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New Private Activity Bonds, Expiring TEFRA Relief, and Other IRS Updates

The 2021 calendar year wrapped up with the biggest expansion of exempt facility bonds in a decade in the Infrastructure Investment and Jobs Act. This article describes those provisions and highlights other recent regulatory activity that will impact the tax-exempt bond market over the coming year.

Infrastructure Investment and Jobs Act

As of January 1, 2022, two new categories of exempt facility private activity bonds can be issued to finance qualifying projects. The new categories, qualified broadband projects and qualified carbon dioxide capture facilities, were authorized by the Infrastructure Investment and Jobs Act (IIJA), signed by President Joe Biden on November 15, 2021.

Qualified broadband project bonds can be used to finance 100/20 broadband internet access for residential and commercial locations in census block groups in which more than 50% of residential households do not have access to 25/3 broadband. Only 25% of the amount of qualified broadband project bonds issued for privately owned broadband projects is subject to volume cap restrictions, and broadband projects that are owned by a governmental unit do not require any volume cap.

Qualified carbon dioxide capture facility bonds can be used to finance eligible components of an industrial carbon dioxide facility, or a direct air capture facility. Eligible components include, generally: equipment used for the capture, treatment and purification, compression, transportation, or on-site storage of carbon dioxide, which is installed on industrial buildings that emit carbon dioxide as a result of certain industrial processes.

Eligible components also include equipment that is integral or functionally related and subordinate to a process that converts certain coal, petroleum residue, biomass, or other materials, into a synthesis gas for direct use or subsequent physical conversion. A

direct air capture facility, further defined in Section 45Q of the Internal Revenue Code of 1986 (the “Code”), is a facility using carbon capture equipment to capture carbon dioxide directly from the ambient air. Only 25% of the amount of carbon dioxide capture facility bonds is subject to volume cap restrictions.

In addition to creating these two new types of private activity bonds, IIJA also added \$15 billion to the national volume cap limitation available for qualified highway or surface freight transfer facilities private activity bonds, which may be used to finance any surface transportation projects or facilities for the transfer of freight from truck to rail or rail to truck (including temporary storage facilities directly related to such transfers) which receive Federal assistance under Title 23. The increase provides the Department of Transportation with a total of \$30 billion of volume cap to allocate for projects nationwide.

LIBOR Transition Regulations

The IRS and Department of Treasury released final regulations related to the transition away from LIBOR, which were published in the Federal Register on January 4, 2022. The regulations, which go into effect on March 7, describe “covered modifications” necessary to change the interest rate from LIBOR to another rate that will not be treated as a reissuance, and provides specific examples of other modifications that would *not* be covered modifications. Noncovered modifications will not benefit from the special treatment afforded to covered modifications and would need to be tested under the rules of Section 1001 of the Code to determine whether the noncovered modification results in a reissuance. Importantly, the final regulations treat as covered modifications any modification made within the scope of Rev. Proc. 2020-44, issued on October 9, 2020, which creates a safe harbor for changes using fallback language recommended by the Alternative Reference Rates Committee (ARRC) and the International Swaps and Derivatives Association (ISDA).

TEFRA Hearings

The IRS's temporary relief measure permitting issuers to hold public hearings required under the Tax Equity and Fiscal Responsibility Act (TEFRA hearings) telephonically is expiring on March 31, 2022. The temporary relief provided in response to the coronavirus (COVID-19) pandemic in Rev. Proc. 2020-21 (as modified by Rev. Proc. 2020-49) was extended by Rev. Proc. 2021-39 until March 31, 2022. Issuers should be aware that the temporary period is expiring soon, and, absent another extension, should be prepared to hold in-person TEFRA hearings again beginning on April 1. The Government Finance Officers Association, the National Association of Bond Lawyers, and other national groups, requested the IRS to permit TEFRA hearings to be held telephonically on a permanent basis in a letter sent February 14. It would be a good idea to contact bond counsel towards the end of March to determine the proper TEFRA hearing format.

Compliance Strategy: Arbitrage Violations

From a compliance perspective, the IRS has identified arbitrage violations as a priority compliance strategy for fiscal year 2022. This strategy concerns potential arbitrage violations by an investment of bond proceeds in higher-yielding investments beyond the allowable temporary period. By auditing bond issues, the IRS will determine whether issuers of tax-exempt bonds have complied with arbitrage rules by determining whether the issuer had a reasonable expectation it would satisfy the 3-year temporary period, whether it did, in fact, satisfy it, and if the issuer still had unspent proceeds after three years, whether yield reduction payments were made or the invested proceeds were yield restricted.

Guidance Plan

In the 2021-2022 Guidance Plan jointly published by the IRS and Department of Treasury, the two agencies identified guidance projects that are priorities for the year. The projects specific to tax-exempt bonds include: (1) guidance related to student loan bonds under Section 144(b) of the Code; (2) regulations under Section 148 of the Code related to refunding bonds; (3) revenue procedure on the recovery of rebate under Section 148 of the Code; and (4) final

regulations on bond reissuance under Section 150 of Code related to qualified tender bonds. The proposed regulations on this topic were published on December 31, 2018.

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