BDA Bond Dealers of America

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**Statement of the Bond Dealers of America**
**IRS Public Hearing**
**RE: (REG—129067) Definition of Political Subdivision**

Good morning. I am John Vahey, Director of Federal Policy for the Bond Dealers of America. The BDA appreciates the opportunity to testify at this public hearing on the proposed amendments to the definition of 'political subdivision' for the purposes of issuing tax-exempt bonds and appreciates the efforts of the IRS in holding this hearing.

The BDA is the only DC-based association representing the interests of middle-market securities dealers and banks focused on the U.S. fixed- income markets, including tax-exempt municipal bonds.

The proposed definition of political subdivision amends decades of legal, regulatory, and legislative precedent that has allowed political subdivisions to issue tax-exempt bonds if certain criteria are met. In the view of BDA members, the proposal does not achieve the stated goals of clarifying the definition of 'political subdivision' and would not provide certainty for the marketplace.

BDA recognizes that this is a complex policy area and that crafting a rule that strikes the appropriate balance between protecting the tax exemption from abuse while also allowing

beneficial public projects to continue to appropriately access the tax-exempt bond market is a challenge. However, as drafted, we do not believe the proposed rule strikes the proper balance. Therefore, the BDA has urged the IRS to withdraw and re-propose the rule and is committed to working with the IRS to improve the rule. To that end, we have offered some specific recommendations.

BDA understands the belief that it is reasonable to require political subdivisions to not only possess sovereign powers, but to have a public purpose and be subject to a sufficient level of control by a governmental entity. However, in our view, the proposal demonstrates that these concepts are difficult to implement in a practical, non-disruptive manner. The IRS should take a more limited and targeted approach to address its concerns because the proposed regulations would be unnecessarily restrictive, would cause a disruption in the ability of many communities to finance valuable public infrastructure projects in the tax-exempt market—thus raising the cost of infrastructure projects.

**BDA members have significant concerns regarding the Public Purpose Test**

The proposed public purpose definition introduces a level of subjectivity that would threaten the economic viability of development projects and inject a significant level of uncertainty for market participants.

The proposal goes far beyond the broadly defined "public purposes" that have been sufficient in the past, both in the political subdivision context and elsewhere under the Internal Revenue Code and regulations. We believe it should be sufficient to require that an entity carries out a public purpose.

The terms "significant public benefit" and "incidental private benefit" are undefined in the regulation. And the BDA believes that the uncertainty introduced by those terms alone would cause a disruption in the ability of political subdivisions established by state and local governments to issue tax-exempt bonds. There is little existing tax law guidance for governmental entities to rely on to determine whether they are providing a significant public benefit or to analyze the many different ways in which governmental entities do, in fact, assist private entities whether with tax-exempt bonds or otherwise. Most governmental entities have as part of their mandate, providing different types of assistance to non-governmental persons. It is our belief that the IRS does not intend to limit this type of governmental function.

Clearly, the IRS is particularly concerned with community developer districts. The challenge for these districts is that, assuming that a district can satisfy the governmental control test, the entity must still satisfy the proposed governmental purpose test. It is BDA's belief that the language of the proposed public purpose section would negatively impact developer districts.

For example, it is unclear if the increase in the value of land that takes place when the initial land development is complete will trigger a private benefit that will be considered by the IRS to be greater than 'incidental'. This is a significant question that the proposed rule raises.

**Therefore, the BDA has offered a few recommendations with respect to developer districts.**

BDA suggests that the IRS amend the language of the proposed rule to better reflect the economic realities of community developer districts. BDA views reasonable benefits accruing to private individuals to be part of the incentive structure that allows public projects to be developed across the United States—to the benefit of the public.

Therefore, a more targeted regulation focused on new development districts (and other specific areas of concern) should be adopted. With respect to new districts, we suggest the adoption of a safe harbor under which such a district is treated as a political subdivision if the following three requirements are satisfied:

1. It is reasonably expected by the governmental entity that created the district that the district would not be controlled by a small number of voters within a reasonable period (e.g., five years).
2. The governmental entity creating the district approves the district and its

purposes with some specificity and including approving the geographic boundaries and scope of the improvements to be financed, and

3. The district is created to finance/serve an essential governmental function and is provided with one or more sovereign powers. The requirements related to the expectations of the governmental entity creating the district would have to be reasonably based on that entity's independent determination or the analysis of a third party that is independent of the developer associated with the district.

**With respect to the Governmental Control requirements of the proposed amendments.**

BDA's view is that the proposed governmental control requirements represent a "one-size-fits-all" federal approach that is not workable given the variety of structures employed by governmental entities.

The likely result of this approach is a reduction in the level of tax-exempt bond issuance far beyond the level that is necessary for protecting against abuse of the federal tax exemption.

Instead, the BDA recommends that the IRS draft rules to address the type of entity analyzed in the 2013 Technical Advice Memorandum without attempting to rewrite rules that have been workable for decades for the vast majority of tax-exempt bond issuers.

If certain structures allow for excessive private control it would be a better result for the IRS to draft narrowly tailored rules to address those issuances rather than upending the market in all fifty states with a federal approach that does not adequately acknowledge the value of the structures set up by different states.

**Conclusion**

In conclusion, BDA believes the IRS has not struck the right balance between ensuring that beneficial projects continue to be developed and the protection of the tax exemption from abuse and is committed to working with the IRS to amend the proposal.

Thank you. And I am happy to take your questions.