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Mr. Steven Chamberlin
Internal Revenue Service
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Dear Sirs:

The National Association of Bond Lawyers ("NABL") respectfully submits a comment with respect to the recent posting by the Internal Revenue Service to its website entitled "Sale of Assets Financed with Tax-Exempt Bonds by State and Local Governments and 501(c)(3) Organizations." This posting, dated May 14, 2012, states that it is "not intended to be cited as an authoritative source," but rather to serve as educational materials for the municipal bond community. Nonetheless, we have a comment pertaining to one of the three examples in the posting. We believe that your due consideration of our comment may further assist you in providing educational information to the bond community.

Example 3 sets forth facts involving multiple sources of funds applied toward a single project, in this case a continuing care facility. The example posits a facility costing $10 million, financed $4 million from the conduit borrower's existing funds and $6 million from tax-exempt bond proceeds (the issue size also being $6 million). In the example, the conduit borrower sells the entire facility for $12 million. Although there are multiple sources of funds contributed to the acquisition of the facility, the example concludes that if the conduit borrower chooses to avail itself of the "alternative use of disposition proceeds" option, it must use $12 million for an alternative use within two years. The example also concludes that, of the $12 million of disposition proceeds, $6 million are considered gross proceeds.

We submit that the conclusion that there are $12 million of disposition proceeds does not give sufficient weight to the contribution of the conduit borrower's other source of funds – here, cash from the conduit borrower's revenues. We think a more appropriate interpretation of the Treasury Regulations would be first to apply Section 1.141-12(c)(1) of the Treasury Regulations, which provides that "[d]isposition proceeds are any amounts . . .

derived from the sale, exchange, or other disposition . . . of property . . . financed with the proceeds of an issue." We suggest that only a portion of the continuing care facility – 60% (representing $6 million of the $10 million acquisition cost) – should be considered property financed with the proceeds of an issue.

It follows that, of the $12 million received for the sale of the entire facility, only $7.2 million (60% of $12 million) should be considered disposition proceeds subject to the rules of Section 1.141-12, of which at most $6 million would be considered gross proceeds for purposes of Section 148 of the Internal Revenue Code (the "Code").[1] Thus, if the conduit borrower were to choose the alternative use of disposition proceeds option, only $7.2 million should be required to be spent on qualifying assets within two years of the date of the facility's sale.

Section 1.141-12(c)(3) of the Treasury Regulations provides in part that "[i]n no event may disposition proceeds be allocated to . . . a source of funding not derived from a borrowing (such as revenues of the issuer) if the disposition proceeds are not greater than the total principal amounts of the outstanding bonds that are allocable to that property." Even if the conclusion in Example 3 is based on the notion of allocating disposition proceeds first to tax-exempt bonds and only thereafter to other funds, the application of Section 1.141-12(c)(3) of the Treasury Regulations is limited to situations in which the amount of disposition proceeds is not greater than the principal amount of bonds allocable to the disposed-of property. Whether one considers the amount of disposition proceeds to be $12 million or, under the approach we describe above, $7.2 million, both figures are greater than the $6 million of tax-exempt bonds used toward the acquisition of the continuing care facility. Consequently, the prohibition in Section 1.141-12(c)(3) of the Treasury Regulations against allocating disposition proceeds to revenues or other sources of funds is inapplicable.

We note that a proration approach to analyzing multiple sources of funds is consistent with the logic followed by Section 1.141-4 of the Treasury Regulations, addressing the private security or payment test. We point you specifically to Section 1.141-4(c)(3)(iii) of the Treasury Regulations, which provides in part with respect to multiple sources of funds: "In general, . . . if a payment is made for the use of property financed with two or more sources of funding (for example, equity and a tax-exempt issue), that payment must be allocated to those sources of funding in a manner that reasonably corresponds to the relative amounts of those sources of funding that are expended on that property."

Finally, consider the result reached by Example 3 with numbers that are a bit more skewed. Assume the conduit borrower contributed $9.5 million of its own funds to acquire the facility and then used $500,000 of tax-exempt bonds to install a new roof. Five years after issuance, the conduit borrower sells the facility for $12 million. To require the conduit borrower to reinvest the entire $12 million in such scenario would be extremely disproportionate to the amount of tax-exempt financing availed of by the conduit borrower. Rather, the borrower should either be required to redeem $500,000 of bonds or, at most, to spend $600,000 (5% of $12 million) on qualifying assets within two years of the date of sale of the facility.

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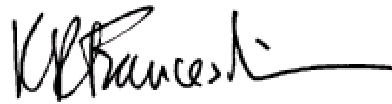
[1]A slightly different, but related, open question is raised in Example 2 of the posting, which this letter does not address. This question, arising when multiple facilities are financed with a single bond issue, is whether an amount greater than the amount of nonqualified bonds should be considered gross proceeds for purposes of Section 148 of the Code.

NABL exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the law affecting public finance. We respectfully provide the above comment in furtherance of that mission. Members who participated are listed in Exhibit A.

If NABL can provide further assistance, please do not hesitate to contact Bill Daly in our Washington, D.C., office at (202) 503-3300.

Sincerely,



Kristin H. R. Franceschi

Enclosure

EXHIBIT A
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