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# Public Finance Advisory

## American Recovery and Reinvestment Act (ARRA) Bond Provisions

On February 17, 2009, President Barack Obama signed into law the American Recovery and Reinvestment Act of 2009 (the "ARRA"), which is intended to stimulate economic growth with a mixture of increased federal spending and tax reductions. Division B of the ARRA, designated the "American Recovery and Reinvestment Tax Act of 2009," includes subtitles dealing with general tax relief, energy incentives, tax incentives for business, manufacturing recovery provisions, economic development tools, infrastructure financing tools, economic recovery payments to certain individuals, trade adjustment assistance, and other provisions.

*Interest on "new money" tax exempt bonds issued in 2009 and 2010 will not be taken into account as an item of tax preference or in the determination of a corporation's adjusted current earnings when computing the alternative minimum tax for individuals or corporations.*

Several provisions of the ARRA that may be of interest to issuers of tax exempt and tax credit bonds are summarized below.

### Provisions Related to Bonds Held by Financial Institutions

For bonds issued in 2009 and 2010, banks can deduct 80% of the interest on debt allocable to their purchase of tax exempt bonds issued by qualified small issuers whose annual bond issuance is less than $30 million. The annual limit for qualified small issuers had previously been $10 million. In addition, for purposes of determining whether an issuer meets the requirements of the small issuer exception, qualified 501(c)(3) bonds issued in 2009 or 2010 are treated as if they were issued by the 501(c)(3) organization for whose benefit they were issued, rather than by the actual issuer of the bonds. Individual borrowers in a pool issue are generally treated as if they are separate issuers for purposes of qualification. [Section 1502]

In addition, the administrative safe harbor under which corporations may invest up to two percent (2%) of their assets in tax exempt bonds without a portion of their interest expense deduction being disallowed under Section 265 of the Code is extended to financial institutions. Therefore, banks can now purchase tax exempt obligations issued during 2009 and 2010 and can deduct 80% of the interest incurred to carry such obligations to the extent that the banks' tax exempt bond holdings do not exceed two percent (2%) of the bank's assets. This provision does not apply to refundings of bonds that were originally issued prior to 2009. [Section 1501]

### Temporary Exemption from AMT for Tax Exempt Bonds

Interest on "new money" tax exempt bonds issued in 2009 and 2010 will not be taken into account as an item of tax preference or in the determination of a corporation's adjusted current earnings when computing the alternative minimum tax for individuals or corporations. Bonds issued in 2009 and 2010 to refund bonds issued in 2004 through 2008 are also included. [Section 1503]

### Industrial Development Bonds

For bonds issued after the date of enactment of the ARRA and before January 1, 2011, the definition and scope of "manufacturing facility" are expanded. Facilities used in the production of intangible property (including any patent, copyright, formula, process, design, knowhow, format, or other similar item) can be considered manufacturing facilities. In addition, the 25% limit on financing directly related and ancillary property has been removed and such property may be financed if it is "functionally related and subordinate" to the manufacturing facility. [Section 1301]

### Build America Bonds

For bonds issued before January 1, 2011, certain governmental bonds that otherwise could be issued as tax exempt bonds can be issued as taxable interest bearing bonds with a tax credit to bondholders or a cash subsidy to the issuer. The holder of the taxable governmental bond will accrue a tax credit in the amount of 35% of the interest payable on the bond during the calendar year. The issuer may designate taxable governmental bonds, 100% of the available project proceeds of which are used for capital expenditures, as "qualified bonds". In lieu of the tax credit to bondholders for such qualified bonds, the issuer can elect to receive payments from the federal government equal to the amount of the credit. [Section 1531]

### Qualified School Construction Bonds

A new type of tax credit bond is authorized 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 (60%) of the national limit is allocated among the States and 40% among the largest school districts in proportion to the respective amounts each State or local educational agency received under Section 1124 of the Elementary and Secondary Education Act of 1965 for the most recent fiscal year ending before such calendar year. [Section 1521]

### Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds

Two new types of bonds are authorized to finance economic development projects in certain designated recovery zones. Specifically, $10 billion of Recovery Zone Economic Development Bonds and $15 billion of Recovery Zone Facility Bonds are authorized for issuance in 2009 and 2010. Allocations of the bond limitations to States will be in the proportion that each State's 2008 State employment decline bears to the aggregate 2008 State employment declines for all States. States will allocate similarly to counties and municipalities based on proportionate employment declines. [Section 1401]

Recovery Zone Economic Development Bonds 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.

Recovery Zone Facility Bonds are a new category of tax exempt private activity bonds to finance the cost of depreciable property, substantially all of the use of which is in a recovery zone and in the active conduct of a trade or business.

### Tribal Economic Development Bonds

With certain exceptions, Indian tribal governments are authorized to issue tax exempt bonds for any purpose able to be financed by a State or local government under Section 103(a) of the Internal Revenue Code of 1986 without regard to the "essential governmental function" requirement normally applicable to tribal bonds. Tribal Economic Development Bonds are limited to $2 billion nationwide and cannot be used to finance any facility located outside of an Indian reservation or for class II or class III gaming facilities. [Section 1402]

### Qualified Zone Academy Bonds

An additional $1.4 billion of Qualified Zone Academy Bonds are authorized in both 2009 and 2010. [Section 1522]

### New Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds

An additional $1.6 billion of New Clean Renewable Energy Bonds and an additional $2.4 billion of Qualified Energy Conservation Bonds are authorized. [Sections 1111 and 1112]

*For bonds issued before January 1, 2011, certain governmental bonds that otherwise could be issued as tax exempt bonds can be issued as taxable interest bearing bonds with a tax credit to bondholders or a cash subsidy to the issuer.*

## High-Speed Intercity Rail Facility Bonds

Exempt facility bonds can be issued to finance high-speed intercity rail facilities. The previous requirement that high-speed intercity rail transportation facilities use vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour has been modified so that such facilities must now use vehicles capable of attaining a maximum speed in excess of 150 miles per hour. [Section 1504]

## Davis-Bacon Requirements

The Davis-Bacon prevailing wage requirements are made applicable to projects financed with the proceeds of any New Clean Renewable Energy Bonds, Qualified Energy Conservation Bonds, Qualified Zone Academy Bonds, Qualified School Construction Bonds, and Recovery Zone Economic Development Bonds issued after the date of enactment of the ARRA. [Section 1601]

## Deferral of Withholding Tax on Governmental Contractors

The implementation of a 2005 law that would require state and local governments to withhold three percent of any payments made for property or services has been deferred for one year. [Section 1511]

## Increase in New Markets Tax Credits

An additional $1.5 billion for the 2008 allocation round and $1.5 billion for the 2009 allocation round is authorized. [Section 1403]

Please feel free to contact any of the Edwards Angell Palmer & Dodge LLP lawyers listed below should you have any questions about the provisions of the ARRA.

Boston MA | Ft. Lauderdale FL | Hartford CT | Madison NJ | New York NY | Providence RI | Stamford CT
Washington DC | West Palm Beach FL | Wilmington DE | London UK | Hong Kong (associated office)

This advisory is for guidance only and is not intended to be a substitute for specific legal advice. If you would like any further information please contact:


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