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July 10, 2008

Internal Revenue Service
CC:PA:LPD:PR (Notice 2008-41)
(REG-118788-06)
Room 5203
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Notice 2008-41: Reissuance for State and Local Bonds (REG-118788-06)

Ladies and Gentlemen:

The National Association of Bond Lawyers (NABL) respectfully submits the enclosed comments with respect to Notice 2008-41, 2008-15 I.R.B. 742, relating to reissuance standards for State and local bonds (the “Notice”).

NABL appreciates both the significant effort of the Department of the Treasury and the Internal Revenue Service in the preparation of Notice 2008-41 (and its predecessor, Notice 2008-27) as well as the request for and consideration of NABL’s submission.

These comments were prepared by an Ad Hoc Subcommittee of the NABL Tax Law Committee, chaired by Michael Larsen of Parker Poe Adams & Bernstein LLP, and Cliff Gerber of Sidley Austin LLP. Substantial contributions were made by other NABL members listed in Exhibit I.

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.

If you have any questions, please contact me at 205/226-3482 or through email at fclark@balch.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

cc: Eric Solomon
Donald L. Korb
Stephen Larson
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Aviva M. Roth
Clifford J. Gannett
NABL Ad Hoc Tax Law Subcommittee Members

RECOMMENDATIONS
BY THE
NATIONAL ASSOCIATION OF BOND LAWYERS
TO THE
DEPARTMENT OF THE TREASURY
OFFICE OF TAX POLICY
AND THE
INTERNAL REVENUE SERVICE
REGARDING
NOTICE 2008-41:
REISSUANCE STANDARDS FOR STATE AND LOCAL BONDS
(REG-118788-06)

JULY 10, 2008

The following comments are submitted on behalf of the National Association of Bond Lawyers ("NABL"). These comments relate to Notice 2008-41, 2008-15 I.R.B. 742 (the "Notice"), which provides reissuance standards for State and local bonds. Specifically, the comments provide suggested clarifications and additions to the Notice and anticipated Treasury Regulations (the "Proposed 150 Regulations") to be issued under Section 150 of the Internal Revenue Code of 1986, as amended (the "Code"), as well as certain related provisions. While these comments focus primarily on the Notice, NABL recommends that the suggestions set forth herein, to the extent applicable, also be considered by the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS") in drafting the Proposed 150 Regulations.

1. Expand the Scope of the Notice. Section 3.1 of the Notice provides that the guidance provided in the Notice and in the Proposed 150 Regulations, concerning whether tax-exempt bonds are treated as reissued or retired, apply solely for purposes of Sections 103 and 141 through 150 of the Code. The temporary rule in Section 4 of the Notice and the special rules in Section 6 of the Notice are similarly limited. While NABL believes, in the interest of consistency of treatment of specific debt instruments, avoidance of confusion, and avoidance of unanticipated and unwarranted results, that the reissuance guidance should apply to tax-exempt obligations for certain other federal income tax purposes, an expansion of the scope of the Notice

to those sections of the Code that do and should work in harmony with the provisions of Sections 103 and 141 through 150 is particularly needed.

The determination of whether a transaction with respect to tax-exempt bonds constitutes a refunding has significance under several other provisions of the Code: Section 57(a)(5), in determining whether interest on bonds is subject to alternative minimum tax as an item of tax preference, to assure that a permitted remarketing at a premium need not rely on the refunding exception; Sections 265(b) and 291(e), in determining the extent to which certain deductions of financial institutions are allowable (based on when a tax-exempt obligation is acquired); and Section 265(b) in determining the need to rely on the refunding exceptions under certain circumstances. Accordingly, NABL recommends that Treasury and the IRS expand the scope of the Notice to the determination of whether a reissuance of tax-exempt bonds has occurred for purposes of applying Sections 57(a)(5), 265(b) and 291(e). NABL is also considering the extent to which the Notice should also apply for purposes of the original issue discount ("OID"), market discount and other related provisions in Chapter 1, Subchapter P, Part V (Sections 1271 through 1288) of the Code, and may provide follow-up comments on that issue. NABL did comment below (number 2), however, regarding whether discount derived upon a qualified interest rate mode change is treated as OID or market discount.

2. Clarify How to Treat Discount on a Conversion to Fixed to Maturity. Pursuant to the Notice, qualified tender bonds may be converted pursuant to a qualified interest rate mode change without triggering a reissuance of the bonds for purposes of Sections 103 and 141 through 150 of the Code. Included within the definition of a "qualified interest rate mode change" are conversions of qualified tender bonds to fixed to maturity at "a market discount from the stated principal amount…." The Notice does not indicate whether a discount derived upon a qualified interest rate mode change is treated as OID or market discount. This distinction is significant, since OID on a tax-exempt bond is exempt from federal income tax, while market discount is generally taxable to the holder. Because such discount arises from a remarketing of the bonds by, or on behalf of, the issuer, not from a secondary market transaction, NABL believes that discount arising from a conversion of qualified tender bonds to fixed to maturity should be treated for federal income tax purposes no differently than discount derived upon an original issuance of tax-exempt bonds. Accordingly NABL recommends that Treasury and the IRS clarify that such discount is tax-exempt OID.

3. Provide Greater Flexibility for Reimbursement Refundings. Treas. Reg. § 1.150-1 defines a "refunding issue" as "an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue (a prior issue, as more particularly defined in paragraph (d)(5) of this section), including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue." Treas. Reg. § 1.150-1(d)(2)(iv) provides that "[i]n the absence of other applicable controlling rules under this paragraph (d), the determination of whether an issue is a refunding issue is based on the substance of the transaction in light of all the facts and circumstances." When an issuer uses funds other than bond proceeds to acquire outstanding tax-exempt bonds, NABL recommends that Treasury and the IRS clarify application of the "substance of the transaction…facts and circumstances" standard of Treas. Reg. § 1.150-1(d)(2)(iv) to so-called "reimbursement refundings."

While the Notice has aided issuers and borrowers of tax-exempt bonds in the recent market turmoil, NABL notes that the rule allowing issuers to acquire their own auction rate bonds is temporary, and that the rules which permit acquisition of qualified tender bonds impose additional burdens on issuers and borrowers (*e.g.*, the "best efforts" remarketing requirement discussed below). NABL recommends that Treasury and the IRS allow reimbursement refundings similar to the rules set forth in Treas. Reg. § 1.150-2 for reimbursements of capital expenditures, in situations when an issuer has clearly demonstrated in writing an intent to retire a tax-exempt obligation and a contemporaneous intent to reimburse itself with proceeds of a tax-exempt borrowing in the near future. More specifically, NABL recommends that Treasury and the IRS treat a transaction as a refunding when the issuer, within 60 days of acquiring its bonds, adopts a declaration of the issuer's intention to later reimburse itself for the costs associated with retiring the debt, and such reimbursement (in the form of a future tax-exempt bond issuance) takes place within 18 months of the extinguishment.

4. Clarify Determination of Yield of Bonds Held by Issuer or Conduit Borrower. Section 3.1 of the Notice provides that "a purchase of a tax-exempt bond by a conduit borrower that is not a governmental issuer" does not cause a retirement of the bond. Section 3.2(3)(b) of the Notice similarly provides that a "bond purchased by or on behalf of a governmental issuer pursuant to a qualified tender right is treated as not retired" during 90 or 180 day periods, subject to certain conditions. Section 4 of the Notice further provides that "a governmental issuer may

purchase its own tax-exempt auction rate bond on a temporary basis without resulting in a reissuance or retirement of the purchased tax-exempt bond if it meets [certain] requirements."

NABL believes that the effect on bond yield of the purchase, holding and remarketing of bonds by issuers and conduit borrowers is unclear. NABL recognizes that legitimate concerns may exist regarding the validity of the stated interest rate on variable rate bonds held only by the issuer or conduit borrower, since the role of holder and borrower are, at that point, merged. Although the use of a benchmark to establish the rate on auction rate bonds or variable rate demand obligations while held by the issuer or the conduit borrower could be a solution, NABL believes that a significant potential may exist for overstating or understating the yield on the bond issue. Accordingly, NABL recommends that, for purposes of determining bond yield, Treasury and the IRS clarify that the period of time during which all of the bonds are held by the issuer or the conduit borrower is effectively ignored and the interest and principal (if any) payments on the bonds (as well as any corresponding payments with respect to a qualified guarantee or a qualified hedge) during such period are treated as neither payments nor receipts. Further, NABL recommends that Treasury and the IRS treat the principal amount of the bonds as a payment on the bonds on the date the bonds are acquired by the issuer or the conduit borrower and as a receipt (or "negative" payment of debt service) on the bonds on the date the bonds are remarketed by or on behalf of the issuer or conduit borrower. NABL believes that such treatment would be neutral and would avoid bond yield distortion, as bond yield would not be treated as zero during this period and would not be blended with the yield during the other periods. In addition, NABL believes that such treatment would be analogous to the treatment of temporary uninvested cash in an advance refunding escrow. If the issuer or conduit borrower acquires less than all of the bonds of an issue, and at least 5% of the then outstanding principal amount of the bonds is held by holders unrelated to the issuer or the conduit borrower, NABL recommends that Treasury and the IRS continue to determine the yield on the bonds based on the actual rate set in the remarketing or auction process.

5. Incorporate the Concept of Commercial Reasonableness in the "Best Efforts" Standard for a Qualified Tender Right. Section 3.2(3)(a) of the Notice states that, in order for a tender right to constitute a "qualified tender right," the right "must require the issuer or its remarketing agent to use *at least best efforts* to remarket a bond upon a purchase pursuant to the tender right." (*Emphasis added.*) Under typical commercial business practice today, NABL

believes that the unmodified term "best efforts" may be construed in some jurisdictions to mean "what it says," thus imposing a requirement to do whatever is possible, even if commercially impractical, to remarket. NABL believes that current commercial business practice is to modify a "best efforts" requirement with some reference to reasonability. Although case law interpreting these standards is inconsistent, NABL believes that the following summarizes the current perception of these standards:

> The commitment standards most often used to address these contractual issues are "best efforts," "reasonable best efforts" and "commercially reasonable efforts." These standards generally are perceived by practitioners as constituting a sliding scale of effort levels. "Best efforts" is at the top of the scale and is generally perceived to mean that a party must do all that can possibly be done to seek and obtain an end, even if the impact would be materially adverse to the seeking party and even if there is a material monetary cost to the action.
>
> "Reasonable best efforts" is a level down from the top end of the scale and is generally perceived as requiring substantial efforts be exerted in the process, but that a party would not ultimately be required to take any actions that would be commercially unreasonable under the circumstances. Finally, "commercially reasonable efforts" is toward the bottom of the scale and is generally perceived as limiting both the effort required to be exerted in the process as well as what a party may ultimately be obligated to do in order to obtain the desired end.[1]

NABL is concerned that parties to remarketing agreements that have a best efforts clause may believe they are required to expend substantial assets in exercising those best efforts. For example, market disruptions may result in the cost and time spent remarketing the bonds to be as much as 100 times greater than the normal cost and time spent for a typical remarketing, and under a "best efforts" standard, the remarketing agent may nonetheless be required to expend such time and money; however, under a "reasonable best efforts" standard, the remarketing agent would typically not be required to take such commercially unreasonable steps.

The recent market disruptions have made remarketing efforts in some circumstances (*e.g.*, when the insurer of the bond being remarketed has been downgraded) more difficult, and NABL members and their clients have encountered substantial resistance from remarketing agents to incorporation of a "best efforts" standard in remarketing agreements. If the remarketing agents are successful in negotiating a standard that is not "*at least best efforts*,"

[1] David Shine, "'Best Efforts' Standards Under New York Law: Legal and Practical Issues," *The M & A Lawyer*, Vol. 7, No. 9 (2004).

NABL believes that a substantial risk exists that the agreement would not comply with the Notice. (*Emphasis added*.) On the other hand, if the remarketing agents agree to this standard, but are not, in fact, complying with it, NABL believes that a question arises as to whether the issuer is effectively waiving the provision, and whether such a waiver prevents the issuer from utilizing the Notice. In either case, in today's business world, a standard tied to reasonableness would be more typical and would not cause either of these problems. NABL, therefore, recommends that Treasury and the IRS change the language "at least best efforts" in Section 3.2(3)(a) of the Notice to "at least reasonable best efforts" or "at least commercially reasonable efforts." If this change is made, NABL also recommends that Treasury and the IRS make conforming changes to the last paragraph of Section 3.2(3)(b), and Section 7, Example 5(i) [two times] and (iv).

6. Expand the Temporary Rule Allowing Governmental Issuers to Purchase Their Own Auction Rate Bonds Without Triggering an Extinguishment. Section 4 of the Notice provides that, assuming certain requirements are satisfied, "a governmental issuer may purchase its own" tax-exempt auction rate bond on a temporary basis without resulting in a reissuance or retirement of the purchased bond. Section 3.2(4) of the Notice defines a "governmental issuer" as an issuer of a tax-exempt bond that is a governmental unit or an agency or instrumentality thereof. This definition omits certain other qualified issuers of tax-exempt bonds under Section 103 of the Code, including constituted authorities, 63-20 corporations, issuers of qualified scholarship funding bonds under Section 150(d) of the Code, and volunteer fire departments. Many of these issuers face the same market turmoil issues currently confronting "governmental issuers," and would benefit greatly from the ability to acquire their own auction rate bonds. Therefore, NABL recommends that Treasury and the IRS amend the definition of "governmental issuer" currently set forth in Section 3.2(4) of the Notice to include any qualified issuer of tax-exempt bonds under Sections 103 and 141-150 of the Code.

7. Eliminate the Prohibition on Obligor Purchases of Bonds Financing the Purpose Investment Acquired From the Obligor/Extend Program Investment Relief to Conduit Borrowers Acquiring Qualified Tender Bonds. Section 5.2 of the Notice provides that, in applying the special arbitrage rule for "program investments" set forth in Treas. Reg. § 1.148-1(b), which restricts a conduit borrower's purchase of tax-exempt bonds for a governmental program in an amount related to the amount of its purpose investment financed by the program, the purchase by

a conduit borrower of an auction rate bond that financed its loan to facilitate liquidity will not be treated as being related for these purposes. NABL thanks Treasury and the IRS for inclusion of this helpful rule in the Notice, which has allayed concerns among bond counsel, issuers and conduit borrowers with respect to acquisitions by conduit borrowers of auction rate bonds issued to finance the conduit borrower's loan that such acquisition will not cause the loan to fail to qualify as a program investment under Treas. Reg. § 1.148-1(b). Prior to the inclusion of this rule in the Notice, members of the bond community were concerned that such an acquisition by a conduit borrower might jeopardize the issuer's and the borrower's ability to take advantage of the definition of "materially higher" set forth in Treas. Reg. § 1.148-2(d)(2)(iii) for program investments of 1.5%.

NABL appreciates the relief set forth in Section 5.2 of the Notice. Nonetheless, NABL believes that the better solution would be to repeal entirely the restriction under the program investment rules on conduit borrowers acquiring bonds that financed their conduit loan. This restriction is derived from former Treas. Reg. § 13.4(b)(2), which provided special relief from the arbitrage rules for bonds issued to finance governmental programs meeting certain specified requirements, including that the program:

> [r]equires that any person (or any related person, as defined in section 103(c)(6)(C)) from whom the governmental unit may, under the program, acquire acquired program obligations shall not, pursuant to an arrangement, formal or informal, purchase the governmental obligations in an amount related to the amount of the acquired program obligations to be acquired from such person by the governmental unit.

Thus, this provision originally did not prohibit a conduit borrower from purchasing the bonds that financed its conduit loan, but rather prohibited an originator of loans who sold such loans to the issuer from purchasing bonds of the issuer that are financing the purchase. Examples of the application of this provision were provided in former Treas. Reg. § 13.4(b)(4): Example (1) showed the provision being applied to a State issuing bonds the proceeds of which were to be used to purchase home mortgage notes from commercial banks, and Example (2) showed the provision being applied to a State issuing bonds the proceeds of which were to be used to purchase student loan notes from commercial banks. Virtually identical language was carried forward in former Treas. Reg. § 1.103-13(h).

NABL believes that, at some point in the course of the numerous amendments to the arbitrage regulations, this rule may have been inadvertently changed to refer to conduit

borrowers rather than loan originators. Accordingly, NABL recommends that Treasury and the IRS delete subparagraph (4) in the definition of "program investment" in Treas. Reg. § 1.148-1(b), or at a minimum, revise subparagraph (4) to refer only to loan originators that sell loans to the issuer as originally provided in former Treas. Reg. § 13.4(b)(2).

If this requirement is not eliminated or so modified, NABL recommends that Treasury and the IRS expand the relief provided in Section 5.2 of the Notice. The rule providing program investment relief set forth in Section 5.2 of the Notice is limited to the acquisition by conduit borrowers of auction rate bonds. NABL recommends that Treasury and the IRS expand this rule to include the acquisition by a conduit borrower of any tax-exempt qualified tender bonds used to finance the conduit borrower's loan.

NABL believes that, in a normal market, conduit borrowers have no economic incentive to hold the tax-exempt debt that financed their loan. NABL also believes that, when faced with a decision as to whether to invest its own funds in the taxable market or to hold tax-exempt bonds that financed its loan (on which it is paying itself interest – a zero sum game), a conduit borrower will, absent special circumstances, elect to keep the tax-exempt debt on the market. Over the past several months, special circumstances have arisen, primarily in the form of the downgrading of the credit rating of the bond insurers resulting in unprecedented interest rates, which have skewed what would otherwise be the norm, and borrowers have sought to acquire tax-exempt debt allocable to their loan in order to prevent interest rate resets at extraordinarily high, and historically unprecedented, levels.

NABL further believes that the same considerations underlying the provision of the Notice for auction rate bonds apply equally to other qualified tender bonds. Accordingly, NABL recommends that Treasury and the IRS revise Section 5.2 of the Notice by replacing the term "auction rate bond" with "qualified tender bond."

8. Clarify that Bonds Which Upon Original Issuance Do Not Satisfy the Definition of a Qualified Tender Bond Can Subsequently Become a Qualified Tender Bond and that a Qualified Interest Rate Mode Change May Be Added Subsequent to the First Initial Issuance. The definition of a "qualified tender bond" set forth in Section 3.2(1) of the Notice requires, *inter alia*, that "for each interest rate mode that is preauthorized under the terms of the bond considered separately, the bond bears interest during the allowable term of that interest rate mode at either a fixed interest rate, a variable interest rate that constitutes a qualified floating rate on a

variable rate debt instrument for a tax-exempt bond under §1.1275-5(b)…or a variable interest rate that constitutes an eligible objective rate for a variable rate debt instrument that is a tax-exempt bond under §1.1275-5(c)(5)….” Similarly, the definition of a “qualified interest rate mode change” states that the change must be “authorized under the terms of the bond upon its original issuance.” NABL believes that questions have arisen under the Notice as to whether tender bonds, which upon original issuance fail to meet the definition of a “qualified tender bond,” but meet the definition upon a subsequent reissuance, are qualified tender bonds, and whether an interest rate mode which is added to the terms of the bond after initial issuance, but before, or as part of, a subsequent reissuance of the bonds, is authorized under the terms of the bond upon its original issuance.

Example 1 of Notice 88-130, 1988-52 I.R.B. 12, expressly recognizes that a bond, which, upon original issuance did not meet the definition of a qualified tender bond, could subsequently become a qualified tender bond upon reissuance. In that Example, the final stated maturity date of the bonds exceeded the 35-year limit set forth in the definition of “qualified tender bond” in Notice 88-130, and the bonds, although tender bonds, are not qualified tender bonds. As such, Example 1 confirms that the bonds are treated as retired and reissued on each subsequent tender date. At the point, however, where the newly reissued bonds satisfy the 35-year limitation, Example 1 properly concludes that the bonds are qualified tender bonds. As set forth above, a similar situation presents itself under the definition of “qualified tender bond” in Section 3.2(1) of the Notice and in the definition of a “qualified interest rate mode change.” Similar to the guidance provided in Example 1 of Notice 88-130, in a situation where there is a reissuance of the bond under Treas. Reg. § 1001-3, NABL recommends that Treasury and the IRS clarify that the proper date for testing both the “original issuance” for purposes of the definition of a qualified tender bond and the “initial issuance” for purposes of the definition of a qualified interest rate mode change is the date of reissuance (if any).

Similarly, NABL believes that Example 4 of the Notice has created confusion concerning the date on which a reissuance is deemed to have occurred. Treas. Reg. § 1.1001-3(c)(6) provides that “an agreement to change a term of a debt instrument is a modification at the time the issuer and holder enter into the agreement, even if the change in the term is not immediately effective,” unless the change is conditioned “on reasonable closing conditions” or “occurs pursuant to a plan of reorganization in a title 11 or similar case.”

Example 4 of the Notice discusses a hypothetical situation in which an issuer amends the bond documents on January 7, 2008, to permit a conversion on interest rate modes that was not, until that point, authorized under the documents, and to require a mandatory tender upon such a conversion. On January 10, 2008, the issuer exercised its new option to make such a conversion and to require a tender and remarketing of the bonds. Because the conversion, tender and remarketing were not pursuant to the terms of the bonds when originally issued, Example 4 of the Notice states that "the change in interest rate mode…is not a qualified interest rate mode change" and that "the tender of the Bonds on January 10, 2008…was not a qualified tender right…. Thus,…the impact of these modifications must be analyzed under §1.1001-3 to determine whether a significant modification of the terms of the Bonds occurred." NABL believes that Example 4 suggests that, if a significant modification occurred, it occurred on January 10, 2008, whereas Treas. Reg. § 1.1001-3(c)(6) suggests that the modification, and possible reissuance, occurred on January 7, 2008, in which case the subsequent conversion, tender and remarketing would have been "pursuant to the terms of the bonds when originally issued."

NABL, therefore, recommends that Treasury and the IRS clarify Example 4 of the Notice to state that the modification and possible reissuance occurs upon amendment of the bond documents.

9. Clarify the Impact of a Non-Qualified Tender Right. Section 3.1 of the Notice provides that "for purposes of §103 and §§141 through 150 only, in the case of a qualified tender bond…, any qualified interest rate mode change…and any qualified tender right…will not be treated as a modification under §1.1001-3. Therefore, solely for these purposes, a qualified tender bond will not be treated as reissued or retired solely as a result of a qualified interest rate mode change or the *existence* or exercise of any *qualified* tender right." (*Emphasis added.*) NABL believes that this language could be interpreted as providing that the mere existence of a non-qualified tender right could trigger a reissuance on each tender date, irrespective of whether the tender right is exercised. NABL recommends that Treasury and the IRS clarify that, unless exercised, the mere existence of a non-qualified tender right does not result in a reissuance on each tender date.

10. Amend the Remedial Action Rules to Account for Conversions to Fixed. Treas. Reg. § 1.141-12(d), (e) and (f) provide for several forms of remedial action an issuer or conduit

borrower can take upon a "change in use" of bond-financed property. Treas. Reg. § 1.141-12(d) provides for the redemption or defeasance of bonds, under which an issuer may call the nonqualified bonds within 90 days of the change in use. This remedial action would be employed, for example, where the issuer has issued variable-rate bonds. For fixed-rate bonds, Treas. Reg. § 1.141-12(d) allows the issuer or conduit borrower to establish a defeasance escrow within 90 days of the change in use. One condition of utilizing a defeasance escrow is that the bonds have a first optional redemption date not more than 10-1/2 years from the date of issuance of the bonds.

NABL believes that, with respect to new money issues and even refundings, the condition for utilizing a defeasance escrow is rarely, if ever, a problem, since call protection only infrequently extends beyond 10 years (plus or minus a couple of months to account for an issuer's or borrower's interest or principal payment dates).

NABL also believes, however, that when bonds are converted to a long-term fixed rate mode to maturity in a transaction that does not constitute a reissuance, often the call date will be set at 10 years from the date of conversion since that is what the market expects.[2] NABL further believes that, because no reissuance occurs, the 10-1/2-year limit under Treas. Reg. § 1.141-12(d) may run from the date of original issuance, which results in issuers either making their fixed-rate bonds callable with unduly short call protection periods or forfeiting call protection altogether; either of these actions results in increased interest cost. Alternatively, the issuer or borrower could take the risk that upon a change in use, it would be required to effect a tender offer for the bonds -- a potentially costly and time consuming process.

NABL believes that a refunding transaction should not be treated more favorably than a non-reissuance conversion, as the issuer is first determining its call protection period at the point of conversion, and the bonds have properly been outstanding without a change in use up until that point. NABL recommends that Treasury and the IRS add a statement to Treas. Reg. § 1.141-12 that, in the case of a conversion that qualifies under the Notice (or Proposed 150 Regulations) as a transaction that does not constitute a reissuance, the 10-1/2 year limit may be measured from the conversion date.

[2] The market does not distinguish between a newly issued fixed-rate bond and, in this context, a bond that has been converted and is reoffered. Call protection expectations are essentially the same.

11. Provide Guidance Regarding the Tax Treatment of Unamortized Bond Insurance Premiums. Treas. Reg. § 1.148-4(f)(6)(i) provides generally that the premium paid for a qualified guarantee is to be allocated "to bonds and to computation periods in a manner that properly reflects the proportionate credit risk for which the guarantor is compensated." Treas. Reg. § 1.148-4(f)(6)(ii) provides a safe harbor for performing such calculation for variable yield issues, under which a "non-level" payment, such as an up-front payment of a bond insurance premium, is allocated over the various computation periods of the bonds by allocating an equal amount to each bond year (or proportionate amounts for short bond years).

The last sentence of Treas. Reg. § 1.148-4(f)(6)(i) provides that, upon an early redemption of a variable yield bond, "fees otherwise allocable to the period after the redemption are allocated to remaining outstanding bonds of the issue or, if none remain outstanding, to the period before the redemption." NABL believes that this sentence may have been intended to address situations wherein the insurance policy terminates concurrently with the redemption of the insured bonds; however, insured bonds are sometimes redeemed (or treated as redeemed, as in the case of a reissuance) and the insurance is not terminated. Conversely, as many bond counsel have observed during the credit crisis resulting from the subprime mortgage debacle, the policy of a downgraded monoline bond insurer may be surrendered, and yet, at the same time, no redemption, refunding or reissuance of bonds occurs (*e.g.*, an exchange of bonds like that described in Example 2 of the Notice (an "Example 2 Exchange")). NABL believes that the application of Treas. Reg. § 1.148-4(f)(6)(i) is unclear in these two scenarios, and that a literal application of that provision in certain circumstances could be contrary to the general principle that the premium should be allocated in a manner that properly reflects the proportionate credit risk for which the guarantor is being compensated.

A. Bonds Refunded/Reissued but Insurance Not Terminated. If the bond insurance policy for which an up-front premium was paid remains in existence and continues to provide a guarantee of debt service on a bond issue, NABL recommends that Treasury and the IRS add a rule similar to the approach employed by the Treas. Reg. § 1.148-4(h)(3)(iv)(C) and (D) regarding the allocation of hedge termination payments. Those provisions draw a distinction between situations in which bonds are redeemed with other than a refunding, in which case the termination payment is allocated to the computation period ending on the termination date, versus situations in which the proceeds of a refunding are used to effect such redemption, in

which case the termination payment is allocated over the life of the refunding bond issue. NABL recommends that Treasury and the IRS amend Treas. Reg. § 1.148-4(f)(6)(i) to similarly provide that when bonds are redeemed with proceeds of a refunding issue and the insurance transfers to the refunding issue, any unamortized insurance premium will be allocated over the life of the refunding bond issue. NABL also recommends that Treasury and the IRS not require the issuer to retest at the time of the reissuance/refunding whether the bond insurance meets the requirements of a qualified guaranty (*e.g.*, no retesting of whether the expected interest savings exceeds the cost of the insurance).

B. Insurance Terminated but Bonds Not Refunded/Reissued. Because of the downgrading of the monoline bond insurers, many issuers and conduit borrowers have sought to "strip" the bond insurance from their financings in connection with recent auction rate security and other restructurings, sometimes in the process of conversions, sometimes in current refundings and sometimes in an "Example 2 Exchange" in which bonds are exchanged with the issuer for identical or substantially identical bonds. In that situation, NABL recommends that, in order to reflect the proportionate allocation of credit risk, Treasury and the IRS modify Treas. Reg. § 1.148-4(f)(6)(i) to indicate that, when the insurance is terminated in the absence of a refunding or reissuance, the unamortized insurance premium is allocated to the computation period in which the insurance is terminated.

C. Prospective Application Only. In light of the current uncertainty regarding the treatment of an unamortized bond insurance premium, NABL recommends that Treasury and the IRS clarify that the modifications to the unamortized bond insurance premium rules apply only to allocations made after the publication of final guidance and add a statement that no inference should be drawn regarding prior application of such rules to any reasonable unamortized bond insurance premium allocation.

EXHIBIT I

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NOTICE 2008-41
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