

INSIGHTS

IRS Releases New Proposed Issue Price Regulations

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By: [R. Todd Greenwalt](#) [Victoria N. Ozimek](#) [Brian P. Teaff](#)

On June 23, 2015, the IRS released new proposed Treasury Regulations (the “2015 Proposed Regulations”) concerning the definition of “issue price” for purposes of arbitrage investment restrictions on tax-exempt bonds. The 2015 Proposed Regulations withdraw the portion of proposed Treasury Regulations released in 2013 (the “2013 Proposed Regulations”) relating to issue price, which have been heavily criticized for their lack of flexibility, and propose revised regulations relating to issue price in their place. Although the 2015 Proposed Regulations would apply prospectively if and when they are made final, they may nevertheless be relied upon currently by issuers of tax-exempt bonds.

Move Away from “Reasonable Expectations” to an “Actual Sales” Test

The 2015 Proposed Regulations parallel the currently applicable Treasury Regulations made final in 1993 (the “Current Regulations”) in that the issue price for which a bona fide public offering is made continues to be defined as the first price at which a substantial amount (defined as 10%) of the bonds is sold to the “public” (see discussion regarding the term “public” below). However, the 2015 Proposed Regulations require that **actual sales** on the sale date determine issue price, whereas the Current Regulations allow the issue price to be determined as of the sale date based on **reasonable expectations** regarding the initial public offering price at which 10% of the bonds of each maturity would be sold.

Like the 2015 Proposed Regulations, the 2013 Proposed Regulations had proposed an actual sales test, but the 2013 Proposed Regulations also proposed that 10% test be replaced by a requirement that 25% of the bonds be actually sold to the public at the issue price. Acknowledging that the 2013 Proposed Regulations lacked flexibility and practicality because 25% (or even 10%) of an issue of bonds is often not in fact sold to the public on the sale date, the 2015 Proposed Regulations offer an alternative method for determining the issue price, provided certain requirements are met.

Alternative Method of Determining Issue Price

If 10% of a maturity of bonds is not actually sold to the public on the sale date, the 2015 Proposed Regulations provide for an alternative method for determining issue price.

Specifically, the alternative method requires that the underwriters (i) fill all initial-offering-price orders placed by the public and received by the underwriters on or before the sale date, and (ii) do not fill any order received by the underwriters on or before the sale date at a price higher than the initial offering price. Further, the lead (or sole) underwriter is required to provide

certification of the following: (i) the initial offering price, (ii) that the underwriters met the requirement to fill all orders at the initial offering price placed by the public and received by the underwriters on or before the sale date at the initial offering price, (iii) that no underwriter will fill an order received from the public after the sale date and before the issue date at a price higher than the initial offering price, unless the higher price is the result of a market change for those bonds after the sale date (e.g., a change in interest rates), and (iv) that the lead (or sole) underwriter will provide the issuer with supporting documentation for the matters covered by the certifications. The issuer must not know or have reason to know, after exercising due diligence, that the certifications are false.

Definitions of “Public” and “Underwriter”

Under the 2015 Proposed Regulations, the term “public” for purposes of determining issue price includes any person other than an underwriter or a related party to an underwriter. An “underwriter” includes (i) any person that contractually agrees to participate in the initial sale of the bonds to the public by entering into a contract with the issuer or into a contract with a lead underwriter to form an underwriting syndicate and (ii) any person that, on or before the sale date, directly or indirectly enters into a contract or other arrangement to sell the bonds with any of the foregoing (for example, a retail distribution contract between a member of an underwriting syndicate or selling group and another dealer that is not in the syndicate or selling group).

Questions Remain but Welcome Improvement

While the 2015 Proposed Regulations introduce new interpretive questions (such as the nature and extent of due diligence required by issuers in connection with obtaining an underwriter’s certifications under the alternative method) and some practical challenges (such as the logistics of receiving information from the underwriters), participants in the tax-exempt bond market have generally agreed that the 2015 Proposed Regulations are an improvement over the 2013 Proposed Regulations. Likewise, the changes made to the definition of underwriter have received a generally favorable market response, as the definition included in the 2013 Proposed Regulations was viewed as overly inclusive.

Click [here](#) to view the text of the 2015 Proposed Regulations. For more information contact [Brian Teaff](#).