

# Client Alert

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## Issue Price Regulations

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Final issue price regulations (“**Final Regulations**”) were published in the Federal Register on December 9, 2016. The definition of “issue price” applies to bonds sold on or after June 7, 2017.

### Prior Regulations.

Previously, Treasury Regulations §148-1(b) defined issue price to be as determined under §§1273 and 1274, the original issue discount and debt-for-property rules of the Internal Revenue Code of 1986, as amended (the “Code”). Treasury Regulation §148-1(b) went on to state that, generally, for publicly offered bonds, the issue price was the first price at which a substantial amount of the bonds was sold to the public. A “substantial amount” was specified to be 10%. The public did not include bond houses, brokers or similar persons or organizations acting in the capacity of underwriters or wholesalers. The issue price of bonds not substantially identical was determined separately. The issue price of bonds offered in a bona fide public offering was determined as of the sale date based on reasonable expectations regarding the initial public offering price. For bonds issued for property, the applicable Federal tax-exempt rate was used in determining the issue price under the debt for property rules of Code §1274. The issue price of bonds could not exceed their fair market value as of the sale date.

### Final Regulations.

The Final Regulations retain the general definition of “issue price” of Code §§1273 and 1274. However, the Final Regulations make a distinction between publicly offered and private placements and incorporate several other changes to the definition, as follows:

#### *Bonds issued for money.*

The Final Regulations state that the issue price of bonds issued for money is the first price at which a substantial amount of bonds is sold to the public. 10% is still a “substantial amount.” The “public” is an individual, trust, estate, partnership, association, company or

corporation other than an underwriter or related party to an underwriter. The Final Regulations define “underwriter” to mean (i) any person that agrees pursuant to a written contract with the issuer or lead underwriter in an underwriting syndicate to participate in the initial sale of the bonds to the public, and (ii) any person that contractually agrees with the person described in clause (i) to participate in the initial sale of the bonds to the public (for example a retail distribution agreement between a national lead underwriter and a regional firm).

If a bond is issued in a private placement to a single buyer who is not an underwriter or related party to an underwriter, the issue price is the price paid by that buyer.

Issue price is not reduced by costs of issuance.

The foregoing changes the current industry standard from one of “reasonable expectations” as of the sales date to actual sales. In addition, the Final Regulations introduce a special rule for the use of an initial offering price to the public, a special rule for competitive sales, and an option for choosing the rule for determining the issue price.

#### *Special rule for use of initial offering price to the public.*

The Final Regulations provide that the issuer may treat the initial offering price to the public as of the sale date as the issue price of the bonds provided:

- (A) The underwriters offered the bonds to the public at a specified initial offering price on or before the sale date and the lead underwriter in the underwriting syndicate or selling group (or, if applicable, the sole underwriter) certifies to the same to the issuer and attaches supporting documentation such as a copy of the pricing wire or an equivalent communication; and

(B) Each underwriter agrees in writing that it will neither offer nor sell the bonds to any person at a price higher than the initial offering price to the public during the period beginning on the sale date and ending on the earlier of (i) the close of the 5th business day after the sale date, or (ii) the date on which the underwriters have sold a substantial amount of the bonds to the public at a price no higher than the initial offering price to the public.

*Special rule for competitive sales.*

For bonds issued for money in a competitive sale, the Final Regulations permit an issuer to treat the reasonably expected initial offering price to the public as of the sale date as the issue price of the bonds if the issuer obtains from the winning bidder a certification of the bonds' reasonably expected initial offering price to the public as of the sale date upon which the price in the winning bid is based. Note that the Final Regulations define competitive sales to require (i) the dissemination of a notice of sale to potential underwriters in a manner that is regularly used and widely available to potential underwriters, (ii) all bidders have an equal opportunity to bid and no one is provided a last look at other bids before bidding, (iii) the issuer receives bids from at least three underwriters established in the industry, and (iv) the issuer awards the sale to the bidder that submits a firm offer to purchase the bonds at the highest price (or lowest interest cost).

*Choice of rule for determining issue price.*

If more than one rule is available for determining the issue price of bonds, at any time before the issue date, an issuer may select the rule it will use. The issuer must identify the rule selected in its books and records maintained for the bonds.

*Separate determinations.*

The Final Regulations provide that the issue price of bonds in an issue that do not have the same credit and payment terms is determined separately. The issuer does not need to apply the same rule to determine the issue price for all of the bonds in the issue.

*Bonds issued for property.*

If a bond is issued for property, the adjusted applicable Federal rate is used in lieu of the applicable Federal rate to determine issue price.

*Additional considerations.*

The preamble to the Final Regulations notes that issuers must use a due diligence standard in its reliance on the certifications of underwriters. Correspondingly, a false statement by an underwriter in its certifications may result in the imposition of a penalty.