

IRS Clarifies Its Stance on Tax-Exempt Advance Refundings After the Tax Cuts and Jobs Act

Description

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Section 13532 of the Tax Cuts and Jobs Act of 2017 (the “2017 Act”) eliminated the tax exemption for interest on advance refunding bonds (defined as bonds issued more than 90 days before the redemption of the bonds to be refunded). However, after the 2017 Act’s passage, a question existed as to whether this provision applied to all advance refunding bonds, or whether advance refunding bonds that refund taxable bonds could be issued on a tax-exempt basis.

This uncertainty stemmed from the fact that, prior to the passage of the 2017 Act, Section 149(d) of the Internal Revenue Code allowed but limited the number of permissible issues of tax-exempt advance refunding bonds. Regulations promulgated under that section set forth the types of bond issues that were taken into account with respect to that limit. For example, taxable advance refunding issues were not taken into account. In addition, advance refundings of taxable issues were generally not taken into account. The question then became whether these types of issues would be taken into account after the passage of the 2017 Act.

The IRS recently provided guidance on this question in a Chief Counsel Advice Memorandum. Under the facts outlined in the memorandum, a local government had issued Build America Bonds with a ten-year call date. The issuer elected to receive direct payment refundable credits with respect to the bonds, and therefore the bonds were considered tax-advantaged, taxable bonds. Two years prior to the call date, the issuer advance refunded the bonds, which were, as of the refunding date, legally defeased, reissued for federal tax purposes, and no longer eligible for the direct payment refundable credit subsidy from the U.S. Treasury Department. Consequently, as of the refunding date, the defeased bonds were no longer tax-advantaged bonds.

In its analysis, the IRS memorandum cited Congressional Reports on both the 2017 Act and the Tax Reform Act of 1986 (the “1986 Act”), which originally placed limits on the number of times bonds could be advance refunded on a tax-exempt basis. The memorandum focused on Congress’s intent to limit the number of tax-advantaged issues of bonds outstanding simultaneously to finance the same project. The key rationale for advance refunding limits, appearing in the Congressional Reports on both the 2017 Act and the 1986 Act, was limiting the number of federal subsidies existing at the same time that are attributable to the financing of a single activity.

Guided by this Congressional intent, the memorandum concluded that, because the Build America Bonds, upon defeasance, were no longer tax-advantaged, the bonds that advance refunded them could be issued on a tax-exempt basis. The memorandum reached this conclusion because there are not two sets of tax-advantaged bonds outstanding for the same project or activity.

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Date Created

December 17, 2018