WEIST LAW

Number 103 February 2009

PUBLIC FINANCE BULLETIN

American Recovery and Reinvestment Act Summary

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On February 17, 2009, President Barack Obama signed into law the American Recovery and Reinvestment Act of 2009 (the "Stimulus Act"), which is intended to stimulate economic growth with a mixture of increased federal spending and tax reductions.

This bulletin highlights some important Stimulus Act provisions that will affect our clients and friends. It is not comprehensive, nor does it try to address all the subjects. However, issues pertaining to the structuring and issuance of tax exempt and tax credit bonds are summarized below.

Build America Bonds

The Stimulus Act creates a new section of the Internal Revenue Code (the "Code") that governs "Build America Bonds," a new category of hybrid tax credit obligations. Under the Stimulus Act, municipal agencies are entitled to issue taxable bonds and either (i) allow their bondholders to receive a federal income tax credit or (ii) elect to receive a payment themselves from the federal government.

Build America Bonds can be issued only for those purposes for which tax-exempt governmental bonds can currently be issued, and the tax rules, such as private-use restrictions, that currently apply to tax-exempt governmental bonds also will apply to these bonds.

There are two general types of Build America Bonds. The first, or basic, form provides the bondholder with a non-refundable federal income tax credit of 35% of the interest paid on the bond in each tax year. If the bondholder lacks sufficient tax liability in any year to fully utilize that year's credit, the excess credit can be carried forward for use in future years.

The second type of Build America Bonds provides no credit to the bondholder, but instead the issuer

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receives payments from the Federal Treasury equal to 35% of the interest paid by the issuer. No more than 2% of the proceeds of this type of Build America Bond may be used to pay costs of issuance and, with this type of Build America Bond, it appears that only new money projects for capital purposes can qualify. Because the credit is paid to the issuer, and Build America Bonds are taxable obligations, the purchasers of these bonds need not be taxpayers.

One important theme of the Stimulus Act legislation is that "tax credit bonds" will become an increasingly important financing tool in addition to traditional tax-exempt bonds. Build America Bonds are the most important new type of tax credit bond, in part because, unlike other types of tax credit bonds, they are not subject to a national volume limitation. Like other types of tax credit bonds, Build America Bonds have a temporary authorization, but it is reasonable to expect that the U.S. Congress will consider extending the authorization for Build America Bonds and other tax credit bond provisions.

Issuing Build America Bonds could permit state and local governments to access market sectors that have not regularly purchased tax-exempt bonds such as pension funds and foreign investors.

Qualified School Construction Bonds

"Qualified school construction bonds" (QSCBs) are a new type of tax credit bond whose proceeds are used to finance construction, rehabilitation and repair of public school facilities, or for the acquisition of land on which a public school facility will be built.

The applicable credit rate is the rate that the Secretary of the Treasury estimates will permit the issuance of the bonds without discount and without interest cost to the issuer. The national limitation is $11 billion for each of calendar years 2009 and 2010. Sixty percent of the national limit is allocated among the States and forty percent of the national limit will be allocated to "large local educational agencies."

In general, a "large local educational agency" is (i) among the 100 local educational agencies with the largest numbers of children aged five through seventeen from families living below the poverty level or (ii) one of not more than twenty-five local educational agencies (other than as described in (i)) that the Secretary of Education determines are in particular need of assistance, based on a low level of resources for school construction, a high level of enrollment growth or certain other factors.

Recovery Zone Bonds

Two new types of bonds, Recovery Zone Economic Development Bonds (RZEDBs), and Recovery Zone Facility Bonds (RZFBs), are authorized to finance economic development projects in certain designated "recovery zones."

Recovery Zones are defined as (i) areas designated by state and local governments as (a) having significant poverty, unemployment, or home-foreclosure rates or (b) being economically distressed due to the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990, or (ii) any area for which a designation as an empowerment zone or renewal community is in effect.

RZEDBs are interest bearing tax credit bonds, with a tax credit rate of 45% of the interest payable. The bonds must be otherwise capable of being issued as tax exempt governmental bonds (i.e., not private activity bonds) issued to finance (i) capital expenditures with respect to property located in a recovery zone, (ii) expenditures for public infrastructure and construction of public facilities, and (iii) expenditures for job training and educational programs.

RZFBs are a new category of tax exempt private activity bonds which may be issued as exempt

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facility private activity bonds for recovery zone facilities provided that 95% or more of the net proceeds of the bonds are used to finance recovery zone property.

Recovery zone property is depreciable property (i) which is constructed, reconstructed, renovated, or acquired by a taxpayer by purchase after the date of designation of a recovery zone, (ii) the original use of which property in the recovery zone commenced with the taxpayer, and (iii) substantially all of the use of which is in the recovery zone and is in the active conduct of the taxpayer's qualified business.

RZFBs are subject to the current rules that apply to private activity bonds; however, unlike other private activity bonds, RZFBs are subject to the rule prohibiting the acquisition of existing property, and they are not subject to the volume cap limitations.

Qualified Energy Conservation Bonds

"Qualified energy conservation bonds" (QECBs) are tax credit bonds the proceeds of which are used for "qualified conservation purposes," with a broad definition including capital expenditures, research grants, and demonstration projects that implement or develop "green" energy technology that reduce greenhouse gas emissions.

The tax credit for QECBs is 70% of the amount deemed necessary to market the QECBs at par value.

QECBs were initially provided for in 2008 with a one-time $800,000,000 national limitation. The Stimulus Act increases that amount to a total of $3,200,000,000 limitation, allocable among the States by the Treasury on the basis of population.

At least 70% of a State's QECB allocation must be used for bonds that are not private activity bonds. The Stimulus Act provides that QECBs will not be treated as private activity bonds merely because bond proceeds are used for capital expenditures to implement "green community programs" aimed at reducing energy consumption in private buildings.

New Clean Renewable Energy Bonds

"New clean renewable energy bonds" (New CREBs) are tax credit bonds the proceeds of which are used for capital expenditures incurred by governmental bodies, public power providers, or cooperative electric companies for a "qualified renewable energy facility."

"Qualified renewable energy facilities" include those that generate electricity from the following resources: wind; closed-loop biomass; open-loop biomass; geothermal; small irrigation; hydropower; landfill gas; marine renewable; and trash combustion facilities.

CREBs have been authorized since 2005. New CREBs replaced CREBs in 2008; the 2008 legislation reduced the amount of the credit to 70% of the amount deemed necessary to enable the New CREBs to be marketed at par.

The Stimulus Act provides for a one-time $1,600,000,000 additional limitation, allocable by the Treasury as one-third to State, local, and tribal governments, one-third to public power providers, and one-third for electric cooperatives.

The Stimulus Act permits the proceeds of qualified energy conservation bonds to be used to make loans and grants for capital expenditures to implement green community programs without being treated as private activity bonds.

Tribal Economic Development Bonds

"Tribal economic development bonds" (TEDBs) are a new form of tax-exempt bonds issued by a tribal government and designated as TEDBs.

TEDBs may be issued generally for any purpose for which tax-exempt bonds could be issued by a State or local government,

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without regard to the "essential governmental function" requirement applicable to bonds issued by tribal governments outside the Stimulus Act.

TEDBs cannot be issued for buildings in which gaming is housed or other property used in the conduct of the gaming. The facilities financed by TEDBs must be located in an Indian reservation.

TEDBs are subject to a national limit of $2,000,000,000. They apparently can be issued as either governmental bonds or tax-exempt private activity bonds, and if issued as private activity bonds they are not subject to the regular private activity bonds State volume ceiling.

"Qualified Tax-Exempt Obligations"

"Qualified tax-exempt obligations" (QTEOs) are tax-exempt governmental bonds and 501(c)(3) bonds that are designated by a "qualified small issuer" as QTEOs. QTEOs held by a financial institution are exempt from allocation to interest expense under section 265. The Stimulus Act implemented special rules that apply only for 2009 and 2010.

Pre-Stimulus Act, a "qualified small issuer" was an issuer who, for a given year, reasonably anticipated issuing less than $10,000,000 in tax-exempt debt, excluding certain non-501(c)(3) private activity bonds and pre-1986 refunding bonds. For 2009 and 2010, that limit is increased to $30,000,000.

Subject to a new exception for 501(c)(3) bonds, the $30,000,000 limit continues to apply to all applicable tax-exempt bonds issued by that issuer during the year, regardless of whether designated as QTEOs.

For 501(c)(3) bonds, the $30,000,000 limit, unlike the Pre-Stimulus Act $10,000,000 limit, applies at borrower level rather than issuer level. For conduit financings and composite or pooled issues where each borrower is a 501(c)(3), each borrower is treated as a separate issuer for the applicable qualified portion borrowed.

The $30,000,000 limit is applied to the issuer or borrower on the basis of each calendar year. Bonds issued in 2009 or 2010 that qualify for it will retain their status as QTEOs for the life of the bonds. For bonds issued after 2010, the limit will revert to Pre-Stimulus Act $10,000,000 limit for each calendar year, with no ability to apply the limit separately at the borrower level.

As under Pre-Stimulus Act law, interest on QTEOs is a financial institution preference item, causing 20% of allocable interest expense to be nondeductible.

In most circumstances, current refunding bonds are not counted in determining the status of a "qualified small issuer," and are not counted in the $30,000,000 limit. Current refundings of QTEOs will be deemed designated and will not count against issuer's $30,000,000 limit.

Temporary Relief from Alternative Minimum Tax

For all non-refunding "new money" bonds issued in 2009 or 2010, the interest on private activity bonds will not be treated as a tax preference item for individual or corporate alternative minimum tax (AMT), and the interest on governmental bonds will not be an adjustment to current earnings for purposes of corporate AMT.

The AMT exemption applies for the life of the bonds if issued in 2009 or 2010. For bonds issued after 2010, pre-ARRTA law comes back into effect: interest on private activity bonds will be a tax preference item, and interest on governmental bonds will be an adjustment to current earnings.

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