Internal Revenue Service

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:TEB - PLR-102575-00
Date:
June 2, 2000

LEGEND:

Issuer	=
X Bonds	=
Y Bonds	=
Trustee	=
Original Borrower	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
$z	=
Borrower	=
Project	=
Bank A	=
Bank B	=
Bank C	=

Corporation M =

Dear :

You have requested a ruling, on behalf of the Issuer, that a proposed new bond issue (the “New Bonds”) will be treated as a current refunding issue, refunding the Y Bonds, within the meaning of § 1.150-1(d) of the Income Tax Regulations and § 1313(a) of the Tax Reform Act of 1986, as amended (the “Act”). You have also requested a ruling that the amount of the New Bonds will not be treated as exceeding the outstanding amount of the Y Bonds for purposes of § 1313(a) of the Act.

FACTS:

The Issuer issued the X Bonds, under the Internal Revenue Code of 1954 (the “1954 Code”), to finance the construction of multifamily residential rental housing project (the “Project”) to be owned by the Original Borrower. The Issuer issued the Y Bonds to current refund the X Bonds. The Y Bonds were issued as variable rate bonds, secured by a letter of credit issued by Bank C (the “Original Letter of Credit”). The Y Bonds were issued at par pursuant to an indenture of trust between the Issuer and the Trustee (the “Indenture”). The proceeds of the Y Bonds were loaned to the Original Borrower pursuant to a loan agreement between the Issuer and the Original Borrower (the “Loan Agreement”). The Y Bonds, issued after the effective date of the Act, satisfied the transition rule for current refundings contained in § 1313(a) of the Act, and accordingly, are generally subject to the 1954 Code.

On Date 1, the Project was acquired by the Borrower. On Date 2, Bank A issued a letter of credit (the “Letter of Credit”) to replace the Original Letter of Credit pursuant to a reimbursement agreement between the Borrower and Bank B (the “Reimbursement Agreement”). The Letter of Credit was issued by Bank A on behalf of Bank B, due to the fact that Bank B is an unrated entity (Bank A and Bank B are affiliates owned by the same common parent). The replacement of the Original Letter of Credit with the Letter of Credit did not cause a reissuance of the Y Bonds.

Under the Reimbursement Agreement, the Indenture, and the Loan Agreement, Bank B is generally responsible for sending default notices to the Trustee and for handling day-to-day matters relating to the administration of the Letter of Credit. Bank A is responsible for sending notices to the Trustee relating to nonrenewals of the Letter of Credit.

The Letter of Credit was scheduled to expire on Date 3. Although Bank A was prepared to renew the Letter of Credit, the Borrower was negotiating for the purchase of a substitute letter of credit from Corporation M. The Borrower took no action and did not intend to redeem (whether by refunding or otherwise) the Y Bonds.

Under the terms of the letter of credit, Bank A was required to send a notice to the Trustee that the Letter of Credit was going to expire and that the Letter of Credit was not going to be extended. This notice was required to be sent at least ninety days prior to the expiration of the Letter of Credit.

On Date 4, an employee of Bank A erroneously sent a notice of default (the “Notice of Default”) to the Trustee with respect to the Letter of Credit. The Notice of Default provided that, pursuant to the terms of the Letter of Credit, an “Event of Default” had occurred and was continuing and directed the Trustee to declare a mandatory redemption of Y Bonds. The Notice of Default was made using a form default notice attached to the Letter of Credit and was signed by an employee of Bank A on behalf of Bank B. At no time during the term of the Letter of Credit was the Borrower in default under the terms of the Letter of Credit or any other document relating to the Letter of Credit.

Bank A had no authority to sign the Notice of Default on behalf of Bank B. The Bank A employee who sent the Notice of Default misread the Letter of Credit, the Reimbursement Agreement and related documents, and erroneously attempted to notify the Trustee of the nonrenewal of the Letter of Credit using the form default notice attached to the Letter of Credit.

Neither the Borrower, the Issuer, nor Bank B received a copy of the Notice of default or otherwise knew of the Notice of Default. To the contrary, one week after the Notice of Default was sent, the Borrower received correspondence from Bank A setting out the relevant time frames in connection with the replacement of the Letter of Credit. This correspondence made no reference to the Notice of Default having been sent.

On Date 5, the Trustee sent a “Notice of Mandatory Full Redemption” (the “Redemption Notice”) to the holders of the Y Bonds pursuant to the Indenture, indicating that the Y Bonds would be redeemed on Date 6. Neither the Borrower, the Issuer, nor Bank B, received a copy of the Redemption Notice or otherwise knew of the Redemption Notice.

During this time, the Borrower continued to work with Corporation M to obtain a new letter of credit for the Y Bonds. At the same time, Bank A and Bank B agreed to a short-term extension of the Letter of Credit in the event that a new letter of credit could not be obtained prior to the expiration of the Letter of Credit. On Date 7, the Borrower received a loan analysis from Corporation M showing a proposed closing date for the substitute letter of credit of Date 8, a date prior to the expiration of the Letter of Credit.

On Date 7, the Trustee executed the certificates for payment under the Letter of Credit (the “Certificates”). These Certificates provided that the Trustee was making draws under the Letter of Credit to retire the Y Bonds on Date 6. The Certificates were sent to the Bank A employee who prepared the Notice of Default, and thus, Bank A did not realize that this was a mistake. Neither the Borrower, the Issuer, nor Bank B received a copy of the Certificates or otherwise knew of the Certificates.

On Date 6, the Y Bonds were retired with funds provided pursuant to the Letter of Credit. Bank A automatically debited the account of Bank B for the amount drawn under the Letter of Credit. Bank B, in turn, automatically debited the account of the Borrower for the amount drawn under the Letter of Credit, causing the Borrower's account to be substantially overdrawn.

The next day, an employee of Bank B noticed that the Borrower's account was overdrawn. The employee immediately contacted Bank A to determine why a draw had been made on the Letter of Credit and learned of the erroneous Notice of Default. The same day, Bank A sent an urgent notice to the Trustee indicating that the Notice of Default was sent in error and requesting that the Trustee attempt to retrieve the funds before the holders of the Y Bonds were paid. The attempt was unsuccessful and the Y Bonds were redeemed. Subsequently, Bank B made a temporary loan to the Borrower, at an interest rate comparable to that borne on the Y Bonds, to finance the costs of redemption of the Y Bonds.

On Date 9, the Issuer adopted a resolution stating its intention and expectation to issue the New Bonds to replace the Y Bonds. The principal amount and issue price (excluding pre-issuance accrued interest) of the New Bonds will be equal to the outstanding principal amount of the Y Bonds immediately prior to redemption. No new volume cap will be obtained for the New Bonds. Issuance costs relating to the New Bonds are not expected to exceed $z and will be paid by either Bank A, the Trustee, or the Borrower from funds that do not constitute "tax-exempt" bond proceeds. The terms of the New Bonds will be identical to the terms of the Y Bonds.

Law and Analysis:

Sections 103 and 141 to 150 of the Internal Revenue Code of 1986, as added by § 1301 of the Act, provide the rules for determining whether interest on a State or local bond is tax exempt. Section 1311 of the Act provides the general rule that the amendments made by § 1301 apply to bonds issued after August 15, 1986.

Section 1313(a) of the Act provides, in general, that the amendments made by § 1301 shall not apply to any bond the proceeds of which are used exclusively to refund (other than to advance refund) a qualified bond (*e.g.*, a bond issued before August 16, 1986) if (A) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and (B)(i) the average maturity of the issue of which the refunding bond is a part does not exceed 120 percent of the average reasonably expected economic life of the facilities being financed with the net proceeds of such issue (determined under § 147(b)), or (ii) the refunding bond has a maturity date not later than the date 17 years after the date the qualified bond was issued.

Section 1.150-1 provides definitions for all purposes of §§ 103 and 141 to 150. Section 1.150-1(d)(1) generally defines "refunding issue" as an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue, including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue. Section 1.150-1(d)(2)(iv) provides that, in the absence of other applicable controlling rules under section 1.150-1(d), the determination of whether an issue is a refunding issue is based on the substance of the transaction in light of all the facts and circumstances.

In this case, although the Issuer will not actually use proceeds of the New Bonds to pay debt service on the Y Bonds, in light of all the facts and circumstances, the substance of the transaction is that the New Bonds will be a refunding issue within the meaning of § 1.150-1(d). The actions of the Borrower indicate that there was no intent to redeem the Y Bonds with a draw on the Letter of Credit. Rather, the Borrower had intended to purchase a substitute letter of credit from Corporation M and keep the Y Bonds outstanding. The Borrower had taken significant action to purchase a substitute letter of credit, including discussing a possible extension of the Letter of Credit with Bank B if the new letter of credit was not obtained prior to the expiration of the Letter of Credit. Even this eventuality was not expected to occur, as Borrower had received a loan analysis from Corporation M indicating a closing date for a substitute letter of credit prior to the expiration of the Letter of Credit.

The erroneous Notice of Default was sent by Bank A in an attempt to send a notice of nonrenewal of the Letter of Credit. The nonrenewal of the Letter of Credit was contemplated by Bank A, as evidenced by their letter to the Borrower sent after the Notice of Default, setting forth the time frames in connection with the replacement of the Letter of Credit. At no time was the Borrower in default under the terms of the Letter of Credit or any other document relating to the Letter of Credit. Finally, neither the Issuer nor the Borrower knew of the Notice of Default, the Redemption Notice, or the Certificates prior to the redemption of the Y Bonds.

The New Bonds will also be treated as a refunding issue for purposes of § 1313(a) of the Act. While by its terms, the definition of refunding issue contained in § 1.150-1(d) applies only for purposes of §§ 103 and 141 to 150, there is no reason why a different definition should apply for purposes of § 1313(a) of the Act. The reasons and concerns surrounding the distinction between new money and refunding transactions are the same for both the Code and the Act. Moreover, the definition of refunding issue contained in § 1.150-1(d) is not inconsistent with any definition of refunding issue in existence at the time the Act was enacted (see, for example, § 1.103-14(e) of the regulations removed by T.D. 8476, 1993-2 C.B. 13, at`19).

The amount of the New Bonds will not exceed the outstanding amount of the Y Bonds for purposes of § 1313(a) of the Act. One purpose of § 1313(a) is to ensure that issuers are not able to issue additional bonds after the effective date of the Act, while avoiding the changes made by the Act through the application of the current refunding exception. Accordingly, in applying this rule, the amount of the refunding bonds is to be determined by reference to the issue price (excluding pre-issuance accrued interest) rather than the face amount, because the issue price and not the face amount represents the actual amount borrowed by the issuer. In this case, the Issuer has represented that the issue price (excluding pre-issuance accrued interest) of the New Bonds will be equal to the outstanding principal amount of the Y Bonds immediately prior to redemption.

CONCLUSION:

Based strictly on the information submitted and the representations made, we conclude that:

1. The New Bonds will be a current refunding issue, refunding the Y Bonds, within the meaning of § 1.150-1(d) and § 1313(a) of the Act; and

2. The amount of the New Bonds will not exceed the outstanding amount of the Y Bonds for purposes of § 1313(a) of the Act.

Except as specifically ruled above, no opinion is expressed concerning this transaction under any other provision of the Code or regulations thereunder. No opinion is expressed about whether interest on the New Bonds or the Y Bonds is excludable from gross income of the holders under § 103(a) of the 1986 Code or the 1954 Code. In addition, no opinion is expressed about whether the application of proceeds of tax-exempt bonds to refinance an obligation other than a State or local bond constitutes a refunding issue within the meaning of § 1.150-1(d) or § 1313(a) of the Act. See, for example, § 1.142-4.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be cited as precedent.

Sincerely yours,
Assistant Chief Counsel
(Exempt Organizations/Employment Tax/
Government Entities)
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Enclosure: copy for § 6110 purposes