

**Government Finance Officers Association
National Association of Bond Lawyers
Regional Bond Dealers Association
Securities Industry and Financial Markets Association**

April 26, 2010

Mr. Michael Mundaca
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
Room 3120
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Doug Shulman
Commissioner
Internal Revenue Service
Room 3000
1111 Constitution Avenue, NW
Washington, D.C. 20224

Dear Assistant Secretary Mundaca and Commissioner Shulman:

On behalf of the undersigned organizations, we are writing to urge you to issue guidance on the determination of the issue price for direct pay Build America Bonds (BABs). Our respective members, as the case may be, issue, underwrite, distribute, and give legal opinions concerning BABs, a financing tool that has been used by almost 1000 state and local governments across the country, creating a \$93 billion - and growing - market.

Recently, uncertainty has arisen concerning one crucial element necessary for BABs – the determination of their issue price. This uncertainty is having a chilling effect on the issuance of BABs as issuers and their advisors struggle to ensure compliance with the applicable rules. This chilling effect has been evident with regard to sales of BABs by competitive bidding. This is unfortunate since aggressive bidding by multiple securities firms can result not only in low interest costs for issuers but reduced subsidy for the Federal Treasury. The issue price of a BAB is a critical element in the determination of whether the BABs have more than the permitted “de minimis” amount of original issue premium and also whether the costs of issuance exceed two percent of the sale proceeds of the issue, both of which are statutory requirements for BABs qualification. The uncertainty could be removed if the Service would issue guidance on the determination of the issue price, even if that guidance is just interim guidance pending a further review of the issue.

One source of the uncertainty stems from questions posed in the compliance check questionnaire that the Internal Revenue Service indicates is being sent to every issuer of BABs. Those questions relate to whether issuers are tracking the secondary market trading of their BABs after the sale date and beyond. These questions have caused concerns that the Service will, at some point in the future after the issuance of the bonds, revisit the determination of the issue price based on trading that occurs in the secondary market after the sale date – with the risk that the Service could say that the issue price had more than a de minimis amount of original issue premium or that costs of issuance exceeded the 2 percent limitation in the Code (i.e., if the excess premium is treated as additional underwriter’s compensation). This is a substantial risk to the issuer of the BABs, since if there is more than a de minimis amount of original issue premium or costs of issuance in excess of 2 percent, then the bonds will not qualify as BABs and will not be eligible for either a portion of the subsidy or even the entire subsidy, equal to 35 percent of the interest paid on the BABs, that the issuer anticipated receiving from the Treasury when issuing its bonds as BABs.

As is the case for tax-exempt bonds, Section 54AA(d)(2)(C) provides that the issue price of a BAB is determined under rules “similar” to the rules under Section 1273(a)(3). The regulations for tax-exempt bonds provide that issue price is determined based on the first price at which at least 10 percent of each maturity of the bonds are sold to the public and that issue price does not change based on subsequent sales of the bonds. In addition, these tax-exempt bond regulations provide that issue price can be determined by the issuer based on the reasonably expected sale price of the bonds to the public, determined as of the sale date, if there has occurred a bona fide offering of the bonds to the public. These rules were developed to provide certainty to issuers of tax-exempt bonds on the sale date as to the issue price; issuers of BABs and their advisors have assumed that these same rules apply to BABs. The issues raised by the IRS in the compliance check questionnaire suggest that the issue price of a BAB may be affected by secondary market sales of the BABs during the period after the sale date and beyond without regard to reasonable expectations at the time of the sale. It is important to remember that the issuer has no control over these secondary market trades. There have been reports of a variety of attempts by issuers and their counsel to deal with this concern, including suggestions that BABs closings not take place if there is secondary market trading at prices in excess of a de minimis amount of original issue premium prior to the issue date. The market cannot function properly with this type of risk being imposed on investors or issuers.

In order to address these uncertainties and preserve the benefits of BABs while the Service is working through these issues, we urge you to issue quickly interim guidance making clear that, at least until further guidance is issued, the issue price for BABs will be determined under the same rules as now apply to determining the issue price for tax-exempt bonds and that secondary market trades will not affect the issue price where there has been a bona fide public offering of the BABs. The guidance should state that for all bona fide public offerings, especially those done by competitive bid, the issue price is determined based on reasonable expectations. We recommend that the guidance also address the consequences of a violation of the de minimis original issue premium restriction (and any resulting violation of the 2 percent costs of issuance limitation). Complete loss of the subsidy is an excessive and disproportionate penalty, and accordingly we recommend that the Service consider alternate remedies.

We understand that the issues raised are difficult but stress that the orderly issuance of BABs must not suffer while the IRS, Treasury and the industry work together to analyze these questions and develop workable long-term solutions.

Thank you for considering our suggestions. We would be happy to work with you toward a permanent resolution to the questions related to the issue price of BABs.

Sincerely,

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