CURRENT TAX ISSUES FOR FINANCING STRUCTURES

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This panel discussion will include analysis of more complex issues encountered in financing and refinancing structures in the current rising interest rate environment, including the use of draw-down loan structures, short-term and interim financing structures, interest rate swaps, variable rate demand obligations (VRDOs), and LIBOR transitions.

1. Draw-Down Loans

In general, no comprehensive definition for the term draw-down loan is provided in the Code or Regulations. Guidance focused on specifying what bonds are part of an issue of bonds and on what is the issue date of an issue of bonds provide some framework for determining what is meant by a draw-down loan.

For tax-exempt bond purposes generally, bonds issued pursuant to a draw-down loan are treated as part of a single issue, with an issue date of the issue being the first date on which the aggregate draws under the loan exceed the lesser of $50,000 or five percent of the issue price of the issue. Reg. § 1.150-1(c)(4)(i). For information reporting purposes, amounts advanced periodically pursuant to a draw-down loan that are equally and ratably secured under a single indenture or loan agreement pursuant to a common plan of financing arrangement during the same calendar year may be treated as part of the same issue. In addition, amounts advanced in different calendar years may be treated as part of the same issue if reasonably expected to be advanced within three years of the date of issue of the first bond (i.e., advance). Reg. § 1.149(e)-1(e)(2)(ii).

Query/Observations: Would two separate draw-down loans entered into at the same time and otherwise satisfying the general rule in Reg. § 1.150-1(c) for same issue treatment be part of the same issue under Reg. § 1.150-1(c)? Do all advances under a draw-down loan have the same sale date or are there multiple sale dates with possible issues with other obligations sold within 15 days of a particular draw? Would certain non-customary conditions to draw or repricing of the interest rate/yield for different advances undermine draw-down-loan treatment?

Issue dates and draw-down loans

- Issue Date of a Bond. In general, Notice 2010-81 states that a bond is considered to be issued on the "issue date" of a bond. Reg. § 1.150-1(b) defines "issue date" of a bond to mean the date on which the issuer receives the purchase price in exchange for that bond, provided interest is accruing. In the context of draw-down loans each advance is a separate bond issued on the date of the advance.

- Issue Date of an Issue. Reg.§ 1.150-1(b) provides in general that the "issue date" of an issue is the first date on which the issuer receives the purchase price in exchange for delivery of any bond included in the issue, provided interest is accruing. A minimum draw requirement is also imposed for draw-down loans as described above.

Draw-down loans-- bond level rules and issue level rules

- Most statutory and regulatory requirements applicable to state and local bonds operate at either the bond level or the bond issue level. This underlying framework, when applied in the context of draw-down loans, can introduce both challenges and questions.

- Among the numerous requirements applicable to state and local bonds that typically operate at the bond level are statutory provisions that directly or implicitly impose time periods for issuing state and local bonds, including sunset provisions, effective date provisions and volume cap-type provisions tied to particular time periods.

- As a general matter, the analysis in Notice 2010-81 concludes that each advance on a draw-down bond is a separate bond for the purposes of applying requirements that operate at the bond level, such as determining whether Build America Bonds were issued before the statutory deadline of Jan. 1, 2011. An exception to this general rule is that Rev. Rul. 89-70 continues in effect for the purpose of applying the qualified small issuer and de minimis exceptions to the tax-exempt carrying cost disallowance provisions under Code Section 265(b)(3) and Code Section 265(b)(7). In addition, Notice 2011-63 amended and supplemented Notice 2010-81 to allow, solely for volume cap purposes, an issuer to elect to treat a bond as issued on the issue date of the issue, subject to certain requirements. As a historical note, this analysis in Notice 2010-81 appears to conflict with PLR 201038014, which pre-dated Notice 2010-81 and applied the issue date of an issue of commercial paper (and not the issue date of each commercial paper note) for purposes of the 2009/2010 AMT refunding exception in Section 57, although the provisions of Section 57 are written to apply at the bond level.

- For requirements applicable to state and local bonds that operate at the bond issue level, the analysis in Notice 2010-81 generally confirms that the various advances under a draw-down bond represent bonds that are part of the same bond issue with an issue date satisfying the minimum draw requirements.

- For example, in determining whether more than 10 percent of the proceeds of an issue are to be used for private business use under Code Section 141(b)(1), in general all advances under a draw-down loan would be treated a part of a single issue. By way of another example, the proceeds resulting from advances under a draw-down loan bond issue would qualify for the 3-year temporary period for investment under Reg. § 1.148-2(e)(2) beginning on the issue date of the issue (determined under Reg. § 1.150-1(c)(4)(i)), if the applicable expenditure, time and due diligence tests are satisfied.

Query/Observations: Because requirements that operate at the bond level could change during the draw period for a draw-down bond, it may be important to consider the formulation of tax

advice and/or to implement procedures in the financing and tax documentation to assure continuity of relevant legal requirements at the time of advances.

Hypothetical: City A entered into a tax exempt $20,000,000 draw-down loan on April 1, 2020 to finance a water system upgrade. The City represented at that time that it reasonably expected to expend $20,000,000 on the project by April 1, 2023, that it would make substantial binding commitments on the project within 6 months and that it would proceed with due diligence to completion of the project within 3 years. The loan bears interest on amounts advanced at 3% and is repayable as to principal in equal principal payments in the years 2024 to 2030. The loan is not subject to optional redemption by City. The nominal stated principal payments starting April 1, 2024 are subject to reduction ratably to the extent of any amounts not advanced on the loan as of April 1, 2023 ("Principal Adjustment Date"). Due to disruptions caused by the Covid epidemic, construction has been delayed. As of April 1, 2023, the City expended $10,000,000 on the Project.

The City seeks advice on the tax exempt bond consequences of seeking a change in the Principal Adjustment Date to April 1, 2024, with nominal stated principal payments beginning on April 1, 2024 being subject to reduction ratably to the extent of any amounts not advanced on the loan as of April 1, 2024 (rather than April 1, 2023).

- Would implementing this change trigger a reissuance under Reg. § 1.1001-3?

- If this change is documented by the City as a reissuance under Reg. § 1.1001-3, (a) what would the Form 8038-G look like?; (b) what expectations would be needed by the City with respect to the unadvanced loan amount?; and (c) would it be advisable to require some additional advance under the loan in connection with the amendment?

- If this change is not treated by the City as a reissuance under Reg. § 1.1001-3, (a) would drawing funds as needed after 3 years raise concerns that the revised arrangement would jeopardize the status of the loan as a draw-down loan under Reg. §1.150-1(c)(4)(i)?; (b) would an additional information filing be required under Reg. § 1.149(e)-1(e)(2)(ii) even though the change is not otherwise treated as a reissuance?; and/or (c) would the additional draws after 3 years be treated as a separate issue, so that two draw-down issues are outstanding?

The City seeks advice on the tax-exempt bond consequences of seeking a change in the loan documentation to permit a draw of all of the remaining $10,000,000 commitment on the loan on April 1, 2023, to be held in a construction fund pending expenditure on project costs.

- Would implementing this change trigger a reissuance under Reg. § 1.1001-3?

- If this change is documented by the City as a reissuance under Reg. § 1.1001-3, (a) what is reissued and what would the Form 8038-G look like?; (b) what expectations would be needed by the City and what investment restrictions would apply with respect to the funds advanced on April 1, 2023?; and (c) would there be any hedge bond concerns or audit risks involved with this approach?

- If this change is not treated by the City as a reissuance under Reg. § 1.1001-3, (a) what expectations would be needed by the City and what investment restrictions would apply with respect to the funds advanced on April 1, 2023?; and (b) would there be any hedge bond concerns or audit risks involved with this approach?

2. Short-Term Financing Structures

Reg. § 1.148-6(d)(1)(i) provides that "In general, reasonable accounting methods for allocating funds from different sources to expenditures for the same governmental purpose include any of the following methods if consistently applied: a specific tracing method; a gross proceeds spent first method; a first-in, first-out method; or a ratable allocation method."

Reg. § 1.148-6(d)(1)(iii) provides that "an issuer must account for the allocation of proceeds to expenditures not later than 18 months after the later of the date the expenditure is paid or the date the project, if any, that is financed by the issue is placed in service. This allocation must be made in any event by the date 60 days after the fifth anniversary of the issue date or the date 60 days after the retirement of the issue, if earlier."

Hypothetical: In 2022, Airport Authority X issued $1 Billion of tax exempt Private Activity Bonds issued pursuant to Section 142 of the Code (the "2022 Bonds") the financing of a major airport revitalization project (the "Airport Renovation Project"). Due to market volatility, the 2022 Bonds were issued as variable rate bonds, with a par call 1 year after the issuance date. The Airport Renovation Project is slated to take more than 5 years to complete. In accordance with Treasury Regulation § 1.148-2(e)(2)(ii), the Airport Authority is applying a 5-year temporary period for the proceeds of the 2022 Bonds. The Airport Authority also anticipates using other non-tax advantaged sources of funds for the Airport Renovation Project, which will start being contributed in April of 2023.

The Airport Authority has expended $550 million of the proceeds of the 2022 Bonds, some of which have not been used for eligible costs for an airport facility, for example working capital, for an airport private activity bond. The plan has been to reallocate costs that are not eligible costs to equity pursuant to Reg. § 1.148-6(d)(1) once equity has been expended on eligible costs. No portion of the Airport Renovation Project has been Placed in Service. The Airport Authority wants to currently refund the 2022 Bonds this summer with long-term fixed rate bonds. Will the Airport Authority's plan to do the current refunding impact its ability to do the reallocations?

- What does account for allocation mean?
    - o Reg. § 1.148-6(a) provides that an issuer may use any reasonable, consistently applied accounting method to account for gross proceeds, investments, and expenditures of an issue. Consistently applied means applied uniformly within a fiscal period and between fiscal periods to account for gross proceeds of an issue and any amounts that are in a commingled fund. Reg. § 1.148-1(b).
    - o Reg. § 1.148-6(a)(2) provides that an accounting method does not fail to be reasonable and consistently applied solely because a different accounting method is used for a bona fide governmental purpose to consistently account for a particular

item. Bona fide governmental purposes may include special state law restrictions imposed on specific funds or actions to avoid grant forfeitures.

  - So, "accounting for" means how the Issuer shows in its books and records sufficient to establish the accounting method for an issue and the allocation of the proceeds must be accounted for consistently. The IRS has stated that by not requiring allocations to be determined when the expenditure is paid or incurred, the regulations acknowledge that day-to-day practicalities require some flexibility for when issuers must make allocations.[1] So making a reallocation within the permitted time periods described in Reg. § 1.148-6(d)(1)(iii), would not result in an inconsistent accounting method being applied for the governmental purposes of the 2022 Bonds.

- Absent another allocation method election by the issuer, if an issuer cannot or does not reallocate expenditures because of the timing limitations or because a lack of expenditures from other sources on eligible costs, this leaves the issuer using direct tracing – meaning that the Airport Authority is stuck with the actual expenditures for which proceeds were expended.

- Proceeds are defined in Reg. § 1.148-1 as any sale proceeds, investment proceeds, or transferred proceeds of an Issue.

- Does this mean that the reallocation time period for the proceeds of the 2022 Bonds, including the $450 million of unspent proceeds, must be allocated 60 days after the retirement of the 2022 Bonds or the Airport Authority is stuck with specific tracing? Not necessarily.

  - The unspent proceeds of the 2022 Bonds will become transferred proceeds of the refunding issue. Reg. § 1.148-9(b)(1) describes that "when proceeds of the refunding issue discharge any of the outstanding principal amount of the prior issue, proceeds of the prior issue become transferred proceeds of the refunding issue and cease to be proceeds of the prior issue."

- When the 2022 Bonds are refunded, the unspent proceeds will become deallocated from the 2022 Bonds when they become transferred proceeds of the refunding issue.

  - *Reg. § 1.148-6(b)(1) provides:*

    i. that amounts are allocable to only one issue at a time as gross proceeds and

    ii. amounts cease to be allocated to an issue as proceeds only when those amounts are allocated to an expenditure for a governmental purpose, are allocated to transferred proceeds of another issue, or cease to be allocated to that

[1] PLR 200924013.

issue at retirement of the issue or under the universal cap of paragraph (b)(2) of this section.

- This means that when we read the allocation timing rules again "an issuer must account for the allocation of proceeds to expenditures not later than 18 months after the later of the date the expenditure is paid or the date the project, if any, that is financed by the issue is placed in service. This allocation must be made in any event by the date 60 days after the fifth anniversary of the issue date or the date 60 days after the retirement of the issue, if earlier."

  (i) After the refunding of the 2022 Bonds, the unspent proceeds will cease to be proceeds of the 2022 Bonds and will become proceeds of the current refunding bonds.

  (ii) So if that is the case, the Airport Authority would need to account for the allocation of the transferred proceeds to expenditures not later than 18 months after the later of the date the expenditure is paid or the date the project, if any, that is financed by the issue is placed in service. This allocation must be made in any event by the date 60 days after the fifth anniversary of the issue date or the date 60 days after the retirement of the issue, if earlier.

  (iii) However, the allocation of proceeds of the 2022 Bonds that were expended would **need** to be made 60 days after the retirement of the 2022 Bonds or the Airport Authority would be stuck with how the proceeds were expended on a direct tracing basis.

3. Swaps

Hypothetical: Higher Education Authority X is going to issue tax-exempt bonds on behalf of conduit borrower, University Y, where the Authority will issue short-term variable rate tax-exempt obligations with a 5-year maturity (the "2023 Bonds"). The University intends on requesting the Authority to issue another issue of fixed-rate tax-exempt obligations with a 30-year maturity to currently refund the 2023 Bonds sometime before the 2023 Bonds mature in 2028 (the "Future Bonds").

The University wants to enter into a single swap transaction (the "Swap") that serves two functions:

- To hedge the variable rate nature of the 2023 Bonds during the time that the 2023 Bonds are outstanding, and

- An anticipatory swap to hedge against interest rate changes for the Future Bonds.

Because the yield curve is inverted, the portion of the Swap that is the anticipatory swap lowers the interest rate to be paid upfront over the term that the Swap is outstanding. The University wants to try to treat the Swap as a "qualified hedge" under Reg. § 1.148-4(h) so that the Swap termination cost, if any, can be financed by the Future Bonds.

Can the Swap be identified by the Authority and the University and treated as a "qualified hedge" under Treasury Regulation § 1.148-4(h)?

- Under Reg. § 1.148-4(h)(2), a "qualified hedge" is a contract that satisfies each of the following requirements:

  (i) *A hedge*: The contract is entered into primarily to modify the issuer's risk of interest rate changes with respect to a bond (a hedge).

  (ii) *No significant investment element*: The contract does not contain a significant investment element.

  (iii) *The parties*: The contract is entered into between the issuer or the political subdivision on behalf of which the issuer issues the bonds (collectively referred to in this paragraph (h) as the issuer) and a provider that is not a related party (the hedge provider).

  (iv) *Hedged bonds*: The contract covers, in whole or in part, all of one or more groups of substantially identical bonds in the issue (i.e., all of the bonds having the same interest rate, maturity, and terms).

  (v) *Interest-based contract and size and scope of hedge*: The contract is primarily interest-based (for example, a hedge based on a debt index, including a tax-exempt debt index or a taxable debt index, rather than an equity index). In addition, the size and scope of the hedge under the contract is limited to that which is reasonably necessary to hedge the issuer's risk with respect to interest rate changes on the hedged bonds.

  (vi) *Payments closely correspond*: The payments received by the issuer from the hedge provider under the contract correspond closely in time to either the specific payments being hedged on the hedged bonds or specific payments required to be made pursuant to the bond documents, regardless of the hedge, to a sinking fund, debt service fund, or similar fund maintained for the issue of which the hedged bond is a part.

  (vii) *Source of payments*: Payments to the hedge provider are reasonably expected to be made from the same source of funds that, absent the hedge, would be reasonably expected to be used to pay principal and interest on the hedged bonds.

  (viii) *Identification*: The actual issuer must identify the contract on its books and records maintained for the hedged bonds not later than 15 calendar days after the date on which there is a binding agreement to enter into a hedge contract (for example, the date of a hedge pricing confirmation, as distinguished from the closing date for the hedge or start date for payments on the hedge, if different).

  (ix) *Anticipatory Hedges:* Identification of whether the Issuer anticipates for the anticipatory hedge to terminate substantially contemporaneously with the issuance of the hedge bonds.

- Assuming items (i), (iii), (v), (vii), (viii), and (ix) would be met by both issues and the Swap, the analysis regarding whether the Swap could be considered a "qualified hedge" turns on:

  (i) In part, the economics of the transaction: The interest rate of the Swap is considered off-market as a hedge for both, the 2023 Bonds (lower) but also for the anticipatory hedge for the Future Bonds (higher).

  i. As a result of the lower interest rate paid to hedge the 2023 Bonds over time, there is an expectation of a possible future return on the Swap. The Swap termination cost would be higher than it otherwise would be in the event that there were two swaps: one for the 2023 Bonds and one for the Future Bonds.

  ii. There is likely a significant investment element and a portion of the payments do not closely correspond.

  (a) When the regulations were originally promulgated, Treasury Decision 8718, 1997-1 CB 47, May 8, 1997 provided that "[a] hedge contains a significant investment element if the issuer's payments for the hedge are significantly front-loaded. In addition, a hedge contains a significant investment element if the issuer's payments are significantly back-loaded."

  (b) The blended rate for the Swap truly results in an off-market hedge. The receipt of the upfront benefit in the early years for the Term Loan Swaps (because of the averaging of the lower rate for the Anticipatory Swap) is something that ultimately has to be paid for at termination; could mean that the entirety of the Swap would be considered off-market.

  (ii) The Hedged Bonds: The 2023 Bonds and the Future Bonds aren't going to be substantially identical bonds, nor are they going to be part of the same issue.

  i. Under Reg. §1.148-4(h)(2)(iii), the hedge must cover all of one or more groups of substantially identical bonds in the issue (i.e., all of the bonds having the same interest rate, maturity, and terms). If the hedge does not cover all interest payments on all of the substantially identical bonds being hedged, it must cover, in whole or in part, the same specific identifiable interest payments on each of the substantially identical bonds.

  ii. Some variation may be allowed. In technical advice,[2] the IRS approved of a swap that covered a portion of the interest payments varying by 1.5 percentage points over the term of the swap. The variation was based on scheduled principal reductions and scheduled reductions in notional principal amount. As of the execution date, the variation was fixed and determinable. That isn't the case here.

[2] Letter Ruling 200051001.

iii. It should be noted that in certain circumstances not described in this hypo, a one-time "off-market payment/deemed payment" does not result in an inability to treat a portion of the on-market portion of the hedge as a "qualified hedge." In that circumstance, a portion of the hedge termination payment would not be eligible for financing with tax-exempt bonds.

4. Variable Rate Demand Obligations (VRDOs)

Because of the current rising interest rate environment, counsel may encounter publicly offered multi-model financing instruments, commonly known as variable rate demand obligations (VRDOs), and privately placed bank debt that may be issued for a term of years at a variable rate with some option to convert to a fixed rate to maturity at a later date. These VRDOs or convertible instruments may become even more popular in a rising interest rate environment when the U.S. Treasury yield curve inversion becomes a normal yield curve.

Hypothetical: Solid Waste Authority A issues governmental VRDOs as qualified tender bonds (QTBs) under IRS Notice 2008-41 (relating to Reissuance Standards for State as and Local Bonds). The QTBs are initially being offered at a rate that constitutes a "qualified floating rate on a floating rate debt instrument for a tax-exempt bonds under Reg. § 1.1275-5(b)." The QTBs when originally issued are issued bearing variable interest rates.

What floating rate do you use in determining the size of your "reasonably required reserve or replacement fund" under Reg. § 1.148-2(f)(2)?

- Do you look to see if the Indenture provides any guidance? Or if State law provides any guidance?

- Do you look at an average of that index during a recent period for a comparable credit?

- Does PLR 8351138 provide any guidance? In that private letter ruling the IRS stated that the amount of the reserve fund for a floating rate bond should be geared to what would have been a reasonably required reserve fund if the bond had been issued at a fixed interest rate. Or is this PLR too dated?

Later, when interest rates decline, the Solid Waste Authority elects to convert the QTBs to a fixed yield instrument to its final maturity date.

Has a reissuance occurred? Consider Reg. § 1.148-4(d):

- Conversion from variable yield issue to fixed yield issue. *For purposes of determining yield under this section,* as of the first day on which a variable yield issue would qualify as a fixed yield issue if it were newly issued on that date (a conversion date), that issue is treated as if it were reissued as a fixed yield issue on the conversion date. The redemption price of the variable yield issue and the issue price of the fixed yield issue equal the aggregate values of all the bonds on the conversion date. Thus, for example, for plain par bonds (e.g., tender bonds), the deemed issue price would be the outstanding principal amount, plus accrued unpaid interest. If the conversion date occurs on a date other than a

computation date, the issuer may continue to treat the issue as a variable yield issue until the next computation date, at which time it must be treated as converted to a fixed yield issue.

- Are the Bonds treated as reissued for any purpose other than for purposes of determining yield under Reg. § 1.148-4(d). It appears not because the lead in language in the regulation specifically states that the conversion is treated as a fixed yield issue for purposes of determining yield under this section. Thus, there is no need to file a new Form 8038 or 8038-G, as applicable, or to determine if any arbitrage rebate is due on the "prior bonds" within sixty (60) days of the issue date of the "reissued debt."

Hypothetical: The note issued by Hospital Authority B is a qualified 501 (c)(3) note under Section 145. The note is privately placed with a bank. The debt is structured as a twenty-year note which bears interest at a variable rate keyed to SOFR plus X bps for the first ten (10) years. On Date 10 and for the remaining ten (10) years to its maturity, the note will bear interest at an external index rate determined on Date 10 plus XX bps (which computes to a fixed rate from Date 10 through maturity); thus, the note on Date 10 converts to a fixed yield issue.

- Does the private placement structure change the analysis in the first Hypothetical?

- **Private business use:** The Hospital for whose benefit the note is being issued is using the note proceeds to construct a facility that will have a significant amount of private business use in the earlier years of the term of the note and which will be substantially reduced during the later note term. It needs the benefit of averaging the private use during the term of the note.

  - Reissuance consideration under Reg. § 1.148-4(d) is merely intended to treat the debt as reissued for yield purposes under Section 148 and is not also considered a reissuance for purposes of Sections 141, 142, 146, 147 and 150, and thus doesn't cause the non-arbitrage-related tax regulations to be reviewed for compliance. See Reg. § 1.141-12(e)(2) and (f)(2) (relating to change in use) in each case the IRS specifically notes the Codes sections for which the bonds shall be treated as reissued. As such, when the IRS intends to extend the reissuance concept to multiple Code sections, those two previously cited regulations are examples of how the IRS will specifically enumerate.

5. LIBOR Transition Rules

Hypothetical: Wastewater Authority A issued tax-exempt variable rate multi-modal bonds in 2018. Authority is currently in a weekly reset mode and wants to convert to an index floating mode under the indenture. The only index option in the Indenture, however, is LIBOR. The bonds are currently hedged by a LIBOR referenced qualified hedge.

Can the Wastewater Authority amend its Indenture on a reset date to allow for SOFR without causing a reissuance? What about the hedge? What if the hedge was super-integrated?

Can the Wastewater Authority also build in additional backup index options to provide flexibility in the event SOFR is discontinued?

The Final Regulations

On January 4, 2022, IRS published Final Reg. § 1.1001-6 (the "Final Regulations")[3] addressing reissuance considerations in transitioning contracts (including bonds and hedges) from a discontinued IBOR to a new qualified rate.

- To avoid reissuance status other than testing under Reg. § 1.1001-3, the replacement of the IBOR must be considered a "covered modification."

- A covered modification includes any modification under Revenue Procedure 2020-44, 2020-45 I.R.B. 991 ("Rev. Proc. 2020-44").[4]

    - Under Rev. Proc. 2020-44, modifications of existing contracts resulting from the adoption of the Alternative Reference Rates Committee ("ARRC") fallback language for debt or the ISDA protocol language for hedges will not be treated as a reissuance of bonds or a termination of a qualified hedge.

    - Rev. Proc. 2020-44 addresses only a formulaic approach without negotiation and does not apply to amendments made through negotiation of the parties or to one-time payments as a substitute for any portion of the ARRC or ISDA language.

    - Rev. Proc. 2020-44 applies only to modifications of contracts occurring on or after 10/9/2020 (but issuers may choose to rely upon it for modifications occurring before that date), but **before 01/01/2023**.

    - The actual replacement of IBOR requires use of Reg. § 1.1001-6. In the hypothetical, this would help facilitate adding fallback language.

- Absent being covered under Rev. Proc. 2020-44, a covered modification must replace a "discontinued IBOR" with a "qualified rate," and can include one-time payments and associated modifications, including "incidental payments" to accounts for valuation differences.

- A qualified rate can also replace a discontinued IBOR as a fallback, or add a fallback, including a "waterfall" of fallback rates.

    - If the rate being tested is comprised of more than one fallback rate, each individual rate must satisfy the requirements to be a "qualified rate." If the likelihood that any value will ever be determined under the fallback rate is "remote," the rate qualifies.

[3] https://www.federalregister.gov/d/2021-28452
[4] https://www.irs.gov/pub/irs-drop/rp-20-44.pdf

- Upon activation of a fallback, the change must be retested under Reg. § 1.1001-3. This may mean that bond counsel should provide for an opinion upon "activation."

- A "qualified rate" includes any "qualified floating rate," as defined in Reg. § 1.1275-5(b), without regard to the limit on multiples, including a rate determined by adding or subtracting basis points, or a multiple. Rates also includes certain rates recommended by central or reserve banks or those selected by ARRC, under certain conditions.

  - A "qualified floating rate" is one that reasonably can be expected to measure contemporaneous variations in the cost of newly borrowed funds.

  - It is implied that SOFR is a qualified rate; what about others? E.g., BSBY?

- A discontinued IBOR is an IBOR, such as LIBOR, but only during the period beginning on the date of the announcement of its discontinuance and ending on the date one year after the administrator of the rate ceases to provide it. Thus, there is a time limit to effectuate substitutions. Publication of overnight, 1-month, 3-month, 6-month and 12-month USD LIBOR will cease on June 30, 2023; thus, the Final Regulations may only be relied on until June 30, 2024.

- Certain modifications are deemed by the Final Regulations to be "noncovered modifications," e.g., a modification intended to induce one or more parties to consent, or to compensate one or more parties for the modification, are "noncovered modifications."

- The Final Regulations address the impact on **non-super-integrated** hedges. A covered modification of a qualified hedge or of the hedged tax-advantaged bonds is not treated as terminating the hedge, provided no later than the 90-day period beginning on the date of the first covered modification the qualified hedge satisfies the rules to be a qualified hedge. Any upfront payment is amortized and treated as a periodic payment.

  - In our hypothetical, we have ninety days to perhaps alter our discontinued IBOR referenced hedge and retest to determine qualified hedge status. We do not need to check "on-market" nature of hedge nor re-identify it.

  - What if the hedge in our hypothetical was super-integrated? We must apply Reg. §1.148-4(h)(4)(iv), "Consequences of certain modifications."

  - The modification of the super-integrated hedge from LIBOR to SOFR will result in a deemed termination of the hedge (and a deemed reissuance of the related hedged bonds), unless "based on the facts and circumstances (e.g., taking into account both the termination and any qualified hedge that immediately replaces the terminated hedge), there is no change in the yield."