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## IRS: You Can Still Issue Tax-Exempt Bonds to Advance Refund Most Taxable Bonds, Including BABs

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[For those who still had doubts](#), the IRS has now made it crystal clear: You can still issue tax-exempt bonds to advance refund most taxable bonds. In other words, the much-lamented [“repeal of tax-exempt advance refunding bonds”](#) in the [Tax Cuts and Jobs Act](#) from December 2017 isn’t ironclad. The repeal prevents the issuance of tax-exempt bonds to advance refund only (1) other tax-exempt bonds and (2) a very limited subset of taxable bonds. The IRS expressed this conclusion in [Chief Counsel Advice Memorandum 201843009](#), dated August 31 and released on October 26.

As set forth in this guidance, the only taxable bonds that can’t be advance refunded with tax-exempt bonds are taxable bonds that:

- [Have a federal subsidy, such as Build America Bonds \(i.e., “tax-advantaged bonds,” as defined in Reg. 1.150-1\(b\), that are not tax-exempt bonds\)](#) **and**
- Do not lose their subsidy at the time that the tax-exempt bonds that advance refund them are issued.

One way to force a tax-advantaged taxable bond to lose its tax advantage is to [“legally defease” it](#), which happens in almost all advance refundings once the issuer deposits Treasury securities acquired with proceeds of the advance refunding bonds into the refunding escrow on the issue date. Perhaps the only exception – certain governmental bonds cannot be legally defeased under state law.<sup>[1]</sup>

That’s the bottom line. Read on for a little more about this guidance and the history behind it.

The Tax Cuts and Jobs Act amended Section 149(d) of the Code to provide that a bond isn’t tax-exempt if it’s “issued to advance refund another bond.” The definition of “bond” does not distinguish between tax-exempt bonds and taxable bonds and thus appears to include both. How do we get from that seemingly conclusive language to the more permissive position that most taxable bonds can be advance refunded?

There are Treasury Regulations<sup>[2]</sup> about advance refundings that predate the Tax Cuts and Jobs Act but are still on the books. These regulations provide that a tax-exempt advance refunding of a taxable obligation isn’t taken into account “for purposes of” the old rule that prevented most governmental and qualified 501(c)(3) bonds from being advance refunded more than once. This old rule was replaced by the new rule in the Tax Cuts and Jobs Act that we quoted above; Congress replaced the “one advance refunding” statute with a “zero advance refundings” statute. Because the old rule had been repealed, there was some uncertainty about whether a Treasury Regulation interpreting the old rule was still valid.

In the months after Congress enacted the Tax Cuts and Jobs Act, John Cross at Treasury and Vicky Tsilas at the Office of the Chief Counsel of the IRS<sup>[3]</sup> said publicly that the Treasury Regulation allowing us to ignore tax-exempt advance refundings of most taxable bonds was still valid even though Congress had repealed the statute that it interprets. John and Vicky’s statements meant that the policy folks at Treasury agreed that some tax-exempt advance refundings were still allowed, but there was some concern that the enforcement side of the IRS would take a different position in examinations of tax-exempt bonds. So, NABL wrote a letter<sup>[4]</sup> to Christie Jacobs,

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who is the Director of the IRS Indian Tribal Governments/Tax Exempt Bonds office, asking her to instruct enforcement personnel to follow the position of the tax policy folks at Treasury and the Office of the Chief Counsel. Specifically, the NABL letter asked for “[w]ritten guidance, such as issuance of an audit technique guideline by the Senior Manager, Field Operations (ITG/TEB), to ITG/TEB examination personnel, supported if necessary by a chief counsel advice memorandum.”

This Chief Counsel Advice Memorandum, addressed to one of the attorneys in the Division Counsel for Tax-Exempt and Government Entities division of the IRS (which includes the tax-exempt bonds enforcement function), appears to have been issued in response to the NABL request.

We will have more to say on the specifics of the memorandum, its precedential weight, and some interesting points around the edges in future posts. The punchline, though is this: Most bond counsel (including your humble bloggers) were already taking the position that tax-exempt advance refunding bonds could be issued to advance refund most taxable bonds. This Chief Counsel Advice Memorandum will allow bond counsel to more comfortably take that position.

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[1] There have been requests to the IRS over the past months for a means of voluntarily relinquishing the subsidy on tax-advantaged taxable bonds. That guidance was not issued, however. A legal defeasance works just as well, though.

[2] Treas. Reg. 1.149(d)-1(e)(1).

[3] At the time; Vicky is now back at Ballard.

[4] This is where Actual Journalists would say something along the lines of: “Full disclosure (humblebrag?) – I helped draft the letter.

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