

HAWKINS ADVISORY

IRS NOTICE 2011-63 – VOLUME CAP AND TIMING OF ISSUING BONDS

On August 3, 2011, the Internal Revenue Service (“IRS”) released Notice 2011-63 (the “2011 Notice”), providing supplemental guidance on how to determine when State and local bonds, specifically bonds issued pursuant to a draw-down loan or issued pursuant to a commercial paper program, are considered “issued” for purposes of volume cap limitations under section 146 of the Code. The 2011 Notice amends and supplements Notice 2010-81 that was released November 23, 2010 (the “2010 Notice”).

2010 Notice

- The 2010 Notice provided a new definition of “issue date” in connection with bonds structured as a draw-down loan or issued as commercial paper.
- Under the 2010 Notice, *each draw under a draw-down loan or commercial paper program constitutes a separate bond that is issued on the date of that draw*, when the issuer receives the purchase price and interest begins to accrue for Federal income tax purposes.
- Volume cap under section 146 of the Code is applied and allocated to each draw under a draw-down loan or commercial paper program at the time of the draw.
- The primary motivation behind the new definition of “issue date” was the expiring special provisions of the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat 115 (2009) (“ARRA”), which was expiring on December 31, 2010. The 2010 Notice served to forestall issuers from artificially extending the deadline in respect of these ARRA provisions by the issuance of draw-down bonds and commercial paper programs pursuant to the rules of section 1.150-1(c)(4)(i) and (ii) of the Regulations.
- Specifically exempted from the new definition of “issue date” are provisions for “applying the qualified small issuer and de minimis exceptions to the tax-exempt carrying cost disallowance provision under section 265(b)(3) and section 265(b)(7) to draw-down loans.”

2011 Notice

The 2011 Notice provides that an issuer may treat State and local bonds subject to volume cap under section 146 of the Code and other bond volume caps under Federal law as “issued” either on:

- the issue date of the bond, as provided under the 2010 Notice (the “2010 Notice Option”), or
- the issue date of the issue, if the issuer meets the additional requirements of the 2011 Notice (the “Alternative Option”). An issuer that selects the Alternative Option cannot retroactively alter this treatment.

To meet the Alternative Option under the 2011 Notice, the Issuer must issue all of the bonds of the issue (determined as provided under the 2010 Notice) by no later than the earlier of: (A) the statutory deadline for issuing the bonds or (B) the end of the maximum carryforward period for unused volume cap under the applicable statute, treating all of the unused volume cap for the issue as volume cap arising in the year in which the issue date of the issue occurs.

The following example provided in the 2011 Notice illustrates the 2010 Notice Option as well as the Alternative Option.

In Year 1, an issuer receives a \$1 million volume cap allocation from state volume cap that arose in Year 1 under § 146 for a draw-down bond issue of exempt facility bonds under § 142 and issues \$50,000 in Year 1. Thus the issue date of the issue under § 1.150-1(c)(4)(i) occurs in Year 1. In Years 2 through 4, the issuer issues the \$950,000 in remaining bonds of the issue. Under the general rule in Notice 2010-81, \$50,000 of the bonds would be treated as issued in Year 1 on the issue date of those bonds, \$50,000 of volume cap would be treated as used in Year 1, the remaining \$950,000 of the bonds would be treated as issued upon funding of the draws in Years 2 through 4, respectively, and the issuer would use carryforward volume cap (or obtain additional volume cap) to cover those remaining bonds. Under the alternative option, for volume cap purposes, if the issuer in Year 1 treated all of the \$1 million in bonds as issued on the issue date of the issue, the entire \$1 million of bonds of the issue is treated as issued on the issue date of the issue and the entire \$1 million of volume cap is treated as used in Year 1. If the \$1 million in volume cap in Year 1 were a carryforward volume cap, the issuer would have three years from Year 1 to use the carryforward because the alternative option in § 3.01 would treat the amount of the carryforward as volume cap arising in Year 1 (the year in which the issue date of the issue occurs). If the bonds were small issue bonds under §144(a), the alternative option would not be available because under §146 there is no carryforward period for unused volume cap for small issue bonds.

The 2011 Notice specifically excludes small issue bonds issued under section 144(a) of the Code, for which volume cap issued under section 146 may not be carried forward from the year in which it arises, from the relief afforded other categories of tax-exempt bonds the issuance of which is dependent on an allocation of volume cap.

For purposes of information reporting, the 2011 Notice provides that in the case of bonds issued as draw-down bonds and commercial paper after August 3, 2011, issuers who apply the Alternative Option should write or type *“Filed in Accordance with Notice 2011-63 State and Local Bonds: Volume Cap and Timing of Issuing Bonds”* at the top of the applicable information reporting return. An amended information return is not required for bonds treated as issued under the 2011 Notice before August 3, 2011.

Attached are copies of Notice 2010-81 and Notice 2011-63. Please contact a member of the Tax Department if you have any questions regarding the application of the notices.

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Part III - Administrative, Procedural, and Miscellaneous

State and Local Bonds: Volume Cap and Timing of Issuing Bonds

Notice 2011-63

SECTION 1. PURPOSE

This Notice provides supplemental guidance on the determination of when State and local bonds (as defined in § 103(c) of the Internal Revenue Code (the “Code”)) are considered “issued” for purposes of volume cap limitations on private activity bonds under § 146 and other bond volume caps and limitations under Federal law. This Notice amends and supplements Notice 2010-81.

SECTION 2. BACKGROUND

In Notice 2010-81, 2010-50 I.R.B. 825 (December 13, 2010), the Treasury Department and the IRS provided guidance regarding when State and local bonds (as defined in § 103(c)) are considered issued for purposes of various deadlines on issuing bonds. Under the general rule set forth in Notice 2010-81, a bond is treated as issued on the “issue date” of the “bond” under § 1.150-1(b) of the Income Tax Regulations (as contrasted with the “issue date” of the “issue” that includes the bond). This analysis

particularly affects certain financing structures, such as draw-down loans and commercial paper, in which bonds of the same issue are issued at different times. Notice 2010-81 applies to various types of deadlines on issuing bonds, including, among others, volume caps on private activity bonds under § 146 and other bond volume caps under Federal law such as national limitations for the amount and timing of bonds issued as Qualified Zone Academy Bonds or Qualified Gulf Opportunity Zone Bonds.

In general, § 146 imposes annual State volume caps on private activity bonds and allows issuers to “carry forward” unused volume cap for use during a three-year carryforward period after the calendar year in which the original bond volume cap authorization arose. Other volume caps on bonds issued by State or local governments may apply in a similar manner, subject to different carryforward periods based on statutory deadlines, depending on the particular program.

The Treasury Department and the IRS have received comments that prior to Notice 2010-81, various States and issuers treated a bond as issued on other than its issue date as provided in Notice 2010-81, creating concerns for the treatment of draw-down loans and commercial paper for purposes of allocation, use, and administration of volume caps on private activity bonds under § 146.

SECTION 3. SCOPE AND APPLICATION

01. Bond Issuance for Purposes of Volume Cap Allocations. Solely for purposes of the private activity bond volume cap under § 146 and other bond volume caps on

State and local bonds under Federal law, an issuer may treat a bond as issued either: (1) on the issue date of the bond under the general rule in Notice 2010-81 or (2) in the alternative, on the issue date of the issue provided that the issuer meets the additional requirements of this § 3.01. An issuer that treats the bonds as issued on the issue date of the issue may not retroactively alter such treatment.

The issuer meets the additional requirements of this § 3.01 if the issuer issues all of the bonds of the issue, determined for this purpose by treating each bond of the issue as issued on the issue date of that bond under the general rule in Notice 2010-81, by no later than the earlier of: (i) the statutory deadline for issuing the bonds or (ii) the end of the maximum carryforward period for unused volume cap under the applicable statute, treating all of the unused volume cap for the issue as volume cap arising in the year in which the issue date of the issue occurs.

02. Example. In Year 1, an issuer receives a \$1 million volume cap allocation from state volume cap that arose in Year 1 under § 146 for a draw-down bond issue of exempt facility bonds under § 142 and issues \$50,000 in Year 1. Thus the issue date of the issue under § 1.150-1(c)(4)(i) occurs in Year 1. In Years 2 through 4, the issuer issues the \$950,000 in remaining bonds of the issue. Under the general rule in Notice 2010-81, \$50,000 of the bonds would be treated as issued in Year 1 on the issue date of those bonds, \$50,000 of volume cap would be treated as used in Year 1, the remaining \$950,000 of the bonds would be treated as issued upon funding of the draws in Years 2 through 4, respectively, and the issuer would use carryforward volume cap

(or obtain additional volume cap) to cover those remaining bonds. Under the alternative option, for volume cap purposes, if the issuer in Year 1 treated all of the \$1 million in bonds as issued on the issue date of the issue, the entire \$1 million of bonds of the issue is treated as issued on the issue date of the issue and the entire \$1 million of volume cap is treated as used in Year 1. If the \$1 million in volume cap in Year 1 were a carryforward volume cap, the issuer would have three years from Year 1 to use the carryforward because the alternative option in § 3.01 would treat the amount of the carryforward as volume cap arising in Year 1 (the year in which the issue date of the issue occurs). If the bonds were small issue bonds under § 144(a), the alternative option would not be available because under § 146 there is no carryforward period for unused volume cap for small issue bonds.

.03. Information Reporting. Section 1.149(e)-1(e)(2)(ii) of the Income Tax Regulations provides guidance on applicable information reporting requirements under § 149(e) for State and local bonds issued as draw-down bonds and commercial paper. For such information reporting purposes, in the case of issues issued after August 3, 2011, issuers who apply the alternative option under § 3.01 of this Notice should write or type “Filed in Accordance with Notice 2011-63 State and Local Bonds: Volume Cap and Timing of Issuing Bonds” at the top of the applicable information reporting return. Pursuant to §1.149(e)-1(e)(2)(ii), amended information reporting returns are not required for this purpose for bonds treated as issued under this notice before August 3, 2011.

SECTION 4. EFFECT ON OTHER DOCUMENTS

This Notice amends and supplements Notice 2010-81.

SECTION 5. DRAFTING INFORMATION

The principal authors of this Notice are Vicky Tsilas and Timothy L. Jones of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this Notice, contact Vicky Tsilas at (202) 622-3980 (not a toll-free call).

Part III - Administrative, Procedural, and Miscellaneous

Build America Bonds and Other State and Local Bonds: Timing of Issuing Bonds

Notice 2010-81

SECTION 1. PURPOSE

This Notice provides guidance on the determination of when State and local bonds (as defined in § 103(c)) of the Internal Revenue Code (the “Code”) are considered “issued” for purposes of deadlines on issuing bonds. This Notice provides guidance on the relevant distinction between the “issue date” of a “bond” versus the “issue date” of an “issue” for purposes of this determination. One instance, among others, in which this Notice applies is in determining when Build America Bonds, structured as “draw-down” bonds or loans in which draws are funded at different times, are considered issued for purposes of statutory deadlines on issuing these bonds under § 54AA.

This Notice does not apply for purposes of applying the qualified small issuer and de minimis exceptions to the tax-exempt carrying cost disallowance provision under § 265(b)(3) and § 265(b)(7) to draw-down loans.

SECTION 2. BACKGROUND

Section 1531 of Title I of Division B of the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009) (“ARRA”) added § 54AA to the Code, which authorizes State and local governments, at their option, to issue Build America Bonds as taxable governmental bonds and receive Federal subsidies for a portion of their borrowing costs. Sections 54AA(d), 54AA(g), and 6431 require that Build America Bonds be issued before January 1, 2011.

In a related provision, § 1401 of ARRA added §§ 1400U-1 through 1400U-3 to the Code, which authorizes two types of “Recovery Zone Bonds,” including a type of Build America Bond known as “Recovery Zone Economic Development Bonds” and a type of traditional tax-exempt bond known as “Recovery Zone Facility Bonds.” These Recovery Zone Bonds have bond volume limitations and a statutory deadline that requires the bonds to be issued before January 1, 2011.

Section 1503(a) of ARRA amended § 57(a)(5)(C) to add new clause (vi), which provides, in part, that for purposes of the alternative minimum tax preference for interest on certain tax-exempt private activity bonds under § 57(a)(5)(C)(i), the term “private activity bond” shall not include any bond issued after December 31, 2008, and before January 1, 2011. Section 1503(b) of ARRA amended § 56(g)(4)(B) to add new clause (iv), which provides that the adjusted current earnings (ACE) adjustment under § 56(g)(4)(B)(i) for interest on certain tax-exempt bonds shall not include any interest on certain bonds issued after December 31, 2008, and before January 1, 2011.

In addition, other statutory provisions impose statutory time periods for issuing State and local bonds in both targeted circumstances and in more general circumstances. Another selected example of a targeted bond program that imposes a statutory time period on issuing bonds is the Gulf Opportunity Zone Bond program under § 1400N. One general provision that imposes statutory time periods on issuing bonds is the annual State private activity bond volume cap under § 146, which generally limits the amount of tax-exempt private activity bonds that may be issued in a State in a particular year. Similarly, certain types of qualified tax credit bonds under § 54A have volume caps and statutory time periods for issuing bonds. Another general provision is § 265(b)(3), which generally provides an exception to the carrying cost disallowance provision for financial institutions that purchase tax-exempt obligations from “qualified small issuers” that reasonably expect to issue no more than \$10 million in tax-exempt bonds in a calendar year. ARRA raises the amount of this exception to \$30 million for bonds issued in 2009 and 2010. Thus, the determination of when bonds are issued is relevant to the statutory limitations affecting Build America Bonds and many other State and local bond programs.

Recently, questions have arisen about which issue date rule applies for the statutory deadline on issuing Build America Bonds with respect to a financing structure known as “draw-down” loans in which funds are advanced at different times. The regulations provide issue date rules for “bonds” and for “issues” of bonds (with subsidiary special rules which treat bonds issued under draw-down loans or commercial

paper programs as part of the same issue). Section 1.150-1(b) of the Income Tax Regulations includes a general definition for the “issue date” of a “bond,” that provides the issue date is the date on which the issuer receives the purchase price in exchange for that bond, provided that in no event is the issue date of a bond earlier than the first day on which interest begins to accrue on such bond for Federal income tax purposes. See also Harbor Bancorp v. Commissioner, 105 T.C. 260 (1995), aff’d 115 F.3d 722 (9th Cir. 1997)(citing regulatory predecessors to this general definition in interpreting statutory deadlines for issuing bonds under the Tax Reform Act of 1986).

Section 1.150-1(b) defines a “bond” to mean any “obligation” of a State or political subdivision thereof under § 103(c)(1). Section 1.150-1(b) also defines an “obligation” to mean any valid evidence of indebtedness under general Federal income tax principles.

By comparison, § 1.150-1(c) defines the broader term bond “issue” under a general definition and various special rules that may include bonds as part of the same issue even if they are issued at different times under a common tax plan. Section 1.150-1(b) defines the “issue date” of an “issue” to mean the first date on which the issuer receives the purchase price in exchange for delivery of the evidence of indebtedness representing any bond included in the issue, provided that in no event is the issue date of an issue earlier than the first day on which interest begins to accrue on the first bond included in the issue for Federal income tax purposes. Section 1.150-1(c)(1) provides a general rule which treats bonds as part of the same issue if the bonds

are sold (versus issued) at substantially the same time (meaning sold less than 15 days apart), the bonds are part of the same plan of financing, and the bonds are reasonably expected to be paid from the same source of funds.

Section 1.150-1(c)(4)(i) treats bonds issued pursuant to a “draw-down loan” as part of the same bond issue. This special rule further provides that the issue date of the issue is the first date on which the aggregate draws under the loan exceed the lesser of \$50,000 or five percent of the issue price. Section 1.150-1(c)(4)(ii) allows commercial paper issued pursuant to the same commercial paper program to be treated as part of the same issue. This special rule further provides that the issue date of the issue is the first date on which the aggregate amount of commercial paper issued under the program exceeds the lesser of \$50,000 or five percent of the issue price. This special rule generally allows commercial paper to be treated as part of the same issue if it is issued to finance or refinance the same governmental purposes pursuant to a single master legal document during an 18-month period or if it is issued to refinance such commercial paper for up to 30 years if there is no increase in the principal amount after the initial 18-month period. These 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. In Rev. Rul. 89-70, 1989-1 C.B. 88, however, the IRS ruled that the entire stated principal amount of a draw-down loan was considered issued on the date on which more than a de minimis amount of the loan was first advanced.

SECTION 3. SCOPE

This Notice applies for determining compliance with deadlines for issuing State and local bonds such as Build America Bonds under §§ 54AA(d), 54AA(g) and 6431, and Recovery Zone Bonds under §§ 1400U-1 through 1400U-3. The analysis in this Notice also applies for other deadlines for issuing bonds, such as, among others, the exceptions to the alternative minimum tax preferences and adjustments for interest on certain tax-exempt bonds under §§ 56(g)(4)(B)(iv) and 57(a)(5)(C)(vi), Gulf Opportunity Zone Bonds under § 1400N and various volume cap limitations on State and local bonds (as defined in § 103(c)).

This Notice does not apply for purposes of applying the qualified small issuer and de minimis exceptions to the tax-exempt carrying cost disallowance provision under § 265(b)(3) and § 265(b)(7) to draw-down loans. For this purpose, Rev. Rul. 89-70 will continue in effect until further guidance is provided, which guidance will be prospective.

SECTION 4. GUIDANCE

In general, for determining compliance with deadlines on issuing bonds covered by this Notice, a bond is considered issued on the “issue date” of the “bond” under § 1.150-1(b). Section 1.150-1(b) defines the “issue date” of a “bond” to mean the date on which the issuer receives the purchase price in exchange for that bond, provided that in no event is the issue date of a bond earlier than the first day on which interest begins to accrue on such bond for Federal income tax purposes.

By contrast, the issue date of an “issue” under § 1.150-1(b) is the first date on

which the issuer receives the purchase price in exchange for delivery of the evidence of indebtedness representing any bond included in the issue, provided that in no event is the issue date of an issue earlier than the first day on which interest begins to accrue on the first bond included within the issue for Federal income tax purposes. Bonds may be issued at different times and nonetheless be treated as part of the same bond “issue” under the various special provisions for single issues under § 1.150-1(c). Thus, to ensure that an entire issue of bonds meets a statutory deadline on issuing bonds, all of the bonds that are part of the issue should be issued by the applicable statutory deadline.

In the particular case of a “draw-down” loan under § 1.150-1(c)(4)(i) or a commercial paper program under § 1.150-1(c)(4)(ii), in which a bond is issued as a draw or as commercial paper at different times and interest begins to accrue on each draw or commercial paper when it is funded, each draw or commercial paper constitutes a separate bond that is issued on the issue date of that draw or commercial paper when the issuer receives the purchase price, and interest begins to accrue, on that draw or commercial paper for Federal income tax purposes. Thus, for Build America Bonds structured as draw-down loans or commercial paper programs, only those draws or commercial paper that are funded before January 1, 2011, and for which interest begins to accrue for Federal income tax purposes before January 1, 2011, may qualify as Build America Bonds for purposes of the statutory time deadlines for issuing Build America Bonds.

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The principal authors of this notice are Vicky Tsilas and Timothy L. Jones of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice contact Vicky Tsilas at (202) 622-3980 (not a toll-free call).