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Tax-Exempt Bond Update:
IRS Publishes Final Issue Price Regulations

On Friday, December 9, 2016, the Internal Revenue Service published long-awaited final regulations regarding the definition of "issue price" for tax-exempt bond issues (the "Final Regulations"). These Final Regulations will apply to bonds sold on or after June 7, 2017.

Tax-exempt bonds are subject to various restrictions relating to arbitrage, including whether the issuer is permitted to earn or to keep the earnings on investments made at a yield exceeding the arbitrage yield on the bonds, and the determination of issue price is central to the computation of arbitrage yield on those bonds. The Final Regulations set out three methods for determining the issue price of bonds with the same credit and payment terms:

- A general rule, with variations for publicly sold and privately placed bonds;
- A special rule for publicly sold bonds based on the initial offering price; and
- A special rule for bonds sold in a competitive sale.

The general rule under the Final Regulations is consistent with current practice, while the special rules address concerns raised by the tax-exempt bond community for bonds not meeting the general rule requirements.

General Rule. For bonds sold in a public offering (whether through a negotiated or competitive sale), the issue price is the first price at which ten percent (10%) of the bonds are sold to the public (a buyer or buyers who are not an underwriter, part of the underwriter's distribution syndicate, or a related party to the underwriter or a syndicate member).

For bonds that are "privately placed" (sold to a single buyer who is not an underwriter, such as a bank), the issue price of the bond is the price paid by the buyer.

Special Rule for Publicly Sold Bonds. An issuer may also choose to treat the issue price of bonds as the initial offering price to the public as of the sale date if the following conditions are met:

- The underwriters offered the bonds to the public at a specified initial offering price on or before the sale date;
- The lead underwriter provides the issuer on or before the issue date: (i) certification of the offer to the public described above, and (ii) reasonable supporting documentation, such as a pricing wire; and
- Each underwriter agrees in writing not to offer or sell the bonds at a price higher than the initial offering price until the earlier of (i) close of business on the fifth business day after the sale date or (ii) the date ten percent (10%) of the bonds are sold at a price no higher than the initial offering price.

Special Rule for Competitive Sales. In a competitive sale, an issuer may treat the reasonably expected initial offering price to the public (that is, the price in the winning bid) as of the sale date as the issue price if:

- The issuer's competitive offering process had a disseminated notice of sale sent in a way reasonably designed to reach potential underwriters;
- All bidders have an equal opportunity to bid;
- At least three underwriters with industry reputations bid on the bonds; and
- The winning bid is the firm offer with the highest price (or lowest true interest cost).

Application. In instances where more than one rule may apply, the issuer may select the rule it will use to calculate the issue price. This selection must be made on or before the issue date, and be identified in the records the issuer maintains for the bonds.

Issuers and underwriters should expect to see changes in bond purchase agreements, tax certificates, and the underwriter's issue price certificates once the Final Regulations go into effect to address these changes. There is no option to rely upon the Final Regulations for bonds sold prior to June 7, 2017.

Contact Information. For further information regarding calculating issue price, please consult any of our public finance attorneys:

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