March 25, 2008

Part III – Administrative, Procedural, and Miscellaneous

Reissuance Standards for State and Local Bonds

Notice 2008-41

SECTION 1. Purpose. This Notice clarifies, amends, supplements, and supersedes Notice 2008-27, 2008-10 I.R.B. 543 (March 10, 2008), regarding reissuance standards for tax-exempt bonds. The Internal Revenue Service ("IRS") and the Treasury Department expect to issue regulations under §150 of the Internal Revenue Code of 1986, as amended ("Code") to modify and clarify the determination of when tax-exempt bonds are treated as reissued or retired solely for purposes of §103 and §§141 through 150. (Except as noted, section references in this Notice are to the Code and the Income Tax Regulations). This Notice provides interim guidance until the promulgation of such regulations. In part, this Notice is intended to provide greater certainty and flexibility to address certain potential Federal tax issues that have arisen in the tax-exempt bond market as a result of recent rating agency downgrades of major municipal bond insurers and failures of auctions in the auction rate bond sector of the tax-exempt bond market.

In general, this Notice clarifies, amends, supplements, and supersedes Notice 2008-27, which modified certain special reissuance standards for "qualified tender bonds" under IRS Notice 88-130, 1988-2 C.B. 530 for purposes of §103 and §§141 through 150, and modified certain aspects of the application of §1.1001-3 of the Income Tax Regulations as they apply to tax-exempt bonds.

The following discussion summarizes the changes and clarifications to Notice 2008-27 made in this Notice:

Qualified Tender Bond Rules. With respect to the qualified tender bond provisions, this Notice does the following: (1) it clarifies that the determination of whether a bond is a "qualified tender bond" is generally applied on a bond-by-bond basis, except to the extent that such test requires a determination of the weighted average maturity of the entire issue; (2) it adds qualified inflation rates and qualified inverse floating rates under §1.1275-5(c) as eligible interest rates for qualified tender bonds; and (3) it clarifies how the 90-day remarketing requirement in the definition of a qualified tender right operates but also provides a temporary 180-day remarketing requirement.

New Temporary Rule Allowing Governmental Issuers to Purchase Their Own Auction Rate Bonds. In order to facilitate liquidity in the tax-exempt market in light of current market conditions, this Notice introduces a temporary rule which allows a governmental issuer to purchase its own tax-exempt auction rate bonds on a temporary basis without causing a retirement or extinguishment of the debt represented by the purchased tax-exempt bonds.

Certain Arbitrage Rules. This Notice also adds several rules which address the consequences of certain actions for purposes of the arbitrage investment restrictions under § 148, including actions taken pursuant to this Notice relating to qualified hedges, purchases of tax-exempt bonds by conduit borrowers, and sales of bonds at a market premium pursuant to a qualified interest rate mode change under this Notice. This Notice supplements the arbitrage rule on the treatment of minor modifications of

qualified hedges from Notice 2008-27 with a rule which provides that a deemed termination of an otherwise qualified hedge under §1.148-4(h) will not result from bonds being held by or on behalf of a governmental issuer during the 90-day permitted holding period or the temporary 180-day permitted holding period for remarketing pursuant to a qualified tender right or during the 180-day permitted holding period for temporary purchases of auction rate bonds. With respect to a conduit borrower's purchase of tax-exempt bonds, the Notice adds a special rule which provides that such a purchase will not cause a violation of a technical arbitrage restriction against purchases of tax-exempt bonds by conduit borrowers under the "program investment" definition in §1.148-1(b) in certain circumstances. Further, with respect to certain permitted resales of bonds at a market premium upon a conversion of the interest rate to a fixed interest rate to maturity, this Notice provides that, solely for arbitrage purposes, any premium properly received by an issuer pursuant to a qualified interest rate mode change is treated as additional sale proceeds (as defined in §1.148-1(b)).

Certain Special Rules. Finally, with respect to two special rules from Notice 2008-27 which address certain temporary waivers of interest rate caps and certain nonrecourse debt, this Notice continues those rules and extends the period during which interest rate caps may be waived without resulting in a significant modification under § 1.1001-3 until October 1, 2008.

Changes to Examples

This Notice removes certain language from Example 2 of Notice 2008-27, because that language has proven confusing. No other inference should be drawn with

respect to the transaction. In addition, this Notice contains an additional example illustrating the temporary 180-day qualified tender bond remarketing requirement.

Scope and Effective Date. This Notice applies solely for purposes of §103 and §§141 through 150. No inference should be drawn regarding whether a debt modification described in this Notice would constitute an exchange for purposes of §1001. In addition, no inference should be drawn about whether similar consequences would obtain if a transaction falls outside the scope of this Notice.

This Notice is effective as of March 25, 2008. For the scope of application of this Notice, see §8 of this Notice.

This Notice invites public comment on the guidance provided herein.

SECTION 2. Background

Reissuance

Reissuance of a tax-exempt bond for purposes of the tax-exempt bond provisions triggers retesting of all the various program requirements for new issues of tax-exempt bonds. A reissuance of an issue of tax-exempt bonds may result in various negative consequences to a bond issuer, including, among other things, changes in yield for purposes of the arbitrage investment restrictions, acceleration of arbitrage rebate payment obligations, deemed terminations of integrated interest rate swaps under the qualified hedge rules for arbitrage purposes, new public approval requirements for qualified private activity bonds, and change in law risk.

In general, the standard for determining whether tax-exempt bonds are reissued, retired, or otherwise modified significantly enough to trigger a retesting of the program requirements for new issues of tax-exempt bonds under the tax-exempt bond provisions

of the Code is based on the general Federal tax standards for debt exchanges under §1001 and regulations thereunder.

In general, §1.1001-3 employs a significant modification standard to determine whether modifications to a debt instrument in any form are sufficiently significant to cause the debt instrument to be treated as reissued or exchanged for purposes of §1001. Section 1.1001-3 applies to modifications in the form of amendments to the terms of an existing debt instrument and to modifications in the form of actual exchanges of existing debt instruments for different debt instruments. The determination of whether a resulting debt instrument is treated as a reissued new debt instrument or a continuation of the original debt instrument depends on whether the result represents a "significant modification" of the original debt instrument, as defined in §1.1001-3.

Notice 88-130 provides certain special reissuance rules for certain eligible tax-exempt bonds that are "qualified tender bonds," as defined therein. Notice 88-130 provides that qualified tender bonds will not be treated as reissued for purposes of §103 and §§141 through 150 as a result of certain tender rights and certain changes in interest rate modes and other terms of bonds that are covered specifically by the detailed rules and limitations set forth in Notice 88-130.

Debt Extinguishment

Subject to limited exceptions, a debt instrument generally is treated as retired or extinguished when, among other circumstances, an issuer acquires its own debt because a merger of the interests of the issuer and the holder occurs. Notice 88-130 reflects this debt extinguishment principle in §2.2(d) thereof, which generally treats a

tax-exempt qualified tender bond as retired if it is purchased or otherwise acquired by or on behalf of an issuer which is a governmental unit or an agency or instrumentality thereof. If tax-exempt bonds treated as retired as a result of a debt extinguishment upon a governmental issuer's purchase of the tax-exempt bonds, that treatment may have different consequences depending on whether it is retired with the proceeds of another debt instrument or whether it is retired from equity or other non-borrowed funds.

A borrowing, whether taxable or tax-exempt, that is treated as retiring or reissuing a separate borrowing, generally constitutes an issue of refunding bonds which are viewed as financing the same governmental purpose or project as the original bonds (or "stepping into the shoes" of the original bonds) and trigger consequences involving the need to retest certain tax-exempt bond program requirements.

Tax-exempt bonds that are treated as retired through a debt extinguishment without a link to another borrowing, such as potentially an issuer's purchase of its own tax-exempt bonds using equity or other non-borrowed funds, may trigger additional consequences, including the potential adverse consequence of generally limiting the ability to refinance those extinguished bonds later with tax-exempt refunding bonds for the same governmental purpose as the original bonds.

Interest Rate Modes—Tender Option Modes and Auction Rate Modes

Issuers may issue fixed rate tax-exempt bonds that bear interest at fixed rates to maturity or variable rate bonds that bear interest at variable rates which float periodically in accordance with various market-based interest-rate setting mechanisms. Issuers often include multi-modal interest rate features in the preauthorized terms of the bond

documents which provide issuers with the flexibility to change interest rate modes under parameters set forth in the bond documents.

One common interest rate mode employed with tax-exempt bonds is a tender option mode. "Tender option bonds" are also referred to commonly as "variable rate demand bonds." Tender option bonds have short-term interest features tied to current market rates necessary to remarket the bonds at par. Tender option bonds have ongoing tender options or put options associated with the interest rate-setting mechanism which allow bondholders to tender their bonds for purchase at par at specified intervals, typically every seven days. Tender option bonds generally have creditworthy third-party liquidity facilities from banks or other liquidity providers to support the tender options and may have credit enhancement from bond insurers or other providers. Tender option bonds also may have interest mode conversion options which grant to the issuer or a conduit borrower an option to change the interest rate mode on the bonds from a tender option mode to another short-term interest rate mode or to a fixed interest rate to maturity. At the time of a conversion to another interest rate mode, tender option bonds typically are subject to a mandatory tender for purchase but a bondholder may be allowed to elect to retain the bonds. Upon the exercise of ongoing tender options associated with the short-term interest rate-setting mechanism for tender option bonds and upon any mandatory or optional tender upon conversion of the interest rate on the bonds to another interest rate mode, a remarketing agent or a liquidity provider typically will acquire the bonds subject to the tender at par and resell the bonds either to the same bondholders or to others willing to purchase such bonds. In general, Notice 88-130 provides guidance for when the tenders associated with

tender option bonds will not constitute reissuances if they meet the specific detailed eligibility requirements for "qualified tender bonds," as defined in Notice 88-130.

Another interest rate mode used with tax-exempt bonds is an auction rate mode. The interest rate on auction rate bonds is reset at predetermined intervals (generally under one year) using a modified Dutch auction process. Auction rate bonds generally trade at par and are callable at par on any interest payment date at the option of the issuer. Unlike bonds in a tender option mode, however, bonds in an auction rate mode have no ongoing tender options or put options to support the interest rate-setting process. Thus, auction rate bonds are viewed as long-term investments with a short-term interest rate-setting process. Auction rate bonds generally have maximum rates based on state law restrictions or certain formulas, such as a multiple of a tax-exempt or taxable index. Auction rate bonds may have credit enhancement from bond insurers or other providers. Auction rate bonds also may have interest mode conversion options similar to tender option bonds which grant to the issuer or a conduit borrower an option to change the interest rate mode on the bonds from an auction rate mode to another short-term interest rate mode or to a fixed interest rate to maturity. At the time of a conversion to another interest rate mode, auction rate bonds typically are subject to a mandatory tender for purchase in a process similar to mandatory tenders on conversions of interest rate modes used with tender option bonds.

Questions have arisen regarding whether or to what extent auction rate bonds can be treated as qualified tender bonds for purposes of Notice 88-130. In addition, in light of recent guidance by the Securities and Exchanges Commission which authorizes issuers of tax-exempt bonds to bid on and acquire their own auction rate bonds in an

auction in certain circumstances, additional questions have arisen regarding the tax consequences of such acquisitions in various circumstances and whether such acquisitions would result in a retirement or extinguishment of such bonds.

SECTION 3. Reissuance Standards for State and Local Bonds

3.1. Scope and General Rules. The IRS and the Treasury Department expect to promulgate regulations under § 150 to provide guidance on whether tax-exempt bonds are treated as reissued or retired solely for purposes of §103 and §§141 through 150. Specifically, for purposes of §103 and §§141 through 150 only, in the case of a qualified tender bond (as defined herein), any qualified interest rate mode change (as defined herein) and any qualified tender right (as defined herein) will not be treated as a modification under § 1.1001-3. Therefore, for these purposes, a qualified tender bond will not be treated as reissued or retired solely as a result of a qualified interest rate mode change or the existence or exercise of any qualified tender right. Further, in applying §1.1001-3 to modifications of tax-exempt bonds, any interest rate variance directly resulting from a qualified interest rate mode change will not be treated as a modification under § 1.1001-3, and thus such interest rate variances need not be tested under the change in yield rule for determining significant modifications under §1.1001-3(e)(2). Except as otherwise specifically provided in this Notice, the determination of whether any modification to an issue of tax-exempt bonds causes a reissuance or retirement of the tax-exempt bonds for purposes of §103 and §§141 through 150 is based on whether the modifications are significant modifications under §1.1001-3.

Except as expressly provided herein in the special rules for the treatment of "qualified interest rate mode changes" and "qualified tender rights" on "qualified tender

bonds" (all as redefined herein) under §3 of this Notice, the special temporary rule allowing governmental issuers to purchase their own tax-exempt auction rate bonds for a limited holding period under §4 of this Notice, the special arbitrage rules under §5 of this Notice, and the other special rules under §6 of this Notice, a tax-exempt bond generally is treated as reissued or retired on the first date on which: (1) a significant modification to the terms of the bond occurs under §1.1001-3 or a disposition of the bond otherwise occurs under section 1001; (2) the bond is purchased or otherwise acquired by or on behalf of a governmental issuer (as defined herein); or (3) the bond is otherwise retired or redeemed.

For purposes of determining whether a bond is purchased or otherwise acquired by or on behalf of a governmental issuer, except as otherwise expressly provided in §3.2(3) and §4 of this Notice, a bond is treated as purchased or otherwise acquired by or on behalf of a person if the bond is purchased or otherwise acquired by that person in a manner that liquidates the bondholder's investment.

A purchase of a tax-exempt bond by a third-party guarantor or third-party liquidity facility provider pursuant to the terms of a third-party guarantee or third-party liquidity facility is not treated as a purchase or other acquisition by or on behalf of a governmental issuer. Similarly, a purchase of a tax-exempt bond by a conduit borrower that is not a governmental issuer is not treated as a purchase or other acquisition by or on behalf of the governmental issuer.

3.2. Definitions and Operating Rules. The following definitions and special operating rules apply for purposes of this Notice only:

(1). Qualified Tender Bond. The term “qualified tender bond” means a tax-exempt bond that has all of the following features: (a) for each interest rate mode that is preauthorized under the terms of the bond considered separately, the bond bears interest during the allowable term of that interest rate mode at either a fixed interest rate, a variable interest rate that constitutes a qualified floating rate on a variable rate debt instrument for a tax-exempt bond under §1.1275-5(b) (e.g., various interest rate indexes and rate-setting mechanisms that reasonably can be expected to measure contemporaneous variations in the cost of newly-borrowed funds, including, without limitation, interest rates determined by reference to eligible interest rate indexes (e.g., the SIFMA index), tender option-based interest rate measures, or a Dutch auction process), or a variable interest rate that constitutes an eligible objective rate for a variable rate debt instrument that is a tax-exempt bond under §1.1275-5(c)(5) (i.e., a qualified inflation rate or a qualified inverse floating rate); (b) interest on the bond is unconditionally payable at periodic intervals at least annually; (c) the final maturity date of the bond is no longer than the lesser of 40 years after the issue date of the bond or the latest date that is reasonably expected as of the issue date of the issue of which the bond is a part to be necessary to carry out the governmental purpose of the issue of which the bond is a part (with the 120 percent weighted average economic life of financed facilities test under Section 147(b) with respect to the issue of which the bond is a part being treated as a safe harbor for this purpose); and (d) the bond is subject to an optional tender right or a mandatory tender requirement which allows or requires a bondholder to tender the bond for purchase in one or more prescribed circumstances under the terms of the bond.

(2). Qualified Interest Rate Mode Change. In general, a "qualified interest rate mode change" is a change in the interest rate mode on a bond that is authorized under the terms of the bond upon its original issuance. Further, in order to be a qualified interest rate mode change, the terms of the bond must require that the bond be purchased and resold at a price equal to par upon conversion to a new interest rate mode, except only that, upon a conversion to an interest rate mode that is a fixed interest rate for the remaining term of the bond to maturity, the bond may be resold at a market premium or a market discount from the stated principal amount of that bond.

(3). Qualified Tender Right.

(a) In General. A "qualified tender right" is a tender right for the purchase of a bond (regardless of whether the purchase is by or on behalf of a governmental issuer) that is authorized under the terms of a bond upon its original issuance and that meets all of the requirements of this §3.2(3)(a). The tender right must involve either an optional tender right or a mandatory tender requirement which allows or requires the bondholder to tender the bond for purchase on at least one tender date before the final stated maturity date. The tender right must entitle a tendering bondholder to receive a purchase price equal to par (which may include any accrued interest). The terms of the tender right must require the issuer or its remarketing agent to use at least best efforts to remarket a bond upon a purchase pursuant to the tender right.

(b) Operating Rules for Purchases Pursuant to a Qualified Tender Right. A bond purchased by or on behalf of a governmental issuer pursuant to a qualified tender right is treated as not retired pursuant to and as a result of the qualified tender right until not later than the end of the 90-day period from and after the date of such purchase, and

subsequent to the end of this 90-day period, a governmental issuer generally may not hold its own bond without causing a retirement of such bond under the general rules in §3.1 of this Notice. This 90-day period is extended to 180-days, however, with respect to any purchase by or on behalf of a governmental issuer pursuant to a qualified tender right as long as such purchase occurs before October 1, 2008.

Thus, with respect to such bonds purchased before October 1, 2008, during this 180-day period, a governmental issuer or its agent may hold the bond under the terms of the bond without causing a retirement of the bond. In addition, recognizing that the bond is treated as outstanding during this 180-day period, the governmental issuer may refund the bond with a refunding bond during this period upon a failed remarketing.

By contrast, third-party guarantors, third-party liquidity facility providers, and conduit borrowers (other than a conduit borrower that is a governmental issuer) are not treated as purchasers by or on behalf of a governmental issuer under the general rules in §3.1 of this Notice, and, accordingly, any such person may hold a bond purchased pursuant to the exercise of a qualified tender right for an unlimited holding period without causing a retirement of such bond. Further, for example, a governmental issuer may hold a bond purchased before October 1, 2008, pursuant to the exercise of a qualified tender right for a holding period of 179 days while using best efforts under the terms of the bonds to remarket the bond and then resell the bond to a third-party guarantor, third-party liquidity facility provider, or other independent third party before the expiration of the 180-day period in compliance with the operating rules in this §3.2(3)(b).

(4) Governmental issuer. A "governmental issuer" is an issuer of a tax-exempt bond that is a governmental unit or an agency or instrumentality thereof.

SECTION 4. Temporary Rule Allowing Governmental Issuers to Purchase Their Own Auction Rate Bonds

Solely for purposes of §103 and §§141 through 150, a governmental issuer may purchase its own tax-exempt auction rate bond on a temporary basis without resulting in a reissuance or retirement of the purchased tax-exempt bond if it meets the following requirements: (1) the governmental issuer holds the bond for not more than a 180-day period from and after the date of purchase; and (2) the governmental issuer purchases the bond before October 1, 2008. Similar to the treatment of a bond purchased pursuant to a qualified tender right under the operating rule in §3.2(3)(b) of this Notice, an auction rate bond purchased by a governmental issuer pursuant to this §4 is treated as not retired pursuant to and as a result of this special rule until not later than the end of this 180-day period, and, subsequent to the end of this 180-day period, a governmental issuer generally may not hold its own bond without causing a retirement of such bond under the general rules in §3.1 of this Notice.

Thus, recognizing that the bond is treated as not retired during this 180-day period, the governmental issuer may refund the bond with a refunding bond, tender the bond for purchase in a qualified tender right in its capacity as a bondholder, or otherwise resell the bond during this 180-day period. After the end of this 180-day period, however, a governmental issuer generally may not hold its own bond without causing a retirement of such bond under the general rules in §3.1 of this Notice.

SECTION 5. Arbitrage Provisions

5.1. Certain Special Rules on Qualified Hedges for Arbitrage Purposes. Solely for purposes of the arbitrage investment restrictions (including, without limitation, both yield restriction and rebate) under §148, in determining whether a modification of a qualified hedge results in a termination of the hedge under §1.148-4(h), such a modification is not treated as a termination of the hedge if both: (1) the modification is not reasonably expected as of the date of the modification to change the yield on the affected hedged bonds over the remaining term of the hedged bonds by more than one quarter of one percent (.25 percent or twenty-five basis points) per annum; and (2) the payments and receipts on the qualified hedge, as modified, are fully taken into account as adjustments to the yield on those hedged bonds for arbitrage purposes under § 148. Further, for arbitrage purposes under §148, a qualified hedge with respect to bonds is not deemed terminated under §1.148-4(h) as a result of the governmental issuer's holding of the hedged bonds during either the 90-day permitted holding period or the 180-day temporary permitted holding period under §3.2(3), or the 180-day permitted holding period under §4 of this Notice during which the governmental issuer is permitted to hold such bonds without resulting in a reissuance or retirement of such bonds.

5.2. Special Rule for Certain Purchases by Conduit Borrowers. In applying the special arbitrage rule for "program investments" under §1.148-1(b) which restricts a conduit borrower's purchase of tax-exempt bonds for a governmental program in an amount "related" to the amount of its purpose investment financed by the program, a conduit borrower's purchase of a tax-exempt auction rate bond that financed its loan to facilitate liquidity under adverse market conditions is treated as not being so "related" for this purpose.

5.3. Treatment of Certain Premiums as Proceeds for Arbitrage Purposes. Solely for purposes of the arbitrage investment restrictions under §148, any premium received by an issuer pursuant to a conversion of the interest rate on a qualified tender bond to a fixed interest rate for the remaining term of the bond to maturity in a qualified interest rate mode change under §3.2(2) of this Notice is treated as additional sale proceeds (as defined in §1.148-1(b)) of such bonds.

SECTION 6. Special Rules

6.1 Special Rule for Nonrecourse Debt. Solely for purposes of §103 and §§141 through 150, in applying §1.1001-3(e)(4)(iv)(B) to determine whether a modification of the security or credit enhancement on a tax-exempt bond that is a nonrecourse debt instrument is a significant modification, such a modification is treated as a significant modification only if the modification results in a change in payment expectations under §1.1001-3(e)(4)(vi).

6.2. Special Temporary Relief for Certain Waivers of Interest Rate Caps on Auction Rate Bonds. Solely for purposes of §103 and §§141 through 150, in applying §1.1001-3(e)(2) to determine whether a modification to the yield on tax-exempt bonds that bear interest based on an auction rate constitutes a significant modification, a temporary waiver, in whole or in part, of the terms of a cap on the maximum interest rate on such auction rate bonds is disregarded to the extent that any agreement to waive such a cap and the period during which such a waiver is in effect both are within the period between November 1, 2007 and October 1, 2008. Except for the special relief provided in this section, a waiver of a cap on an interest rate on a tax-exempt

bond generally is required to be tested for whether it causes a significant modification under §1.1001-3.

SECTION 7. Examples

The following examples illustrate the application of certain principles in this Notice and §1.1001-3 as they apply to tax-exempt bonds for purposes of this Notice.

Example 1. Insignificant Change in Credit Enhancement and Impact on Floating Interest Rate. On July 1, 2007, a municipality (the "Issuer") issued $1 million in tax-exempt bonds that bear interest at an auction interest rate and that mature in 40 years (the "Bonds"). The Bonds are recourse obligations that are secured by the issuer's underlying primary A-rated investment grade credit. The Bonds are secured further by credit enhancement under a bond insurance policy provided by a AAA-rated bond insurer. Pursuant to the terms of the Bonds, the auction interest rate on the Bonds resets every 7 days. The terms of the Bonds grant the issuer the option to convert the interest rate mode on the Bonds from an auction rate mode to either a 7-day tender option rate mode or to a long-term fixed interest rate to maturity, subject to a mandatory tender of the Bonds upon such a conversion. The Bonds are qualified tender bonds under §3.2 of this Notice.

On January 3, 2008, the auction interest rate on the Bonds is set at 10% as a consequence of a downgrade in the bond insurer's credit rating from a AAA rating to a AA rating and associated market disruption. On January 10, 2008, the issuer amended the terms of the Bonds to replace the now AA-rated bond insurance with a AAA-rated bank letter of credit as credit enhancement, but otherwise made no other changes to the terms of the Bonds. On January 10, 2008, the auction rate on the Bonds floated down to 3% primarily as a result of the change in credit enhancement on the Bonds.

The amendment to the terms of the Bonds to change the credit enhancement is a modification to a recourse debt instrument that must be tested for significance under the change in security or credit enhancement rule in §1.1001-3(e)(4)(iv). Because the change in security or credit enhancement did not cause a change in payment expectations on the Bonds (i.e., the Bonds had an investment grade payment expectation before and after the change in credit enhancement), this change in credit enhancement is not a significant modification of the Bonds under §1.1001-3 and thus does not cause a reissuance of the Bonds under §103 and §§141 through 150. Further, the fact that the market impact of the change in credit enhancement caused the floating interest rate on the Bonds to float down from 10% to 3% is not required to be tested under the 25-basis point change in yield rule for significant modifications under §1.1001-3(e)(2) because the Issuer has made no change to the interest rate-setting mechanism under the terms of the Bonds.

Example 2. Exchange of Bonds to Remove Bond Insurance.

Assume the same facts as in Example 1 above, except that, instead of amending the terms of the existing Bonds (the "Old Bonds") to change the credit enhancement, on January 10, 2008, the Issuer issued new bonds with new Cusip numbers (the "New Bonds") and did an actual exchange of the New Bonds for the Old Bonds. The New Bonds are not backed by any bond insurance or other credit enhancement. The New Bonds without the bond insurance have an A credit rating. There are no other differences between the New Bonds and the Old Bonds. The result would be the same as in Example 1 and no reissuance of the Bonds would occur. Section 1.1001-3 applies the same significant modification standard to amendments to the terms of an existing debt instrument and to actual exchanges of an existing debt instruments for a different debt instrument.

Example 3. Impact of Authorized Changes in Interest Rate Modes and Associated Mandatory Tenders and Effect of Serialization.

(i) Assume the same facts as in Example 1 above, except that, on January 10, 2008, the Issuer also exercised its option under the terms of the Bonds to convert the interest rate mode on the Bonds from an auction rate mode to a fixed interest rate of 5% for the remaining term of the Bonds. The terms of the Bonds also required a mandatory tender and remarketing of the Bonds in connection with this interest rate mode change. The mandatory tender is a qualified tender right and the change in the interest rate mode is a qualified interest rate mode change. Thus, the Bonds are qualified tender bonds, as defined in §3.2 of the Notice, the conversion of the interest rate on the Bonds from an auction rate mode to a fixed interest rate is pursuant to a qualified interest rate mode change" and the associated tender is a qualified tender right, all as defined in §3.2 of the Notice. Thus, under §3.1 of the Notice, in determining whether the Bonds are reissued for purposes of the tax-exempt bond provisions of the Code, the qualified interest rate mode change and the qualified tender right are not treated as modifications under §1.1001-3. Furthermore, the interest rate change on the Bonds from a floating auction rate of 10% to a fixed interest rate of 5% directly resulted from the qualified interest rate mode change and, under §3.1 of the Notice, also is not treated as a modification under §1.1001-3. Finally, as in Example 1, no reissuance of the Bonds occurred for purposes of §103 and §§141 through 150 as a result of the change in credit enhancement.

(ii) Assume the same facts as paragraph (i) above except that the Issuer also amended the terms of the Bonds to modify a term Bond which had a prescribed mandatory sinking fund redemption schedule with alternative Bonds with "serial" maturities instead of the sinking fund redemption schedule. This "serialization" of the term Bond does not directly result from the qualified interest rate mode change. Subject to the particular terms of the Bonds, the serialization of the term Bond generally would be a modification under §1.1001-3 which would be required to be analyzed for significance under the change in yield rule in §1.1001-3(e)(2) and the change in the timing of payments rule in §1.1001-3(e)(3).

Example 4. Impact of Unauthorized Changes. Assume the same facts as in Example 1, except that the terms of the Bonds do not provide for any conversions of the interest rate modes. On January 7, 2008, Issuer amends the Bond documents to allow

the Issuer to convert the interest rate mode on the Bonds from an auction rate mode to either a 7-day tender option rate mode or to a long-term fixed interest rate to maturity, subject to a mandatory tender of the Bonds upon such a conversion. On January 10, 2008, Issuer exercised its option under the amended terms of the Bonds to convert the interest rate mode on the Bonds from an auction rate mode to a fixed interest rate of 5% for the remaining term of the Bonds. The Issuer also required a mandatory tender and remarketing of the Bonds in connection with this interest rate mode change. Because the change in interest rate mode is not pursuant to the terms of the Bonds when originally issued, it is not a qualified interest rate mode change within the meaning of this Notice. Similarly, the tender of the Bonds on January 10, 2008 was not pursuant to the terms of the Bond as originally issued and therefore was not a qualified tender right within the meaning of this Notice. Accordingly, the provisions of this Notice are not applicable either to the interest rate mode change on the Bonds or to the tender of the Bonds. Thus, to determine whether these modifications cause a reissuance or retirement of the Bonds for purposes of §103 and §§141 through 150, the impact of these modifications must be analyzed under §1.1001-3 to determine whether a significant modification of the terms of the Bonds occurred.

Example 5. Operation of the 180-Day Temporary Rule for Qualified Tender Rights.

(i) On July 1, 2007, a municipality (the "Issuer") issued $1 million in tax-exempt bonds that bear interest initially at a variable rate demand rate and that mature in 40 years (the "Bonds"). The interest rate on the Bonds resets every 7 days at the minimum interest rate necessary to remarket the Bonds at par. The Bonds have seven-day tender options exercisable by the holders while the Bonds are in the variable rate demand interest rate mode. The Bonds give the Issuer an option to convert the interest rate on the Bonds to other interest rate modes. The Bonds have a mandatory tender requirement upon an interest rate mode conversion. The Bonds are secured by a third-party liquidity facility in the form of a letter of credit (the "Liquidity Facility") from a bank (the "Bank"). The Bonds are further secured by a third-party guarantee in the form of a bond insurance policy from a bond insurer (the "Bond Insurer"). An investment bank serves as a remarketing agent ("Remarketing Agent") for the Issuer with respect to the Bonds. The terms of the remarketing arrangement require the Remarketing Agent to use at least its best efforts to remarket tendered Bonds. On May 1, 2008, the Issuer exercises its option to convert the interest rate on the Bonds to a fixed interest rate to maturity and the Bonds are subject to mandatory tender by the Bondholders. The Bonds are qualified tender bonds which have a qualified tender right and a qualified interest rate mode change within the meaning of §3.2 of this Notice. During the 180-day period after the date of purchase of the bonds pursuant to the qualified tender right, as a result of difficult market conditions and despite best efforts required pursuant to the terms of the Bonds, the Issuer and the Remarketing Agent are unsuccessful in remarketing the Bonds. The particular terms of the Liquidity Facility require that the qualified tender right be funded by the Bank under the Liquidity Facility, but that the Bank not hold the Bonds upon a draw on the Liquidity Facility. Instead, the Bank merely receives a pledge of the Bonds as collateral for the draw on the Liquidity Facility and the Issuer holds the Bonds upon a draw on the Liquidity Facility. During this 180-day

period, the Bonds are treated as outstanding under the operating rules for qualified tender rights in §3.2(3)(b) even if the Bonds are held by or on behalf of the Issuer. Thus, during this 180-day period, the Issuer may hold the Bonds under the terms of the Bonds without causing a retirement of the Bonds. In addition, recognizing that the Bonds are treated as outstanding during this 180-day period, the Issuer may refund the Bonds with proceeds from refunding bonds during this period or resell the bonds to a third party.

(ii) Assume the same facts as in paragraph (i), but further assume that the Issuer retains the Bonds beyond the 180-day permitted holding period for a governmental issuer under §3.2(3)(b) of this Notice. The Bonds are treated as retired as the end of the 180th day from and after the date of the purchase of the Bonds pursuant to the exercise of the qualified tender right. Thus, the count of the 180-day permitted holding period for the Issuer starts on the date of the purchase pursuant to the qualified tender right (here, starting May 1, 2008) and ends at the end of the 180th day from and after the date of purchase (here, ending at the end of the day on October 27, 2008).

(iii) Assume the same facts as in paragraph (i), but further assume that the terms of the Liquidity Facility provide that the Bank will hold the Bonds upon a draw on the Liquidity Facility, rather than merely receive a pledge of the Bonds as collateral while the Issuer or its agent holds the Bonds. Here, since a third-party liquidity facility provider is not treated as a purchaser by or on behalf of a governmental issuer under the general rules in §3.1 of this Notice, the Bank may hold the Bonds during and beyond the 180-day period after the date of the purchase pursuant to the qualified tender right without causing a retirement of the Bonds.

(iv) Assume the same facts as in paragraph (i), but further assume that the Issuer holds the Bonds for 179 days after purchase of the Bonds pursuant to the exercise of a qualified tender right while using best efforts under the terms of the Bonds to remarket the bond, and then sells the Bonds to the Bank pursuant to the Liquidity Facility. This transaction complies with the operating rules for qualified tender rights in §3.2(3)(b) of this Notice and does not result in a retirement of the Bonds.

SECTION 8. Interim Guidance and Reliance

The effective date of this Notice is March 25, 2008. This Notice provides interim guidance. Issuers of tax-exempt bonds may apply and rely on this Notice for any actions taken with respect to tax-exempt bonds on or after November 1, 2007 and before the effective date of any future regulation under §150 that implement the guidance with respect to any particular applicable provision in this Notice or other public guidance that withdraws or supersedes any particular applicable provision in this Notice. Issuers also may continue to rely on Notice 88-130 until the effective date of such future

regulations. Notice 2008-27 is superseded and may not be relied upon after the effective date of this Notice. The IRS and the Treasury Department may amend or supplement the guidance in this Notice as circumstances warrant.

SECTION 9. Request for Comments

Before any notice of proposed rulemaking is issued with respect to the guidance provided in this Notice, consideration will be given to any written public comments on this Notice that are submitted timely by May 19, 2008, and a signed original and eight (8) copies) of such comments should be sent to the IRS. Send submissions to: CC:PA:LPD:PR (NOT-), room 5203, IRS, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be sent electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-118788-06). All comments will be available for public inspection and copying.

SECTION 10. Drafting Information

The principal author of this Notice is Aviva M. Roth, Office of the Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in its development. For further information regarding this Notice, contact Aviva M. Roth at (202) 622-3980 (not a toll-free call).