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Tax-Exempt Bond Update:
IRS Proposes Changes to Public Approval Requirements for Private Activity Bonds

The Internal Revenue Service has proposed regulations (the "Proposed Regulations") with respect to the public approval requirements for tax-exempt private activity bonds under Section 147(f) of the Internal Revenue Code, commonly known as TEFRA requirements. The Proposed Regulations will affect conduit issuers and borrowers, such as 501(c)(3) organizations and developers of low-income multifamily housing and other exempt facilities.

In general terms, the TEFRA requirements are met when a bond issuance receives "issuer approval" and "host approval" after a public hearing following reasonable public notice. Since 1983, these requirements have been interpreted by temporary regulations codified at 26 C.F.R. § 5f.103-2. The IRS previously proposed regulations in 2008 (published at 73 FR 52220), but they were never adopted and have now been withdrawn.

Under the Proposed Regulations:

Publication of public notice. A 14-day period between publicizing the notice and holding the hearing is still required, but the permitted methods of providing reasonable public notice are expanded to include websites, in addition to newspapers, radio or television, or other methods consistent with applicable state law.

Information in public notice. The notice must include (a) a general functional description of the type and use of the project to be financed, which can be as simple as a reference to the type of exempt facility bond being issued, (b) the maximum stated principal amount of bonds expected to be issued for the project, (c) the name of the initial owner or principal user of the project (or the beneficial party of interest), and (d) a general description of the location of the project by street address, reference to boundary streets or other description. If a bond issue will finance multiple projects at different locations on non-proximate sites, the notice and approval must state the maximum stated amount of bonds expected to be issued for each project.

Deviations from the public notice. A substantial deviation between the stated use of bond proceeds in a notice and the actual use of proceeds may invalidate a public approval, but "insubstantial deviations" continue to be acceptable. The Proposed Regulations specify that (a) an increase of no more than 10% in the principal amount of bonds issued for the project or (b) a change in the initial owner or user of the project if the parties are related parties on the issue date are both insubstantial deviations. In addition, in some circumstances, a supplemental public approval may cure substantial deviations from the original public approval.

Public hearing. The public hearing must be held in a location that is convenient for residents of the approving governmental unit. A location in an approving governmental unit's capital or seat of government is presumed to be convenient. A governmental unit may select its own procedure for the public hearing, provided that interested individuals have a reasonable opportunity to express their views.

Special rules for certain types of bond issues. Mortgage revenue bonds, qualified student loan bonds, and qualified 501(c)(3) bonds issued to finance working capital expenditures are not subject to the "host approval" requirement. Pooled financings consisting of multiple loans to 501(c)(3) corporations may opt to comply with the TEFRA requirements through a two-step approval process. The two-step process consists of (a) public approval of the pooled financing prior to bond issuance and (b) a supplemental approval of the particular project to be financed prior to origination of each loan of bond proceeds.

A 90-day public comment period will follow publication of the Proposed Regulations in the Federal Register on September 28, 2017. The Proposed Regulations may be found at 82 FR 45233. Issuers may elect to apply the Proposed Regulations, in whole but not in part, to bonds that are issued pursuant to a public approval that occurs on or after September 28, 2017.

If you have any questions on the Proposed Regulations or other topics relating to tax-exempt bonds, please contact any of our public finance attorneys.

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