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Tax and Securities Law Update 2019

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SECURITIES LAW UPDATES

Presented by

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SECURITIES LAW UPDATES

RULE 15c2-12 AMENDMENTS:

- I. BACKGROUND
- II. TEXT OF AMENDMENTS
- III. APPLICABILITY OF AMENDMENTS
- IV. PRACTICAL CONSIDERATIONS

RULE 15C2-12 AMENDMENTS

I. BACKGROUND

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- Adopted: August 20, 2018
- Effective Date: February 27, 2019

RULE 15C2-12 AMENDMENTS

II. TEXT OF AMENDMENTS

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“(5)(i) A Participating Underwriter shall not purchase or sell municipal securities in connection with an Offering unless the Participating Underwriter has ***reasonably determined*** that ***an issuer*** of municipal securities, ***or an obligated person*** for whom financial or operating data is presented in the final official statement ***has undertaken***, either individually or in combination with other issuers of such municipal securities or obligated persons, in a written agreement or contract for the benefit of holders of such securities, ***to provide*** the following ***to the Municipal Securities Rulemaking Board. . .***

* *

*

“(C) In a timely manner not in excess of ten business days after the occurrence of the event, notice of any of the following events ***with respect to the securities being offered in the Offering:***”

II. TEXT OF THE AMENDMENTS

“(15) **Incurrence** of a **financial obligation** of the obligated person, if **material**, or **agreement to covenants, events of default, remedies, priority rights, or other similar terms** of a financial obligation of the obligated person, any of which **affect security holders**, if **material**; and

“(16) **Default**, event of acceleration, termination event, **modification of terms**, or other **similar events** under the terms of a financial obligation of the obligated person, any of which **reflect financial difficulties**;”

II. TEXT OF THE AMENDMENTS - “FINANCIAL OBLIGATION”

“(11)(i) The term **financial obligation** means a:

“(A) **Debt obligation**;

“(B) **Derivative instrument** entered into **in connection with**, or **pledged as security** or a source of payment for, an existing or planned debt obligation;
or

“(C) **Guarantee** of paragraph (f)(11)(i)(A) or (B).

“(ii) The term *financial obligation* shall not include **municipal securities** as to which a **final official statement** has been provided to the Municipal Securities Rulemaking Board **consistent with this rule.**”

RULE 15C2-12 AMENDMENTS

III. APPLICABILITY OF AMENDMENTS

III. APPLICABILITY OF AMENDMENTS – DEBT OBLIGATIONS

1. Release Guidance.

- a. Ordinary Course Exception:** “[D]oes not include ordinary financial and operating liabilities incurred in the normal course of . . . business, only . . . debt, debt-like, and debt-related obligations.”
- b. Debt-like Leases:** Includes “lease arrangements . . . that operate as vehicles to borrow money”, e.g., “lease-revenue” and “certificates of participation” transactions, but not other leases.
- c. State Law Not Limiting:** Not limited to “debt” as defined under state law, but applies more broadly to when an issuer has effectively borrowed money.
- d. Duration Ignored:** Includes both short- and long-term obligations.

III. APPLICABILITY OF AMENDMENTS – LEASES

In evaluating *whether a lease operates as a vehicle to borrow money*,

“[t]he fundamental question that an issuer or obligated person needs to ask is, does the lease represent a borrowing, or as stated in the Adopting Release, is the issuer obligated to repay borrowed money under the terms of the lease?”

III. APPLICABILITY OF AMENDMENTS – LEASES

To elaborate, the Staff has presented the following contrasting examples:

(i) a lease between a police department for a fleet of police cruisers from a car dealership, pursuant to which a police department makes fixed monthly payments for the right to possess and use the vehicles, with or without the right to purchase at the end of the lease, **is not a lease** that operates as a vehicle to borrow money.

III. APPLICABILITY OF AMENDMENTS – LEASES

(ii) a lease financing corporation purchases the vehicles from the dealership with money borrowed by the police department and then leases the vehicles to the police department, with the payments under the lease going towards repaying the borrowed money and title for the vehicles passing to the police department at the end of the lease would be a lease that operates as a vehicle to borrow money.

RULE 15C2-12 AMENDMENTS

IV. PRACTICAL CONSIDERATIONS

WHEN IS A FINANCIAL OBLIGATION INCURRED?

1. Release Guidance:

- a. **In General:** A financial obligation “generally should be considered to be incurred *when it is enforceable against an issuer or obligated person.*”
- b. **Conditions:** Consistent with Form 8-K, Item 2.03, where there is no duty to disclose an agreement until it is enforceable against the registrant, “*whether or not subject to conditions.*”
- c. **Drawdown Bonds:** If an issuer enters into an agreement for a material drawdown bond, it “generally should provide notice at the time the terms of the obligation are legally enforceable against the issuer . . . , *instead of each time a draw is made.*”

“MATERIAL” OBLIGATIONS AND TERMS

1. Release Guidance.

- a. In General:** In the amendments, “material” has its meaning in the antifraud provisions, i.e., whether the event “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information available.”
- b. Considerations:** In determining whether an obligation is material, “it may be appropriate for issuers and obligated persons to consider. . . the source of security pledged for repayment of the financial obligation, . . . the rights associated with such a pledge (e.g., senior versus subordinate), par amount or notional amount . . ., covenants, events of default, remedies, or other similar terms that affect security holders.”

“MATERIAL” OBLIGATIONS AND TERMS (CONT’D)

- c. **Materiality Guidelines:** “Forms . . . that the industry may develop . . . could . . . assist issuers . . . in evaluating which financial obligations should be disclosed.”
- d. **Integration:** “[I]f the issuer or obligated person enters into a series of transactions that, though related, are incurred at different points in time *for legitimate business purposes* . . . the issuer or obligated person would need to assess the materiality of each transaction at the time it was incurred.” Separation of “issues” for federal income tax purposes is a legitimate business purpose.

EVENTS THAT “REFLECT FINANCIAL DIFFICULTIES”

1. **“Default”**: Includes non-payment defaults, even if not events of default.
2. **“Modification of Terms”**: Includes written or oral waivers.
3. **“Other Similar Events”**: Include “events arising under the terms of a financial obligation that similarly reflect financial difficulties” and “share similar characteristics with one of the preceding listed events.”
4. **Pre-CDA Debt**: Events under pre-CDA obligations are reportable.
5. **“Reflect Financial Difficulties”**: The term is not defined, but the reportable events “are *significant* in nature,” so issuers “should be aware that they have occurred.”

POST-INCURRENCE AMENDMENTS

1. **Notice Required?** Must notice of a post-incurrence amendment be given if it is material but does not reflect financial difficulties?
2. **Interpretive Questions.** If material amendments must be reported:
 - a. **Elections:** Would an issuer's election to exercise an option to change terms (e.g., a mode change) be an "agreement" to the new terms?
 - b. **Remarketings:** If bonds are remarketed to new owners as a condition to the change, would the election and remarketing evidence a constructive "agreement"? The incurrence of a financial obligation?
 - c. **Primary Offering:** Does the answer depend on whether the remarketing is a primary offering?

REQUIRED CONTENT AND FORM OF NOTICES

1. **Content:** Notices of financial obligations “generally should include a description of the material terms of the financial obligation.”
2. **Material Terms:** “Examples of some material terms may be the *date* of incurrence, *principal* amount, *maturity* and *amortization*, interest *rate*, if fixed, or method of computation, if variable (and any default rates); other terms may be appropriate as well, depending on the circumstances.”

REQUIRED CONTENT AND FORM OF NOTICES (CONT'D)

- 4. Form:** Issuers may “either submit a description of the material terms of the financial obligation, or alternatively, or in addition, submit related materials, such as transaction documents, term sheets . . . or financial covenant report.
- 5. Redactions:** Notices need not provide “confidential information such as contact information, account numbers, or other personally identifiable information.”



Thank you

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TAX LAW UPDATES

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Federal Tax Update

- Federal Tax Law Overview
 - Member benefit available on AGLF website
- Updated as of Fall 2018
 - Regularly updated in recent years
- Significant Changes
 - Reduction in maximum corporate tax rate
 - Prohibition on advance refunding*

IRS Update

- Old tax-exempt bond group has been merged into Indian Tribal Government Group
 - What does this mean for you?
- Attempting to do more with less
 - Surveying more bond issues through audits
 - Selection - trying to be more sophisticated
 - Typically focused on single issue

IRS Update

- FY 2019 Audit Focus Areas
 - Public Safety Debt
 - Federal government & mgmt. contract use of financed assets
 - Series 8038 Forms
 - Looking for indicators of non-compliance
 - Costs of Issuance
 - 2% limitation for private activity debt
 - Notice of defeasance provided to IRS
 - Remedial actions (typically excessive private use)

Public Hearing and Approval (TEFRA Hearing)

- New Final Regulations
- Public Approval on or after April 1, 2019
- Private Activity Bonds



APRIL 2019

SUN	MON	TUE	WED	THU	FRI	SAT
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30				

Download & Print Free Calendars From www.wiki-calendar.com

Public Approval Requirements

- Published Public Notice

Timing

- Old Regs:



- New Regs:



Public Approval Requirements

- Published Public Notice



Website posting, newspaper publication, radio or television broadcast, alternative state law public notice procedure

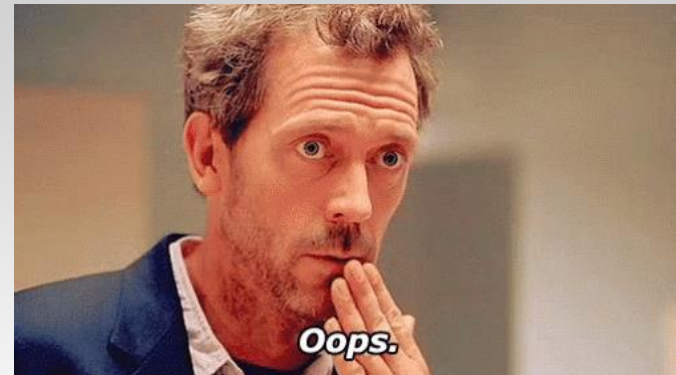
Public Approval Requirements

- Contents of Public Notice
 - Max amount of bonds to be issued for the project
 - Multiple projects – must specify max principal amount for each project separately!!



Public Approval Requirements

- Mistake?????
- “Insubstantial Deviation”
 - Size of bond issues is no more than 10% greater than max principal amount or any amount less
 - Change in initial legal owner or principal user – ok if related parties on the issue date



Public Approval Requirements

- Mistake?????
- What if not insubstantial
- New ability to cure
- Must be done **BEFORE** change
 - Practical problem
- Supplemental Public Approval



Energy Performance Contract

- Scope of work with cost allocation
- Allocations often among type of improvements
- Improvements often scattered among sites and buildings
- Federal Tax – Private Business Use analysis
 - How are improved buildings used?
 - If private use, allocation of cost among buildings?

Volunteer Fire Departments

- General Rule: For interest to be tax-exempt
 - Issuer must be a state or local government
- Narrow Exception to General Rule
 - Qualified Volunteer Fire Departments



Requirements: Volunteer Fire

Dept.

- ✓ Organized & operated to provide firefighting or EMS Services
- ✓ Services provided in area not provided with any other firefighting services*
- ✓ Written agreement with political subdivision
- ✓ Public hearing and approval process (TEFRA)

Requirements: Volunteer Fire

Dept.

- Use of proceeds
 - 95% or more of net proceeds must be used for a firehouse or fire truck
 - Specific prohibition on financing
 - Emergency medical services (EMS)
 - Rescue vehicles
 - Portion of firehouse allocable to storing EMS or rescue vehicles

Structuring Options – Volunteer Fire Department Bonds

- Volunteer Fire Department Bond
 - Benefits:
 - Direct financing with VFD – no conduit structure
 - Streamlines financing process and cost
 - Challenges:
 - Other firefighting services available?
 - Written agreement with political subdivision?
 - Desire to finance EMS assets?

Structuring Options – Volunteer Fire Department Bonds

- Governmental Bond
 - Benefits:
 - No restrictions on type of assets financed
 - EMS or related assets that may not qualify under VFD
 - No public hearing and approval process (TEFRA)
 - Challenges:
 - Involvement of political subdivision in financing
 - Is VFD use private use of financed asset?

Structuring Options – Volunteer Fire Department Bonds

- 501(c)(3) Bond

- Benefits:

- No restrictions on type of assets financed
 - EMS or related assets that may not qualify under VFD

- Challenges:

- Involvement of conduit issuer
 - Financing process and costs
- Costs of issuance limitation (2%)
- Form 990, Schedule K reporting

Friendly Reminder – Hedge Bond Rule

- Purpose: prevent early or imprudent issuance
- Violation results in taxable debt & inability to refund tax-exempt
- Investment return is *IRRELEVANT*
- Primary test:
 - Qualify for 3-year capital project temporary period; and
 - Limit on guaranteed investments (4 years)



Thank you

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