January 20, 2023

Helen Hubbard, Esq.
Associate Chief Counsel
Financial Institutions and Products (CC:FIP)
Internal Revenue Service (IRS)

Re: Declaration of Intent Requirement of Treasury Regulations § 1.150-2

Dear Ms. Hubbard,

The National Association of Bond Lawyers ("NABL") is a non-profit organization and specialty bar association of approximately 2,500 lawyers. NABL exists to promote the integrity of the municipal bond market by advancing the understanding of and compliance with the law affecting public finance. NABL members and their firms are involved every year in a significant portion of the municipal financings by United States state and local governments.

Enclosed, please find a commentary prepared by NABL's Tax Law Committee describing the declaration of intent requirement contained in Treasury Regulations § 1.150-2 and setting forth its historical background. The purposes of this commentary are to (1) highlight that the declaration of intent requirement does not mandate the use of specific words and phrasing in order to find that an official intent has been declared and (2) suggest that additional clarifying guidance may be necessary at this time.

We hope this commentary will be helpful not only to practitioners but also to Treasury Department officials and field examiners in evaluating the validity of official intent declarations. We would be happy to discuss the commentary with you at your convenience if you have questions or concerns. Our Director of Governmental Affairs, Brian Egan, can coordinate these discussions. You can reach Brian via email at began@nabl.org or via phone at (202) 503-3290.

Sincerely,

Joseph (Jodie) E. Smith
President
National Association of Bond Lawyers

cc:

- Lily Batchelder, Assistant Secretary for Tax Policy, U.S. Department of Treasury
- Brett York, Deputy Tax Legislative Counsel, U.S. Department of the Treasury
- Jian H. Grant, Branch Chief, CC:FIP:B5, IRS
- Johanna Som de Cerff, Senior Technical Reviewer, CC:FIP:B5, IRS
- Edward Killen, Commissioner, Tax Exempt & Government Entities, IRS
- Robert Choi, Deputy Commissioner, Tax Exempt & Government Entities, IRS
- Robert Malone, Director, Exempt Organizations and Government Entities, IRS

NATIONAL ASSOCIATION OF BOND LAWYERS

DECLARATION OF OFFICIAL INTENT REQUIREMENT OF TREASURY REGULATIONS § 1.150-2

I. INTRODUCTION

The rules in Treasury Regulations § 1.150-2 (the "Final Regulations") determine when capital expenditures paid from funds other than proceeds of debt may be reimbursed with the proceeds of a subsequent borrowing. The Final Regulations reflect a concern that, without these rules, issuers[1] may "avoid compliance with sections 103 and 141-150 by simply allocating bond proceeds to capital expenditures paid long before issuance of the bonds and without reliance on the bond issue."[2]

The Final Regulations address this concern by forcing an issuer to reimburse expenditures within a timely manner and by requiring an issuer to declare its official intent with respect to the expenditures within a prescribed time period. The timing limit directly tackles the problem by limiting how far back an issuer can go to find expenditures to reimburse. The declaration of intent requirement addresses the problem in a more indirect way by requiring an issuer to state its intentions regarding a project at the time the original project expenditures are made, rather than in hindsight. Even if Treasury had never created a declaration of intent requirement, the reimbursement timing limit already seriously limits the ability of an issuer to use a reimbursement to avoid tax restrictions or requirements.

The Final Regulations are the result of several rounds of proposed and revised regulatory provisions. The declaration of intent requirement was revised throughout this process. The regulators at Treasury considered at great length whether they should require an official intent to contain certain "magic" words, such as a specific reference to "reimbursement". They ultimately determined that requiring specific language needlessly intruded into the existing practices of issuers and presented a trap for the unwary, as described below in more detail.

We understand that the Internal Revenue Service (the "IRS") in recent bond examinations has been taking the position that a reimbursement resolution does not meet the declaration of intent requirement if the declaration does not specifically use the word "reimburse" or some form of such word. We believe the history of the Final Regulations clearly demonstrates that there is no requirement

[1] Any references in this report to the "issuer" as the entity that adopts a declaration of official intent also include a governmental or 501(c)(3) conduit borrower that is authorized to declare an official intent under the definition of "issuer" in Treasury Regulations § 1.150-2(c).

[2] Preamble to Proposed Treasury Regulations §§ 1.103-17 and 1.103-18, FI-59-89 (Apr. 25, 1991).

to state a declaration of intent using any “magic” words. We note that Treasury specifically considered such a requirement but abandoned it prior to publishing the Final Regulations. We believe that the IRS’s bond examination position conflicts with the well-established understanding of the reimbursement provisions by participants in the municipal marketplace ever since the Final Regulations were finalized in 1993. Additional guidance clarifying that no particular form or specific wording is required for a declaration of intent beyond what is set forth in the Final Regulations may be necessary at this time.

The following discussion describes the history of the declaration of intent requirement and discusses what we believe is the prevailing industry practice based on the guidance set forth in the Final Regulations. We are providing this commentary to assist practitioners and Treasury officials and field examiners in evaluating the validity of official intent declarations.

II. DISCUSSION

A. Summary

Over 30 years ago, Treasury considered how an issuer should indicate its intent to ultimately finance project costs originally paid from other sources. Over the course of three years, from 1991 to 1993, the regulators exhaustively discussed how to prevent abuses in connection with the reimbursement of such costs, resulting in the promulgation of the Final Regulations in 1993.

The history of the Final Regulations, described below, is essential to understanding the reimbursement rules. The Final Regulations replaced interim final regulations issued in 1992 (T.D. 8394 (Jan. 30, 1992)) (the “Interim Final Regulations”). The Interim Final Regulations finalized a set of proposed regulations issued in 1991 (56 F.R. 19046 (Apr. 15, 1991)) (the “Proposed Regulations”). The standard set forth in both the Proposed Regulations and the Interim Final Regulations required the issuer to affirmatively state its intent “to reimburse” project costs paid prior to the issue date of the bonds and to cite the reimbursement regulations in the declaration.

The Final Regulations **deliberately deleted** these requirements. Under the Final Regulations, issuers are no longer required to state a specific intent “to reimburse” an original expenditure or cite the reimbursement regulations. See Treasury Regulations § 1.150-2(e)(1), which provides that “the official intent [may be] made in any reasonable form” and § 1.150-2(e)(2), which requires that the “official intent generally describes the project for which the original expenditure is paid and states the maximum principal amount of obligations expected to be issued for the project.” Neither paragraph requires specific wording or a citation to the reimbursement regulations.

The drafters of the Final Regulations acknowledged that the declaration of intent requirement of the “official action rules” (described below) that existed at the time, together with the issuer’s course of action in issuing the bonds and reimbursing the expenditures, and certain timing rules, were sufficient to safeguard the proper application of bond proceeds to reimburse project costs paid prior to the issuance date of the bonds. Because Treasury’s primary reason for regulating reimbursement financings (as it said in the Proposed Regulations) is to prevent issuers from avoiding the tax-advantaged bond rules "by simply allocating bond proceeds to capital expenditures paid long before issuance of the bonds and without reliance on the bond issue," the reimbursement timing limit is a more important safeguard than the declaration of intent requirement. In deleting the requirement that the official intent use any particular "magic" words or refer specifically to reimbursement, the Final Regulations recognize that issuers employ a diverse array of practices to budget for capital projects and to decide whether and when to use debt to finance them.

B. Pre-1993 Treasury Regulations § 1.103-8(a)(5)

Historically, the reimbursement bond rules applied only to industrial development bonds ("IDBs"), which were the predecessors to modern-day private activity bonds. Treasury Regulations § 1.103-8(a)(5) (commonly referred to as the "official action rules") established the rules pursuant to which project costs paid prior to the issue date of tax-exempt IDBs could be preserved for inclusion in a subsequent bond issue. These rules required that a conduit issuer take "official action" that demonstrated the conduit borrower's "intent to finance" the project. Such official action needed to be taken prior to the conduit borrower having paid a cost to be subsequently reimbursed. This "intent to finance" established the nexus between the project cost and the eventual bond issue.

C. Pyramid Bonds

In the late 1980s and early 1990s, the question of inappropriate reimbursements in the context of governmental bonds came to the IRS's attention. The concern was that issuers were issuing tax-exempt governmental bonds to finance "old and cold" project costs on a reimbursement basis. Once the issuer made the reimbursement allocation, the bond proceeds that were the target of the allocation were "cleansed" of their status as tax-exempt bond proceeds and could be used for any purpose, including general working capital expenditures. These "old and cold" structures came to be known derisively as "pyramid bonds." An article entitled "Underwriters May be Trying to Force Spate of 'Pyramid' Deals, IRS Aide Says," published in The Bond Buyer on June 4, 1990, described the transactions and the Treasury Regulations that were expected to be issued to address the abuses inherent in such transactions (and explained the etymology of the "pyramid bond" epithet):

> Pyramid deals are issues sold to reimburse an issuer for a project completed long ago that the issuer never intended to finance with tax exempt bonds. The term "pyramid" alludes to the absurdity of issuing bonds now to recover the costs of building the Egyptian pyramids centuries ago . . . upcoming regulations are designed to spell out when a reimbursement is legitimate and when it is not.

D. Proposed Regulations

On April 15, 1991, Treasury issued Proposed Regulations § 1.103-17(c) that set forth the operating rules for all types of tax-exempt bond issues pursuant to which project costs paid prior to the issue date of the bonds could be reimbursed. Proposed Regulations § 1.103-17(c)(1) also required that the issuer declare "a reasonable intent to reimburse the expenditure with the proceeds of a borrowing." Proposed Regulations § 1.103-17(e) then addressed the procedure for declaring such official intent:

> The issuer . . . states in the publicly available official books, records, or proceedings of the issuer that the issuer **intends to reimburse the expenditure** with proceeds of a borrowing . . . [t]he official intent must state that the issuer **intends to reimburse the expenditure** by either incurring debt the interest on which is excludable from gross income under section 103 ("tax-exempt debt") or by incurring taxable debt or tax-exempt debt. An official intent that states that an issuer only intends to incur debt does not meet the requirements of this paragraph. (Emphasis added.)

The requirements in the Proposed Regulations prompted an outcry of criticism.

On July 15, 1991, NABL submitted its "Comments of the Committee on Arbitrage and Rebate on Proposed Treasury Regulation §§ 1.103-17 and 1.103-18" to the IRS. The committee articulated its "major concern that the rules for establishing the required nexus [were] overly complex, requiring compliance with several detailed tests. Failure to comply with any of these, even if such failure might otherwise be characterized as non-substantive, can preclude a financing which in all other respects is unobjectionable." The NABL comments continued:

> While the proposed regulations are written in a clear and understandable fashion, the level of detail and complexity of the proposed rules stands in sharp contrast to the official action rules which as interpreted and applied, are short, simple and relatively easy to apply . . . we are aware of no abuse stemming from the application of the official action rules. In light of this it is our principal recommendation that the proposed regulations be significantly **simplified by bringing them more into conformance with the format and approach of the official action rules**. (Emphasis added.)

The comments also specifically addressed the "intent to reimburse" requirement of the Proposed Regulations:

> The proposed rule also provides that the official intent declaration must state an intention to reimburse the expenditure with debt and must recite that the financing either will or may be tax-exempt debt. Although the language is somewhat confusing, and the requirement, once understood, is relatively straightforward, we see little need for this level of detail. We believe the appropriate issue is whether the issuer intends to incur debt to finance a capital expenditure. The tax status of the debt should be irrelevant.

E. Interim Final Regulations

On January 30, 1992, Treasury issued the Interim Final Regulations. Interim Final Regulations § 1.103-18(f) provided that a declaration of intent was satisfactory only if it "state[d] that the issuer reasonably expect[ed] to reimburse the expenditure with proceeds of debt to be incurred by the issuer" and "specifically states that it is a declaration of official intent under this section."

The preamble to the Interim Final Regulations explained that, for the declaration of official intent to satisfy the Interim Final Regulations, the issuer must include a statement to the effect that it intends to reimburse a particular cost and must actually cite the Interim Final Regulations. As discussed below, the Final Regulations (which are in force today) **specifically removed this requirement.**

F. Final Regulations

Prior to the publication of the Final Regulations, proposed Treasury Regulations were published on November 6, 1992 (57 FR 53046) (the "Proposed Arbitrage Regulations"), which addressed arbitrage rules in general and made certain changes to the reimbursement bond rules previously set forth in the Interim Final Regulations. In describing the changes to the Interim Final Regulations, the drafters stated in the preamble to the Proposed Arbitrage Regulations that they were replacing "the requirement that the declaration of official intent be consistent with the budgetary and financial circumstances of the issuer with a **broad anti-abuse rule** relating to replacement proceeds, the principal concern of the existing requirement." (Emphasis added).

The Final Regulations (T.D. 8476, 58 FR 33551) were published on June 18, 1993. The preamble to the Final Regulations note that "[t]he [Proposed Arbitrage Regulations] provide simplified and expanded rules to determine when an allocation of bond proceeds to reimburse expenditures previously made by an issuer is treated as an expenditure of those bond proceeds."

As noted above, Final Regulations § 1.150-2(e) sets forth the exhaustive list of what an issuer must include in a declaration of official intent. Final Regulations § 1.150-2(e)(1) provides that the official intent can be "made in any reasonable form." Final Regulations § 1.150-2(e)(2) then provides that a valid "official intent generally describes the project for which the original expenditure is paid and states the maximum principal amount of obligations expected to be issued for the project." Those are the requirements that govern declarations of intent. To reiterate the key point, **in contrast to the Proposed Regulations and the Interim Final Regulations, the Final Regulations specifically do not require the issuer to include the word "reimburse" or any variation thereof or to cite the reimbursement regulations.**

In issuing the Final Regulations, Treasury ultimately determined that the historic IDB official action rules (which required only a statement of intent to finance, a project description and a maximum dollar amount for the project), together with the requirement that the issuer actually reimburse the expenditure within permitted time limits, adequately addressed any concerns regarding improper reimbursements of project costs paid prior to the issue date of the bonds. This important development in the IRS's position regarding reimbursement allocations illustrates that Treasury appreciated that, when an issuer expresses an intent to ultimately finance an original expenditure for a project, there is a clear nexus between the project and an eventual borrowing. In situations in which the allowable reimbursement time period has been exceeded, the governmental entity is precluded from reimbursing itself from the proceeds of tax-advantaged bonds, and the issuer must borrow on a taxable basis.

Additionally, the Final Regulations distinguish between the information that must be included in a declaration of official intent (which, as described above, allows the issuer the flexibility to make the declaration in any reasonable form) and the reasonable expectations of the issuer at the time such declaration is made to reimburse original expenditures. These expectations may be established by facts and information outside of the stated language of the declaration of intent. However, there is no requirement that the issuer explicitly state this reasonable expectation through use of the term "reimburse" or any variation thereof.

Moreover, the Final Regulations also address the IRS's concern regarding abusive reimbursement financings by invalidating reimbursement declarations if the issuer adopts them as a matter of course, or engages in a pattern of failure to reimburse. These requirements adequately police the abusive pyramid bond transactions, which originally prompted the reimbursement regulations.

G. <u>Industry Practice</u>

The experience of NABL members and their issuer clients in the nearly thirty years since Treasury issued the Final Regulations has been that the process by which issuers adopt official intents for reimbursements purposes continues to be broadly diverse, just as it was when the Treasury issued the Final Regulations. Until recently, NABL was not aware of the Tax-Exempt and Governmental Entities Division of the IRS taking the position, during examinations or otherwise, that the Final Regulations require issuers to specifically state that they will reimburse (as opposed to finance) original expenditures with future bonds or to cite the reimbursement regulations in a declaration of intent.

A leading treatise aptly summarizes the state of play:

> "[I]n an earlier version of the regulations [i.e., the Proposed Regulations and Interim Final Regulations], particular language was required. This was viewed as a trap for the unwary and was removed from the [Final Regulations]. Because there is this flexibility on the form of the declaration, issuers at times will search for documents (such as budgets), that while adopted for other purposes include sufficient declarations."[3]

[3] Bloomberg Tax Management Portfolio – 183 1st: *Tax-Advantaged Bonds*, Section V(G), n. 1634.

NABL is not aware of any new and abusive reimbursement structures or techniques that would necessitate returning 30 years after the fact to the abandoned approach of the Proposed Regulations and the Interim Final Regulations.

H. Conclusion

The development and history of the Final Regulations illustrate why an issuer does not need to specifically mention reimbursement or specifically cite the Treasury Regulations when adopting a declaration of intent for reimbursement purposes. Specifically, taking into consideration (a) the deliberate deletion of the requirement that an issuer use specific language in its official action in favor of a reasonableness standard, (b) the historical official action rules of Treasury Regulations § 1.103-8(a)(5) that formed the basis of the reimbursement regulations, (c) the timing limits and course of conduct requirements that already effectively control the danger that reimbursement rules are intended to address, and (d) the anti-abuse rules included in the Final Regulations, we respectfully submit that the Treasury Regulations, as currently in effect, require only that an issuer's declaration of intent generally describe the project to be financed and indicate the maximum amount of debt expected to be issued in respect of such project.