



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-141739-08]

RIN 1545-BI22

Reissuance of State or Local Bonds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that address when tax-exempt bonds are treated as retired for purposes of section 103 and sections 141 through 150 of the Internal Revenue Code (Code). The proposed regulations are necessary to unify and to clarify existing guidance on this subject. The proposed regulations affect State and local governments that issue tax-exempt bonds.

DATES: Comments and requests for a public hearing must be received by **INSERT DATE 60 DAYS AFTER THE DATE OF PUBLICATION IN THE FEDERAL REGISTER**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-141739-08), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-141739-08), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, or sent

electronically via the Federal eRulemaking Portal at www.regulations.gov (REG-141739-08).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Spence Hanemann, (202) 317-6980; concerning submissions of comments and requesting a hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 under sections 150 and 1001 of the Code (Proposed Regulations).

1. In general

In general, under section 103, interest received by the holders of certain bonds issued by State and local governments is exempt from Federal income tax. To qualify for the tax exemption, a bond issued by a State or local government must satisfy various eligibility requirements under sections 141 through 150 at the time of issuance of the bond. If the issuer and holder agree after issuance to modify the terms of a tax-exempt bond significantly, the original bond may be treated as having been retired and exchanged for a newly issued, modified bond. Similarly, if the issuer or its agent acquires and resells the bond, the bond may be treated as having been retired upon acquisition and replaced upon resale with a newly issued bond.

The term “reissuance” commonly refers to the effect of a transaction in which a new debt instrument replaces an old debt instrument as a result of retirement of the old debt instrument pursuant to such an exchange or extinguishment. In the case of a reissuance, the reissued bond must be retested for qualification under sections 103 and

141 through 150. The reissuance of an issue of tax-exempt bonds may result in various negative consequences to the issuer, such as changes in yield for purposes of the arbitrage investment yield restrictions under section 148(a), acceleration of arbitrage rebate payment obligations under section 148(f), and change-in-law risk.

2. Tender Option Bonds

Tender option bonds and variable rate demand bonds (collectively, tender option bonds) have special features that present reissuance questions. Specifically, tender option bonds have original terms that provide for a tender option interest rate mode, as described in this paragraph. Issuers of tax-exempt bonds often preauthorize several different interest rate modes in the bond documents and retain an option to switch interest rate modes under parameters set forth in the bond documents. During a tender option mode, tender option bonds have short-term interest rates that are reset periodically at various short-term intervals (typically, every seven days) based on the current market rate necessary to remarket the bonds at par. In connection with each resetting of the interest rate, the holder of a tender option bond has a right or requirement to tender the bond back to the issuer or its agent for purchase at par. Tender option bonds also may have interest rate mode conversion options that permit the issuer or conduit borrower to change the interest rate mode on the bonds from a tender option mode to another short-term interest rate mode or to a fixed interest rate to maturity. At the time of a conversion to another interest rate mode, the holder of a tender option bond typically has the right or requirement to tender the bond for purchase at par.

Tender option bonds generally have third-party liquidity facilities from banks or other liquidity providers to ensure that there is sufficient cash to repurchase the bonds upon a holder's tender, and they also commonly have credit enhancement from bond insurers or other third-party guarantors. Upon a holder's exercise of its tender rights in connection with either a resetting of the interest rate during a tender option mode or a conversion to another interest rate mode, a remarketing agent or a liquidity provider typically will acquire the bonds subject to the tender and resell the bonds either to the same bondholders or to others willing to purchase such bonds.

3. Existing Guidance

To address reissuance questions related to tax-exempt bonds, on December 27, 1988, the IRS published Notice 88-130, 1988-2 CB 543, which provides rules for determining when a tax-exempt bond is retired for purposes of sections 103 and 141 through 150. Notice 88-130 provides in part that a tax-exempt bond is retired when there is a change to the terms of the bond that results in a disposition of the bond for purposes of section 1001. In addition, Notice 88-130 provides special rules for retirement of certain tender option bonds that meet a definition of the term "qualified tender bond."

On June 26, 1996, the Department of the Treasury (Treasury Department) and the IRS published final regulations under §1.1001-3 (1996 Final Regulations) in the **Federal Register** (61 FR 32926). These regulations provide rules for determining whether a modification of the terms of a debt instrument, including a tax-exempt bond, results in an exchange for purposes of section 1001. In recognition of a need to coordinate the interaction of the prior guidance in Notice 88-130 with the subsequent

final regulations under §1.1001-3 for particular tax-exempt bond purposes, the Treasury Department and the IRS stated their intention to issue regulations under section 150 on this subject in the **Federal Register** (61 FR 32930).

On April 14, 2008, the IRS published Notice 2008-41, 2008-1 CB 742. Like Notice 88-130, Notice 2008-41 provides rules for determining when a tax-exempt bond is retired for purposes of sections 103 and 141 through 150 and includes special rules for qualified tender bonds. While the retirement standards provided in these two notices are similar, Notice 2008-41 was intended to coordinate the retirement standards for tax-exempt bond purposes with the 1996 Final Regulations on modifications of debt instruments under §1.1001-3 and to be more administrable than Notice 88-130. In order to preserve flexibility and to limit potential unintended consequences during the 2008 financial crisis, Notice 2008-41 permitted issuers to apply either notice. Generally, under Notice 2008-41, a tax-exempt bond is retired when a significant modification to the terms of the bond occurs under §1.1001-3, the bond is acquired by or on behalf of its issuer, or the bond is otherwise redeemed or retired. The notice clarifies that, for purposes of these retirement standards, the purchase of a tax-exempt bond by a third-party guarantor or third-party liquidity facility provider pursuant to the terms of the guarantee or liquidity facility is not treated as a purchase or other acquisition by or on behalf of a governmental issuer. Although these general rules apply to a qualified tender bond, Notice 2008-41 also provides that certain features of qualified tender bonds will not result in a retirement. In Notice 2008-41, the Treasury Department and the IRS reiterated their intention to provide guidance on the retirement of tax-exempt bonds in regulations under section 150.

The Proposed Regulations provide rules for determining when tax-exempt bonds are treated as retired for purposes of sections 103 and 141 through 150. The Proposed Regulations also amend §1.1001-3(a)(2) to conform that section to the special rules in the Proposed Regulations for retirement of qualified tender bonds.

Explanation of provisions

1. Section 1.150-3: Retirement of Tax-Exempt Bonds

A. General Rules for Retirement of a Tax-Exempt Bond

The Proposed Regulations generally provide retirement standards that apply to tax-exempt bonds for purposes of sections 103 and 141 through 150. These retirement standards follow the guidance in Notice 2008-41 with technical refinements. The Proposed Regulations provide that a tax-exempt bond is retired if a significant modification to the terms of the bond occurs under §1.1001-3, if the issuer or an agent acting on its behalf acquires the bond in a manner that liquidates or extinguishes the bondholder's investment in the bond, or if the bond is otherwise redeemed (for example, redeemed at maturity).

For this purpose, the Proposed Regulations define the term "issuer" to mean the State or local governmental unit that actually issues the bonds and any related party (as defined in §1.150-1(b)) to that actual issuer. In the case of a governmental unit, the applicable related party definition under §1.150-1(b) applies a controlled group test under §1.150-1(e) to determine related party status, based generally on all of the facts and circumstances. This controlled group test includes special rules which specifically treat control over the governing board of a governmental unit and control over use of funds or assets of a governmental unit as giving rise to controlled group status.

By focusing on the actual issuer rather than on a conduit borrower, this definition of issuer maintains and respects the essential legal construct necessary for issuance of many tax-exempt bonds, such as qualified private activity bonds under section 141(e), that the actual issuer be treated as the obligor in conduit financings. Thus, under the Proposed Regulations, the acquisition of a tax-exempt bond by a conduit borrower that is not a related party to the actual issuer does not result in the retirement of that bond.

The Proposed Regulations also prescribe certain consequences for a bond that is retired pursuant to a deemed exchange under §1.1001-3 or following the acquisition of the bond by the issuer or the issuer's agent. In the former case, the bond is treated as a new bond issued at the time of the modification as determined under §1.1001-3. In the latter case, if the issuer resells the bond, the bond is treated as a new bond issued at the time of resale. If the issuer does not resell the acquired bond, the acquired bond is simply retired. In either case in which a retired bond is treated as a newly issued bond, the issuer must consider whether the new bond refunds the retired bond. For this purpose, the rules regarding the definition of a refunding issue under §1.150-1(d) apply. For example, if the issuer of the bond retired pursuant to §1.1001-3 is the same as the issuer (or a related party to the issuer) of the newly issued bond, the newly issued bond will be part of a current refunding issue that refunds the retired bond.

B. Exceptions to Retirement of a Tax-Exempt Bond

The Proposed Regulations provide three exceptions that limit retirements resulting from the operation of the general rules. Two of these exceptions are intended to prevent the special features of tender option bonds from resulting in a retirement. A third exception applies to all tax-exempt bonds.

The first two exceptions in the Proposed Regulations apply to qualified tender bonds, a defined term that is essentially a tender option bond meeting certain requirements. Specifically, a qualified tender bond is a tax-exempt bond that, pursuant to the terms of its governing contract, bears interest during each interest rate mode at a fixed rate, a qualified floating rate under §1.1275-5, or an objective rate that is permitted for a tax-exempt bond under §1.1275-5(c)(5). Furthermore, interest on a qualified tender bond must be unconditionally payable at periodic intervals of no more than a year. Finally, a qualified tender bond may not have a stated maturity date later than 40 years after its issue date and must include a qualified tender right. This definition is similar to the definition of qualified tender bond provided in Notice 2008-41.

The Proposed Regulations define a qualified tender right required for a qualified tender bond in terms of the mechanics by which the tender right operates. The Proposed Regulations define a qualified tender right to include either a tender right that arises periodically during a tender option mode or a tender right that arises upon the exercise of the issuer's option under the original terms of the bond to change the interest rate mode.

A qualified tender bond has two features that otherwise could result in retirement of the bond under the general rules for retirement in the Proposed Regulations. First, when accompanied by a qualified tender right, an exercise of the issuer's option to change the interest rate mode might, in some circumstances, qualify as a modification under the rule in §1.1001-3(c)(2)(iii) for alterations that result from the exercise of an option. Thus, absent the exception in the Proposed Regulations, a qualified tender right might result in a modification that, if significant, would cause the qualified tender bond to

be retired. To address this circumstance, the Proposed Regulations provide an exception that avoids retirement by disregarding a qualified tender right for purposes of determining whether a significant modification of a qualified tender bond under §1.1001-3 results in retirement of the bond. Consequently, the issuer's option to change the interest rate mode typically would qualify as a unilateral option and the change of interest rate mode resulting from exercise of that option would not be a modification of the qualified tender bond.

The second feature of a qualified tender bond that could result in retirement of the bond under the general rules for retirement in the Proposed Regulations is the financing structure feature that may require the issuer or its agent to acquire the bond upon exercise of the qualified tender right. To address this circumstance, the Proposed Regulations provide another exception under which an acquisition of a qualified tender bond pursuant to the exercise of a qualified tender right will not result in retirement, provided that neither the issuer nor its agent holds the bond for longer than 90 days. This 90-day period is intended to provide the issuer or its remarketing agent with sufficient time to resell a tendered bond to a new holder.

The Proposed Regulations also provide an exception to the general rules of retirement for all tax-exempt bonds. This exception, carried forward from Notice 2008-41, provides that acquisition of a tax-exempt bond by a guarantor or liquidity facility provider acting as the issuer's agent does not result in retirement of the bond if the acquisition is pursuant to the terms of the guarantee or liquidity facility and the guarantor or liquidity facility provider is not a related party (as defined in §1.150-1(b)) to the issuer.

2. Applicability Dates

The rules in §1.150-3 of the Proposed Regulations are proposed to apply to events and actions taken with respect to bonds that occur on or after the date that is 90 days after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Issuers may apply these regulations to events and actions taken with respect to bonds that occur before that date. The Treasury Department and the IRS expect that the final regulations will obsolete Notice 88-130 and Notice 2008-41.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. Because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small entities.

Comments and Requests for Public Hearing

Before the Proposed Regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the ADDRESSES heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available

at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Spence Hanemann of the Office of Associate Chief Counsel (Financial Institutions and Products) and Vicky Tsilas, formerly of the Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the Treasury Department and the IRS participated in their development.

Availability of IRS Documents

The IRS notices cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at www.irs.gov.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.150-3 is added to read as follows:

§1.150-3 Retirement standards for state and local bonds.

(a) *General purpose and scope.* This section provides rules to determine when a tax-exempt bond is retired for purposes of sections 103 and 141 through 150.

(b) *General rules for retirement of a tax-exempt bond.* Except as otherwise provided in paragraph (c) of this section, a tax-exempt bond is retired when:

(1) A significant modification of the bond occurs under §1.1001-3;

(2) The issuer or its agent acquires the bond in a manner that liquidates or extinguishes the bondholder's investment in the bond; or

(3) The bond is otherwise redeemed (for example, redeemed at maturity).

(c) *Exceptions to retirement of a tax-exempt bond--(1) Qualified tender right does not result in a modification.* In applying §1.1001-3 to a qualified tender bond for purposes of paragraph (b)(1) of this section, both the existence and exercise of a qualified tender right are disregarded. Thus, a change in the interest rate mode made in connection with the exercise of a qualified tender right generally is not a modification because the change occurs by operation of the terms of the bond and the holder's resulting right to put the bond to the issuer or its agent does not prevent the issuer's option from being a unilateral option.

(2) *Acquisition pursuant to a qualified tender right.* Acquisition of a qualified tender bond by the issuer or its agent does not result in retirement of the bond under paragraph (b)(2) of this section if the acquisition is pursuant to the operation of a qualified tender right and neither the issuer nor its agent continues to hold the bond after the close of the 90-day period beginning on the date of the tender.

(3) *Acquisition of a tax-exempt bond by a guarantor or liquidity facility provider.*

Acquisition of a tax-exempt bond by a guarantor or liquidity facility provider acting on the issuer's behalf does not result in retirement of the bond under paragraph (b)(2) of this section if the acquisition is pursuant to the terms of the guarantee or liquidity facility and the guarantor or liquidity facility provider is not a related party (as defined in §1.150-1(b)) to the issuer.

(d) *Effect of retirement.* If a bond is retired pursuant to paragraph (b)(1) of this section (that is, in a transaction treated as an exchange of the bond for a bond with modified terms), the bond is treated as a new bond issued at the time of the modification as determined under §1.1001-3. If the issuer or its agent resells a bond retired pursuant to paragraph (b)(2) of this section, the bond is treated as a new bond issued on the date of resale. In both cases, the rules of §1.150-1(d) apply to determine if the new bond is part of a refunding issue.

(e) *Definitions.* For purposes of this section, the following definitions apply:

(1) *Issuer* means the State or local governmental unit (as defined in §1.103-1) that actually issues the tax-exempt bond and any related party (as defined in §1.150-1(b)) to the actual issuer (as distinguished, for example, from a conduit borrower that is not a related party to the actual issuer).

(2) *Qualified tender bond* means a tax-exempt bond that, pursuant to the terms of its governing contract, has all of the features described in this paragraph (e)(2). During each authorized interest rate mode, the bond bears interest at a fixed interest rate, a qualified floating rate under §1.1275-5(b), or an objective rate for a tax-exempt bond under §1.1275-5(c)(5). Interest on the bond is unconditionally payable at periodic

intervals of no more than one year. The bond has a stated maturity date that is not later than 40 years after the issue date of the bond. The bond includes a qualified tender right.

(3) *Qualified tender right* means a right or obligation of a holder of the bond to tender the bond for purchase as described in this paragraph (e)(3). The purchaser under the tender may be the issuer, its agent, or another party. The tender right is available on at least one date before the stated maturity date. For each such tender, the purchase price of the bond is equal to par (plus any accrued interest). Following each such tender, the issuer or its remarketing agent either redeems the bond or uses reasonable best efforts to resell the bond within the 90-day period beginning on the date of the tender. Upon any such resale, the purchase price of the bond is equal to par (plus any accrued interest).

(f) *Applicability date*. This section applies to events and actions taken with respect to bonds that occur on or after the date that is 90 days after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 3. Section 1.1001-3 is amended by:

1. Revising paragraph (a)(2).
2. Revising the paragraph (h) subject heading.
3. Revising the first sentence of paragraph (h)(1).
4. Revising the paragraph (h)(2) subject heading.
5. Adding paragraph (h)(3).

The revisions and addition read as follows:

§1.1001-3 Modifications of debt instruments.

(a) * * *

(2) *Qualified tender bonds.* For special rules governing whether tax-exempt bonds that are qualified tender bonds are retired for purposes of sections 103 and 141 through 150, see §1.150-3.

* * * * *

(h) *Applicability date.* * * *

(1) * * * Except as otherwise provided in paragraphs (h)(2) and (3) of this section, this section applies to alterations of the terms of a debt instrument on or after September 24, 1996. * * *

(2) *Alteration or modification results in an instrument or property right that is not debt.* * * *

(3) *Qualified tender bonds.* Paragraph (a)(2) of this section applies to events and actions taken with respect to qualified tender bonds that occur on or after the date that is 90 days after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Kirsten Wielobob

Deputy Commissioner for Services and Enforcement.