

For Release at 3:00 p.m., E.D.T.,  
July 17, 1986

JOINT STATEMENT BY THE HONORABLE DAN ROSTENKOWSKI (D., ILL.),  
CHAIRMAN, COMMITTEE ON WAYS AND MEANS,  
THE HONORABLE BOB PACKWOOD (R., ORE.)  
CHAIRMAN, COMMITTEE ON FINANCE, AND  
THE HONORABLE JAMES A. BAKER, III,  
SECRETARY OF THE TREASURY

The following is a joint statement made by Chairman Dan Rostenkowski (D., Ill.), House Committee on Ways and Means, Chairman Bob Packwood (R., Ore.), Senate Committee on Finance, and Secretary of the Treasury James A. Baker, III, with respect to the effective date of a proposed requirement that certain arbitrage profits on tax-exempt bonds be rebated to the Federal Government:

On March 14, 1986, we issued a joint statement indicating our intention that certain new restrictions on tax-exempt bonds contained in tax reform legislation (H.R. 3838), as passed by the House of Representatives and the Senate, not be applied to bonds used to finance operations of State and local governments that are issued before the earlier of the date of enactment of H.R. 3838, or September 1, 1986.

As we stated in March, it is not our intent to restrict the ability of State and local governments to finance their direct governmental operations or to force States to change their existing practices governing financing of those operations while tax reform legislation is pending. As we also stated, however, we did not intend by our statement to create an atmosphere where tax-motivated issuance of bonds would occur. To that end, we instructed our staffs in that statement to monitor the tax-exempt bond market as consideration of tax reform legislation continued, and to advise us of any indications of tax-motivated bond issuance.

During the past week, Congressional and Treasury staffs have informed us of a substantial increase in volume of transactions that are motivated primarily by the ability to earn and retain arbitrage profits. These arbitrage-motivated transactions were never intended to be covered by our joint statement in March. The arbitrage-motivated transactions to which we are referring involve the funding of so-called "blind pools" with tax-exempt bonds. Issuance of tax-exempt bonds for the pools in question generally has not occurred before 1986, or has occurred in much smaller amounts than in 1986. In addition, there are few or no binding commitments as to the ultimate users of the proceeds of the bonds in question, and the bonds are being issued for longer terms than is customary for such issues.

After reviewing these transactions, we have determined that issuance of bonds for these arbitrage-motivated pools is not within the spirit of our statement of March 14, 1986. We are announcing, therefore, that the provisions of that statement relating to rebate of certain arbitrage profits are not applicable to bonds issued after 3:00, p.m., E.D.T., Thursday, July 17, 1986, for --

- (1) Pools the proceeds of which are to be used to make loans to governmental units other than subordinate governmental units within the jurisdiction of the issuer (or the jurisdiction of the governmental unit on behalf of which the issuer acts); or
- (2) Pools with respect to which --
  - (a) Less than 75 percent of the proceeds of the issue is to be used to make loans to initial borrowers to finance projects identified (with specificity) by the issuer on the date of issue as projects to be financed with the proceeds of such issue; or
  - (b) On or before the date of issue, commitments have not been entered into by such initial borrowers to borrow at least 25 percent of the proceeds of such issue.

Paragraph (2) applies only if bonds were not issued by the issuer before 1986 to fund similar pools, or, if the issuer had established a pool before 1986, the issuance in 1986 exceeds 250 percent of the average annual issuance for such pools during the period 1983 through 1985; or

- (3) Pools where the term of the bonds exceeds 30 years if the principal repayments on any loans are to be used to make or finance additional loans.

For purposes of this announcement, an issue of bonds sold to a securities firm, broker, or other person acting in the capacity of an underwriter or wholesaler is not treated as issued before such bonds have been re-offered to the public (pursuant to final offering materials) and at least 25 percent of such bonds actually have been sold to the public.

This statement is not intended to address the issue of whether interest on these bonds is tax-exempt under present law or whether such bonds qualify for temporary periods when unlimited arbitrage profits may be earned. That determination must be made on a case-by-case basis by the Treasury Department.

We believe that this limited action will permit continued access to tax-exempt financing for actual needs of States and local governments while

preventing a further rush to market of tax-motivated transactions. We are, however, instructing our staffs to continue to monitor the tax-exempt bond market as the conference committee meets and to report to us any evidence of further tax-motivated transactions.