National Association *of* Bond Lawyers

NATIONAL ASSOCIATION OF BOND LAWYERS
Suggested Technical Corrections Relating to the American Recovery and Reinvestment Act of 2009

EXECUTIVE SUMMARY

Enacted on February 17, 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) contains a number of new statutory provisions aimed at stimulating economic growth and assisting State and local governments in meeting their capital borrowing needs. Among other things, ARRA creates several new forms of federally-subsidized debt instruments, expands the ability of borrowers to benefit through the issuance of "bank qualified" bonds, and provides for preferential treatment for interest on certain bonds for alternative minimum tax purposes.

Overwhelmingly, the National Association of Bond Lawyers (NABL) views the public finance provisions of ARRA as a success. There are, however, a number of provisions within ARRA for which corrective legislative action would clarify the application of the law, more readily permit issuers and borrowers to take advantage of the provisions of the law or would correct what appear to be unintended consequences of the statutory language. NABL has divided its suggestions into seven parts, with particular emphasis on the provisions of ARRA that establish the rules applicable to Build America Bonds (BABs), Recovery Zone Economic Development Bonds (RZEDBs), Recovery Zone Facility Bonds (RZFBs) and Qualified School Construction Bonds (QSCBs).

With respect to BABs and RZEDBs, NABL recommends that the 100% capital expenditure requirement for such bonds be replaced with a concept similar to that of "capital projects" applicable to tax-exempt bonds, which would expand the ability of issuers and borrowers to use BABs and RZEDBs proceeds for certain de minimis working capital purposes and avoid some of the more burdensome and, NABL believes, unintended consequences of the 100% capital expenditure requirement, such as having to use investment earnings on a reasonably required reserve fund for capital expenditures years after the project for which the BABs or RZEDBs were originally issued have been placed in service. NABL also suggests that Congress clarify that credit payments allowable for BABs and RZEDBs will not cause tax-exempt bonds issued on a parity basis with BABs and RZEDBs to be "federally guaranteed," that Congress direct the Treasury Department to establish regulations regarding the application of the tax-exempt bond remedial action rules to BABs and RZEDBs, that Congress provide guidance related to the refunding of a BAB or RZEDB, including guidance as to when a BAB or RZEDB for which a defeasance escrow has been established is treated as reissued and how to account for allowable credit payments in sizing a refunding escrow.

NABL has requested technical corrections to the provisions of ARRA creating and implementing RZFBs, including corrections that would clarify that an issuer of RZFBs may refund such bonds after December 31, 2010 without additional recovery zone facility bond issuance authority, and that proceeds of a RZFB used to acquire land that is functionally related and subordinate to recovery zone property will qualify as an eligible expenditure.

Finally, NABL recommends several technical corrections related to the expansion by Congress in ARRA of the available types of tax credit bonds, particularly QSCBs. NABL recommends that the provisions in ARRA related to reimbursement using proceeds of tax credit bonds be conformed to the rules applicable to tax-exempt bonds, that Congress clarify that proceeds of QSCBs may be used to finance equipment for a school that is not otherwise being improved with proceeds of the issuance and may be used to finance the acquisition and renovation of existing facilities, and that Congress provide that the term “public school facility” has the same meaning for purposes of the provisions in ARRA applicable to QSCBs as it does for tax-exempt qualified public educational facilities bonds.

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April 23, 2010

1) **Refunding of Qualified Small Issue Bonds.** The American Recovery and Reinvestment Act of 2009 (the "Act") expands the definition of facilities that may be financed with qualified small issue bonds issued after the date of enactment of the Act and before January 1, 2011. This expanded authorization should include bonds issued to, directly or indirectly, refund an issue covered by the Act. In addition, references in section 144(a)(12)(C)(iii)[1] to "bonds" and "issue" should be conformed to other such references in section 144(a)(12). Inclusion of refunding bonds and these other conforming changes could be accomplished by amending clause (iii) to read:

   > *"Special rules for bonds issued in 2009 and 2010. In the case of any bond issued as part of an issue which is issued after the date of enactment of this clause and before January 1, 2011, including any bond issued to directly or indirectly refund a bond issued after the date of enactment of this clause and before January 1, 2011, provided that the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, clause (ii) shall not apply and the net proceeds from a bond shall be considered to be used to provide a manufacturing facility if such proceeds are used to provide -"*

   This amendment should be effective as of the date of enactment of the Act.

2) **Refunding of Tribal Economic Development Bonds.** The Act authorizes the issuance by Indian tribal governments of tribal economic development bonds ("TEDBs") subject to a requirement of TEDB volume limitation. TEDB volume limitation should not be required for refundings of TEDBs, which could be clarified by adding the following language to section 7871(f)(3)(C):

   > *"provided that such limitation shall not apply to any bond which is issued to directly or indirectly refund another bond to the extent that the amount of such refunding bond does not exceed the outstanding amount of the refunded bond"*

   This amendment should be effective as of the date of enactment of the Act.

3) **Recovery Zone Facility Bonds.**

   A. **Refunding of Recovery Zone Facility Bonds.** The Act authorizes the issuance of recovery zone facility bonds ("RZFBs") as a new form of exempt facility bond. RZFBs must be issued before

[1] Unless otherwise indicated, all section references herein are to the Internal Revenue Code of 1986, as amended.

January 1, 2011, and may not be issued in an amount greater than the amount of recovery zone facility bond limitation allocated to the issuer. The Act should expressly permit refundings of RZFBs. To achieve this result, the following language could be added after the reference to January 1, 2011, in section 1400U-3(b)(1)(B):

> *"or is issued to refund another bond described in this subsection (or in the case of a series of refundings, an original bond described in this subsection) to the extent that the amount of such bond does not exceed the amount of the refunded bond"*

Furthermore, to clarify that recovery zone facility bond limitation is not required for a refunding, section 1400U-3(b)(2) could be revised by adding the following language:

> *"provided that a refunding bond described in section 1400U-3(b)(1)(B) shall not be subject to this limitation"*

These amendments should be effective as of the date of enactment of the Act.

B. Acquisition of Land Using Recovery Zone Facility Bonds. Section 1400U-3(c)(1) provides that "the term 'recovery zone property' means any property to which section 168 applies (or would apply but for Section 179)...." The requirement that section 168 apply to property to be financed with RZFBs would apparently preclude the use of RZFBs to finance land. RZFBs, however, are exempt facility bonds, and Treas. Reg. section 1.103-8(a)(3) provides that an exempt facility includes any land that is functionally related and subordinate to the financed facility. In addition, section 1400U-3 uses the concept of "recovery zone property," which is very similar to the provisions for enterprise zone facility bonds under section 1394, where the statute specifically provides that proceeds can be used to finance land that is functionally related and subordinate. The requirements of section 1400U-3 should be modified to clarify that land that is functionally related and subordinate may be financed using RZFBs.

To clarify that proceeds of RZFBs may be used to acquire functionally related and subordinate land, section 1400U-3(c)(1) should be revised by adding the following language after the parenthetical:

> *"and land functionally related and subordinate to such property"*

This amendment should be effective as of the date of enactment of the Act.

C. Acquisition of Existing Property Using Recovery Zone Facility Bonds. Section 1400U-3(d) provides that section 147(d), relating to the acquisition of existing property, shall not apply to any RZFB. Instead, section 1400U-3(c)(3) provides that rules similar to the rules of subsection (a)(2) of section 1397D shall apply in the case of substantial renovations. These provisions suggest that existing property, including property subject to a prior use in the recovery zone, may be financed using RZFBs, but only if the property to be acquired is "substantially renovated." For these purposes, section 1397D(a) states that property shall be treated as substantially renovated by the taxpayer if, during any 24-month period beginning after the date on which the designation of the recovery zone[2] took effect, additions to basis with respect to such property in the hands of the

[2] Section 1397D(a)(2) uses the term "empowerment zone."

taxpayer exceed the greater of (i) an amount equal to the adjusted basis at the beginning of such 24-month period in the hands of the taxpayer, or (ii) $5,000. In the case of a substantial renovation, it is unclear as to when the 24-month period described in section 1397D(a)(2) is to begin.

Consistent with the exception for rehabilitation expenditures found in the acquisition of existing property rules in section 147(d), the 24-month period described in section 1397D(a)(2) should begin on the later of the date the property was acquired or the date of issue of the RZFBs financing the property. To clarify this application, the following language could be added at the end of section 1400U-3(c)(3):

> *", the 24-month period described in section 1397D(a)(2) beginning on the later of the date on which the property was acquired or the date on which the recovery zone facility bond issued to acquire such property was issued."*

This amendment should be effective as of the date of enactment of the Act.

D. Enable Issuance of "Draw-Down" Recovery Zone Facility Bonds. In a draw-down bond structure, bonds of the issue are delivered and proceeds are advanced as amounts are needed by the borrower to pay project (and other) costs. A draw-down structure is often advantageous to both the borrower and the United States Treasury - the borrower is able to avoid the cost of carry on the bonds prior to the point at which the proceeds are needed, and the United States Treasury benefits because bonds of the issue generally are not issued until funds are needed by the borrower. Recognizing that treating each draw under a draw-down structure as a separate issue would be impractical and unduly burdensome, Treas. Reg. section 1.150-1(c)(4)(i) provides that bonds issued pursuant to a draw-down structure are treated as part of a single issue, the issue date of which is the first date on which aggregate draws under the loan exceed the lesser of $50,000 or 5 percent of the issue price.

Section 1400U-3(b)(1)(B) requires that, in the case of a RZFB, the "bond" must be issued before January 1, 2011. This requirement may effectively preclude the utilization of a draw-down bond structure for RZFBs where a borrower would otherwise make one or more draws on or after January 1, 2011, as even if the "issue" of draw-down RZFBs of which such bond is a part is issued prior to January 1, 2011, it is not clear that individual bonds of that issue delivered on or after January 1, 2011 would be issued before January 1, 2011. To accommodate draw-down RZFBs where one or more draws may take place on or after January 1, 2011, the following revision could be made to section 1400U-3(b)(1)(B):

> *"the issue of which such bond is a part is issued before January 1, 2011,*"

This amendment should be effective as of the date of enactment of the Act.

4) Refunding of Qualified Tax-Exempt Obligations Issued in 2009 or 2010. The Act increases the amount of "qualified tax-exempt obligations" that may be issued by qualified small issuers in 2009 and 2010 from $10,000,000 to $30,000,000. Section 265(b)(3)(D)(ii) provides that "except as provided in clause (iii), in the case of a refunding (or a series of refundings) of a qualified tax-exempt obligation, the refunding obligation shall be treated as a qualified tax-exempt obligation…" assuming certain requirements are satisfied. Section 265(b)(3)(D)(iii) provides that no obligation may be treated as designated under section 265(b)(3)(D)(ii) if (I) any obligation issued as part of such issue is issued to refund another obligation, and (II) the aggregate face amount of the issue exceeds $10,000,000. For obligations issued in 2009 and 2010, the $10,000,000 limit set forth in section 265(b)(3)(D)(iii)(II) is raised to $30,000,000. However, refundings of qualified tax-exempt obligations issued after 2010 that exceed $10,000,000 appear to not qualify for deemed designated treatment because the increase from $10,000,000 to $30,000,000 for purposes of section 265(b)(3)(D)(iii)(II) only applies to obligations issued in 2009 and 2010. The following addition to section 265(b)(3)(G)(i) would clarify that refundings in excess of $10,000,000 of qualified tax-exempt obligations issued in 2009 and 2010 may be deemed designated:

> *"In the case of an obligation issued to directly or indirectly refund an obligation issued during 2009 or 2010, subclause (D)(iii)(II) shall be applied by substituting "$30,000,000" for "$10,000,000".*

This amendment should be effective as of the date of enactment of the Act.

5) Provisions Impacting Alternative Minimum Tax and Adjusted Current Earnings Treatment.

A. Refundings of Non-AMT Bonds Issued After December 31, 2010. Section 57(a)(5)(C)(vi) exempts interest on private activity bonds issued in 2009 or 2010 from treatment as an item of tax preference for purposes of the alternative minimum tax ("AMT"). In the case of a refunding, the Act provides that refunding bonds are treated as issued on the date of the original bond, except if the original bond was issued on or between January 1, 2004 and December 31, 2008. The existing Code language, as amended by the Act, applies the AMT exemption to bonds issued in 2009 or 2010 to refund bonds issued during the 2004-08 period, regardless of whether the refunded bonds were "new money" bonds, refundings of bonds issued during the 2004-08 period, or refundings of bonds issued prior to 2004. There remains a question as to the status of refunding bonds issued after December 31, 2010, to refund bonds covered by the AMT exemption. Arguably, the AMT exemption of refunding bonds is established by the provision that relates the date of issuance of refunding bonds back to the date of the refunded bonds. However, the relationship between that provision and the provision relating to refundings of bonds issued during the 2004-08 period is unclear, and, accordingly, clarification appears to be appropriate. Clarification could be accomplished by adding language to section 57(a)(5)(C)(vi) in the following form:

> *"(IV) REFUNDING BONDS ISSUED AFTER DECEMBER 31, 2010— For purposes of clause (i), the term 'private activity bond' shall not include any bond issued after December 31, 2010, to refund a bond described in subclause (I)."*

This language is intended to apply, for example, to refunding bonds issued in 2015 to refund bonds issued in 2009, regardless of whether the 2009 bonds are new money bonds or are a refunding of bonds issued in the 2004-08 period.

This amendment should be effective as of the date of enactment of the Act.

B. Refundings of Bonds the Interest on Which is Not Includible in Adjusted Current Earnings Issued After December 31, 2010. The same problem described in Paragraph 5A exists with respect to the inclusion of interest in adjusted current earnings required by section 56(g)(4)(B)(iv), which could be cured by adding the following language to that section:

> *"(IV) REFUNDING BONDS ISSUED AFTER DECEMBER 31, 2010— For purposes of clause (i), the term 'private activity bond' shall not include any bond issued after December 31, 2010, to refund a bond described in subclause (I)."*

In addition, there is some ambiguity over the ability to treat an advance refunding of bonds issued between January 1, 2004 and December 31, 2009 as excepted from the rule described in subclause (II) of section 56(g)(4)(B)(v). Subclause (II) of that section provides that "a refunding bond *(whether a current or advance refunding)* shall be treated as issued on the date of issuance of the refunded bond…" (emphasis added). Subclause (III) provides an exception to this rule for "any refunding bond which is issued to refund any bond which was issued after December 31, 2003, and before January 1, 2009." The lack of a reference to the ability to advance refund a bond issued during the 2004-08 period has caused some concern as to whether advance refundings qualify for the exception to the rule that refunding bonds trace back to the date of issuance of the original bond. This ambiguity could be clarified by adding "(whether a current or advance refunding)" to subclause (III).

This amendment should be effective as of the date of enactment of the Act.

6) Build America Bonds and Recovery Zone Economic Development Bonds.

A. Capital Expenditure Requirement. Section 54AA(g)(1) provides that, with respect to build America bonds ("BABs"), in the case of a "qualified bond," in lieu of federal tax credits allowed with respect to a BAB, the issuer of the BAB shall be allowed a credit as provided in section 6431. Section 54AA(g)(2) defines "qualified bond" as a BAB issued as part of an issue 100% of the excess of the available project proceeds of such issue, over amounts in a reasonably required reserve with respect to such issue, are to be used for capital expenditures. Effectively, 100% of sale proceeds, less amounts used to pay costs of issuance and amounts deposited to a reasonably required reserve, plus the investment earnings thereon, must be used to finance capital expenditures. The term "capital expenditure" is defined in Treas. Reg. section 1.150-1(b) to mean "any cost of a type that is properly chargeable to capital account (or would be so chargeable with a proper election or with the application of the definition of placed in service under § 1.150-2(c)) under general Federal income tax principles."

To clarify that items customarily financed with tax-exempt bonds such as qualified guarantee fees, payments for a qualified hedge and interest on an issue for up to three years after issuance qualify as eligible expenditures using the proceeds of direct-pay BABs, the term "capital expenditures" in section 54(g)(2)(A)(ii) could be replaced with a concept similar to the term "capital projects" found in the Treas. Reg. section 1.148-1(b) (which term incorporates related de minimis working capital expenditures under Treas. Reg. section 1.148-6(d)(3)(ii)(A)).

This amendment should be effective as of the date of enactment of the Act.

B. Expenditure of Earnings on a Reasonably Required Reserve Fund. Section 54AA(g)(2)(A)(ii) allows an issuer to use the proceeds of direct-pay BABs to fund a debt service reserve fund ("DSRF"), but does not clearly indicate that earnings on the DSRF are not required to be used for capital expenditures. This issue arises as a result of the cross reference in section 54AA(g)(2)(A)(i) to the definition of "available project proceeds" in section 54A(e)(4). That definition includes investment earnings, but since DSRFs are not permitted to be financed by bonds issued under section 54A, there is no exception for DSRF earnings. This issue has created significant logistical problems for issuers, requiring issuers to spend DSRF earnings on project costs even after the projects for which the BABs were issued have been completed and placed in service. This problem could be solved by amending section 54AA(g)(2)(A)(ii) to read as follows:

> *"the amounts deposited in a reasonably required reserve (within the meaning of section 150(a)(3)) with respect to such issue, including investment earnings thereon,"*

This amendment should be effective as of the date of enactment of the Act.

C. Federal Guarantee Prohibition. Section 54AA(d)(2)(A) provides that a BAB shall not be treated as federally guaranteed by reason of the credit allowed under section 6431. While this provision is helpful for BABs, it does not address federal guarantee issues arising out of parity financing structures where both tax-exempt bonds and BABs are secured by revenues, including credit payments under section 6431, pledged under a master indenture. The exception from the federal guarantee provisions for BABs without a corresponding exception for tax-exempt bonds issued under a parity structure has caused concern as to whether, in issuing BABs, the tax-exempt status of bonds outstanding under a parity structure is jeopardized. The following revision to section 54AA(d)(2)(A) would clarify that credit payments allowable under section 6431 will not cause tax-exempt bonds outstanding under a master indenture, or otherwise on a parity basis, with BABs to be federally guaranteed:

> *"for purposes of section 149(b), neither a build America bond nor a parity obligation the interest on which is otherwise excludable under section 103 shall be treated as federally guaranteed by reason of the credit allowed under subsection (a) of section 6431,"*

This amendment should be effective as of the date of enactment of the Act.

D. Sizing of Reasonably Required Reserve Funds. Section 54AA(g)(2) allows the issuer of a direct-pay BAB to deposit proceeds into a "reasonably required reserve (within the meaning of section 150(a)(3)." Notice 2009-26, in accord with the Conference Committee report, states that the arbitrage rules in section 148(d)(2) shall apply to determine the size of a reasonably required reserve fund. Notice 2009-26 also points out that a reserve fund containing proceeds in excess of 10% would violate the statutory rule of section 148(d)(2), causing the bonds to ineligible for treatment as BABs. Presumably, a reasonably required reserve fund cannot exceed the two limits imposed by Treas. Reg. section 1.148-2(f) on the basis of debt service: specifically, the fund cannot exceed maximum annual debt service or, if less, 125% of average annual debt service. While section 54AA(g) does not address the relevance of debt service in reserve fund sizing, section 6431(c) provides generally that the yield on a direct-pay BAB is to be determined by reducing the issuer's interest cost by the amount of the refundable credits allowable to the issuer on account of the bonds. To prevent any implication from section 6431(c) that the debt service tests for sizing a reasonably required reserve should be applied by offsetting the credit against the interest payments on the bond, the following language should be added to section 6431(c):

> *"provided that for purposes of section 148 a reasonably required reserve or replacement fund shall be determined by reference to debt service on the issue under applicable regulations under section 148 without reduction for such credit"*

This amendment would reflect the market reality that bondholders do not generally have a lien on the credits allowable under section 6431 and therefore look for a reserve fund to be sized based on total debt service, as well as comport with the fact that issuers are not required to use the credit in fact to pay bond interest and therefore should not be required to take it into account in a way that may reduce the permitted size of the reserve.

This amendment should be effective as of the date of enactment of the Act.

E. Enable Issuance of "Draw-Down" Build America Bonds and Recovery Zone Economic Development Bonds. In Paragraph 3D, above, the draw-down bond structure and incompatibility of that structure with a "bond issuance" deadline of December 31, 2010 is described. The points made in that paragraph apply equally to BABs and Recovery Zone Economic Development Bonds ("RZEDBs"). To accommodate draw-down BABs where one or more draws may take place on or after January 1, 2011, the following revision could be made to section 54AA(d)(1)(B):

> "*the issue of which such obligation is a part is issued before January 1, 2011*."

To enable RZEDBs to be issued as draw-down bonds, the following revision could be made to Section 1400U-2(b)(1):

> "*For purposes of this section, the term "recovery zone economic development bond" means any build America bond (as defined in section 54AA(d)) the issue of which such obligation is a part is issued before January 1, 2011 if -*"

These amendments should be effective as of the date of enactment of the Act.

F. Ability to Treat Recovery Zone Economic Development Bonds as Direct-Pay Build America Bonds and Permit Tax Credits Under Section 54AA. Section 1400U-2(a) provides that a RZEDB shall be treated as a qualified bond for purposes of section 6431, entitling an issuer to receive a 45% interest subsidy. Literally, however, nothing in the Act precludes also treating a RZEDB as a tax credit BAB. Section 1400U-2(b) should be amended to state that treatment of an RZEDB as a direct-pay BAB for purposes of section 6431 is in lieu of any credit allowed otherwise allowed under section 54AA. Otherwise, an issuer of RZEDBs could take a 45% credit under section 1400U-2 and also provide for bondholders to receive a 35% tax credit under section 54AA, clearly not the intended result. The following addition to section 1400U-2(b) would clarify that holders of RZEDBs are not eligible for tax credits under section 54AA:

> *"(3) Credit payable under section 6431 is in lieu of federal tax credits. The credit payable under section 6431 to an issuer of a recovery zone economic development bond shall be in lieu of any credit against tax otherwise allowable under section 54AA."*

This amendment should be effective as of the date of enactment of the Act.

G. Continuation of Section 6431 Payments until Discharge of Bonds. Section 6431 is ambiguous as to whether the payments under section 6431 are to be made without regard to whether the borrower makes the corresponding payments of cash interest on the bonds. This problem could be cured by adding the following language to section 6431(b):

> *"The credit shall be paid in respect of the interest payable on each interest payment date until the maturity or prior discharge of the bond (including discharge through payment, discharge in bankruptcy, or discharge by agreement with bondholders), without regard to whether the interest is in fact paid."*

This amendment would increase the value of a pledge of the credit to the bondholders in the event of a default by the issuer in payment of the underlying interest.

This amendment should be effective as of the date of enactment of the Act.

H. Suit in District Court for Section 6431 Payment. Section 6401(b)(1) treats "refundable" credits in excess of tax liability as if they were an overpayment of tax, for which the taxpayer may bring suit in a Federal District Court under 28 U.S.C. § 1346. Section 1531(c)(5) of the Act amends section 6401(b)(1) by inserting a reference to subpart J (relating to BABs) in a manner that was clearly intended to give unpaid credits under section 6431 the status of overpayments for this purpose. However, the reference to subpart J was inserted erroneously. The problem could be cured by revising section 6401(b)(1) to read as follows:

> *"If the amount allowable as credits under subpart C of part IV of subchapter A of chapter 1 (relating to refundable credits) and subpart J of such part IV (relating to build America bonds) exceeds the tax imposed by subtitle A (reduced by the credits allowable under subparts A, B, D, G, H, and I of such part IV), the amount of such excess shall be considered an overpayment."*

This amendment should be effective as of the date of enactment of the Act.

I. Section 6431 Subsection References. Subsection (d) of section 6431 states "[f]or purposes of this subsection, the term 'interest payment date' means each date on which interest is payable by the issuer under the terms of the bond." The reference to "subsection" in 6431(d) should be to "section." The same issue is found in subsection (e) of section 6431.

These amendments should be effective as of the date of enactment of the Act.

J. Application of the Remedial Action Rules. The Treasury Regulations applicable to tax-exempt governmental bonds provide generally that failures to use bond proceeds for qualified purposes can be cured by taking a "remedial action" including, in general, redemption or defeasance of the bonds or application of proceeds from disposition of the financed property to a new, qualified purpose. Presumably, the remedial action rules of Treas. Reg. section 1.141-12 are available for BABs, however, it would be helpful if this were clarified. Also, an additional alternative remedial action, whereby an issuer of direct-pay BABs could determine a nonqualified bond amount and cease claiming credit on such amount, should be provided in the Regulations. This alternative would, in substance, convert the financing of the nonqualified bond amount to a non-subsidized taxable financing, just as if the proceeds of a new taxable issue had been used to redeem the nonqualified portion in accord with the remedial action regulations applicable to tax-exempt bonds, but would avoid the unnecessary transaction costs that would be associated with an issuance of new taxable refunding bonds. The following addition to section 1531 of the Act would clarify that the remedial action rules of section 1.141-12 apply to BABs, as well as provide for the alternative remedial action described above:

> *"(e) REMEDIAL ACTION RULES. The Secretary of the Treasury or his delegate shall promulgate Federal income tax regulations providing for the application of the remedial action rules found in Federal income tax regulations section 1.141-12 to build America bonds, including the ability of an issuer to cease claiming credits under section 6431 of the Internal Revenue Code of 1986 for the portion of any build America bond which does not constitute a 'qualified bond' within the meaning of section 6431(e)."*

K. Advance Refundings.

i. Reissuance of a Build America Bond. Section 54AA(f)(1) provides that interest on BABs is includible in gross income. Thus, although a BAB must qualify as an obligation (other than a private activity bond) the interest on which would be excludible from gross income under section 103 but for Section 54AA, BABs are taxable obligations. As a result, questions have arisen as to whether BABs may be advance refunded after 2010 using tax-exempt bonds without causing the defeased BABs to cease to qualify for credit payments under section 6431.

Treas. Reg. section 1.1001-3(e)(5) provides that the change in recourse nature of a debt instrument from recourse (or substantially all recourse) to nonrecourse (or substantially all nonrecourse) is a significant modification resulting in a reissuance of the debt instrument. To illustrate this point, Treas. Reg. section 1.1001-3(e)(5)(ii)(A) states "for example, a legal defeasance of a debt instrument in which the issuer is released from all liability to make payments on the debt instrument…is a significant modification." Treas. Reg. section 1.1001-3(e)(5)(ii)(B) contains an exception to this rule for "tax-exempt bonds," defined to mean "a state or local bond that satisfies the requirements of section 103(a)." A BAB must satisfy all of the requirements of section 103(a), but it is somewhat counterintuitive to classify an obligation that bears interest that is taxable to the holder as a "tax-exempt bond." If a BAB is a tax-exempt bond for purposes of Treas. Reg. section 1.1001-3(e)(5)(ii)(B), the defeasance of a BAB will not result in a reissuance. If, however, a BAB is not a tax-exempt bond for these purposes, a post-2010 defeasance of a BAB would result in a reissuance of the obligation, and the reissued obligation could no longer qualify as a BAB because it would have been issued after 2010.

The following addition to section 1531 of the Act would clarify that, notwithstanding the fact that interest on a BAB is taxable, a BAB is treated as a tax-exempt bond for purposes of Treas. Reg. section 1.1001-3:

> *"(f) REISSUANCE OF A BUILD AMERICA BOND. The Secretary of the Treasury or his delegate shall amend the provisions in the Federal income tax regulations to state that a build America bond shall not be treated as reissued pursuant to section 1001 of the Internal Revenue Code of 1986 as a result of a defeasance."*

This amendment should be effective as of the date of enactment of the Act.

ii. Sizing of an Advance Refunding Escrow Using Tax-Exempt Bond Proceeds. An advance refunding of tax-exempt bonds using the proceeds of other tax-exempt bonds is typically structured such that, accounting for contributions of funds from a debt service fund or debt service reserve fund for the refunded bonds, the proceeds of the refunding bonds deposited to the escrow account established for the refunded bonds, and the investment earnings thereon, are sufficient to pay the principal and interest coming due on the bonds to be refunded through the call date. Section 6431(c) provides that, in the case of a qualified bond, the arbitrage yield on such bond shall be reduced by the credit payments allowed under section 6431(c). The below change to section 1531 of the Act would serve to avoid any implication that the need to account for credit payments allowable under section 6431(c) for purposes of section 148 precludes the ability to fund an advance refunding escrow containing tax-exempt bond proceeds without regard to such credit payments:

> *"(g) ADVANCE REFUNDING OF A BUILD AMERICA BOND USING TAX-EXEMPT BONDS. The Secretary of the Treasury or his delegate shall promulgate Federal income tax regulations under section 54AA of the Internal Revenue Code of 1986 providing that, in the case of an advance refunding of a build America bond using proceeds of an obligation described in section 103(a) of the Internal Revenue Code of 1986, credit payments allowable pursuant to section 6431 of the Internal Revenue Code of 1986 shall not be taken into account for purposes of determining the amount of interest payable on the refunded issue."*

This amendment would comport with the fact that issuers are not required to use the credit in fact to pay bond interest and therefore should not be required to take the credit into account in a way that would reduce the permitted size of a tax-exempt advance refunding issue.

This amendment should be effective as of the date of enactment of the Act.

7) Tax Credit Bonds.

A. Reimbursements Using Proceeds of Tax Credit Bonds. Section 54A(d)(2)(D) allows proceeds of tax credit bonds to be used for reimbursements of prior expenditures under a statutory rule that resembles, but departs in a number of respects, from the general rules for tax-exempt bonds in Treas. Reg. section 1.150-2. Specifically, section 54A(d)(2) applies only to expenditures made "after the date the Secretary makes an allocation of the bond limitation with respect to such issue" and then only if both of two overlapping requirements of an intent declaration are satisfied by reference to a declaration that references to tax credit bonds as distinguished from debt financing generally. Further, section 54A(d)(2) imposes an 18-month deadline that is based solely on the date of payment of the expenditure and not on the in-service date in the alternative, as provided in Treas. Reg. section 1.150-2. Finally, there is no preliminary expenditures or de minimis exception as in Treas. Reg. section 1.150-2. Section 54A(d)(2) could be improved in all these respects if it were conformed with Treas. Reg. section 1.150-2.

This amendment should be effective as of the date of enactment of the Act.

B. Use of Qualified School Construction Bond Proceeds to Finance Equipment. Section 54F(a)(1) provides that 100% of the available project proceeds of a qualified school construction bond ("QSCB") must be used for the construction, rehabilitation or repair of a public school facility or the acquisition of land on which a facility is to be constructed. This statutory language would not seem to permit use of QSCB proceeds to finance equipment. Notice 2009-35, Section 3.05 says that QSCB proceeds can be used to finance equipment that is to be used in the portion of a facility being constructed, rehabilitated or repaired with the proceeds of a QSCB. The question is whether Congress intentionally left out equipment as a qualified use, thus preventing a school from purchasing equipment for a school that is not otherwise being financed with the QSCB. This issue could be resolved by adding the term "equipping" to the list of permitted uses in section 54F(a)(1).

This amendment should be effective as of the date of enactment of the Act.

C. Use of Qualified School Construction Bond Proceeds to Finance an Existing Building. Section 54F(a)(1) provides that 100% of the available project proceeds of a QSCB must be used for the construction, rehabilitation or repair of a public school facility or the acquisition of land on which a facility is to be constructed. This language would appear to preclude the use of QSCBs to fully pay for costs of acquiring and renovating a school, as is often the case with charter schools which buy or obtain a long-term ground lease for surplus schools. As a result, a school could apparently use QSCBs to acquire the site land of an existing building and to rehabilitate it (even this interpretation is undercut to some extent by the fact that the reference to land refers to construction of a school but not rehabilitation), but the school could not use QSCBs proceeds to purchase the building itself. This restriction seems unwarranted and could be fixed by including an authorization for acquisition of existing buildings.

This amendment should be effective as of the date of enactment of the Act.

D. Definition of a "Public School Facility". Section 54F(a)(1) limits the use of QSCB proceeds to a "public school facility" but does not define this term. This could be rectified through a cross reference in section 54F to section 142(k), which provides generally for exempt facility bonds for qualified public educational facilities. Section 142(k) defines "school facility" and "public schools" in a manner that includes land and depreciable property generally together with functionally related and subordinate facilities, including a stadium or other facility primarily used for school events. The section 142(k) definition would include a central office building for a school system, which is functionally related and subordinate to the individual public school facilities, but would not be located at the same site.

This amendment should be effective as of the date of enactment of the Act.

E. Use of Tax Credit Bond Proceeds to Finance Credit Enhancement. In the tax-exempt bond market, premiums for third-party credit enhancement are customarily paid out of proceeds of the tax-exempt bond issue and the ability to do the same with proceeds of tax credit bonds may be important to many borrowers that need third-party credit enhancement to access the tax credit bond market. Section 54A(d)(2)(A)(i) provides that 100% of the available project proceeds of a qualified tax credit bond must be spent on one or more "qualified purposes" as defined in section 54A(d)(2)(C). These "qualified purposes" do not specifically include fees for credit enhancement on the issue of tax credit bonds. "Available project proceeds" is defined in section 54A(e)(4) as the proceeds of a tax credit bond issue less the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds). The following revision to section 54A(e)(4)(ii) would clarify that proceeds of tax credit bonds may be used to acquire third-party credit enhancement:

> "*the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds) and the costs of any qualified guarantee (within the meaning of section 148) financed by the issue*"

This amendment should be effective as of the date of enactment of the Act.

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