May 23, 2019

Internal Revenue Service Releases Broad Current Refunding Guidance

On May 22, 2019, the Internal Revenue Service released I.R.S. Notice 2019-39 (the "Notice"). A copy of the Notice is attached to this memorandum. The Notice answers the following question: ***"Can bonds that are subject to volume cap limits or issuance time deadlines be current refunded if the legislation authorizing such bonds is silent as to the ability to current refund such bonds?"***

The Notice broadly approves the issuance of tax-exempt current refunding bonds ("Refunding Bonds") to refund obligations ("Original Bonds") for which there is not otherwise statutory authority for a current refunding. However, the Notice imposes several limitations described below:

- The refunding ability applies only to Original Bonds for which there are bond volume caps, issuance time deadlines or both, and for which the authorizing statute does not address the permissibility of current refunding bonds. Original Bonds can include bonds issued under programs that existed previously or programs that may be introduced by Congress in the future. For example, Original Bonds can include Build America Bonds (BABs), Tribal Economic Development Bonds and bonds issued pursuant to programs to provide disaster relief (such as Gulf Opportunity Zone Bonds) or to promote economic development or redevelopment (such as Recovery Zone Facility Bonds).

- The Original Bonds (or the initial bonds in a chain of refundings) must have been issued with any required bond volume cap allocation and before any applicable time deadline for the issuance of the Original Bonds (or of the initial bonds in a chain of refundings) has expired.

- The issue price of the Refunding Bonds must not be greater than the outstanding stated principal amount of the Original Bonds. For Original Bonds issued with more than a de minimis amount of original issue discount or premium, the present value of the Original Bonds is used instead of the outstanding stated principal amount. The purpose of this requirement is to ensure that no more Refunding Bonds are issued than necessary to pay the redemption price of the Original Bonds. Costs of issuance and other transaction costs of the refunding would generally need to be paid from other sources of funds and not with proceeds of the Refunding Bonds.

- The Refunding Bonds must meet all applicable requirements for the issuance of the Original Bonds (excluding, of course, any bond volume cap requirement or original issuance time deadline). For example, the Refunding Bonds must satisfy the requirement that the average maturity of the bonds not be longer than 120 percent of the reasonably expected economic life of the refinanced facilities, if such requirement applied to the Original Bonds.

As a reminder, a "current refunding" generally consists of an issue of bonds that is issued to refund (and pay off) bonds of a prior issue not more than 90 days after issuance of the refunding bonds. The Notice applies only to tax-exempt current refundings. The Notice does not provide authority to issue tax-exempt bonds for advance refundings (i.e., where bonds of the prior issue are refunded and paid off more than 90 days after issuance of the refunding bonds). The Notice also will not apply to bonds for which the authorizing statute may prohibit current refundings.

While the Notice states that Build America Bonds may be current refunded, the Notice is presently of limited value because the current refunding issue must consist of tax-exempt bonds. The Notice is not written to allow the Refunding Bonds to continue to exist as Build America Bonds. We are participating in industry efforts to receive clarification from the Internal Revenue Service as to the references in the Notice to Build America Bonds.

Similar refunding guidance has existed for Recovery Zone Facility Bonds (see I.R.S. Notice 2014-9) and for various disaster relief bonds including Gulf Opportunity Zone Bonds, qualified Midwestern disaster area bonds and qualified Hurricane Ike disaster area bonds (see I.R.S. Notice 2012-3). The Notice is intended to supersede Notices 2014-9 and 2012-3 and applies to current refunding issues that are issued on or after May 22, 2019 – but issuers may also apply the Notice to current refunding issues that are issued before May 22, 2019.

This memorandum was prepared by the national public finance tax group of Kutak Rock LLP. Questions, comments or corrections to this memorandum may be addressed to:

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This memorandum was prepared for the general informational use of the clients and attorneys of Kutak Rock LLP and reflects our understanding of the matters set forth herein as of the time of its release. The views on the topics presented may change as our experience with the matters discussed herein deepens. If you have questions, please contact your Kutak Rock attorney or visit us at www.kutakrock.com.

Current Refundings for Certain Targeted State, Local, and Indian Tribal Government Bond Programs

Notice 2019-39

SECTION 1. PURPOSE

This notice provides guidance regarding the issuance of tax-exempt State and local bonds under § 103 of the Internal Revenue Code[1] and tax-exempt Indian tribal government bonds under § 7871 in current refunding issues (as defined in § 1.150-1(d)(3)) to refund (directly or indirectly in a series of current refunding issues) original bonds issued in eligible targeted bond programs, as more particularly specified in section 3 of this notice.

SECTION 2. BACKGROUND

Congress from time to time enacts statutory program provisions under the Code or special legislation to authorize various targeted bond programs that permit the issuance of State, local, or Indian tribal government bonds the interest on which is excluded from the gross income of the holders ("tax-exempt bonds") to facilitate lower borrowing costs, subject to bond volume caps or issuance time deadlines, or both

[1] Unless otherwise provided, section references are to the Internal Revenue Code or the Income Tax Regulations.

("targeted bond programs"). Targeted bond programs often involve incentives to provide disaster relief or to promote economic development or redevelopment in underserved areas in targeted circumstances.

Examples of targeted bond programs include the following: (1) certain tax-exempt exempt facility bonds and qualified mortgage bonds known as "GO Zone Bonds" issued under former § 1400(N) for a defined portion of the Hurricane Katrina disaster area known as the "Gulf Opportunity Zone," subject to a bond volume cap (population-based formula) and an issuance time deadline (before January 1, 2012); (2) tax-exempt bonds issued under §§ 702(d)(1) and 704(a) of the Heartland Disaster Tax Relief Act of 2008, Pub. L. No. 110-343, 122 Stat. 3912, 3913, 3919 (2008), to provide relief in the Midwestern and Hurricane Ike Disaster Areas, subject to bond volume caps (population-based formulas) and an issuance time deadline (before January 1, 2013); (3) certain tax-exempt exempt facility bonds known as "Recovery Zone Facility Bonds" issued under former § 1400U-3 for projects in certain defined "Recovery Zones," subject to a bond volume cap ($15 billion nationally) and an issuance time deadline (before January 1, 2011); and (4) Tribal Economic Development Bonds issued by Indian tribal governments under § 7871(f) to finance eligible projects on Indian reservations under program qualification parameters comparable to those that apply to State and local governments under § 103, subject to a bond volume cap ($2 billion).

In the case of the general ongoing program for tax-exempt qualified private activity bonds under § 141(e) that are subject to volume caps, § 146(i) generally authorizes current refunding issues without additional volume cap if the amount of the refunding bonds does not exceed the outstanding amount of the refunded bonds. However, the statutory provisions authorizing targeted bond programs often do not address the permissibility of issuing bonds in current refunding issues[2] to refund or refinance bonds originally issued pursuant to these programs. As a result, questions have arisen regarding whether original bonds issued under these targeted bond programs may be refinanced in current refunding issues without additional volume cap and whether such current refunding issues may be issued after an issuance time deadline for the original bonds.

Current refunding issues within appropriate size limits that do not increase the outstanding amount of tax-exempt bonds generally are favored transactions for economic and policy purposes because these transactions are done primarily to reduce borrowing costs and these transactions also reduce the Federal costs of the associated tax benefit. Previous published guidance permits current refunding issues for several targeted bond programs. See, e.g., Notice 2012-3, 2012-3 I.R.B. 289 (GO Zone, Midwest, and Hurricane Ike Disaster Area Bonds); Notice 2014-9, 2014-5 I.R.B. 455

[2] Under § 1.150-1(d)(3), a current refunding issue generally consists of an issue of bonds that is issued to refund or refinance bonds of a prior issue not more than 90 days before the last expenditure of any proceeds of the refunding issue to pay principal or interest on the prior issue.

(Recovery Zone Facility Bonds); see also Notice 2003-40, 2003-2 C.B. 10 (treatment of current refunding issues and other tax issues regarding New York Liberty Bonds).

The purpose of this notice is to reduce or eliminate the need for separate program-by-program guidance on this favored type of refinancing for each such program, subject to applicable statutory restrictions.

SECTION 3. SCOPE AND APPLICATION

The guidance in section 4 of this notice applies to tax-exempt bonds issued in current refunding issues to refund (directly or indirectly in a series of current refunding issues) original bonds in existing and future tax-exempt targeted bond programs that impose bond volume caps, issuance time deadlines, or both, on the issuance of the original bonds and that operate under statutory parameters that do not address the permissibility of current refunding bonds. Bonds issued in these tax-exempt targeted bond programs are referred to in this notice as "Qualified Bonds."

In addition, the references in this notice to "original bonds" or "original Qualified Bonds" include tax-advantaged build America bonds issued under former § 54AA.

SECTION 4. GUIDANCE

Any current refunding issue the proceeds of which are used (directly or indirectly in a series of current refunding issues) to refund original Qualified Bonds qualifies for issuance as an issue of tax-exempt Qualified Bonds without regard to any bond volume cap or issuance time deadline for the original Qualified Bonds if all of the following requirements are met:

(1) The original Qualified Bonds were issued with any required bond volume cap allocation and before any applicable time deadline for issuance of the original Qualified Bonds;

(2) Except as provided herein, the issue price (as defined in § 1.148-1(f)) of the current refunding issue is no greater than the outstanding stated principal amount of the refunded bonds of the prior issue (as defined in § 1.150-1(d)(5)) of Qualified Bonds (the refunded bonds). For refunded bonds originally issued with more than a de minimis amount of original issue discount or premium (as defined in § 1.148-1(b)), the present value of the refunded bonds (as determined under § 1.148-4(e)) must be used in lieu of the outstanding stated principal amount to determine the maximum issue price of the current refunding issue that may qualify as tax-exempt Qualified Bonds pursuant to this notice; and

(3) The current refunding issue meets all applicable requirements for the issuance of Qualified Bonds (excluding any bond volume cap or original issuance time deadline), including, without limitation, the requirements under § 149(g) that the original Qualified Bonds met the requirements applicable to hedge bonds, and, in the case of private activity bonds to which § 147(b) applies, the requirement under § 147(b) that the average bond maturity be no longer than 120 percent of the average reasonably expected economic life of the facilities financed or refinanced with the net proceeds of such issue.

SECTION 5. EFFECT ON OTHER DOCUMENTS

This notice supersedes Notice 2012-3 and Notice 2014-9.

SECTION 6. EFFECTIVE DATES

This notice applies to current refunding issues that are issued on or after May 22, 2019. Issuers may apply this notice to current refunding issues that are issued before May 22, 2019.

SECTION 7. DRAFTING INFORMATION

The principal authors of this notice are Johanna Som de Cerff and David White of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice contact David White on (202) 317-6980 (not a toll-free call).