

cost to the extent that the present value of the commission, as of the date the contract is allocated to the issue, does not exceed the lesser of (x) a reasonable amount within the meaning of § 1.148-5(e)(2)(i) or (y) the present value of annual payments equal to .05 percent of the weighted average amount reasonably expected to be invested each year of the term of the contract. Present value is computed using the taxable discount rate used by the parties to compute the commission, or if not readily ascertainable, the yield to the issuer on the investment contract or other reasonable taxable discount rate.

C. Special Rule for Yield Restricted Defeasance Escrows

Section 1.148-5(e)(2)(iv) of the existing regulations provides that, for investments purchased for a yield restricted defeasance escrow, a fee paid to a bidding agent is a qualified administrative cost only if the fee is comparable to a fee that would be charged for a reasonably comparable investment if acquired with a source of funds other than gross proceeds of tax-exempt bonds, and it is reasonable. The fee is deemed to meet both the comparability and reasonableness requirements if it does not exceed the lesser of \$10,000 or .1 percent of the initial principal amount of investments deposited in the yield restricted defeasance escrow.

II. Proposed Regulations

The proposed regulations were issued in response to comments stating that issuers were having difficulty applying § 1.148-5(e)(2)(iii) and (iv), primarily because of uncertainty about whether a particular broker's commission or similar fee is reasonable. The proposed regulations delete the existing provisions of § 1.148-5(e)(2)(iii) and (iv) and create a single rule for qualified administrative costs that treats a broker's commission or similar fee incurred in connection with a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow as a qualified administrative cost if the fee is reasonable within the meaning of § 1.148-5(e)(2)(i) of the existing regulations.

The proposed regulations also set forth a safe harbor, which treats a broker's commission or similar fee incurred in connection with the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow as reasonable within the meaning of § 1.148-5(e)(2)(i) if two requirements are met. Under the first requirement for the

safe harbor, the amount of the broker's commission or similar fee treated by the issuer as a qualified administrative cost cannot exceed the lesser of \$25,000 or 0.2 percent of the computational base (the per-investment safe harbor). For guaranteed investment contracts, the computational base is the aggregate amount reasonably expected as of the issue date to be deposited over the term of the contract. For example, for a guaranteed investment contract used to earn a return on what otherwise would be idle cash balances from maturing investments in a yield restricted defeasance escrow, the aggregate amount reasonably expected to be deposited includes all periodic deposits reasonably expected to be made pursuant to the terms of the contract. For investments, other than guaranteed investment contracts, deposited in a yield restricted defeasance escrow, the computational base is the initial amount invested in those investments. Under the second requirement for the safe harbor, for any issue of bonds, the issuer cannot treat as qualified administrative costs more than \$75,000 in brokers' commissions or similar fees with respect to all guaranteed investment contracts and investments for yield restricted defeasance escrows purchased with gross proceeds of the issue (the per-issue safe harbor).

III. Final Regulations

A. Safe Harbor Approach

Some commentators suggested that the existing regulations, coupled with competitive market forces, work well to produce reasonable brokers' fees. Commentators also suggested that the proposed regulations will eliminate much of the incentive for the independent bidding agent to actively participate in the market, with the result that, in many cases, tax-exempt bond proceeds will be placed in lower-yielding and often riskier investments. These commentators recommended against adopting the safe harbor in the proposed regulations.

Other commentators suggested that the existing regulations do not work well. They stated that the current rules provide little practical guidance upon which an issuer can rely to determine whether a broker's fee for a guaranteed investment contract is a reasonable amount. These commentators recommended that the safe harbor be adopted with modifications. They suggested that the safe harbor will provide a much needed level of certainty.

The IRS and Treasury Department do not believe the final regulations will

result in tax-exempt bond proceeds being invested in low-yielding, risky investments because the regulations do not adversely affect an issuer's incentive to realize investment earnings and to invest in secure investments. To provide simplicity and certainty, the final regulations retain the safe harbor, with certain modifications discussed below. The final regulations do not limit the amount of brokers' fees that may be paid by issuers. Thus, for example, the final regulations do not restrict the ability of an issuer to pay a particular fee that exceeds the safe harbor amount. Furthermore, brokers' commissions or similar fees in excess of the safe harbor are qualified administrative costs if they are reasonable within the meaning of § 1.148-5(e)(2)(i).

B. Per-Investment Safe Harbor

Commentators suggested that, if the per-investment safe harbor is retained, it should be increased. These commentators stated that in some circumstances the safe harbor does not reflect the value provided by brokers, particularly in the case of small or large transactions and long-term debt service reserve fund investments. Suggestions for modifying the per-investment safe harbor included adding a minimum fee for smaller transactions and a sliding scale for larger transactions. Commentators also suggested increasing the computational base for long-term guaranteed investment contracts by treating them as a series of shorter-term contracts.

The final regulations increase the \$25,000 amount to \$30,000 and provide for a minimum fee of \$3,000. Thus, if 0.2 percent of the computational base is less than \$3,000, the per-investment safe harbor is \$3,000. The final regulations do not adopt a sliding scale and do not treat long-term contracts as a series of shorter-term contracts because the IRS and Treasury Department have concluded that the per-investment safe harbor in the final regulations provides much needed certainty without requiring issuers to pay less than fair market value for brokers' fees.

C. Per-Issue Safe Harbor

Commentators recommended that the per-issue safe harbor be increased or eliminated. Some commentators suggested replacing the per-issue safe harbor with an anti-abuse rule to prevent the artificial creation of multiple investments when a single investment would be appropriate. Suggestions included aggregating separate investments that (1) are made at or about the same time if the bond proceeds being invested have similar