General Tax Law

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General Tax Law

What is the tax-exemption for state and local bonds?

History of tax-exemption

Overview of federal income tax requirements

- Use of proceeds
- Arbitrage
- Other tax requirements

Tax-exemption for state and local bonds

Interest is not included in gross income for federal income tax purposes

- Indirect federal tax subsidy to state and local governments

AMT vs. Non-AMT

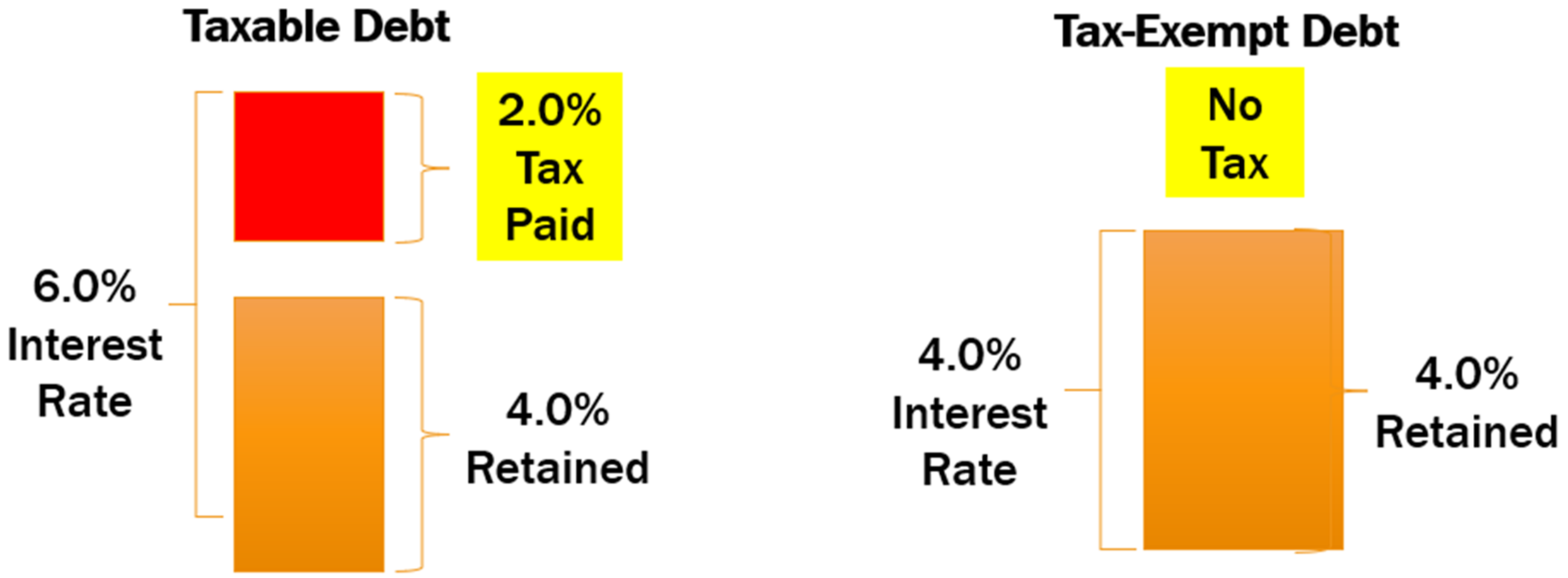
Bank Qualified

Taxation under state and local law varies

History

- **1968** – Revenue and Expenditure Control Act of 1968
- **1969** – Tax Reform Act of 1969
- **1982** – Tax Equity and Fiscal Responsibility Act of 1982
- **1984** – Tax Reform Act of 1984 (Deficit Reduction Act of 1984)
- **1986** – Tax Reform Act of 1986
- **2009** – American Reinvestment and Recovery Act of 2009
- **2017** – Tax Cuts and Jobs Act of 2017

Understanding the Basis and Beneficiary of the Subsidy



Debt of a State or Political Subdivision

Debt - **An exercise of the borrowing power.**

- Eminent domain? If the entity can compel the seller to accept a note, it may not be an exercise of the borrowing power.
- Debt for federal tax purposes may include installment sales contracts and financing leases that are not "debt" under state law.

State or Political Subdivision

- State includes D.C. and possessions (Puerto Rico, Guam, etc.)
- Political subdivision--must have a “not insubstantial” amount of one of the three sovereign powers—taxation, eminent domain, or police power.
- "On Behalf Of" Issuers. Constituted authorities and 63-20 issuers.

Overview of Federal Tax Restrictions

What is the project being financed and how will it be used?

- Determines classification of tax-exempt bonds under §§141-145

2) How will the proceeds be invested until spent on the projects?

- Arbitrage and rebate restrictions under §148

3) Other restrictions

- Volume cap (§146) for certain types of bonds
- Private activity bond restrictions for certain types of bonds (§147)
- Registration requirement, federal guarantee, 8038 filings, hedge bond, advance refundings, pool loan restrictions (§149)
- Definitions, Reimbursement (§150)

What is the project?

Tax classification—determined by project being financed and how will it be used

- Governmental bonds (§141). Governmentally owned projects that do not exceed private activity limits (i.e., private business use, private loan).
- Exempt facility bonds (§142). Particular types of projects where Congress has provided for tax-exempt bonds regardless of private use. Airports, multifamily housing, sewage, etc.
- Mortgage bonds and veterans mortgage bonds (§143).
- Small issue manufacturing bonds (§144(a)).
- Student loan bonds (§144(b)).
- Redevelopment bonds (§144(c)).
- 501(c)(3) Bonds (§145). Hospitals/health care, universities, museums, charter schools, etc. Subject to private activity limits, but use by a 501(c)(3) as part of its exempt purpose is treated as governmental use.

Governmental Bonds & Private Activity

Governmental bonds (§141) are subject to private activity restrictions. In general, any use of property by an entity other than a state or local government is potential private use.

- No more than the lesser of 5% or $5mm of proceeds can be used for private loans
- No more than the lesser of 10% or $15mm can be used to finance projects that are subject to private business use (“PBU”), if either (i) more than 10% or $15mm are secured by property used for PBU or by payments with respect to such property (“private security”), or (ii) payments with respect to PBU of the financed property will exceed 10% or $15mm (“private payments”)
- Additional private activity limitations apply to output facilities

Private Business Use

Private Business Use	Exceptions
• Ownership of bond-financed property • Leases • Management or service contracts (safe harbors) • Sponsored research contracts • Output facilities—contracts for sale of water, electricity or gas • Special legal entitlements & special economic benefits	• General public use • Short term leases (<50, <100, or <200 days) • Grants—may have PBU, but no private payments or security • Safe harbors for management or service contracts (Rev. Proc. 2017-13)

Rev. Proc. 2017-13 & Management Contracts

Rev. Proc. 2017-13 replaces Rev. 97-13. It creates a safe harbor for when a management contract will not be considered private business use.

All compensation must be reasonable

Service provider must not have a net profits/net losses interest in the facility

Contract must not exceed lesser of 30 years or 80% of reasonably expected economic life

Qualified user must exercise significant degree of control over managed property

Qualified user must bear risk of loss upon damage or destruction

Service provider must agree not to take inconsistent tax position

Restrictions as to service provider's role in voting power of qualified user

Measuring Private Business Use

How to measure private business use

- Measure use by reference to square feet of project (leases, etc.)
- Measure use by reference to time used (e.g. days used for private use)
- Measure use by comparison of revenues (naming rights, etc.)

Measured over time, allows blending

Special rules for allocating private business use to "qualified equity"

Compliance must be reasonably expected at date of issuance

Remedial Action options if limits are exceeded

VCAP

Qualified Private Activity Bonds

Bonds that may have private business use, but nonetheless Congress has provided for the ability to issue tax-exempt bonds in Sections 142 through 145 because of the type of project being financed.

- Certain types are subject to AMT
- See earlier slide for list (exempt facility, mortgage, small issue, student loan, 501(c)(3), etc.)

Special rules relate to each; in general 95% of the proceeds must be used for "good costs"

May require volume cap (§146). Limits amount of bonds that can be issued.

Subject to TEFRA (§147(f)). Gives public an opportunity to comment on issuance of bonds.

Subject to other private activity bond restrictions (§147). No acquisition of used property, limitations on financing land, no airplanes, skyboxes, health clubs, gambling or packaged liquor, 2% COI limit.

Arbitrage and Rebate

Arbitrage restrictions (can you earn it)

- Track investment of the bond proceeds until spent
- Also applies to other funds that may be treated as replacement proceeds
- Unless exception applies, cannot invest proceeds above the bond yield
  - Broad exception for new money bonds allowing investment at higher rates
  - For conduit loans, restrictions on spread between loan yield and bond yield

Rebate requirement (can you keep it)

- If bond proceeds were allowed to be invested above the bond yield, unless an exception applies, all earnings above bond yield must be rebated to Treasury
- Spenddown exceptions for new money issues—If proceeds are spent quickly enough, may qualify for an exception from rebate
- Small issuer exception

Certain Other Tax Restrictions

Registration Requirement (§149(a)).

Federal Guarantee (§149(b)). Prevents issuance of bonds where debt service is guaranteed (directly or indirectly) by federal government.

No advance refundings (§149(d)). Prevents issuance of refunding bonds more than 90 days before call date of refunded tax-exempt bonds.

Information reporting (§149(e)). Requires filing of Form 8038-G/8038.

Pool loan limitations (§149(f)). Restricts issuance of bonds used to make future loans.

Hedge Bonds (§149(g)). Generally requires that at least 85% of bond proceeds are expected to be spent within 3 years from issuance.

Definitions—New Money vs. Refunding

New money. Bonds issued to fund or reimburse costs of projects.

- Reimbursement rules (§1.150-2). Generally requires declaration of official intent to issue bonds to reimburse costs paid before issuance and imposes timing limitations.

Refunding. Bonds issued to repay prior debt. Tax analysis looks through to projects financed or refinanced by prior debt.

- Current refunding. Bonds issued within 90 days of date that prior debt will be repaid.
- Advance refunding. Bonds issued more than 90 days before prior debt will be repaid.
    - Pre-2018, only one advance refunding allowed for governmental and 501(c)(3) bonds (no advance refunding allowed for most other types).
    - Post-2017, no advance refundings of tax-exempt debt.
    - Yield restriction on advance refunding escrows—SLGS or 3-bid safe harbor.

Definitions—Issue of Bonds (§1.150-1(c))

“Issue” of tax-exempt bonds

- Tax restrictions generally apply in aggregate to each issue of bonds
- A single issue includes all bonds that are:
  - Sold less than 15 days apart;
  - Sold pursuant to the same plan of financing
  - Expected to be payable from the same source of funds

A single issue can include bonds of different tax classifications, but requires multipurpose allocations to be made between the different types

Special rules for draw-down loans and commercial paper

Questions