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Tax-Exempt Bonds/Political Subdivision: Municipal Water/Wastewater Organizations Joint Comments on Proposed Internal Revenue Service Rules

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Several municipal water and wastewater advocacy organizations submitted joint comments on proposed Internal Revenue Service (“IRS”) regulations addressing the definition of “political subdivision” for tax-exempt bonds. See 81 Fed. Reg. 8870 (Feb. 23, 2016) for the proposed rules.

The organizations submitting the joint comments included:

- National Association of Clean Water Agencies
- The Association of Metropolitan Water Agencies
- The National Association of Flood and Stormwater Management Agencies
- The California Association of Sanitation Agencies
- Water Environment Federation
- American Water Works Association (collectively referenced as “NACWA”)

NACWA collective comments request that the IRS redraft the aspects of the proposed rule addressing the term “political subdivision” for tax-exempt bond purposes. The proposal is described as creating a new, more restrictive, and less clear definition. The comments further state that:

... in order to ensure that our members continue to have access to funding from tax-exempt bonds, it is imperative that the Proposed Regulations be redrafted so that they preserve the existing regulations and add on nothing more than a targeted rule that abandons the broad focus on public purpose and government control and focuses narrowly on special districts that are intended to perpetuate private control and remain politically unaccountable. At the very least, we urge Treasury to modify the Proposed Regulation to allow public stormwater utilities, flood control districts, drinking water agencies and publicly owned treatment works, known as “clean water utilities” to continue to qualify as political subdivisions and maintain their current and long-standing access to tax-exempt financing even though some may be controlled by multiple governmental entities that may not possess all three of the traditional sovereign powers or have board members who are removable only for cause.

The arguments in support of their position include:

- Drinking water, clean water, and stormwater management utilities and regional flood control districts currently enjoy access to the tax-exempt financing markets, notwithstanding their varying governance structures.
- Drinking water, clean water, stormwater management and regional flood control agencies throughout the nation depend on the lower-cost financing that they obtain through the tax-exempt debt market to finance water resources infrastructure for their consumers, ratepayers and taxpayers.
- Many water systems could lose their status as political subdivisions under the Proposed Regulations and could therefore lose access to tax-exempt financing.
- Many of our members would fail to meet the public purpose requirement under the Proposed Regulations.
- Many of our members would fail to meet the governmental control requirement under the Proposed Regulations.

The NACWA comments recommend:

- The Proposed Regulations must not be finalized in their current form.
- If Treasury must make new rules in this area, it should abandon the current approach to the public purpose and control requirements, and narrowly focus the rules on the real problem that it perceives.
- Treasury should delete the “no more than incidental private benefit” provision in the public purpose requirement.
- Treasury should clarify the control test to make clear that a political subdivision can have board members appointed by any number of public entities, without any one entity exercising majority control.
- Treasury should clarify the control test to make it clear that the inability to remove board members without cause does not violate the control requirement

[The comments can be downloaded here.](#)