NATIONAL ASSOCIATION OF BOND LAWYERS

GOVERNMENTAL AFFAIRS OFFICE
601 THIRTEENTH STREET, NW
SUITE 800 SOUTH
WASHINGTON, DC 20005-3875

202/682-1498
Fax 202/637-0217
governmentalaffairs@nabl.org
www.nabl.org

June 3, 2004

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (notice 2004-26)
1111 Constitution Avenue, N.W.
Washington, DC 20224

RE: Notice 2004-26 – 2004-2005 Guidance Priority List

Dear Sir or Madam:

The General Tax Committee of the National Association of Bond Lawyers welcomes the opportunity to provide input to the Treasury-IRS 2004-2005 Guidance Priority List. Enclosed is a list of recommendations made by the General Tax Committee. I hope you find our suggestions helpful as you formulate this year's plan. Please feel free to contact me at (212) 839-5341 if you would like to discuss these recommendations further.

Sincerely,

Patti T. Wu, Chair

Enclosure

cc: Stephen Watson, Esq.
Rebecca Harrigal, Esq.
Timothy Jones, Esq.
Mark Scott, Esq.

NATIONAL ASSOCIATION OF BOND LAWYERS

Recommendations for 2004-2005 Guidance Priority List

of U.S. Treasury and Internal Revenue Service

The following are recommendations for the 2004-2005 Guidance Priority List from the National Association of Bond Lawyers ("NABL"), as compiled by its Tax Matters Committee. In compiling this list, NABL solicited comments from its membership. These recommendations have been grouped into three categories: certain items on the 2003-2004 Treasury-IRS Priority Guidance Plan that have not been published to date, new recommendations, and certain of our recommendations from last year that were not included in the 2003-2004 Priority Guidance Plan.

Items Remaining on 2003-2004 Priority Guidance Plan

Mixed Use Accounting Rules. We recommend that allocation and accounting rules be issued under Section 141 for so-called "mixed use" projects involving both governmental use and private business use. Certain rules for mixed use projects were first proposed over ten years ago. In the preamble to the 1997 final private activity bond regulations, Treasury and the IRS stated that they would be taking a flexible approach to tax-exempt financing in the mixed use context to accommodate public-private partnerships. These rules have not yet been finalized despite their importance in an era of economically strained state and local governments seeking to work with the private sector to finance projects.

Naming Rights. We recommend that public guidance be issued with an opportunity for public comment on the important issue of the effect of sales of naming rights for purposes of the private business restrictions on tax-exempt bonds under Section 141.

Arbitrage (Simplification and Technical Clarifications). The current plan includes an item on guidance with respect to arbitrage. NABL recommends that regulations be issued to simplify the arbitrage regulations further and to address various technical issues. We refer you to our recommendations for the 2003-2004 Treasury-IRS Priority Guidance Plan for a number of specific recommendations in this regard.

New Items Recommended for 2004-2005 Guidance Priority List

Long-Term Working Capital Financings. Given the financial difficulties that State and local governments are experiencing, we believe that it is important to provide public guidance for long-term tax-exempt bonds used to finance working capital purposes. The arbitrage rules relating to "other replacement proceeds," particularly for long-term working capital financings, should be reviewed and clarified. Clear workable safe harbors are needed for situations in which long-term bonds are issued for working capital financings. These safe harbors should address any appropriate constraints or ongoing compliance mechanisms for bonds in these situations.

Regulations under Section 6700 in the Tax-exempt Bond Context. In light of the appropriate increasing importance and use of tax shelter promoter penalties under Section 6700 as an enforcement tool to target wrongdoers in the tax-exempt bond audit area and the dearth of

guidance in this area, we recommend that public guidance be provided under Section 6700 with respect particularly to its application in the tax-exempt bond area, including public guidance on such fundamental issues as the standard of liability (with respect to which we believe that the statute clearly suggests a knowing fraud standard as contrasted with a negligence standard) and the precise measure of the Section 6700 penalty in the tax-exempt bond context about which there has been considerable uncertainty (e.g., $1,000 per sale of a bond issue, $1,000 per sale of an individual $5,000 bond, or some other measure). This guidance also should address the divisibility of the penalty for purposes of refund claim and refund litigation procedures. Given the onerous consequences of Section 6700 penalties and concerns about how Section 6700 may be applied in the audit context in the absence of clear standards, we believe that it is particularly important to provide public guidance in this area, with a full opportunity for public comment. Moreover, consideration should be given to providing public guidance to address standards for referrals to the IRS Office of Professional Responsibility in the case of Section 6700 violations.

Recordkeeping for Tax-exempt Bond Issues. We recommend that public guidance be issued to address State and local governmental recordkeeping requirements in the tax-exempt bond context. We recommend that due consideration be given to the importance of striking an appropriate balance between the need to monitor the continuing qualification for tax exemption of a bond issue and the administrative and financial burdens imposed on State and local governmental entities. We recommend that the Service issue guidance that would permit a combination of assumptions, certifications, and summaries of original documents to ease the compliance burden. The IRS website contains a section entitled "FAQ's regarding record retention requirements", which provides generally that, under existing general tax recordkeeping rules, the parties to a bond issue must retain sufficient records to support the continued tax exemption of the bonds and that such records must be maintained for as long as any tax exempt bonds, including refunding bonds, are outstanding plus three years. With a standard 30 year bond issue, the requirements are particularly burdensome in the context of bonds that are refunded and combined with other issues, thus giving rise to a retention period that spans many issuer administrations and many document production and document preservation technologies. For large governmental issuers that issue frequently and bond issues that finance multiple projects for multiple beneficiaries, e.g., large 501(c)(3) health care systems, this could potentially result in a mountain of records that would be extremely expensive to maintain or retrieve given technology changes.

Updating Revenue Procedure 97-14, dealing with Sponsored Research. The 1994 Proposed Regulations on Private Activity Bonds and Revenue Procedure 97-14 provided some elaboration on the legislative history (including the explanation by the Joint Committee on Taxation) from the Tax Reform Act of 1986. When Rev. Proc. 97-14 was released in January 1997, the Service indicated that it had not received many comments on sponsored research and requested additional comments. The Service has issued a few private letter rulings on research over the past several years. There have been dramatic changes in potential uses for sponsored research over the 18 years since the 1986 Act, and universities and hospitals are entering into different contracts than those considered in the safe harbors. We recommend that the IRS issue an advance notice of proposed rulemaking (similar to the recent notices on allocation of output facilities and solid waste issues) to solicit additional information about the current characteristics of research and contractual relationships in order to develop revisions to the safe harbor.

Updating Revenue Procedure 97-13, relating to Management and Service Contracts. Over the past several years, the IRS has released private letter rulings interpreting aspects of the safe harbors for management and service contracts. It would be helpful to incorporate these interpretations into the safe harbors so that they can be relied upon by issuers and practitioners, and to expand upon the factors that were important to the IRS analysis. Particular areas which should be covered include treatment of reimbursement to the service provider of employee compensation in various contexts, the applicability of a capitation fee beyond the health insurance context, accommodation with the same contracts of separate analyses of development periods before management services commence in operating contexts, and how deferred or subordinated fees are treated.

Sections 142(d) and 145(d). We recommend that guidance be issued under Section 142(d) or 145(d) to provide a reasonable transition period to allow an owner to come into compliance with the low income set-aside requirements when tax-exempt bond proceeds are used to acquire an occupied housing project. Both Section 42 and Revenue Procedure 96-32 address this issue by allowing the owner up to one year after acquisition to come into compliance. Many bond-financed projects involve either tax credits under Section 42 or a 501(c)(3) entity subject to Rev. Proc. 96-32, and we request that the same one year rule apply under Sections 142(d) and 145(d) to promote more effective tax administration. In addition, it would be helpful to have guidance as to the meaning of "reasonable period" in Section 145(d)(3)(A)(iii).

Prior Recommendations for 2003-2004 Priority Guidance Plan

Hedging and Swaps. We underscore the importance of completing the pending project to address the treatment of LIBOR-based swaps under the arbitrage hedging rules under § 1.148-4(h), including the hedging treatment under both the arbitrage simple "integration" rule (i.e., taking into account the bond interest rate, the hedge and the basis differential on a net basis in arbitrage yield as a variable yield issue) and "super-integration" rule (i.e., taking into account the bond interest rate and the hedge, with a disregard of certain differences in substantially similar interest indexes, as a fixed yield issue). Guidance on the treatment of hedges of investments (so-called "asset hedges") for arbitrage purposes under Section 148 would also be helpful. Finally, in tax-exempt bond audits recently, issues have arisen about whether interest rate swaps should be bid out for reasons similar to those that underlie the fair market value pricing safe harbor for the bidding of investments for arbitrage purposes. There is nothing in the Treasury Regulations that require swaps to be competitively bid and issuers have full economic incentives to obtain the lowest possible swap rates in the same way that issuers have full economic incentives to achieve the lowest possible tax-exempt bond borrowing rates. If for some reason Treasury and the IRS seek to encourage or require a bidding process for swaps involving tax-exempt bonds, any such safe harbor or requirement should be done through the published guidance process, with a full opportunity for public comment.

Public Approval Rules. We recommend that guidance be issued to update the outdated public approval rules under Section 147(f). Recent activity in connection with audits has made it clear that guidance is needed on the application of the public approval rules to qualified 501(c)(3) bonds and pooled financing transactions. The existing 1983 temporary regulations were written with very different industrial development bond transactions in mind, and have

never been modified to reflect public comments. Furthermore, the 1986 Blue Book states that Congress intended that the rules would be amended for student loans, mortgage loans, and 501(c)(3) pooled financings.

Single Family Housing Regulations Updated. The existing single family regulations under Code Section 143 were issued in 1982 and need to be updated to take into account the changes made by the 1986 Tax Act, subsequent statutory changes (such as the ten year recycling rule and 42-month rule), and subsequent industry developments on refundings, crosscalling and yield blending.

Federal Guarantee Defined. Although Code Section 149(b) was enacted in substantially similar form in 1982, there is no definition of what constitutes a federal guarantee for this purpose. Recent audit activity related to the treatment of guarantees issued by Federal Home Loan Banks illustrates the need for guidance on this issue.

Reissuance Rules Amended. The so-called "reissuance" regulations contained in Treas. Reg. Section 1.1001-3 (modifications of debt instruments) contain an exception for tax exempt bonds that are "qualified tender bonds," which are subject to their own specialized reissuance rules under Notice 88-130. Notice 88-130, however, provides that a qualified tender bond will be treated as retired if, among other things, there is a change that would constitute a disposition under Section 1001. The rules are circular and contradictory. We recommend that the rules be modified to place all the reissuance rules for tax-exempt obligations in one regulation, presumably under Section 1001, as modified to address the qualified tender bond principles specifically. In light of the significant continuing issuance of qualified tender bonds each year, this item should receive prompt attention if possible.

Qualified Public Educational Facilities. Guidance is needed under section 142(k) to clarify that the requirement that the ownership of a qualified public educational facility for tax purposes is determined without regard to the requirement of the Code that the facility be transferred to the State or local educational agency for no additional consideration. Although it is clear that this is the result intended in the enactment of section 142(k), no transactions will go forward until such clarification is provided.

NABL is committed to assisting the Treasury and IRS with respect to these matters. At the present time, NABL has undertaken comment projects on a number of these matters. Given the relatively large number of important projects, we would be pleased to provide other forms of assistance (for example, submitting drafts of regulatory provisions or rulings). In submitting these suggestions, NABL also wishes to again state that, while it supports a vigorous, fair enforcement program, it continues to believe that the proper method of issuing new guidance in the tax-exempt bond area is through the issuance of regulations that provide an opportunity for comment and, where necessary, other published guidance.