

INSIGHTS

IRS Provides Issuers Of Tax-Advantaged Debt with New "DIY" Tools to Fix Nonqualified Use

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On April 11, 2018, the IRS released [Revenue Procedure 2018-26](#) ("Rev. Proc. 2018-26"), which provides an expansion of the remedial actions available to issuers of tax-advantaged bonds. Specifically Rev. Proc. 2018-26 provides:

- Additional options for issuers seeking to remediate private business use associated with eligible long-term leases; and
- Options for remediating "build America bonds" and qualified tax credit bonds, such as qualified school construction bonds.

As we have [previously reported](#), a remedial action is a "do-it-yourself" option for issuers whose plans have changed and find themselves facing an unexpected change of use of bond-financed property. By taking an authorized remedial action, an issuer is able to cure otherwise impermissible use of the bond-financed property without having to negotiate with the IRS, as would be the case under the Voluntary Closing Agreement Program or pursuant to a Private Letter Ruling request. Rev. Proc. 2018-26 expands the toolkit available to issuers to cure unexpected changes in use that might otherwise disrupt the tax-advantaged status of their bonds.

Remediation of Long-Term Leases

Prior to the release of Rev. Proc. 2018-26, the only option to remediate "bad" use created by a long-term lease to a private business user was to redeem or defease the related bonds. Rev. Proc. 2018-26 provides an additional option by allowing issuers to remediate private use resulting from eligible long-term leases by recycling an amount equal to the present value of the payments to be received under the lease (the "disposition proceeds") into "good" use within two years of entering into the lease.

This new remedial action provides issuers with more flexibility to remediate private use associated with a bad lease, thus allowing these issuers to avoid, for example, the negative arbitrage that might be associated with establishing a defeasance escrow for debt that is not currently callable. We note, however, that an issuer must actually have access to amounts equal to the disposition proceeds to avail itself of this option, which could present a challenge since the issuer presumably will receive payments from the lessee over the term of the lease. Nonetheless, it never hurts to have options, especially as more governmental entities consider entering into "public-private partnerships."

Remedial Actions For Tax Credit Bonds

Prior the release of Rev. Proc. 2018-26, there were no specific remedial actions for tax credit bonds such as “build America bonds” and other qualified tax credit bonds (e.g., qualified school construction bonds, qualified energy conservation bonds and qualified zone academy bonds). The provisions of Rev. Proc. 2018-26 attempt to fill this gap by providing issuers with the remedial action options described below.

Adjustment of Federal Subsidy Payment for Direct Pay Tax Credit Bonds

“Direct pay” tax credit bonds are issued as taxable bonds that entitle the issuer to receive a subsidy payment from the federal government in an amount equal to all or a portion of the interest paid on the bonds. Rev. Proc. 2018-26 provides a new remediation option for issuers of direct pay tax credit bonds that have nonqualified use relating to their outstanding direct pay bonds. Specifically, this option allows an issuer to make a downward adjustment to the associated federal subsidy payment in an amount related to the nonqualified use, all in connection with the process the issuer would already otherwise be undertaking to receive the federal payment (i.e., the filing of Form 8038-CP).

Application of General Remedial Actions to Tax Credit Bonds

Rev. Proc. 2018-26 allows tax credit bonds (whether issued as direct pay or holder tax credit) to be remediated either through the redemption or defeasance of nonqualified bonds or the alternative “good” use of any disposition proceeds within a two-year period. To avail itself of these remedial actions, an issuer must meet the requirements set forth in Rev. Proc. 2018-26, including yield restriction of amounts, payment of rebate, and timing requirements.

Closing Remarks

As with almost any release of this nature, there are interpretive items that will require additional consideration by tax counsel and/or clarification from the IRS. Generally, however, the release of Rev. Proc. 2018-26 is a favorable development for issuers who might find themselves considering tweaking their original plans regarding bond-financed projects.

For more information or if you have specific questions regarding any of the above, please contact [Victoria Ozimek](#), [Brian Teaff](#) or [Todd Greenwalt](#), or any other member of [Bracewell’s Public Finance Team](#).