

IRS NOTICE RAISES QUESTIONS ON TAX-EXEMPT BOND STATE VOLUME CAP ALLOCATIONS

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On November 23, 2010, the IRS issued Notice 2010-81 ("Notice") relating to establishment of the "issue date" of tax-exempt bonds issued under "drawn-down" loan structures. The primary purpose of the Notice was to provide guidance and clarification with respect to determining the issue date of Build America Bonds ("BABs") and other special temporary tax-exempt bond programs established under the American Recovery and Reinvestment Act of 2009 that were subject to sunset on December 31, 2010*.

In anticipation of the rush to market of BABs and other terminating special tax-exempt bonds before December 31, 2010, particularly through the structuring of these bonds as "drawn down" financings that would close by year end but be subject to draw-down after that date, the IRS sought to provide guidance as to when such obligations would be considered by the IRS to have been "issued" for purposes of meeting the statutory deadline. In the Notice, the IRS recites the rules regarding the issue date of an "issue" of tax-exempt bonds under IRS Regulation 1.150-1(b) and the general rules under IRS Regulation 1.150-1(c)(1) as to when bonds issued as part of an issue will constitute the same "issue" for federal tax purposes. The Notice further recognizes and discusses the special rules regarding so-called "draw-down" loans and commercial paper financings under IRS Regulation 1.150-1(c)(4)(i) and (ii), but creates a distinction between the issue date of the issue itself and the issue date of the bonds comprising such issue by concluding that "[t]hese special rules apply to the issue date of the issue. The regulations do not provide special issue date rules for the issue date of bonds issued as draws under draw-down loans or as commercial paper."

The Notice by its terms is applicable for purposes of determining whether a bond is "issued" for purposes of any Internal Revenue Code ("Code") statutory deadlines, such as those applicable to BABs or other ARRA bond programs that terminated on December 31, 2010. The Notice expressly does not apply for purposes of applying the rules for so-called "bank-qualified" bonds under Sections 265(b)(3) and 265(b)(7) of the Code, leaving those items to future IRS guidance. Clear enough. However, the Notice also provides that it is applicable for determining whether bonds have been issued for purposes of "various volume cap limitations on State and local bonds..."

This last missive is broad enough to arguably include any bond that is subject to the state volume cap imposed on the issuance various private activity bonds under Code Section 146, which generally includes all private activity bonds other than qualified 501(c)(3) bonds, certain exempt-facility bonds and qualified veterans' mortgage bonds. Read literally, the Notice would not permit a volume cap allocation obtained for an issue in a given calendar year to extend to "draw-down bonds" deemed (under the logic of the Notice) to be issued in a different calendar year, thereby raising questions as to how to deal with volume cap allocations for draw-down loans at time of initial issuance of the "issue" of which the individual draw-down bonds are a part. Further, the Notice is not limited to bonds issued after its date of adoption and could potentially impact volume-cap allocations for draw-down bonds currently in place under existing interpretations and practices.

The tax-exempt bond community has been quick to recognize and react to this potential quagmire. The National Association of Bond Lawyers has, by letter dated December 20, 2010, requested the IRS to provide additional announcement clarification that would either (i) permit bonds subject to the volume cap restrictions of Code Section 146 that have been issued or which are subject to binding purchaser commitments prior to November 24, 2010 to establish their issue date under rulings, practices and procedures existing prior to promulgation of the Notice or (ii) expressly make clear that issuers may obtain the full volume cap allocation for a series of draw-down bonds at the time of issuance.

Also, and in response to the Notice, the State of California Debt Limit Allocation Committee has issued an open memo to all interested parties of the existence of the Notice and its potential impact on state volume allocations. The California memo advises that (i) it is "vitally important" that any 2010 applicant who believes that the recent changes brought about by the Notice may negatively impact a past bond issuance immediately contact the Committee to discuss the situation and (ii) it may be necessary for the Committee to supplant the loss of expiring 2010 or prior year allocation not already used in a qualified draw(s) during calendar year 2010.

Hopefully, the IRS will act quickly to clarify the ambiguities and potential difficulties for Section 146 volume cap allocations presented by the Notice. In any event, there will no doubt be more to come on this topic.

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