

Public Finance Alert: IRS Initiates Build America Bonds (Direct Payment) Program

4/6/2009

On April 3, 2009, the Internal Revenue Service (IRS) released guidance necessary to permit state and local government issuers to begin issuing the type of Build America Bonds (BABs) authorized by the American Recovery and Reinvestment Act of 2009, involving a 35% direct interest subsidy from the federal government to issuers of taxable bonds financing governmental capital projects. Due to the depth of the subsidy, it is expected that many governmental bond issues for capital projects will consist of BABs during 2009 and 2010, the period for which BABs are authorized under current law. IRS Notice 2009-26 sets forth procedures relating to election, information reporting and payments which have been eagerly awaited by the industry. This alert does not cover portions of the Notice addressing (i) tax credit BABs, whose 35% bondholder tax credit is anticipated to produce only an approximately 25% subsidy for the issuer, and (ii) Recovery Zone Economic Development Bonds, with a 45% direct interest subsidy, which will become operational in a similar manner to BABs when volume cap allocations are released. The key requirements of the Notice as applicable to direct payment BABs are summarized below.

Eligibility

All taxable governmental bonds that could otherwise be issued on a tax-exempt basis, and are issued before January 1, 2011, to finance capital expenditures (net of a reasonably required reserve and an amount not greater than 2% of proceeds for costs of issuance) are eligible to be issued as BABs without restriction as to amount. Refunding bonds and private activity bonds are ineligible. Under a special rule which may have limited application, BABs may reimburse (i) capital expenditures paid or incurred after February 17, 2009 pursuant to a declaration of intent for which the issuer advanced funds and (ii) such expenditures temporarily financed after February 17th on a short term basis. In its press release, the U.S. Treasury Department listed examples of the types of capital projects intended to be subsidized as including “public buildings, courthouses, schools, roads, transportation infrastructure, governmental hospitals, public safety facilities and equipment, water and sewer projects, environmental projects, energy projects, governmental housing projects and public utilities.”

Election

An issuer must make an irrevocable election on or before the date of issuance of the bonds on its books and records to apply the BAB provisions of the Internal Revenue Code. Typically, such an election would be made in the tax certificate prepared for the transaction.

Information Reporting

The Notice instructs issuers to file Form 8038-G for any BAB bond issue regardless of amount. Line 18, "Other," must be checked and "Build America Bond (payment option)" inserted. The description of type of bond normally entered on lines 11 to 18 (*e.g.* education, health and hospital, etc.) is instead required to be entered on a separately attached schedule. A schedule is also required to be attached providing complete debt service information for fixed rate bonds listing, for each interest payment date, total interest payable, the expected principal amount outstanding, and credit payment expected to be requested. For variable rate bonds, the schedule must include interest payment dates, expected principal amount outstanding on each date, and a description of the applicable interest rate formula. Importantly, in addition to the regular Form 8038-G filing requirements, the Form 8038-G must be filed at least 30 days before the filing of any Form 8038-CP subsidy payment request (discussed below) except that, for bonds issued before July 1, 2009 the Form 8038-G may be filed less than 30 days before the filing of the first Form 8038-CP provided it is filed separately and prior to the filing of the Form 8038-CP.

Direct Subsidy Payment Request

For 2009, pending development of a more efficient electronic system expected by 2010, the IRS has established procedures for requesting subsidy payments, on a periodic basis, via the filing of a Form 8038-CP, Return for Credit Payments to Issuers of Qualified Bonds (which was released on the same date as the Notice). The IRS will begin accepting these forms by May 1st and issuers should expect to receive payments by check within 45 days of filing. Payments will be sent to the issuer or to the entity designated by the issuer on the Form 8038-CP. For fixed rate bonds, payments will be made contemporaneously with payments on the bonds; the due date for filing the Form 8038-CP is the 45th day before the applicable payment date. For variable rate bonds, payments will be made quarterly on a reimbursement basis; the applicable due date for filing is the 45th day after the last interest payment date within the quarterly period to be reimbursed.

For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.

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