



**Patrick McCoy Testimony  
on behalf of  
Government Finance Officers Association  
IRS Public Hearing on Proposed Regulations  
Arbitrage Guidance for Tax-Exempt Bonds  
REG-106143-07  
January 30, 2008**

Thank you very much for providing a forum today to discuss the recently proposed rulemaking on arbitrage guidance for tax-exempt bonds. On behalf of the Government Finance Officers Association's 17,300 members, we welcome the opportunity to comment on this matter.

I am Patrick McCoy, Executive Director of New York City's Municipal Water Finance Authority. However, today I am testifying on behalf of the GFOA, where I serve as the Chairman of the Financial Policies Subcommittee of the Committee on Governmental Debt Management. The views that I express today are those of the GFOA and not of the City of New York or the New York City Municipal Water Finance Authority. The Governmental Debt Management Committee provides the GFOA's Executive Board with guidance and suggestions for adopting recommended practices and public policy statements for our members.

In the comments GFOA submitted to you on December 20, we noted that many of the provisions contained in the proposed regulations are viewed as positive changes. However, there is one area where we must express our objections. Where it has been acknowledged by the IRS that an arbitrage rebate overpayment by the issuer has occurred, the GFOA believes that in addition to receiving that full amount, an issuer should be paid interest from the time the overpayment was paid to the time the reimbursement is processed. Certainly the opposite is true when an issuer underpays, and must remit not only the corrected amount but interest as well to the IRS. We thus question the IRS's position that interest will not be provided to issuers – who the IRS has consistently treated as taxpayers for purposes of the tax-exempt bond rules - and respectfully request that the IRS reconsider its position.

We must also inquire about the rationale for the IRS's position. Does the IRS not believe it has the authority to provide interest payments? A reason for the denial of interest on overpayments has eluded us. An explanation of the rationale would be greatly appreciated, because if the IRS does not believe it has such authority, a legislative change could be sought.

An example of our concerns has been cited by the Vice Chair of the Debt Committee, Julia Cooper, Deputy Finance Director of San Jose, California. Ms. Cooper notes that in January 2006 a request for refund for arbitrage overpayment (Form 8038-R) was filed with the IRS requesting a refund of \$367,445. While acknowledgement of the City's request for refund of overpayment was received within several months, official written notification that a refund would be processed was not provided to the City until August 2007 (19 months after filing Form 8038-R). The check was not received by the City until November 2007; 21 months after filing the initial request for refund. The length of time that the money was held exacerbates the problem that interest did not accompany the refund for overpayment from the IRS. Again, we strongly urge the IRS and Treasury to look at this issue and determine why this particular policy is in place, and consider reversing its 'no interest on overpayments' position. The IRS should make every effort to pay interest on these amounts. If, for some reason, the IRS determines that it is unable to make interest payments, we believe that the IRS should support legislative or other changes necessary for it to make these interest payments. We would welcome the opportunity to discuss with the IRS and Treasury ways to enhance the overpayment reimbursement program so that it can work more efficiently for both the IRS and state and local government finance officials.

NABL notes in its January 28<sup>th</sup> letter that there may also be a problem with the calculation for determining the amount of the overpayment that may need clarification. Its recommendation relates to the IRS position that it will not pay a refund in excess of the rebate amount actually paid and indicates that, despite this IRS position, in order for the rebate computation to be made properly, rebate payments must be future valued as part of the rebate computation. Whether or not the IRS is able to pay refunds with interest, we support the comment that rebate payments must be future valued.

Again as noted in our December 20<sup>th</sup> letter, we support the remaining proposals, although we encourage Treasury and IRS to review the comments of others, especially the technical comments provided by NABL and S-I-F-M-A on the interest rate swap rules.

This is particularly true with SIFMA's comments about the proposed regulations provision related to the correspondence between the rate on an interest rate swap and the rate on the bonds. We support SIFMA's comments that the requirement that hedges and bonds closely correspond as evidenced by the use of a 25 basis point historical and snapshot test will be problematic in many circumstances and should be substantially modified or eliminated.

The proposed clarifications provided in the interest rate swaps and hedges heading are very helpful and provide needed clarification in this area, especially the new hedge integration rules related to LIBOR-based swaps, and the permitted use of yield reduction payments for escrow funds established in advanced refundings.

Lastly, we again support and appreciate the modifications made to allow safe harbor bidding procedures for guaranteed investment contracts. These changes reflect marketplace practices and the industry's use of electronic means for bond and investment administration. Also, expanding the existing IRS procedures to allow issuers to make yield reduction payments with respect to advance refunding escrow investments when the SLGS window is closed is very helpful.

Thank you very much for the opportunity to appear before you today. Both our testimony today and written comments submitted last month reflect our support for these proposed regulations, with the exception of the inability for an issuer to receive interest on an arbitrage rebate overpayment.

We look forward to working with you and others in our community on these and other issues of importance to the tax-exempt bond community. We hope that in the next few months clarification of the regulations relating to issue price, per NABL's 2006 recommendations will be proposed, in addition to other issues that are part of the Treasury's and IRS's workplans this year.

GFOA stands ready to provide any assistance to the IRS and Treasury on these and any other matters.