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Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20044

CC:PA:RU (REG-13248-03)

Re: Proposed Regulations addressing Remedial Actions for Tax-exempt Bonds

Ladies and Gentlemen:

Enclosed are comments of the subcommittee of the General Tax Matters Committee of the National Association of Bond Lawyers addressing the notice of proposed rulemaking (REG-13248-03), Remedial Actions for Tax-exempt Bonds, RIN 1545-BC40, published in the Federal Register on July 21, 2003 (the "Proposed Regulations"). We appreciate your consideration of the enclosed comments and would be pleased to make ourselves available to discuss the comments or any other aspect of the Proposed Regulations with you and representatives of the Department of Treasury.

If you have any questions or would like to receive any other materials or information, please feel free to contact me at 202.682.7234.

Sincerely yours,

Loretta J. Roby

Loretta J. Roby

Enclosure

cc: Rebecca Harrigal, Esq.
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COMMENTS ON IRS PROPOSED REGULATIONS REGARDING REMEDIAL ACTIONS

I. INTRODUCTION

The following are comments prepared by a subcommittee[1] of the General Tax Matters Committee (the "Committee") of the National Association of Bond Lawyers ("NABL") addressing the notice of proposed rulemaking (REG-13248-03), Remedial Actions for Tax-exempt Bonds, RIN 1545-BC40, published in the Federal Register on July 21, 2003 (the "Proposed Regulations"). These comments were prepared by the Committee in accordance with NABL's purposes. While not all members of the Committee necessarily concur in each of these comments, the comments represent the consensus of the participants. Reference herein to the term "we" or "the Committee" is to the participants identified in footnote 1 hereof. We would welcome the opportunity to discuss these comments with representatives of the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") and to answer any questions that the comments may raise.

NABL was incorporated as an Illinois nonprofit corporation on February 5, 1979, for the purposes of educating its members and others in the law relating to state and municipal bonds and other obligations, providing a forum for the exchange of ideas as to law and practice, improving the state of the art in the field, providing advice and comment at the federal, state and local levels with respect to legislation, regulations, rulings and other actions, or proposals therefor, affecting state and municipal obligations, and providing advice and comment with regard to state and municipal obligations in proceedings before courts and administrative bodies through briefs and memoranda as a friend of the court or agency. NABL currently has approximately 3,100 members.

As an initial matter we want to commend the IRS and Treasury for reviewing and proposing amendments to the final Treasury Regulations addressing remedial actions for tax-exempt bonds. Our recommendations outlined below are intended to highlight certain areas where additional clarification would be helpful and where further improvements would be welcomed to allow greater flexibility for issuers of tax-exempt bonds. These comments do not purport to be comprehensive but we hope that they are constructive.

II. BACKGROUND

Section 103(a) of the Internal Revenue Code (the "Code") provides that, generally, interest on any State or local bond is not included in gross income. This

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1 These comments were prepared through the efforts of Clifford Gerber, Nancy Lashnits, Scott Lilienthal, Mark Norell, Loretta Roby and Linda Schakel.

exclusion, however, is not applicable to any private activity bond that is not a qualified bond.

A. Summary of Final Treasury Regulations relating to Remedial Actions.

In general, section 141 of the Code provides that a private activity bond is any bond issued as part of an issue that meets either (1) the private business use test and the private security or payment test (the "private business tests"), or (2) the private loan financing test. In particular, an issue of bonds meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. An issue of bonds meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of the issue is directly or indirectly (1) secured by any interest in property used or to be used for a private business use, (2) secured by any interest in payments in respect of such property, or (3) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use. An issue of bonds meets the private loan financing test if more than the lesser of $5 million or 5 percent of the proceeds of the issue are to be used to make or finance loans to persons other than governmental units.

Section 1.141-2(d) of the Treasury Regulations provides that an issue is an issue of private activity bonds if the issuer reasonably expects, as of the issue date, that the issue will meet either (1) the private business tests or (2) the private loan financing test. Section 1.141-2(d) of the Treasury Regulations further provides that an issue is also an issue of private activity bonds if the issuer takes a deliberate action, subsequent to the issue date, that causes the conditions of either the private business tests or the private loan financing test to be met. Section 1.141-12(a) of the Treasury Regulations provides, however, that an action that would cause an issue to meet the private business tests or the private loan financing test is not treated as a deliberate action if the issuer takes one of the three described remedial actions and if certain other enumerated requirements are met.

The three described remedial actions in Section 1.141-12 of the Treasury Regulations include the following:

- redemption or defeasance of "nonqualified bonds," if certain requirements are met; but a defeasance is not a permitted remedial action if the period between the issue date and the first call date of the bonds is more than 10 ½ years;
- alternative use of disposition proceeds, if the deliberate action is a disposition of the bond-financed property for which the consideration is exclusively cash, and certain other requirements are met; and
- alternative use of the facility, if certain requirements are met.

With respect to the second remedial action outlined above, §1.141-12(e)(2) of the Treasury Regulations provides, in part, that if the disposition proceeds are to be used by a

501(c)(3) organization, the nonqualified bonds must be treated as reissued for purposes of sections 141, 145, 147, 149 and 150. A similar rule appears in §1.141-12(f)(2) of the Treasury Regulations relating to the third remedial action outlined above which provides, in part, that the nonqualified bonds must be treated as reissued, as of the date of the deliberate action, for purposes of the alternative minimum tax rules and for purposes of Code sections 141, 142, 144, 145, 146, 147, 149 and 150.

Section 1.141-12(j) of the Treasury Regulations provides that the amount of the nonqualified bonds is the percentage of the outstanding bonds equal to the highest percentage of private business use in any 1-year period commencing with the deliberate action. In addition, §1.141-12(j) of the Treasury Regulations provides that allocations to nonqualified bonds must be made on a pro rata basis, except that, for purposes of the remedial action relating to redemption or defeasance of the nonqualified bonds, an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds.

B. Summary of Proposed Regulations Amending Final Treasury Regulations relating to Remedial Actions.

On July 21, 2003, the Proposed Regulations were published in the Federal Register by the IRS amending the final Treasury Regulations that provide certain permitted remedial actions for tax-exempt bonds issued by State and local governments. The Proposed Regulations modify the method by which the nonqualified bonds are determined under §1.141-12 of the Treasury Regulations by specifying that the nonqualified bonds are a portion of the outstanding bonds in an amount that, if the remaining bonds were issued on the date on which the deliberate action occurs, the remaining bonds would not satisfy the private business use test or private loan financing test, as applicable. The Proposed Regulations continue the concept that is in the final Treasury Regulations that the amount of private business use is the greatest percentage of private business use in any one-year period commencing with the deliberate action.

The Proposed Regulations also amend the provisions of §1.141-12 of the Treasury Regulations relating to allocations of nonqualified bonds. Under the Proposed Regulations, allocations of nonqualified bonds must be made on a pro rata basis. An exception provides that for purposes of the remedial action relating to redemption or defeasance, an issuer may treat any bonds of an issue as the nonqualified bonds if (i) the remaining weighted average maturity of the issue, determined as of the date on which the nonqualified bonds are redeemed or defeased (the "determination date"), and excluding from the determination the nonqualified bonds redeemed or defeased by the issuer, is not greater than (ii) the remaining weighted average maturity of the issue, determined as of the determination date, but without regard to the redemption or defeasance of any bonds (including the nonqualified bonds) occurring on the determination date.

Finally, the Proposed Regulations amend §§1.141- 15(e) and 1.141-16(c) of the Treasury Regulations to provide that for bonds issued before May 16, 1997, issuers may apply §§1.141-12 and 1.142-2 of the Treasury Regulations without regard to the 10 ½ year limitation on defeasances contained in those regulations.

II. COMMENTS AND RECOMMENDATIONS

A. Proposed Regulation § 1.141-12(j)(1) – Determination of Nonqualified Bonds.

The Proposed Regulations would continue the rule in the current Treasury Regulations under which, for purposes of determining the amount of nonqualified bonds, the amount of private business use is "the greatest percentage of private business use in any one-year period commencing with the deliberate action." Under Treasury Regulation § 1.141-3(g), private business use is generally measured on the basis of the average annual private business use over the entire measurement period. For consistency within the Treasury Regulations, general policies supporting "measurement-over-time" should apply for purposes of the remedial action rules. For example, assume there are five years remaining in the measurement period for an issue, and the issuer leases 100% of the financed facility to a private business user for one year (and that this lease would cause the issue to be private activity bonds). Under the Proposed Regulations (and the current Treasury Regulations), the issuer would be required to treat 100% of the issue as nonqualified bonds. Compare this to a situation where the issuer instead leases only 20% of the facility, but for the entire remaining 5 years of the measurement period. In the second case, the issuer would only be required to treat 20% of the issue as nonqualified bonds. We so no reason why there should be this discrepancy, when under the general measurement rules of § 1.141-3(g) they would both be treated as resulting in 20% private business use for the remainder of the measurement period. Accordingly, we recommend that the general methodology for determining private business use under Treasury Regulation § 1.141-3(g) also apply for purposes of determining the amount of nonqualified bonds under the remedial action test, using a measurement period beginning on the issue date of the bonds. Again, measuring from the issue date of the bonds would be consistent with the general "measurement-over-time" policy in the Treasury Regulations addressing private activity bonds. Alternatively, if the IRS prefers a measurement period beginning on the date of the change in use, we suggest that such a rule be limited to the situation of an alternate use of disposition proceeds, and that all other remedial actions be permitted to utilize a measurement period beginning on the issue date of the bonds.

We also recommend that it be clarified that, in applying the private business tests to the remaining bonds after a remedial action, those provisions in the Treasury Regulations addressing private activity bonds that are based on the issuer's reasonable expectations should be applied as of the date of the remedial action, but <u>only</u> with respect to the use of disposition proceeds or an alternate qualifying use of the facility. In other words, there should be no retesting of reasonable expectations with respect to other facilities financed by the issue which have not undergone a change in use. The basic premise of the Treasury Regulations addressing private activity bonds is that an issuer's expectations should be determined as of the issue date, and that remedial actions will be required thereafter only as a result of an actual change in use, not merely a change in expectations. The fact that a facility financed by an issue has undergone a change in use should not affect how this basic premise applies to other facilities financed by the same issue.

B. Proposed Regulation § 1.141-12(j)(2) – Selection of Nonqualified Bonds.

Section 1.141-12(j)(2) of the Treasury Regulations provides that allocations to nonqualified bonds must be made on a pro rata basis, except that, for purposes of the redemption or defeasance of bonds, an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds. In response to previous suggestions, and in part to allow issuers greater flexibility in the selection of the nonqualified bonds, the Proposed Regulations would revise Treasury Regulation § 1.141-12(j)(2). The Proposed Regulations provide that, other than on a pro rata basis, an issuer may treat any bonds of an issue as the nonqualified bonds so long as the remaining weighted average maturity of the issue, determined as of the date on which the nonqualified bonds are redeemed or defeased (the "determination date"), and excluding from such determination the nonqualified bonds redeemed or defeased by the issuer in accordance with the remedial action rules generally, is not greater than the remaining weighted average maturity of the issue, determined as of the determination date, but without regard to the redemption or defeasance of any bonds (including the nonqualified bonds) occurring on the determination date.

We applaud the inclusion of a weighted average maturity approach as a means by which the nonqualified bonds are selected by an issuer. Such approach provides greater flexibility in applying the Treasury Regulations. We recommend, however, for the reason hereinafter described, that the IRS retain, in drafting final Treasury Regulations, the ability to select the longer bonds of the bond issue as an alternative to the weighted average maturity approach. Bond indentures, trust agreements and other similar documents for fixed rate bond issues typically provide for the manner in which the principal of a term bond that has been redeemed or defeased is applied against the remaining principal of such term bond. A term bond generally provides for the payment of a portion of its principal at its maturity and, before then, the payment of principal (typically annually) as so-called "mandatory sinking fund payments." Term bonds are customarily the longest bonds of a fixed rate bond issue, with serial bonds (a single payment of principal on a single date) making up the shorter end of the issue. Whether a particular holder of a term bond is repaid as part of a mandatory sinking fund payment is determined by lottery each year. In addition to providing for this mechanism, the bond indenture, trust agreement or other similar document will generally specify whether the principal of a term bond that has been redeemed or defeased is applied (i) pro rata against all of the remaining mandatory sinking fund payments, (ii) first against the final maturity, second against the latest sinking fund payment and thereafter against the next preceding mandatory sinking fund payment, (iii) first against the earliest mandatory sinking fund payment and thereafter against the next succeeding mandatory sinking fund payments and ultimately the payment due at final maturity, or (iv) in some manner that may not adhere to any of these protocols.

In the case of an issuer that selects as the nonqualified bonds the longest term bonds of an issue where such term bonds have a mechanism described in (iii) above (this may also affect some scenarios within (iv), depending on the particular provisions of the bond documents), the redemption or defeasance of the nonqualified bonds will be applied first against the earliest mandatory sinking fund payment of such term bonds, solely as a result of the bond documents. If such mandatory sinking fund payment, as of the date of the remedial action, has a principal payment date that is shorter than the bond issues' remaining weighted average maturity as of that date, the redemption or defeasance of these term bonds, though the longest bonds of the bond issue, will nonetheless cause the remaining weighted average maturity of the bond issue to be <u>extended</u> following such redemption or defeasance.

We believe that an issuer in such circumstances should not be required to be relegated to a pro rata approach in the selection of nonqualified bonds simply because of the above-described anomaly. While pro rata approaches in many cases are workable, frequently, in the context of remedial actions of a small portion of a much larger bond issue (e.g., a multi-project 501(c)(3) bond deal where a small portion of the project is sold to a nonexempt entity and violates the ownership requirement but is well under 5 percent of the bond issue), using a pro rata approach can become disproportionately cumbersome. This can be exacerbated as a result of having to round each maturity of the prorated approach up to the nearest $5,000 denomination to be sure that, if anything, more and not fewer bonds are redeemed or defeased.

As a policy matter, particularly where the issuer has selected the longest bonds of the bond issue, given the absence of any significant opportunity for abuse, the issuer should have a choice between (a) selecting the longer bonds of the bond issue, currently in the Treasury Regulations, and (b) employing the remaining weighted average maturity approach put forth by the Proposed Regulations.

We suggest the following two alternatives to the language in the Proposed Regulations to remedy this glitch (the first alternative preserves more of the language in the existing Treasury Regulations; the second alternative may be preferable as a drafting matter):

Alternative 1
§ 1.141-12(j) ...
(2) *Allocation of nonqualified bonds.* Allocations of nonqualified bonds must be made on a pro rata basis, except that, for purposes of paragraph (d) of this section (relating to redemption or defeasance), an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds. An issuer that treats any bonds of the issue as the nonqualified bonds will nonetheless be deemed to treat bonds with longer maturities as the nonqualified bonds so long as—

(i) The remaining weighted average maturity of the issue, determined as of the date on which the nonqualified bonds are redeemed or defeased (determination date), and excluding from the determination the nonqualified bonds redeemed or defeased by the issuer in accordance with this section, is not greater than

(ii) The remaining weighted average maturity of the issue, determined as of the determination date, but without regard to the redemption or defeasance of any bonds (including the nonqualified bonds) occurring on the determination date.

Alternative 2
§ 1.141-12(j) ...
(2) *Allocation of nonqualified bonds.* Allocations of nonqualified bonds must be made on a pro rata basis, except that, for purposes of paragraph (d) of this section (relating to redemption or defeasance),
(i) An issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds, or
(ii) An issuer may treat any bonds of the issue as the nonqualified bonds so long as—

(A) The remaining weighted average maturity of the issue, determined as of the date on which the nonqualified bonds are redeemed or defeased (determination date), and excluding from the determination the nonqualified bonds redeemed or defeased by the issuer in accordance with this section, is not greater than

(B) The remaining weighted average maturity of the issue, determined as of the determination date, but without regard to the redemption or defeasance of any bonds (including the nonqualified bonds) occurring on the determination date.

C. Treasury Regulation § 1.141-12(e)(2) – Alternative Use of Disposition Proceeds by 501(c)(3) Organizations.

The current Treasury Regulations relating to remedial actions provide that if the deliberate action is a disposition for which the consideration is exclusively cash and where the disposition proceeds are to be used by a 501(c)(3) organization, the nonqualified bonds must be treated as "reissued" for purposes of Code sections 141, 145, 147, and 149 (the "Code Requirements").

We recommend that Treasury Regulation § 1.141-12(e)(2) be modified to clarify that the term "reissued" means "current refunded" for purposes of applying the Code Requirements. Consequently, if that is the case, then the specific rules under the Code Requirements would apply as if the 501(c)(3) organization were doing a refunding. In addition, we note that if (a) the bonds were originally issued as qualified 501(c)(3) bonds, (b) the disposition is to a nongovernmental entity, and (c) the proceeds were to be used for another project by the 501(c)(3) organization, the Code Requirements would have been met when the bonds were originally issued. We also believe that the Code

Requirements should only need to be met with respect to the portion of the bonds allocated to the disposition proceeds.

The rationales for such recommendations include the following:

- there is no increase in the overall principal amount of the bonds (that is, the issuer is not adding more bonds to the market);

- the issuer has already identified the bond-financed project; and

- if the disposition proceeds are to be treated as a deemed re-issuance of that portion of the bonds allocable to the disposition proceeds, then the current refunding rules should apply to determine whether a TEFRA Approval is necessary.

In addition, we also see no reason for the necessity of a public hearing and approval ("TEFRA Approval") if the disposition proceeds are treated as a current refunding, since the underpinning of the alternative use of disposition proceeds remedial action is a reallocation of the bond proceeds from the disposed asset to new qualifying assets, which logically may also fall within the original TEFRA Approval. This would be true, for example, in the instance where a 501(c)(3) hospital issues bonds for several projects and then sells one of its clinics to a nongovernmental entity and uses the disposition proceeds for other hospital capital projects that were included in the original TEFRA Approval. In that case, if the hospital originally did a TEFRA Approval for the facilities where the disposition proceeds will be used, there appears to be no need for another TEFRA Approval. Under this approach, a new TEFRA Approval would be required only if the facilities where the disposition proceeds will be used were not originally described in the TEFRA Approval. If this suggestion of not requiring a new TEFRA Approval is not accepted for all cases, we recommend that a TEFRA Approval be required only in the situation where the original TEFRA Approval was obtained more than 3 years earlier, applying the plan of financing provisions in Treasury Regulation § 5f.103-2(f)(ii).

D. Treasury Regulation § 1.141-12(f)(2) – Alternative Use of Facility.

With respect to the remedial action of alternative use of a facility, Treasury Regulation § 1.141-12(f)(2) generally provides that the nonqualified bonds are treated as reissued for purposes of the alternative minimum tax rules, and Code sections 141, 142, 144,145,146, 147,149 and 150. For the same reasons articulated above relating to our recommendation for clarification in Treasury Regulation § 1.141-12(e)(2) relating to the deemed reissuance requirement, the deemed reissuance requirement in Treasury Regulation § 1.141-12(f)(2) should also be treated as a current refunding for purposes of applying Code section 147(f). We recommend that the Treasury Regulations be modified to provide that no TEFRA Approval should be required in this situation because the facility itself is already in existence and there is no new functional use of that facility--

just a new owner and a different method for concluding that the original bonds are tax-exempt bonds.

E. Treasury Regulation § 1.141-12 -- Redemption or Defeasance of Nonqualified Bonds and Requirement that Bonds be Callable within 10 ½ Years.

Treasury Regulation § 141-12(d)(4) requires that for the remedial action of redemption or defeasance of nonqualified bonds action to be used, the period between the issue date and the first call date of the bonds not be more than 10 ½ years (the "10 ½ Year Call Requirement"). Revenue Procedure 93-17, 1993-1 C.B. 507, the prior remedial action rules, did not contain the 10 ½ Year Call Requirement. Proposed Regulation §§ 1.141-15(e) and 1.141-16(c) provide that for bonds issued prior to May 16, 1997, the effective date of the 1997 Treasury Regulations relating to private activity bonds, the remedial action of redemption or defeasance of nonqualified bonds is to be applied without regard to the 10 ½ Year Call Requirement.

The preamble to the 1997 Treasury Regulations relating to private activity bonds provides that the 10 ½ Year Call Requirement was placed in the regulations to prevent the improper use of the defeasance as a remedial action for bonds that cannot be called for an extended period of time. We recognize that the general industry practice for structuring tax-exempt bonds is to provide that such bonds are callable after approximately 10 years after the issue date thereof ("10 Year Call Protection"). The "call protection" provides assurance to investors that their bonds cannot be called for at least a ten year period. At the same time, it provides issuers the ability to refund bonds with lower yielding bonds, thereby providing the issuer savings.

From time to time, however, circumstances arise whereby there will not be compliance with the 10 ½ Year Call Requirement. It has come to our attention that the following described circumstances have arisen on numerous occasions since the release of the 1997 Treasury Regulations relating to private activity bonds.

Example 1. Issuer is considering issuing refunding bonds to refund bonds maturing in the range of 11 to 16 years. Issuer will issue refunding bonds with principal maturing in the same years as principal matures on the refunded bonds. Present value savings can be achieved by refunding such bonds. Underwriter proposes that the refunding bonds be structured without any call protection (i.e., the refunding bonds are not callable prior to final maturity). Underwriter proposes noncallable refunding bonds because lower yields can be achieved by making such bonds non-callable. The issuer may opt to forego call provisions since the first and only permitted advance refunding may have been used and since after 10 years (the standard call protection on tax-exempt bonds) the bonds will be outstanding for only a few years. Given such short remaining duration, such bonds are unlikely to be called. Under these circumstances, bond counsel advises the issuer that by making the bonds noncallable, the issuer is giving up the flexibility to use the remedial action of redemption or defeasance of nonqualified bonds. In many instance, the issuer has chosen to proceed with making the bonds noncallable since the issuer thinks it unlikely that there will be a change of use with respect to the assets financed or refinanced with such bonds and the issuer would prefer to have the lower yield on the refunding bonds.

Example 2. Issuer issues qualified tender bonds. For the first five years the bonds remain in a short-term mode (e.g., the interest rate is reset every seven days and the bonds can be tendered on seven days notice). While the bonds are in the seven day mode, they can be called by the issuer on seven days notice. Effective the fifth anniversary of the issue date, the issuer converts the issue to fixed rate bonds to maturity. Once the bonds are in fixed rate mode, they can be called ten years from the date that the bonds are sold as fixed rate bonds. Such a provision is typical since, based on marketplace practices, purchasers of the fixed rate bonds expect 10 Year Call Protection. Since the bonds are qualified tender bonds, there will be no reissuance of the bonds at the time they are converted to a fixed rate mode. The first call date of the bonds will be fifteen years after the bonds were issued. Under these circumstances and under the current Treasury Regulations, the bonds will not comply with the 10 ½ Year Call Requirement. Similar circumstance may arise with regard to auction rate securities and the application the general reissuance rules under Treasury Regulation § 1.1001-3.

Imposing the 10 ½ Year Call Requirement under the circumstances described in the above examples penalizes issuers because such issuers are denied the ability to use the remedial action of redemption or defeasance of nonqualified bonds. In Example 1, the penalty is unwarranted because the issuer is issuing noncallable bonds to obtain more favorable rates, thereby reducing the amount of tax-exempt interest in the marketplace. In Example 2, the penalty is unwarranted because it is the nature of the qualified tender bond provisions (and the general reissuance rules in the case of auction rate securities) that causes a failure to comply with the 10 ½ Year Call Requirement. Additionally, the general marketplace practice of requiring 10 Year Call Protection provides sufficient assurance that bonds are not outstanding for an extended period of time.

Consequently, we recommend that the 10 ½ Year Call Requirement be removed from Treasury Regulation § 1.141-12(d)(4). Alternatively, we recommend that Treasury Regulation § 1.141-12(d)(4) be modified to clarify that if an issue of bonds consists of bonds that have 10 Year Call Protection and bonds that are not callable prior to maturity, the issuer can utilize the remedial action of redemption or defeasance of nonqualified bonds with respect to the bonds that have the 10 Year Call Protection. If neither of the above recommendations are accepted, we recommend that Treasury Regulation § 1.141-12(d)(4) be modified to provide that an issuer may make a payment to the IRS so as to preserve the issuer's ability to use the remedial action of redemption or defeasance of nonqualified bonds. The payment would be based on the period of time during which the noncallable bonds are outstanding subsequent to 10 ½ years after the issue date and would be similar to the payment under Revenue Procedure 97-15, 1997-1 C.B. 635.

F. Application of Remedial Action Rules to Private Payment Test.

Section 1.141-12(a) of the Treasury Regulations provides that an action that causes an issue to meet the private business tests or the private loan financing test is not treated as a deliberate action if the issuer takes a remedial action described in paragraph (d) (redemption or defeasance), (e) (alternate use of disposition proceeds) or (f) (alternate use of facility) of Treasury Regulation § 1.141-12 and if certain other requirements set forth in that section are met. The private business tests include the private business use test and the private security or payment test. The balance of Treasury Regulation § 1.141-12 describes the various steps and approaches toward the taking of remedial action with respect to private business uses in excess of the limitations of Section 141(b) of the Code (which do, by reference extend to the private ownership test as well under Section 145 of the Code), but do not provide for the manner in which excess private security or private payments may be addressed and the manner in which remedial action may be taken to cure violations of those tests. We encourage the IRS to create a framework for the taking of remedial action in the context of excess private security and excess private payments. In that regard, consideration might be given to a mechanism substantially similar to that currently employed by the Treasury Regulations in the context of private business use test violations. In that regard, the mechanism would contemplate determining the manner in which private security and/or private payments are quantified (presumably through a present value approach) and converted into values that would form the basis for determining the amount of bonds that might be required to be redeemed or defeased in order to preserve the tax-exempt status of a bond issue.

At this time, we are not providing detailed comments relating to such issues because addressing the private security or payment test in detail appears beyond the scope of the current regulatory project. We would be happy to provide constructive comments and suggestions toward the achievement of that objective at a future date upon your request.