

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200813022**

Release Date: 3/28/2008

Index Number: 148.12-01, 148.12-02,
147.07-00

Person To Contact:

Telephone Number:

Refer Reply To:

CC:FIP:B05

PLR-133388-07

Date:

November 20, 2007

LEGEND:

Issuer =

Bonds =

Borrower =

Dear :

This letter is in response to your request for a ruling concerning the treatment, for purposes of §§ 147(g) and 148 of the Internal Revenue Code of 1986, as amended (the "Code"), of certain fees, described below, to be paid by the conduit borrower in an exempt facility bond financing.

Facts and Representations

The Issuer intends to issue the Bonds and loan the proceeds to the Borrower for the purpose of financing a solid waste disposal facility. To improve the credit rating assigned to the Bonds and thereby lower the interest rate payable on the Bonds, the Issuer expects to obtain a letter of credit or other credit enhancement (the "Credit Enhancement") relating to the Bonds from a bank or other financial institution (the "Credit Enhancer"). It is expected that the Borrower will pay the direct costs associated

with the actual transfer of credit risk relating to the Credit Enhancement, including the initial commitment fee and the periodic on-going fee for maintenance of the Credit Enhancement. In addition, the Borrower is expected to pay certain fees and expenses for the Credit Enhancer's attorneys (the "Additional Attorneys' Fees").

Finally, because the Borrower is expected to execute a mortgage on the financed property as security for its promise to repay the loan, the Borrower is expected to pay for title insurance (the "Mortgagee Policy;" the payment for which, the "Mortgagee Policy Fee") to ensure that the security provided by the mortgage is free and clear of all liens ahead of the lien created by such mortgage and that the lien created by the mortgage is valid and enforceable. The Mortgagee Policy is separate and distinct from the title insurance policy that protects a borrower (the "Borrower Policy") from losses or damages incurred by such borrower as the owner of the insured property. The Borrower Policy protects a borrower if: it is found that the property belongs to someone else; there is a defect in the title to the property or a lien on the property title; the title is unmarketable; or there is no access to the land.

Because there will be Credit Enhancement with respect to the Bonds, the mortgage will be executed in favor of the Credit Enhancer and the Mortgagee policy will be obtained for the Credit Enhancer's benefit. In cases where there is no credit enhancement, a mortgage may be executed in favor of the issuer or the bond trustee, in which case a mortgagee policy is obtained in the name of the issuer or the bond trustee.

The Issuer represents that the Additional Attorneys' Fees and the Mortgagee Policy Fee will be separately stated, reasonable, and excluded from the fee for the Credit Enhancement.

Law

Section 103(a) provides that gross income does not include interest on any state or local bond. Section 103(b) provides that the exemption from gross income described in § 103(a) does not apply to any private activity bond which is not a qualified bond within the meaning of § 141, any arbitrage bond within the meaning of § 148 or any bond that does not meet the applicable requirements of § 149.

Section 147(g)(1) provides that a private activity bond shall not be a qualified bond if the issuance costs financed by the issue (of which the bond is a part) exceed 2 percent of the proceeds of the issue.

Section 1.150-1(a) of the Income Tax Regulations provides that except as otherwise provided, the definitions in § 1.150-1 apply for all purposes of §§ 103 and 141 through 150. Section 1.150-1(b) defines the term issuance costs to mean costs to the extent incurred in connection with, and allocable to, the issuance of an issue within the meaning of § 147(g) and provides the following examples of issuance costs if and only

to the extent such costs are incurred in connection with, and allocable to, the borrowing: underwriters' spread; counsel fees; financial advisory fees; rating agency fees; trustee fees; paying agent fees; bond registrar, certification and authentication fees; accounting fees; printing costs for bonds and offering documents; public approval process costs; engineering and feasibility study costs; guarantee fees, other than for qualified guarantees (as defined in § 1.148-(4)(f)); and similar costs.

Section 148(a) defines the term "arbitrage bond" as any bond issued as part of an issue any portion of the proceeds of which are reasonably expected, at the time of issuance of the bonds, to be used directly or indirectly (1) to acquire higher yielding investment, or (2) to replace funds that were used directly or indirectly to acquire higher yielding investments.

Section 148(b)(1) defines the term "higher yielding investments" as any investment property which produces a yield over the term of the issue which is materially higher than the yield on the issue.

In general, the yield on a bond over any period is the discount rate that, when used in computing the present value as of the first day of such period of all payments of principal and interest and fees for qualified guarantees that are attributable to such period produces an amount equal to the present value, using the same discount rate, of the aggregate issue price of the bond as of the first day of such period. See §§ 1.148-4(b)(1)(i) and (c)(1).

Section 1.148-4(f)(1) provides that fees properly allocable to payments for a qualified guarantee for an issue (as determined under § 1.148-4(f)(6)), are treated as additional interest on that issue under § 148. Section 1.148-4(f)(1) provides that a guarantee is a qualified guarantee if it satisfies each of the requirements of § 1.148-(4)(f)(2) through (4).

Section 1.148-4(f)(4)(i) requires, generally, that the fee for a qualified guarantee not exceed a reasonable, arm's-length charge for the transfer of credit risk. Section 1.148-4(f)(4)(ii) provides that a fee for a guarantee must not include any payment for any direct or indirect services other than the transfer of credit risk, unless the compensation for those other services is separately stated, reasonable, and excluded from the guarantee fee. Section 1.148-4(f)(4)(ii) further provides that fees for the transfer of credit risk include fees for the guarantor's overhead and other costs relating to the transfer of credit risk. As an example, § 1.148-4(f)(4)(ii) provides that the guarantee fee includes payment for services other than transfer of credit risk if: (A) it includes payment for the cost of underwriting or remarketing bonds or for the cost of insurance for casualty to bond-financed property; (B) it is refundable upon redemption of the guaranteed bond before the final maturity date and the amount of the refund would exceed the portion of the fee that had not been earned; or (C) the requirements relating to temporary periods for capital projects are not satisfied and the guarantor is not

reasonably assured that the bonds will be repaid if the project to be financed is not completed.

Section 1.148-5 provides, in general, rules for computing the yield and value of investments allocated to an issue for various purposes under § 148. Section 1.148-5(b)(1) provides, in part, that the yield on an investment allocated to an issue is the discount rate that, when used in computing the present value as of the date the investment is first allocated to the issue of all unconditionally payable receipts from the investment, produces an amount equal to the present value of all unconditionally payable payments for the investment. For this purpose, payments means amounts to be actually or constructively paid to acquire the investment and receipts means amounts to be actually or constructively received from the investment, such as earnings and return of principal.

Section 1.148-5(e)(1) provides that, except as otherwise provided in § 1.148-5(e), an allocation of gross proceeds of an issue to a payment or receipt on an investment is not adjusted to take into account any costs or expenses paid, directly or indirectly, to purchase, carry, sell, or retire the investment (administrative costs). Thus, these administrative costs generally do not increase the payments for, or reduce the receipts from, investments.

Section 1.148-5(e)(3)(i) provides that, in determining payments and receipts on purpose investments, qualified administrative costs are taken into account. Thus, qualified administrative costs increase the payments for, or decrease the receipts from, the purpose investments. This rule applies even if those payments merely reimburse the issuer. Although the actual payments by the conduit borrower may be made at any time, for this purpose, a pro rata portion of each payment made by a conduit borrower is treated as a reimbursement of reasonable administrative costs, if the present value of those payments does not exceed the present value of the reasonable administrative costs paid by the issuer, using the yield on the issue as the discount rate.

Section 1.148-5(e)(3)(ii)(A) defines the term qualified administrative costs for purpose investments as the (1) costs or expenses paid, directly or indirectly, to purchase, carry, sell, or retire the investment and (2) costs of issuing carrying or repaying the issue, and any underwriters' discount.

Analysis

Additional Attorneys' Fees

Pursuant to § 1.148-4(f)(1), fees for qualified guarantees are treated as additional interest when calculating the yield on an issue of bonds. Section 1.148-4(f)(4)(ii) provides that a qualified guarantee fee may not include a fee for the provision of a service other than the transfer of credit risk for the bonds but may include fees such as

a portion of the guarantor's overhead and other costs relating to such transfer of credit risk . To the extent that the Additional Attorneys' Fees are being incurred by the Credit Enhancer with respect to the provision of the Credit Enhancement on the Bonds, such fees are other costs for the transfer of credit risk within the meaning of § 1.148-4(f)(4)(ii) and therefore are fees for a qualified guarantee. As qualified guarantee fees, such Additional Attorneys' Fees are included as additional interest on the Bonds under § 1.148-4(f)(1) and are not subject to the 2 percent cost of issuance limitation of § 147(g).

Mortgagee Policy Fee

Qualified Guarantee

Unlike the Additional Attorneys' Fees, the Mortgagee Policy Fee is not a cost of the Credit Enhancer relating to the transfer of credit risk on the Bonds within the meaning of § 1.148-4(f)(4)(ii). Rather, the Mortgagee Policy Fee is a cost incurred by the Borrower as part of obtaining the loan of Bond proceeds. Were the Bonds not credit enhanced, the Borrower may still have been required to execute a mortgage on the financed property in favor of the Issuer or the bond trustee and provide that party with a Mortgagee Policy. The fact that the Credit Enhancer, rather than the Issuer or the trustee, will be the beneficiary of the Mortgagee Policy does not result in the Mortgagee Policy Fee being treated as a fee for a qualified guarantee. Accordingly, the Mortgagee Policy Fee is not included as additional interest on the bonds. However, because, as the Issuer represents, such fee will be reasonable, separately stated and excluded from the guarantee fee, the Credit Enhancement itself will continue to qualify as a qualified guarantee.

Bond Issuance Cost within the meaning of § 147(g)

Because the Mortgagee Policy Fee is not a fee for a qualified guarantee, we must decide whether such fee is a bond issuance cost subject to the 2 percent cost of issuance limitation under § 147(g). This limitation was introduced as part of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 1 (TRA 1986). The Conference Report published with respect to TRA 1986 explains the introduction of this limitation and provides examples of costs of issuance as follows:

Costs of issuance subject to the two-percent limitation include all costs incurred in connection with the borrowing--in general, all costs that are treated as costs of issuance under the present Treasury Department regulations and rulings. Examples of costs of issuance that are subject to the two-percent limitation include (but are not limited to)--

(1) underwriters' spread (whether realized directly or derived through purchase of the bonds at a discount below the price at which they are expected to be sold to the public);

- (2) counsel fees (including bond counsel, underwriter's counsel, issuer's counsel, company counsel in the case of borrowings such as those for exempt facilities, as well as any other specialized counsel fees incurred in connection with the borrowing);
- (3) financial advisor fees incurred in connection with the borrowing;
- (4) rating agency fees;
- (5) trustee fees incurred in connection with the borrowing;
- (6) paying agent and certifying and authenticating agent fees related to issuance of the bonds;
- (7) accountant fees (e.g., accountant verifications in the case of advance refundings) related to issuance of the bonds;
- (8) printing costs (for the bonds and of preliminary and final offering materials);
- (9) costs incurred in connection with the required public approval process (e.g., publication costs for public notices generally and costs of the public hearing or voter referendum); and
- (10) costs of engineering and feasibility studies necessary to the issuance of the bonds (as opposed to such studies related to completion of the project, but not to the financing).

As described in E., below, bond insurance premiums and certain letter of credit fees may be treated as interest expense under the arbitrage restrictions. To the extent of their treatment as interest, the initial cost of these types of costs of issuance may be financed in addition to the two-percent limit on financing other costs of issuance.

H.R. Conf. Rep. No. 99-841, at 4833 (1987), 1986-3 (Vol 4.) C.B. 729-30.

Section 1.150-1(b) provides substantially the same list of examples except that its list also includes bond registrar. The borrowing referred to in § 1.150-1(b) is the borrowing by the Issuer as evidenced by the Bonds and not the borrowing of the Bond proceeds by the Borrower. Because, as stated above, the Mortgagee Policy Fee is a cost incurred by the Borrower in connection with its receipt of the loan of Bond proceeds and not a cost incurred by the Issuer in connection with the issuance of the Bonds, the Mortgagee Policy Fee is not subject to the 2 percent cost of issuance limitation in § 147(g).

Qualified Administrative Cost

Nor is the Mortgagee Policy Fee a qualified administrative cost within the meaning of § 1.148-5(e)(3)(ii)(A). Pursuant to § 1.148-5(e)(3)(i), qualified administrative costs described in § 1.145-5(e)(3) paid by the conduit borrower increase the payment for, or decrease the receipt from, the purpose investment. Although paid by the conduit borrower, the qualified administrative costs described in § 1.148-5(e)(3)(ii) are costs

incurred by the issuer either to purchase, carry, sell, or retire an investment, as provided in § 1.148-5(e)(3)(ii)(A)(1) or in issuing, carrying, or repaying the issue as provided in § 1.148-5(e)(3)(ii)(A)(2).

The Mortgagee Policy Fee is not a cost of issuing within the meaning of § 1.148-5(e)(3)(ii)(A)(2). The term “costs of issuing” in § 1.148-5(e)(3)(ii)(A)(2) should be interpreted consistently with the term “issuance costs” under § 1.150-1(b). As discussed above, the Mortgagee Policy Fee is not an issuance cost because it is not a cost incurred by the Issuer in issuing, carrying or repaying the Bonds, but is a cost incurred by the Borrower in obtaining the loan. Similarly, the Mortgagee Policy Fee is not a qualified administrative cost within the meaning of § 1.148-5(e)(3)(ii)(A)(1) because it is not a cost incurred by the Issuer to purchase, carry, sell, or retire the loan.

Conclusion

Based upon the above discussion, we conclude:

1. To the extent that the Additional Attorneys' Fees are being incurred by the Credit Enhancer with respect to the provision of the Credit Enhancement on the Bonds, such fees are to be included within the payment for a qualified guarantee within the meaning of § 1.148-4(f)(1) and treated as additional interest on the Bonds. Such Additional Attorneys' Fees, therefore, are not an issuance cost subject to the 2 percent cost of issuance limitation described in § 147(g).
2. The Mortgagee Policy Fee is a cost incurred by the Borrower in obtaining the loan financed with the Bond proceeds. As such, it is not a fee for a qualified guarantee within the meaning of § 1.148-4(f)(1), nor is it a cost of issuance subject to the 2 percent cost of issuance limitation described in § 147(g), nor is it a qualified administrative cost within the meaning of § 1.148-5(e)(3)(ii).

This ruling provides guidance with respect to the treatment of the Additional Attorneys' Fees and the Mortgage Policy Fee for purposes of §§ 147(g) and 148 of the Code only and does not address the treatment of these fees for any other purpose of the Code.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,
Associate Chief Counsel
Financial Institutions & Products

By _____
Johanna Som de Cerff
Senior Technical Reviewer, Branch 5

cc: