Published on *The National Law Review* https://natlawreview.com

A “Good” Tax-Advantaged Bond Bill Tells Issuers Whether They Can Refund

Article By:

John W. Hutchinson

This is the first in a series of posts about neutral principles that make for “good” tax-advantaged bond legislation.

A good muni bond tax bill deals with refundings. For new programs, it provides the terms and conditions under which the new bonds may be refunded.

Over the long life of a project and the bonds that finance it, prevailing market interest rates are almost certain to be more favorable at some point than they were when the bonds were issued.[1] Refinancing transactions thus have always been a part of life in our corner of the world. And so the clock will begin to tick as soon as the bonds under a new bond program are issued, and once the issuer can call the bonds, our phones will begin to ring with the question: Can we refund?

A good tax-advantaged bond program will tell issuers in clear language whether and how they can refund bonds under the program.

Although we’re most interested in the neutral principle – certainty – issuers should be given broad latitude to refund new tax-advantaged bonds with bonds that enjoy the same tax-advantaged status. As the IRS recently acknowledged: “Current refunding issues within appropriate size limits that do not increase the outstanding amount of tax-exempt bonds generally are favored transactions for economic and policy purposes because these transactions are done primarily to reduce borrowing costs and these transactions also reduce the Federal costs of the associated tax benefit.”[2] This quote comes from Notice 2019-39, issued in this benighted age where tax-exempt advance refundings generally are not allowed, but there is no reason that an advance refunding bond structure cannot also accomplish this goal if the structure results in overall debt service savings, which is the reason for doing the vast majority of refundings both current and advance.

Where there is ambiguity about whether issuers can issue new tax-advantaged bonds to refund prior tax-advantaged bonds under a new program, the IRS will be left to fill the gaps. The IRS may feel forced to conclude that refundings are not possible when in fact Congress simply hadn’t considered the question.

For example, Congress left some doubt in 2009 about which of the various new bond programs from the American Recovery and Reinvestment Act of 2009 could be refunded with additional bonds under those programs and which could not.

After ARRA was enacted on February 17, 2009, it was instead left to the IRS to determine which of the new types of bonds could be refunded with comparably advantaged bonds and which could not. The IRS did so in a series of Notices. Notice 2009-26 (issued April 3, 2009) concluded that tax credit build America bonds could be refunded with more tax credit BABs, but direct pay BABs[3] could not be, with the exception of "refunding" (which was graciously recharacterized as a reimbursement[4]) post-ARRA taxable debt. The IRS relied on a statement in the Conference Report for ARRA that direct pay BABs could be used only to finance or reimburse capital expenditures.[5] In Notice 2010-35, the IRS extended this rationale to all other direct pay tax credit bonds, with the similar reimbursement/refunding approach contained in Notice 2009-26.

A similar difficulty arose in the Gulf Opportunity Zone bond program under Section 1400N, and its progeny, the Midwestern disaster bond program,[6] but there the IRS allowed current refundings under certain circumstances in Notice 2012-3, noting that the applicable statutes were "silent" and relying on prior relief provided to New York Liberty Bonds. This guidance from the IRS has now been superseded by Notice 2019-39, which is intended "to reduce or eliminate the need for separate program-by-program guidance on this favored type of refinancing for each such program, subject to applicable statutory restrictions." Another way to reduce or eliminate the need for this guidance from the IRS is a clear statutory directive from Congress. The question of a later refunding will be important in nearly every tax-advantaged bond transaction, and Congress should address it in any new tax-advantaged bond legislation.

[1] Though bonds issued these days may be the ultimate test of this hypothesis.

[2] Notice 2019-39.

[3] Or, what the kids today refer to as "BABs."

[4] Cf. Reg. 1.142-4(b).

[5] Notice 2009-26 (citing ARRA Conference Report at 594, n. 147).

[6] And we'll be returning to that . . . unfortunate. . . drafting episode later in this series.

National Law Review, Volume XI, Number 182