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IRS issues new proposed TEFRA regulations

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On September 27, 2017, the Internal Revenue Service (“IRS”) issued proposed regulations (the “Proposed Regulations”) relating to the TEFRA public approval requirements for tax-exempt private activity bonds. The Proposed Regulations would modify and replace the existing regulations (the “Existing Regulations”) and also replace proposed regulations issued in 2008 (the “2008 Proposed Regulations”).

In connection with the issuance of tax-exempt private activity bonds, the public approval requirements of section 147(f) of the Internal Revenue Code (the “Code”) must be satisfied. Generally, both the governmental unit issuing the bonds (or on behalf of which the bonds are issued) (the “Issuer”) and a governmental unit having jurisdiction over the area in which the bond-financed facility is located (a “Host”) must approve the issuance. The Code requires that (1) an applicable elected representative of the governmental unit must approve the bonds after a public hearing for which reasonable public notice was given, or (2) the bonds may be approved by voter referendum of the governmental unit. Below is a brief summary of the Proposed Regulations.

Reasonable Public Notice and Public Hearing. The Proposed Regulations contain new methods for providing public notice. Issuers are permitted to provide public notice through newspaper publication, radio or television broadcast, postings on a governmental unit’s public website, or alternative methods permitted under a general state law. The Proposed Regulations retain the 14-day notice period presumed reasonable under the Existing Regulations rather than the seven-day notice proposed by the 2008 Proposed Regulations. If notice is posted on a website, the issuer must offer an alternative notice method for residents without access to the Internet (such as telephone recordings). With rules that are substantially identical to the Existing Regulations, public hearings must be held in a location that, based on the facts and circumstances, is convenient for residents of the approving governmental unit.

Contents of Notice and Approval. The public notice and approval must contain a description of the “project,” the maximum stated principal amount of the bonds, the name of the user of the project and the location of the project.

- **Description of Project.** Information in the public notice is required for the “project” being financed, whereas the Existing Regulations use the term “facility.” A “project” generally means

one or more capital projects or facilities, including land, buildings, equipment and other property, to be financed with an issue, that are located on the same site or adjacent or proximate sites used for similar purposes. The Proposed Regulations require a general description of the financed project. For example, an issuer may satisfy this requirement through a statement that identifies the category of exempt facility bond (for example, an airport or a mass commuting facility) or through a statement that identifies the type of bonds and the type and use of the project (for example, qualified small issue bonds for a manufacturing facility).

- **Maximum stated principal amount of bonds.** The public approval information must include the maximum stated principal amount to be issued to finance the project. An issuer financing multiple projects must separately state the maximum stated principal amount to be issued to finance each project, a requirement that differs from the Existing Regulations.
- **Name of initial owner or principal user of the project.** The public approval information must include the name of the expected initial owner or the principal user of the project rather than the expected operator or manager. An issuer may name the true beneficial party of interest as an alternative to naming a legal owner or user (e.g., the nonprofit hospital organization instead of a limited liability company acting as the legal owner).
- **Location.** The public approval information generally must include the location of the project by street address. A description by boundary streets or other geographic boundaries satisfies this requirement. Consolidated descriptions are allowed for projects located on the same site or on adjacent or proximate sites.

Special Rules for mortgage revenue bonds, qualified student loan bonds and certain qualified 501(c)(3) bonds. The Proposed Regulations provide special rules for mortgage revenue bonds, qualified student loan bonds and qualified 501(c)(3) bonds used to finance working capital expenditures. For example, under the Proposed Regulations, no Host approval is required for those financings.

Deviations from the information in the Notice and Approval. As under the Existing Regulations, “insubstantial deviations” from the descriptions of the project and the amount of bonds in the public notice and approval are permitted. In addition, the Proposed Regulations permit a supplemental public approval to cure certain substantial deviations that result from unexpected events or unforeseen changes in circumstances that occur after the issuance of the bonds.

- **Insubstantial Deviations.** A determination of whether a deviation is substantial generally depends on all of the facts and circumstances. A change in the fundamental nature or type of a project is generally treated as a substantial deviation. The Proposed Regulations describe certain deviations that may qualify as insubstantial deviations. A deviation from the size of a proposed project is insubstantial if the stated principal amount of bonds for the project is no more than ten percent greater than the amount publicly approved for the project or is less than that maximum stated principal amount. Using proceeds to pay working capital expenditures directly associated with any project approved in the same public approval is an insubstantial deviation. Finally, a change in the initial owner or principal user identified in the public approval is an insubstantial deviation if the parties are related.

Effective Date. The Proposed Regulations would be effective for public approvals occurring after the date that is 90 days following the publication of final regulations; however, issuers can elect to apply the Proposed Regulations now with respect to any new issuance for which public approval occurs after September 27, 2017.

Public Comments. The IRS requests comments on the Proposed Regulations and a public hearing will be scheduled if requested in writing by any person that timely submits written comments.

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