role is being characterized by others. Moreover, a buyer’s intent might shift over time, perhaps having an initial intention to sell the bonds but subsequently deciding to retain the bonds for a period of time.

In light of the interpretative difficulties with respect to website information, the multiple roles a financial institution could assume, and the fluid intention of participants, these Comments recommend that the scope of the “public” should be presumed to include financial institutions unless the underwriter knows, from a written contract or other agreement, that the financial institution is acting in the capacity of underwriter or wholesaler.

III. Conclusions.

The concerns of the government, bond issuers, underwriters and bond lawyers over the issue price of tax-exempt bonds and Direct Pay Bonds can be best addressed by making the Regulation permanently applicable to tax-exempt bonds and Direct Pay Bonds, with certain clarifications.

Specifically these Comments recommend that:

1. The Regulation be permanently applicable to tax-exempt bonds and Direct Pay Bonds.

20 See Proposed Internal Revenue Service Form 14127, Question 1, part 3.
2. The Regulation be interpreted in formal guidance (e.g., a Notice) as follows:

   a. Establish issue price using the reasonable expectations of the managing underwriter in a negotiated sale (or of the successful bidder in a competitive sale) as of the time the prices of the bonds are agreed to by the issuer’s representative and the managing underwriter (or successful bidder) and using expectations as to the price at which the first ten percent of each maturity is to be sold.

   b. Permit good-faith reliance on the certificate of the underwriting team as to first price at which ten percent of each maturity of the bonds was sold, or reasonably expected to be sold, to the public.

   c. Presume that a public negotiated offering or competitive bid that contractually requires a public offering of all of the bonds is a bona fide public offering, absent clear abuse (e.g., bid-rigging, pay-to-play, or price-fixing) or actual contrary knowledge by the issuer.

   d. Permit the “public” to include financial institutions, unless the underwriting team that has contracted with the issuer knows, based on a written contract or other agreement with the bond purchaser, that the bond purchaser is acting in the role as underwriter or wholesaler, and not as investor.