Changes Proposed to Bonds with "Tax Cuts and Jobs Act"

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House Tax Bill Would Terminate Tax Exemption For Private Activity Bonds, Advance Refunding Bonds And Professional Stadium Bonds; Repeal Authority For Tax Credit Bonds

On November 2, 2017, the U.S. House of Representatives leadership released H.R. 1, a tax bill titled the "Tax Cuts and Jobs Act," that would terminate the federal tax exemption for interest on all private activity bonds and advance refunding bonds issued after December 31, 2017. The bill also would repeal provisions of the Internal Revenue Code for tax credit bonds issued after December 31, 2017. Finally, the bill would deny the federal tax exemption for interest on "professional stadium bonds" issued after November 2, 2017.

Tax-Exempt Private Activity Bonds Terminated. Effective for bonds issued after December 31, 2017, interest on private activity bonds would not be excluded from gross income for federal income tax purposes under Section 103(a) of the Code - *i.e.*, would not be tax-exempt. Currently, certain "qualified" private activity bonds may be issued as tax-exempt bonds, including:

- Exempt facility bonds issued for multifamily residential rental projects, airports and solid waste disposal facilities;
- Qualified 501(c)(3) bonds issued for qualified 501(c)(3) organizations such as nonprofit hospitals and health care organizations and colleges and universities; and
- Small issue bonds issued for manufacturing facilities.

The House bill would eliminate this tax exemption for qualified private activity bonds issued after December 31, 2017, by repealing Section 142 through 147 of the Code.

The termination of the tax exemption for interest on exempt facility bonds issued for multifamily residential rental projects would severely reduce access to four percent low-income housing tax credits because those tax credits are premised upon the issuance of tax-exempt private activity bonds to finance at least 50 percent of the cost of the low-income housing project.

Also, if the House bill becomes law, issuers and conduit borrowers who have "draw-down" borrowing arrangements in place (such as lines of credit) that constitute tax-exempt private activity bonds issued prior to January 1, 2018, will have to be concerned that draws made under the arrangement after December 31, 2017, would not be tax-exempt because those draws would constitute separate "bonds" issued after the termination of the tax exemption for qualified private activity bonds.

Further, the elimination of the tax exemption for qualified private activity bonds will heighten issuer concerns about any changes in the terms of outstanding tax-exempt qualified private activity bonds that would result in a "reissuance" of the bonds after December 31, 2017, because the "reissued" bonds would not be tax-exempt under the bill.

<u>No Tax Exemption for Interest on Advance Refunding Bonds</u>. Under current law, an outstanding issue of governmental bonds may be refunded one time with the proceeds of tax-exempt "advance" refunding bonds - *i.e.*, refunding bonds issued more than 90 days before all of the refunded bonds are redeemed with proceeds of the refunding bonds. Advance refunding bonds typically have been issued to allow governmental issuers to realize interest cost savings by refinancing outstanding bonds having higher interest rates with new refunding bonds having lower interest rates. Under the bill, interest on advance refunding bonds issued after December 31, 2017, would not be tax-exempt. However, interest on "current" refunding bonds - *i.e.*, refunding bonds issued not more than 90 days prior to redemption of the refunded bonds - would continue to be tax-exempt.

We observe that, under current law, tax-exempt qualified private activity bonds (except for qualified 501(c)(3) bonds) are not permitted to be *advance* refunded with tax-exempt bonds, but may be *currently* refunded on a tax-exempt basis. However, under the House bill, even current refunding bonds issued after December 31, 2017, to refund outstanding qualified private activity bonds would not be tax-exempt because they would constitute private activity bonds issued after the termination of the tax exemption for private activity bonds.

<u>Repeal of Tax Credit Bonds</u>. The bill would repeal the provisions of the Code authorizing tax credit bonds, effective for bonds issued after December 31, 2017. The authority for certain tax credit bonds, such as "build America bonds," has already expired under existing law. However, the bill also would repeal the authority to issue all other tax credit bonds, such as qualified school construction bonds, qualified zone academy bonds, new clean renewable energy bonds and qualified energy conservation bonds.

<u>No Tax Exempt Bonds for Professional Stadiums</u>. Under the bill, no tax exemption would be allowed for "professional stadium bonds" issued after November 2, 2017. A "professional stadium bond" is any bond issued as part of an issue if any proceeds of the issue are used to finance or refinance capital expenditures for a facility (or any appurtenant real property) that, during at least five days during any calendar year, is used as a stadium or arena for

professional sports exhibitions, games or training. This provision would apply, for example, to bonds issued to refund outstanding bonds previously issued by public facilities districts to finance arenas used by professional hockey or other sports teams.

Bond Changes Subject to Future Legislative Developments. It cannot be predicted whether H. R. 1 will gain the support of the House and Senate needed to be enacted into law, and so it is not clear that these major changes in the tax-exempt bond provisions of the Code will be enacted. For more information about the effects of the proposed Tax Cuts and Jobs Act, please contact any member of the Foster Pepper Public Finance team.