

IRS RELEASES RE-PROPOSED ISSUE PRICE REGULATIONS

June 26, 2015

On June 24, 2015 the IRS published re-proposed issue price regulations (the “Re-Proposed Regulations”) in the Federal Register relating to the determination of the issue price of tax-exempt and certain other tax-advantaged bonds. The Re-Proposed Regulations are proposed to apply to bonds that are sold on or after the date that is 90 days following the publication of the decision adopting such rules as final regulations in the Federal Register (the “Effective Date”). Issuers, however, may rely upon the Re-Proposed Regulations with respect to bonds that are sold on or after June 24, 2015 but before the Effective Date.

The purpose of the Re-Proposed Regulations is to re-propose the definition of “issue price” that was originally proposed in regulations published in the Federal Register on September 16, 2013 (the “2013 Proposed Regulations”) in response to comments received with respect to the 2013 Proposed Regulations.

Existing Definition of “Issue Price”

The existing regulations (the “Existing Regulations”) generally define the “issue price” of a maturity of bonds that are publically offered as the first price at which a substantial amount of such maturity of bonds is sold to the public. A substantial amount is defined as 10%. The issue price does not change if part of the issue is later sold at a different price. The public does not include bond houses, brokers or similar persons acting in the capacity of underwriters or wholesalers. If there is a bona fide public offering of the bonds, the issue price of the bonds may be established as of the sale date based on the reasonable expectations of the underwriter regarding the initial offering price to the public.

The 2013 Proposed Regulations Definition of “Issue Price”

The proposed definition of “issue price” in the 2013 Proposed Regulations differed significantly from that in the Existing Regulations. Although the 2013 Proposed Regulations generally define the “issue price” of bonds issued for money as the first price at which a substantial amount of such bonds is sold to the public (similar to the Existing Regulations), the safe harbor for determining whether a substantial amount of sales has occurred is defined as the sale of at least 25% of the subject bonds (not the 10% permitted by the Existing Regulations) and, instead of permitting reasonable expectations to determine the issue price in the case of a bona fide public offering, the issue price must be based on actual orders that are filled. The issue

price of bonds of an issue that do not have the same credit and payment terms is to be determined separately.

The “public” is defined as any person (defined under existing statutes to include an individual, a trust, estate, partnership, association, company or corporation) other than an underwriter. An “underwriter” is any person that purchases bonds from the issuer for the purpose of effecting the original distribution of bonds, or otherwise participates directly or indirectly in the original distribution. An underwriter is intended to include a lead underwriter and any member of a syndicate that contractually agrees to participate in the underwriting of the bonds for the issuer. A securities dealer that purchases bonds for the purposes of effecting the original distribution of bonds is also treated as an underwriter, as is any related party to any underwriter. A person that holds bonds for investment, however, is treated as a member of the public and not as an underwriter.

Comments to the 2013 Proposed Regulations

Some commentators expressed concerns with respect to the definition of “issue price” in the 2013 Proposed Regulations on the basis that issue price should only be determined as of a particular sale date, and that the safe harbor requirement of at least 25% of actual orders imposed too much risk in that insufficient sales could prevent a timely determination of issue price on the sale date and/or result in lower bond offering prices so as to ensure that the safe harbor would be satisfied. In addition, some commentators expressed concern that the definition of underwriter in the 2013 Proposed Regulations was unduly broad and ambiguous. In particular, some commentators expressed concern that the proposed definition of “underwriter” necessitated determining a dealer’s intent for buying bonds because whether a dealer was an underwriter depended upon whether the dealer purchased the bonds with “the purpose of effecting the original distribution of the bonds.”

The Re-Proposed Regulations Definition of “Issue Price”

The Re-Proposed Regulations attempt to address the concerns raised with respect to the 2013 Proposed Regulations. The definition of “issue price” in the Re-Proposed Regulations retains the concept that, with respect to bonds issued for money, the issue price is the first price at which a substantial amount of such bonds is sold to the public. However, the Re-Proposed Regulations eliminate the reference to 25% contained in the 2013 Proposed Regulations with respect to what is a substantial amount, and provide that 10% is a substantial amount consistent with the Existing Regulations. In addition, although the Re-Proposed Regulations rely on actual sales to determine issue price and do not reference reasonable expectations, if the underwriters have not received orders placed by the public for a substantial amount of the bonds on or before the sale date, the issuer may treat the initial offering price to the public as the issue price of the bonds if the following requirements are met:

(a) the underwriters fill all orders at the initial offering price placed by the public and received by the underwriters on or before the sale date (to the extent the orders do not exceed the amount of bonds to be sold), and no underwriter fills an order placed by the public and received by the underwriters on or before the sale date at a price higher than the initial offering price;

(b) the issuer obtains from the lead underwriter in the underwriting syndicate or selling group (or, if applicable, the sole underwriter) certain certifications described below; and

(c) the issuer does not know or have any reason to know, after exercising due diligence, that such certifications are false.

The required certifications referred to in clause (b) above are as follows: (i) the initial offering price; (ii) that the underwriters met the requirements of clause (a) above; (iii) that no underwriter will fill an order placed by the public and received after the sale date and before the issue date at a price higher than the initial offering price, except if the higher price is the result of a market change (such as a decline in interest rates) for the bonds after the sale date; and (iv) that the lead (or sole) underwriter will provide the issuer supporting documentation for the matters covered by the certifications in clauses (i) and (ii), and, with regard to clause (iii), either documentation regarding any bonds for which an underwriter filled an order placed by the public and received after the sale date and before the issue date at a price higher than the initial offering price and the corresponding market change for those bonds, or a certification that no underwriter filled such orders at a price higher than the initial offering price.

The Re-Proposed Regulations define “public” as any person other than an underwriter or a related party to an underwriter. “Underwriter” is defined as: (a) any person that contractually agrees to participate in the initial sale of the bonds to the public by entering into a contract with the issuer (or with the lead underwriter to form an underwriting syndicate); and (b) any person that, on or before the sale date, directly or indirectly enters into a contract or other arrangement with a person described in clause (a) of this paragraph to sell the bonds. Unlike the 2013 Proposed Regulations, there is no specific reference to securities dealers in the Re-Proposed Regulations. Thus, unlike with respect to the 2013 Proposed Regulations, whether a securities dealer is an underwriter is no longer expressly based upon its intent, but is now based on what contractual and other arrangements it had with respect to the bonds on or prior to the sale date.

The issue price of bonds of an issue that do not have the same credit and payment terms is to be determined separately.

Practical Implications

There are significant differences between the Re-Proposed Regulations and the Existing Regulations. One of the most significant is their reliance on actual sales in determining issue price rather than on reasonable expectations. In connection therewith, if less than 10% of a maturity of bonds (i.e., less than the safe harbor for a substantial amount) is sold to the public on the sale date, the Re-Proposed Regulations provide an alternative method of determining issue price for such bonds. Under this alternative method, an issuer may treat the initial offering price to the public as the issue price, provided certain requirements are met. Such requirements include the issuer obtaining certifications from the lead or sole underwriter as to the actual and expected sale prices of the subject bonds through the issue date as detailed above, and the underwriter providing supporting documentation with respect thereto. In addition, the issuer must not know or have reason to know, after exercising due diligence, that such underwriter certifications are false.

At this time there remain several ambiguities with respect to these requirements. For example, it is unclear what supporting documentation may be required to evidence that the sale of bonds at a higher sales price between the sale date and issue date was the result of a market change such as a decline in interest rates. In addition, and perhaps more importantly, it is unclear what steps issuers must take to satisfy their due diligence obligations in connection with the underwriter certifications; however, it appears that merely obtaining a certificate from the underwriter is insufficient. As a result of these ambiguities, and the additional duties imposed on underwriters and issuers, although some of the concerns raised in connection with the 2013 Proposed Regulations have been addressed, the Re-Proposed Regulations will undoubtedly be the subject of further commentary and debate.

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