National Association
of Bond Lawyers

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January 28, 2007

Internal Revenue Service
CC:PA:LPD:PR (REG-106143-07)
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: REG-106143-07: Arbitrage Guidance for Tax-Exempt Bonds

Ladies and Gentlemen:

The National Association of Bond Lawyers (NABL) respectfully submits the enclosed additional comments in response to your request in the Federal Register on September 26, 2007 (REG-106143-07), relating to arbitrage guidance for tax-exempt bonds (Proposed Regulations). These additional comments address certain provisions of the Proposed Regulations that relate to computation of the amount that may be refunded as an overpayment of rebate.

NABL appreciates both the significant effort of the Department of the Treasury and the Internal Revenue Service in the preparation of the Proposed Regulations as well as the request for and consideration of NABL's additional submission.

Primary drafting responsibilities for these comments were assumed by Scott R. Lilienthal, Hogan & Hartson L.L.P. and David J. Cholst, Chapman and Cutler LLP.

NABL believes that participating in the guidance process supports clarification of and facilitates compliance with the tax law and regulations. Accordingly, NABL members would welcome the opportunity to discuss these recommendations to achieve clarity, certainty and administrability in this area of the law.

National Association of Bond Lawyers

If you have any questions, please contact me at 205/226-3482 or through email at fclark@balch.com, or Scott R. Lilienthal at 202/637-5849 or through email at srlilienthal@hhlaw.com, or Elizabeth Wagner, Director of Governmental Affairs, at 202/682-1498 or through email at ewagner@nabl.org.

Thank you again for the opportunity to submit NABL's comments.

Sincerely,

J. Foster Clark

Enclosure

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National Association *of* Bond Lawyers

January 28, 2008

CC:PA:LPD:PR (REG-106143-07)
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044

Re: National Association of Bond Lawyers — Additional Comments to Proposed Regulations on the Arbitrage Restrictions under Section 148 of the Internal Revenue Code

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The following comments are submitted on behalf of the National Association of Bond Lawyers ("NABL"). These comments relate to the proposed regulations on the arbitrage restrictions under Section 148 of the Internal Revenue Code, of 1986, as amended (the "Code") published in the Federal Register on September 26, 2007 (the "Proposed Regulations"), and are in addition to comments previously submitted by NABL to the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS") by letter, dated December 26, 2007. Specifically, these additional comments address certain provisions of the Proposed Regulations that modify an example contained in existing Treasury Regulation §1.148-3(j) relating to computation of the amount that may be refunded as an overpayment of rebate.

The new language in Example 2(iii)(D) in §1.148-3(j) of the Proposed Regulations would go far beyond the stated purpose of clarifying that the IRS may not pay interest on refunds of rebate overpayments.

Under §1.148-3(b) of the existing Treasury Regulations, the rebate amount as of any particular date is defined as the excess of the future value, as of that date, of all receipts on nonpurpose investments over the future value, as of that date, of all payments on nonpurpose investments. For this purpose, future value is determined on an economic accrual basis using the yield on the bond issue, based on the same compounding interval and financial conventions used to compute that yield. The amount of a required rebate payment as of a particular date is generally determined by reference to this rebate amount, less the future value as of that date of all prior rebate payments made by the issuer.[1] This methodology is commonly referred to as the "future value method."

[1] Interim rebate payments must be at least 90% of this amount, the final rebate payments must be 100% of this amount. Treas. Reg. §1.148-3(f).

Section 1.148-3(i)(1) of the existing Treasury Regulations generally provides that an issuer may recover an overpayment of arbitrage rebate with respect to an issue by establishing to the satisfaction of the IRS Commissioner that an overpayment has occurred. The preamble to the Proposed Regulations (the "Preamble") notes that §1.148-3(i)(1) of the existing Treasury Regulations defines an "overpayment" of rebate that may be recovered from the IRS as "the excess of the amount paid to the United States for an issue under section 148 over the sum of the rebate amount for the issue as of the most recent computation date and all amounts that are otherwise required to be paid under section 148 as of the date the recovery is requested." The Preamble further states that, under this provision, "even if the future value of the issuer's arbitrage rebate payment on a computation date, computed under the method for determining arbitrage rebate, is greater than the issuer's rebate amount on that date, the issuer is only entitled to a refund to the extent that the amount actually paid exceeds that rebate amount." The Preamble states that the reason for this limitation is that Treasury and the IRS are concerned about whether the IRS has statutory authority to pay interest on refunds of arbitrage rebate payments. The Preamble concludes that "[t]o permit a refund in an amount calculated in whole or in part based upon a future value of the amount actually paid would effectively result in an interest payment on that payment."

This discussion in the Preamble is implemented in the Proposed Regulations through an amendment to Example 2(iii)(D) in §1.148-3(j) of the existing Treasury Regulations. As currently drafted, the example involves a bond issue with a positive rebate amount as of the computation date for the first interim rebate payment, and 90% of this amount was paid to the IRS, but due to a higher bond yield during the second computation period (the issue consisted of variable yield bonds), the rebate amount as of the computation date for the second (and final) rebate payment was less than the future value as of that date of the prior interim rebate payment. The example in the existing Treasury Regulations basically concludes that, in this circumstance, the issuer would have overpaid the rebate amount by the excess of the future value of the prior interim rebate payment as of the final computation date over the rebate amount as of the final computation date.

The Proposed Regulations would keep the same basic facts for this example, but would further state that, although the future value of the prior interim rebate payment exceeds the rebate amount, "§1.148-3(i) limits the amount recoverable as a defined overpayment of rebate under section 148 to the excess of the total 'amount paid' over the sum of the amount determined under the future value method to be the 'rebate amount' as of the most recent computation date and all other amounts that are otherwise required to be paid under section 148 as of the date the recovery is requested," and, therefore, the issuer is not entitled to recover any overpayment because the actual amount of the interim rebate payment did not exceed the rebate amount as of the final computation date.

NABL believes that the methodology described in the new language added by the Proposed Regulations would go far beyond that purpose stated in the Preamble of preventing the payment by the IRS of interest on refunds of rebate overpayments. This methodology would actually result in the erosion of the amount that may be recovered, so

that the issuer will often not be able to recover even the amount actually paid. Indeed, in many cases it could result in no recovery at all, even where the issuer has clearly made an overpayment of rebate.

A simple example will illustrate the problem. Issuer issues Bonds in 2000 with a fixed yield of 5% based on annual compounding. All proceeds are spent before the 5-year anniversary of the issue date, and Issuer decides to pay 100% of the rebate amount in 2005 to avoid future calculations. The rebate amount in 2005, calculated using the future value method per the existing Treasury Regulations, is $1,000,000. Due to a calculation error, Issuer mistakenly believes that the rebate amount in 2005 is $1,100,000, and pays that amount to the IRS. The Bonds are retired in 2010, and Issuer discovers the 2005 miscalculation. The rebate amount in 2010 is $1,276,281, being the future value of the 2005 rebate amount of $1,000,000. The future value in 2010 of Issuer's 2005 rebate payments is $1,403,909. Issuer arguably has made a rebate overpayment of $127,628 as of 2010 ($1,403,900 minus $1,276,281), but, at a minimum, Issuer paid $100,000 more than it was required to pay in 2005.

However, the new example language in the Proposed Regulations states that §1.148-3(i) limits the amount recoverable as a defined overpayment of rebate to the excess of the total "amount paid" over the sum of the amount determined under the future value to be the "rebate amount" as of the most recent computation date as of the date the recovery is requested. As of 2010, the rebate amount under the future value method is $1,276,281, which is greater than the total amount paid by Issuer in 2005 of $1,100,000. So, based on the new example language, Issuer would not be entitled to any recovery, not even the excess $100,000 actually paid, despite no investment activity after the interim rebate payment. In this example, using the methodology suggested by the Proposed Regulations, Issuer would have been entitled to a $100,000 refund if it had immediately realized the error in 2005 and requested the refund at that time. By not recognizing the error until 2010, the amount recoverable by Issuer has been reduced to zero. Thus, the methodology suggested by the Proposed Regulations does much more than prevent the payment of interest by the IRS on rebate overpayments.

This example highlights the flaw in the analysis articulated in the Preamble, that future valuing prior rebate payments effectively results in payment of interest by the IRS on a refund of a rebate overpayment. What is missing from this analysis is that, while prior rebate payments are indeed future valued under the general rebate computation rules, the rebate amount also continues to be future valued. Thus, when an issuer pays 100% of the rebate amount on an interim rebate payment date with no further investment activity, the amount required to be paid with respect to subsequent rebate computation dates is always zero, since the future value of the rebate amount as of any subsequent rebate payment date is always equal to the future value of the prior interim rebate payment as of that date.

The methodology in the Proposed Regulations not only prohibits future valuing of the amount by which rebate was overpaid, it also prohibits future valuing of the portion of the rebate amount that was properly paid. In order to give an issuer the proper benefit

of the rebate amount that was correctly paid, NABL recommends that the computation allow this amount that was correctly paid to be future valued, because the rebate amount to which it was applied is being future valued. In the above example, Issuer properly paid $1,000,000 of rebate, and overpaid $100,000. If the $1,000,000 of rebate properly paid and the $1,000,000 rebate amount are both future valued to the final computation date, they will properly offset each other. If the overpayment of $100,000 is not future valued, then that amount can be recovered as an overpayment, and the IRS has made no payment of interest on the overpayment.

Accordingly, NABL recommends that the language added to Example 2(iii)(D) in §1.148-3(j) by the Proposed Regulations not be included in the final Treasury Regulations. If Treasury and the IRS believe that interest cannot be paid on refunds of overpayments, NABL recommends that the final Treasury Regulations instead provide only that any amount paid in excess of the rebate amount as of the computation date to which the payment relates should *not* be future valued in computing the amount that may be recovered as an overpayment.[2]

[2] Another possible solution would be to clarify that rebate payments may also be treated as yield reduction payments, since yield reduction payments are taken into account in computing the rebate amount.