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Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044
Attention: CC:PA:LPD:PR (REG-148659-07)

Submitted to www.regulations.gov (IRS REG-148659-07)

RE: Comments on Proposed Treasury Regulations Section 1.148-1(b) Relating to Issue Price Definition REG-148659-07

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to submit the following comments on proposed rulemaking REG -148659-07. We are writing to provide commentary and suggested changes with respect to the recently released proposed Treasury regulations relating to the definition of "issue price" of tax exempt bonds ("proposed regulations") for purposes of the arbitrage rules under Section 148 of the Internal Revenue Code of 1986 (the "Code"). We recognize that the "Treasury Department and the IRS [Internal Revenue Service] are concerned that certain aspects of the Existing Regulations for determining the issue price of tax-exempt bonds are no longer appropriate in light of market developments since those regulations were published." In that respect, SIFMA and the community of tax-exempt bond underwriters wants to be a constructive contributor to updating and streamlining issue price rules.

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

However, as described in detail below, SIFMA disagrees with the approach to determining issue price embodied in the proposed regulations, which seek to formalize policies previously applied through unofficial or non-precedential public statements, examination inquiries and practices of the Tax Exempt Bonds ("TEB") division of the Governmental Entities division of the Tax Exempt and Governmental Entities Division of the Internal Revenue Service.

As also detailed below, we believe it would be inappropriate to abandon the well-accepted, favorably regarded and longstanding principle that allows the issue price of tax exempt bonds to be established by reference to the reasonable expectations of the transaction participants of the price at which the bonds will be sold pursuant to a bona fide public offering. The proposed regulations, while well intentioned, represent an approach to defining and documenting issue price which is unworkable based on limitations on the ability of issuers, underwriters and others to monitor sales of bonds during the order period. We urge the IRS to maintain the reasonable expectations principle and make refinements that take into account the reality of marketing functions as dictated both by free market processes and currently mandated securities law regulatory procedures applicable to municipal bonds.

As further discussed, certain key elements of the proposed regulations would require significant changes in regulations and procedures currently applied by other market participants and regulators (most notably the Municipal Securities Rulemaking Board (the "MSRB")) as well as expensive, complex and time consuming changes to existing reporting and administrative functions that are uncertain as to viability or capacity to effect. Thus, the proposed regulations would be workable only in an environment that does not presently exist and would require significant changes that are not fully within the control of the tax exempt bond transaction participants.

Reasonable Expectations Standard

Understanding the Background of Issue Price Definition. A review of the timeline of developments relating to the topic of the issue price of tax exempt bonds will be helpful to understanding how the current situation has arisen, the problems with the proposed regulations and a workable path for moving forward. The proposed regulations address an essential element of the computation of bond yield for purposes of the arbitrage rules. (The proposed regulations potentially impact many other aspects of the tax rules relating to tax exempt bonds. The primary and direct focus of the issue price definition in the proposed regulations, however, is with respect to the bond yield under the arbitrage requirements and is the focus of this submission.) The basic principle of the arbitrage rules is that an issuer of tax exempt bonds is not permitted to realize arbitrage profits as a result of the comparison of (i) the borrower's cost of borrowed funds and (ii) the borrower's investment return from those borrowed funds.

Throughout the 1970s, this principle was implemented by Treasury regulations which provided that the bond yield limitation on investment earnings was computed by looking at the issuer's borrowing costs, taking into account the costs incurred to effect the borrowing (such as bond underwriting or marketing fees, legal fees and costs of rating agencies, printing, etc.). However, reflecting a concern that, in certain tax exempt bond transactions, this approach to arbitrage compliance allowed a portion of the borrowing transaction costs to be shifted from the municipal issuer to the federal government, in 1978 the IRS changed the regulations so that bond issuance costs were excluded from the calculation of the bond yield for purposes of the investment limitation. This regulation was declared invalid by the D.C. Circuit Court in State of Washington v. Commissioner[2] on the grounds that excluding the costs of issuance was directly inconsistent with

[2] State of Washington v. Commissioner, 692 F.2d 128 (D.C. Cir. 1982).

the core principle that arbitrage is based on a comparison of the issuer's real borrowing cost to the borrower's investment return. In the Tax Reform Act of 1986 (the "1986 Tax Act"), the U.S. Congress effectively reversed the State of Washington case by adding Section 148(h) to the Code and re-instated the proposition that bond issue costs could not be taken into account in computing the bond yield.

While this change to the Code applied to all manner of issuance costs (with an exception for certain credit enhancement fees), Congress singled out the prohibition on taking into account bond underwriting and marketing fees by specifically providing that, for purposes of computing the yield on the bonds, the issue price of the bonds will generally be determined by taking into account (i.e., "on the basis of") the rules of Sections 1273 and 1274 of the Code. These Section 1273 and 1274 rules generally provide that, for purposes of original issue discount and discounts on debt instruments issued for property, the issue price of bonds is the price paid by members of the general public to purchase the bonds in connection with the initial offering and sale of the bonds and must reflect a current market price. It is essential to understand that, for the purpose of assuring that costs of issuance of the bonds are not taken into account in arbitrage compliance, the potential impact of this reference to Sections 1273 and 1274 was to suggest (but not require, as discussed below) a seismic shift in a core principle of the arbitrage concept. The use of Section 1273 and 1274 to determine issue price could be interpreted to suggest that the concept of arbitrage earnings is defined by comparing (i) the borrower's investment return to (ii) the bondholder's investment return. Thus, under this approach, arbitrage, for tax exempt bond purposes, potentially might no longer be based on the borrower's cost of borrowing. While this would certainly be a groundbreaking change, it is also essential to keep in mind that the underlying purpose of the 1986 Tax Act change was not so broad. The change effected by the 1986 Tax Act was more narrowly intended to disallow the inclusion of costs of the borrowing incurred by the issuer of the tax exempt

bonds in the computation of yield. Accordingly, the true intent of the new Code provision was to continue to look to the impact of the bond issuance from the borrower's perspective. That is, the intent was to continue to look to the borrower's cost of borrowing as the basis for comparison to the borrower's investment return, but with an adjustment that eliminated consideration of the borrower's cost of issuance of the bonds.

In 1993, final Treasury regulations were promulgated to implement the 1986 Tax Act arbitrage rules, including a detailed definition of issue price. These regulations started with the issue price being determined in accordance with Sections 1273 and 1274 by providing that, generally, the issue price of bonds is based on the initial offering price pursuant to a bona fide public offering and the first price at which a substantial amount (i.e., ten percent) of the bonds is sold to the public. Importantly, the 1993 final Treasury regulations further provided that the issue price for which a bona fide public offering is made could be determined as of the sale date by the reasonable expectations regarding the initial public offering price. Further, the regulations provide that the issue price does not change if part of the issue is later sold at a different price. Effectively, and as a practical matter, in most transactions this rule allowed for the issue price to be determined based on the initial offering prices as set forth in the bond purchase agreement between the governmental issuer and the underwriters of the bonds and as set forth in a publicly disseminated pricing wire and the official statement relating to the bond issue. If at least 10 percent of the bonds was actually sold to the public at such initial offering price, so much the better evidence for establishing the issue price.

The approach of the 1993 final Treasury regulations properly recognized the two essential elements of the 1986 Tax Act change—while the focus of the bond yield computation is on the purchase of the bonds by the public investor (by reference to the Section 1273 and 1274 rules), the

underlying purpose of the rule is solely to eliminate the issuer's transaction costs from the bond yield computation.

The 1993 final regulations also achieved an appropriate blend of the reference in Section 148(h) to Sections 1273 and 1274 with the core underlying principle of the arbitrage requirement as set forth in Section 148(a) of the Code that the term "arbitrage bond" is determined on the basis of the "reasonably expected (at the time of issuance of the bond)" investment of the bond proceeds. While the issuer's reasonable expectations at the time of issuance of the bonds can be offset by the intentional actions of the issuer to produce arbitrage profits, the reasonable expectations standard is a long-established and essential element of the arbitrage requirement. Accordingly, it was perfectly appropriate that the 1993 final regulations incorporated the concept of reasonable expectations with respect to the initial offering price of the bonds in a bona fide public offering. In fact, it is manifestly clear that to ignore the reasonable expectations standard is counter to Congressional intent and the express language of the Code.

Furthermore, the 1993 final regulations provide a workable definition of issue price that affords issuers and bond counsel with the ability to determine with a reasonable level of certainty the yield on the bonds at the time of the bona fide public offering and the sale date of the bonds. It is essential to the ability of issuers to comply with the tax law requirements and achieve a successful financial closing of the transaction that bond yield be determinable with certainty and without regard to unknown and unknowable subsequent market and marketing developments.

This regulatory approach in the 1993 final regulations was masterful and, accordingly, well accepted and favorably regarded by all participants of the bond transactions. Subsequent submissions to Treasury and the IRS by the Government Finance Officers Association (the "GFOA," a group representing governmental issuers), the National Association of Bond Lawyers ("NABL," a group representing bond counsel), the American Bar Association Section of Taxation

(the "ABA Tax Section," a group representing tax lawyers, primarily members of its Committee on Tax Exempt Financing) and SIFMA (representing, among others, underwriters of tax exempt bonds)[3] each consistently and vigorously supported the basic approach of these Treasury regulations in focusing on the initial offering price of the bonds to the public and the reasonable expectations at which the bonds were to be sold to the public.

The 1993 final regulations blend and balance the focus on the price paid by the public bond purchaser as provided by Sections 1273 and 1274 with recognition that the issuer's cost of issuance relating to underwriting or marketing of the bonds is determined by the negotiations or dealings between the issuer and the underwriters as embodied in the bond purchase agreement. Importantly, the 1993 final regulations do not seek to take into account whether the underwriter may or may not make additional earnings (or realize losses) due to sales of bonds at prices that were not contemplated in the deal between the issuer and the underwriter, which may be due to market movements or other factors that are not part of the price negotiated or established at auction between the issuer and the underwriter and, in fact, represent the elements that the issuer has specifically sought to be separated from through the underwriting process. Further, the approach of these regulations is to eliminate from consideration in the bond yield the trading profits or losses that other market participants may realize from buying and selling the bonds—these are elements entirely unrelated to the core principles of arbitrage compliance as envisioned and implemented by Congress. These regulations achieve the proper balance between the specific wording of the Code to look at Sections 1273 and 1274 and the intent of Congress to maintain the basic principle of restricting arbitrage profits as determined without taking into account the issuer's costs of issuance. Further, consistent with the basic principles of Section 148(a), the final regulations look to

[3] See, letters of comment and guidance recommendation from (1) NABL, dated August 25, 2006, (2) the ABA Tax Section, dated November 9, 2010, (3) SIFMA, dated January 20, 2012 and (4) jointly by GFOA, NABL, RBDA and SIFMA, dated August 5, 2010.

reasonable expectations and, while intentional actions of the issuer to create arbitrage profits are taken into account in arbitrage compliance, that does not encompass market or marketing conduct that is unrelated to the issuer.

The existing regulations have served the municipal bond community well for many years. Difficulties may have arisen in a limited number of transactions in connection with establishing the facts necessary to determine the issue price with certainty and, as some more complex transactions and arrangements developed, the regulations have become more difficult to apply. However, we are not aware that there has been any identification of systemic problems with the application of the existing regulations for purposes determining issue price and consequently of computing the bond yield. Nevertheless, in the mid-2000s some TEB representatives raised the concern that there was some perceived abuse taking place in the context of arbitrage and issue price compliance. The IRS's attention appeared to shift from compliance with the issue price rule as established to market profits realized by "flippers" and other non-underwriting market participants or additional profits made by underwriters which may have been attributable to market movements.

The effect of the IRS's focus over the past several years on price movements after the order period has been to make the establishment of issue price for tax exempt bond deals perhaps the most controversial and time consuming element of tax compliance for many bond transactions. In some instances, procedures mandated by bond counsel in reaction to apparent or perceived IRS concerns have required changes in underwriting procedures, imposed costs and administrative burdens and, most importantly, harmed the ability of governmental issuers to achieve the most favorable terms and lowest cost of borrowing. Despite this attention, SIFMA is not aware of any substantive problems relating to issue price in connection with arbitrage tax law compliance. Nevertheless, we recognize the value in refining issue price rules and providing issuers, compliance and enforcement professionals, and other market participants the ability to determine issue price in a

straightforward and objective manner. In that regard, our comments on the proposed regulation are designed to offer more workable alternatives.

Issue price rules should retain a "reasonable expectation" test. The proposed regulations would abandon the core elements of the existing regulations that look to the bona fide offering process, the initial public offering price and the reasonably expected initial sale price of the bonds. In this manner, we believe the proposed regulations are inconsistent with the purpose and intent of the 1986 Tax Act to simply eliminate issuance costs from the bond yield calculation. Further, we are disappointed that the proposed regulations reject the commentary previously provided by the GFOA, the ABA Tax Section, NABL and SIFMA, all of which encouraged further, not less, direction toward the reasonable expectations test. Most important, the proposed regulation is unworkable in that there is no practical way for issuers or others to accumulate and monitor bond sale data that would be necessary to comply with the rule as proposed.

We believe the reasonable expectations element represents the only practical and workable approach to issue price determination and should be maintained. Further, we believe current rules could be strengthened and streamlined by making changes that clearly reflect real-world market practices and establish objective compliance standards.

We believe the reasonable expectations test is consistent with IRC Sections 1273 and 1274. The reasonable expectations test is a proper and appropriate implementation of the intent of Congress for the reasons described above. The proposed regulations would change the core principle of arbitrage so that it becomes without any nuance or adjustment a conflation of the governmental issuer's investment return and the bondholders' investment return. This is not the meaning of arbitrage and not the intention of Congress. Also, the existing regulations appropriately layer into the requirement of Section 148(h) and the reference to Sections 1273 and 1274 the core principle of the arbitrage rules that look to the issuer's reasonable expectations. Thus, while

Sections 1273 and 1274 do not explicitly include a reasonable expectations standard, those sections are not written as being directly subject to Section 148(a). In contrast, in the application of Sections 1273 and 1274 as referenced in Section 148(h), it is proper to include the reasonable expectation principles of Section 148(a), which serves as the umbrella to which Section 148(h) is subject. Moreover, the regulations need not be constrained by a narrow interpretation of the reference to Sections 1273 and 1274. Rather, we note that Section 148(h) says that "the yield on an issue shall be determined on the basis of the issue price (within the meaning of Sections 1273 and 1274)." This leaves much more room for flexibility than looking only at the express words in Sections 1273 and 1274; that is, the same flexibility as is afforded by the existing regulations. The propriety for affording such flexibility can be found in the expressly stated Congressional intent to simply reverse the State of Washington case and the language of the General Explanation of the Tax Reform Act of 1986 that the yield on the bonds is to be determined "taking into account" the rules of Sections 1273 and 1274 (at page 1205). In addition, the narrow interpretation suggested by strict adherence to only what is expressly set forth in Sections 1273 and 1274 is inconsistent with the more flexible and reasonable approach taken in other provisions of the Treasury regulations relating to arbitrage. The most obvious example of such flexibility in existing Treasury regulations is the provisions relating to the eighteen-month spending exception to the arbitrage rebate requirement that is certainly not expressly provided for in the Code. Finally, we note the specific Code provision granting rule making authority to Treasury under Section 148. Section 148(i) provides that the "Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section." The reasonable expectation principle of the existing regulations adheres to that concept.

Technical and Definitional Requirements

While we are most concerned with the abandonment of the reasonable expectations test, we also believe the proposed regulations are unworkable for other reasons.

Safe Harbor Rule for Determining Issue Price. SIFMA welcomes in concept that the proposed regulations set forth a safe harbor rule for determining the issue price of bonds. The ability to establish the issue price of bonds with certainty is important both for the ability of bond counsel to render the traditional "unqualified" bond counsel opinion at the time of issuance of the bonds and the ability of the borrower to establish with certainty the means for achieving compliance with the tax law requirements. However, the safe harbor rule as crafted by the proposed regulations is unworkable and would result in compliance burdens for bond issuers that would be difficult to surmount.

The proposed safe harbor rule would require that the issue price be set at the first price at which a minimum of 25 percent of the bonds is sold to the public. This proposed new 25 percent threshold is more stringent than even the commonly applied 10 percent standard under Sections 1273 and 1274, as well as specified in the 1993 final regulations. This approach to the rule would result in circumstances where certain maturities of bonds could remain unsold for weeks or months after a bond closing, preventing the establishment of issue price under the rule. Alternatively, in order to avoid a prolonged period of unsold balances, bonds may need to be priced with yields set to absolutely achieve with certainty 25 percent bond sales at rates that may be higher than the lowest cost of borrowing that the market might otherwise provide. The current free market process is designed and, we submit, operates in the overwhelming majority of transactions to achieve the lowest cost of borrowing under market conditions. Any tax rule-driven interference with that free market process raises the risk that less-than-optimal market pricing will be achieved. Thus, the pressure to achieve the certainty of the safe harbor rule may lead to adverse results. The potential

for less-than-optimal borrowing costs would arise from the pressure to achieve compliance with the safe harbor rule as set forth in the proposed regulations. This risk would be exacerbated in the not uncommon circumstance where it is not possible to sell at least 25 percent of one or more maturities despite the yields being set in a bona fide public offering at a level that is perfectly consistent with market perceptions and expectations.

By contrast, a safe harbor rule that would take into account a bona fide public offering process and the reasonable expectation to sell bonds at such offering price is much more likely to achieve the dual benefit of optimal pricing and certainty of tax law compliance. A workable safe harbor would be based on the reasonably expected sale price reflected in the initial offering price as set forth in the bond purchase agreement negotiated between the issuer and the underwriters or in a competitive bid process and in a publicly disseminated pricing wire and the official statement for the bond issue. Standard procedures established by SIFMA model documentation, MSRB rules and other regulations are designed such that the foregoing elements achieve the lowest borrowing costs and a reasonable and fair return for bondholders. As encouraged in the prior submissions by NABL, GFOA, the ABA Tax Section and SIFMA, we encourage the IRS to strengthen the ability to rely on such reasonable expectations under the existing regulations by establishing a safe harbor that is based on best practices associated with bona fide public offerings.

The interplay described above between the manner in which the safe harbor may actually do damage to the economics of the transaction and the benefit of a reasonable expectations standard can be seen with the following example that is not unusual or extreme in actual practice. It is frequently the case that, in the sale of an issue of municipal bonds—which is actually a sale of a series of bonds with differing maturities—the underwriters are able to sell most or all of the bonds that mature in, say, 2028 and 2030. But, the underwriter, despite its expectations and best efforts, is unable to sell even 10 percent (much less 25 percent) of the bonds that mature in 2029. Of course,

in this common example, it is clear from a review of the bond yield curve that the offering yield on the intermediate, unsalable 2029 maturity should fit into a smooth extrapolation of the yield points that apply to the 2028 and 2030 maturities. The underwriters have a regulatory duty under securities laws to make the offering of the intermediate 2029 maturity at a fair and reasonable price to customers, yet the only way to induce the sale of that one stubborn maturity in order to achieve compliance with the safe harbor would be to raise the offered yield. That may suggest the need to raise the yield on the other maturities in order to provide fair and reasonable prices, even though there appears to be a ready market for those bonds at the lower yields. While that would not seem to be the right result, it may be the only way to achieve compliance with the safe harbor and, thereby, allow the bond issue to successfully close with the necessary high level of certainty that the issuer can achieve tax law compliance and bond counsel can render its traditional unqualified opinion. The foregoing example is a clear and simple scenario where basing issue price on the underwriters' reasonable expectations to sell each maturity of the bonds is the appropriate and, perhaps, only sound solution.

The absence of clarity in the proposed regulations as to the consequences of failure to meet the safe harbor exacerbates the problem described in this example. What if, despite reasonable expectations, proper marketing in a bona fide public offering and compliance with all securities law requirements and standards, the 2029 bonds remain unsold at the date of closing of the bond issue and for some unknowable period beyond? Without access to the safe harbor, how is the issue price to be determined under the proposed regulation? In the absence of guidance, will the issue price remain uncertain until resolution through a negotiation between the issuer and the IRS in a subsequent bond audit? We urge the IRS to avoid imposing regulations that may inadvertently lead to pricing consequences that are highly undesirable for transaction participants.

SIFMA also believes that raising the existing regulations' treatment of 10 percent of the bonds as a substantial amount to 25 percent is unwarranted in the absence of actual evidence that there have been abuses or problems with that standard and increases the likelihood that detrimental pricing of bonds will occur in order to satisfy the safe harbor. For example, the higher 25 percent threshold could afford potential investors with the opportunity to exert undue influence on the bond pricing by holding out for a higher rate in order that the safe harbor can be met.

In addition, any process that results in raising bond yields for the purpose of tax compliance could result in windfall tax-exempt interest income for investors.

The element of the safe harbor rule that turns on the first price at which 25 percent of the bonds is sold raises the potential difficulty of establishing with certainty which bonds were the first bonds that were sold and at what price. One problem with applying this timing requirement is that there is no currently available and established reporting mechanism for determining with certainty the timing of bond sales. IRS personnel have often stated that the MSRB's Real-time Trade Reporting System ("RTRS") and Electronic Municipal Market Access system ("EMMA") for bond trade reporting and dissemination can serve as the basis for identifying information that bears on the determination of the issue price of bonds, but have also stated that EMMA is not a perfect reporting platform for such purpose and represents only one source of information to consider. The IRS has not identified any other reliable source of the required information, and we know of no such source.

This dichotomy in recognized value and limitation of the EMMA system is very apparent with respect to the timing of bond sales. In fact, while the time at which bond trades are posted to EMMA is identified, that time record does not necessarily represent the time at which the bond sale actually took place. Further, EMMA does not at all reflect any marketing activity that takes place in advance of the execution of the bond purchase agreement and that may be instrumental in establishing the first price at which 25 percent of the bonds is sold. Thus, as a practical matter, how

would the safe harbor provision of the proposed regulations work where the underwriters certify the price at which the first 25 percent of bond sales took place, but the EMMA trades do not reflect that same timing-of-trade information? This will not be an uncommon situation. Of course, the issuer and bond counsel will want to be absolutely certain that the safe harbor rule is satisfied—that is, after all, the purpose of a safe harbor.

Thus, the concern is that the proposed safe harbor may be of little practical value under currently available information reporting constraints. While significant and expensive modifications of the RTRS and EMMA systems and the reporting and recordkeeping processes of underwriting firms might afford increased reliability regarding timing of bond sales, those improvements could take many years to implement, and we question whether the benefits to the federal tax system would outweigh the substantial costs associated with such modifications.

Definition of Public, Underwriter and Securities Dealer. The proposed regulation would define the term "public" to mean any person other than an "underwriter". This definition, however, raises very difficult practical compliance questions. The most glaring deficiency in the definition of "underwriter" is that it is potentially overly broad by including "any person…that purchases bonds from an issuer for the purpose of effecting the original distribution of the bonds or that otherwise participates directly or indirectly in such original distribution." Further, a securities dealer that purchases bonds—whether or not from the issuer—for purposes of effecting the original distribution of the bonds is treated as an underwriter.

The proposed regulations define a securities dealer by reference to Section 475(c)(1) of the Code, which defines securities dealer as a taxpayer who (A) regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business or (B) regularly offers to enter into, assume, offset, assign or otherwise terminate positions in securities with customers in the ordinary course of a trade or business. This is a very broad definition and could include all manner

of institutional buyers and sellers of bonds that are not registered broker dealers. Drawing such institutional trades into the determination of the bond yield is well beyond the Congressional purpose of eliminating the issuer's issuance costs from the determination of bond yield. Further, as discussed in greater detail below with respect to determining information about bond sales by non-syndicate dealers, it would be impossible to determine accurate and complete bond trading information with respect to such bond traders. The proposed regulations have adopted an overly broad concept of the term "underwriters," and it would be impossible to obtain and track information on trading by "underwriters" as defined in the rule in the manner that would be necessary for compliance. There is simply no way for members of an underwriting syndicate, issuers, bond lawyers or anyone else to determine which parties outside an underwriting syndicate fall under the underwriter definition or to track transactions by these entities.

As discussed at length above, the Congressional intent of the definition of issue price under the 1986 Tax Act was to eliminate costs of issuance, such as underwriting and marketing fees, from the computation of bond yield. Thus, the focus of the proposed regulations should be on identifying the underwriting or marketing fees incurred by the issuer. This is best identified through the bond purchase agreement in which the issuer and the underwriters have agreed to such fees as reflected in the difference between the price paid by the underwriters to the issuer to purchase the bonds and the initial offering price of the bonds by the underwriters in a bona fide public offering. The proposed regulations go well beyond that concept by including in the definition of "underwriter" securities dealers and perhaps others that are not part of the underwriting syndicate. Sales of bonds by such parties have been inappropriately identified by the TEB as necessary to reflect the issue price of the bonds, and unfortunately that concept has been adopted by the proposed regulations. There is no basis for doing so in a manner that is consistent with the Congressional intent of eliminating issuers' issuance expenses from the bond yield. Such non-

syndicate securities dealers earn revenue from their bond sales which are not borne by the issuer as an element of the fees charged by the underwriting syndicate. The same can be said with respect to bond trading profits that may be realized by an open-ended concept of non-dealer entities that "otherwise participate directly or indirectly in the original distribution of the bonds."

By expressly including non-syndicate securities dealers within the definition of underwriter, the proposed regulations impose an obligation on the issuer, bond counsel or the underwriting syndicate to identify with certainty the timing and price of bond sales by such other entities. This is not practical, especially with the degree of certainty that the safe harbor rule would require. While EMMA may serve as a source of some information, as noted above, it was never designed as a source for establishing issue price. For example, EMMA information may reflect delays in reporting information that would mislead as to the first price of sales, would mask sales that are larger than $5 million lots, and may include errors in information. Additionally, any trades that the MSRB believes fall outside their established tolerance levels may not be posted to the EMMA site, as the MSRB reserves the right to withhold trades from public dissemination. There is no way to obtain trading information on sales by non-syndicate entities beyond EMMA. Thus, unless the MSRB and dealers were to incur the substantial costs of modifying the EMMA reporting processes and the issue price safe harbor unequivocally provided a means to rely exclusively on EMMA for issue price compliance purposes, there is no reliable source of such information. Simply put, EMMA currently is not a resource for tracking sales to end customers.

Determining Purchases for Investment. The proposed regulations include the appropriate concept that a person that holds bonds for investment is treated as a member of the public with respect to those bonds. However, without further detailed guidance this concept will be impossible to apply in many situations. Quite simply, it will be impossible for an issuer, bond counsel or an underwriter to identify whether a particular institution is buying the bonds for investment purposes.

There is no guidance on what is meant by holding for investment and there is no practical way for any of the direct transaction participants to obtain that information from a bond purchaser that is not in a direct contractual relationship with the issuer. Furthermore, EMMA information would only further muddy the waters in many cases by identifying any entity that is a bond dealer as such even though the entity may be buying the bonds for investment purposes. It is not practical to expect each investor in a large bond transaction to certify that they are buying bonds for the purpose of investment and not resale.

Use of Term Offering Period. The safe harbor rule of the proposed regulations discussed in greater detail above includes a requirement that the first price of 25 percent of the bond sales would apply only if all orders at this sale price received from the public within the "offering period" are filled. We are not aware of any definition or concept for the term "offering period." Presumably, the term is intended to refer to the "order period" which is an identifiable term under MSRB Rule G-11. The proposed regulations should be modified to use the known term "order period" or should include a definition for "offering period" if that is intended to have some other meaning.

Conclusion.

In the preamble to the proposed regulations, Treasury and the IRS stated that the purpose of the changes to the definition of "issue price" from that of the 1993 final regulations is to "provide greater certainty." SIFMA is confident that, if the proposed regulations were adopted in their current form, that goal would not be achieved. Rather, there would be a heightened level of uncertainty as to the ability of issuers to achieve tax law compliance and, accordingly, the inability of bond counsel to render their traditional unqualified opinions. Uncertainties associated with issue price compliance in recent years has been somewhat tempered by the practical fact that there has been no effective opportunity to earn arbitrage profit in connection with long-term fixed rate bonds and Build America Bonds have not been issued since the end of 2010. We are concerned that the

proposed regulation would inject still greater uncertainty into the issue price compliance process. We believe a workable safe harbor would be based on a reasonable expectations test and the initial offering price of a bond as set forth in the bond purchase agreement negotiated between the issuer and the underwriters or in a competitive bid process and in a publicly disseminated pricing wire and the official statement for the bond issue.

We recognize that the issue price rules are in need of revision and indeed, we have provided constructive suggestions to the IRS on approaches to revised issue price rules that would be workable and would provide objectivity in enforcement. While we do not believe the proposed regulations represent a workable approach to the issue, we continue to offer our assistance in addressing deficiencies in current rules. In particular, we encourage the IRS to examine closely the pricing and issuance process for new-issue tax-exempt bonds with the goal of crafting an issue price rule that is compatible with and draws on best market practices. In that regard, we offer to help in any way that is productive.

We appreciate the opportunity to present our views and we look forward to a continued dialog.

Best regards,

Michael Decker
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