Client Advisory | *June 2009*

Public Finance Advisory

American Recovery and Reinvestment Tax Act (ARRTA) Bond Provisions Update - Summary of Treasury Department Notices Providing Interim Guidance

The American Recovery and Reinvestment Tax Act of 2009 (the "ARRTA"), which was enacted on February 17, 2009, contains various provisions relating to tax-exempt and tax credit bonds. These provisions both modify the tax law requirements for existing bonds and establish new types of tax-exempt and tax credit bonds. Edwards Angell Palmer & Dodge LLP provided an overview of some of these provisions in our February 2009 Public Finance Advisory (http://www.eapdlaw.com/newsstand/detail.aspx?news=1520). The ARRTA, however, left open many interpretational questions relating to the issuance of the these bonds. Over the past several months, the United States Department of the Treasury and the IRS have begun to release guidance on the ARRTA bond provisions.

This advisory summarizes the guidance that has been released to date for various types of bonds described in the ARRTA.

Build America Bonds

The ARRTA authorizes the issuance in 2009 or 2010 of three types of Build America Bonds ("BABs"):

- BABs ("Direct Payment BABs") as to which the issuer has elected to receive cash subsidy payments from the Treasury equal to 35% of the interest payable on the BABs;
- BABs ("Tax Credit BABs") as to which the holders receive a tax credit equal to 35% of the interest payable on the BABs; and
- Recovery Zone Economic Development Bonds ("RZEDBs") as to which the issuer receives cash subsidy payments from the Treasury equal to 45% of the interest payable on the RZEDBs.

IRS Notice 2009-26 provides guidance as to Direct Payment and Tax Credit BABs. The notice includes information on uses of proceeds, how the election to issue BABs must be made and the new information reporting required for such bonds.

The notice provides that in order to obtain cash subsidy payments for an issue of Direct Payment BABs, the issuer must submit IRS Form 8038-CP, Return for Credit Payments to Issuers of Qualified Bonds ("Form 8038-CP") within a prescribed time before or after each applicable interest payment date, depending on whether the bonds are issued as fixed rate or variable rate obligations. For fixed rate Direct Payment BABs, the issuer must submit Form 8038-CP at least 45 days, but not more than 90 days, before each interest payment date. For variable rate Direct Payment BABs, the issuer must submit Form 8038-CP within 45 days after the last interest payment date within the quarterly period for which reimbursement is requested. Under the Notice, the actual issuer of the Direct Payment BABs must file Form 8038-CP, though the issuer can direct Treasury to pay the subsidy to a third party such as a bond trustee. This notice provides that issuers should expect to receive requested payments within 45 days of the date that Form 8038-CP is filed with the Internal Revenue Service. Treasury has solicited comments on improving the procedures for capturing the cash subsidy on Direct Payment BABs, and issuers can anticipate that further guidance will be released on this subject. Treasury also released Form 8038-CP, along with instructions on completing it, with this notice.

Issuers of BABs must also comply with existing informational reporting requirements, including submission of IRS Form 8038-G, Information Return for Tax-Exempt Governmental Obligations, on or before the 15th day of the 2nd calendar month after the close of the calendar quarter in which the issue was issued.

The notice also provides that the election to designate bonds as BABs must be made on the issuer's books and records on or before the issue date of the bonds.

Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds

The ARRTA authorizes State and local governments to issue Recovery Zone Bonds in 2009 and 2010 in the form of RZEDBs and Recovery Zone Facility Bonds ("RZFBs"), and imposes a national bond volume limitation of $10 billion with respect to RZEDBs and $15 billion with respect to RZFBs. Notice 2009-50 provides guidance on the maximum face amount of RZEDBs and RZFBs that may be issued within each State and, specifically, within counties and large municipalities in each State. The ARRTA requires each State to suballocate volume cap among counties and large municipalities based on relative unemployment decline. In order to ease the administrative burden on States of calculating this required suballocation, the IRS has performed the calculation in connection with the release of Notice 2009-50, and has posted the results on the IRS website (http://www.irs.gov/taxexemptbond/index.html). Under the ARRTA and this notice, counties and large municipalities may waive their respective suballocations for reallocation by the State to eligible projects or programs elsewhere within the State. The notice also provides interim guidance on various aspects of issuing Recovery Zone Bonds.

Eligible issuers of Recovery Zone Bonds include States, political subdivisions, and entities empowered to issue bonds on behalf of States and political subdivisions. Issuers may designate bonds as RZEDBs or RZFBs (assuming the requirements for each type of bond are met) up to the amount of volume cap allocated to that issuer. Alternatively, an issuer may allocate its volume cap to another eligible issuer to issue such bonds. This allocation can be made in any reasonable manner as may be determined in good faith by the issuer for use for eligible costs for an economic development project. However, the property or purpose to which the proceeds of the bonds relate must be in the jurisdiction of both the issuer and the entity to which volume cap was allocated.

RZEDBs are an "enhanced" type of Direct Payment BABs with respect to which the governmental issuer receives cash subsidy payments from Treasury equal to 45% (rather than 35%) of the interest payable thereon. Accordingly, the principles applicable to Direct Payment BABs, including those in Notice 2009-26 (discussed in the Build America Bonds section above), also apply to RZEDBs. Proceeds of the RZEDBs, other than up to 2% used to pay issuance costs and amounts held in a reasonably required reserve, must be used to finance qualified economic development purposes including (1) capital expenditures paid or incurred with respect to property located in a recovery zone, expenditures for public infrastructure and construction of public facilities and (3) expenditures for job training and educational programs.

RZFBs are a new category of "exempt facility bonds" under Section 142 of the Internal Revenue Code and, as such, are tax-exempt private activity bonds. At least 95% of the proceeds of RZFBs, less amounts held in a reasonably required reserve, must be used for recovery zone property in the active conduct of a qualified business. Recovery zone property is defined as depreciable property which was constructed, reconstructed, renovated or acquired by purchase by the taxpayer after the date on which the recovery zone designation took effect.

As required by the ARRTA, proceeds of Recovery Zone Bonds must be used to fund projects and programs related to designated "recovery zones." The notice provides that the designation of an area as a "recovery zone" may be made by an issuer in any reasonable manner as it shall determine in good faith.

The ARRTA requires each State to suballocate volume cap among counties and large municipalities based on relative unemployment decline. In order to ease the administrative burden on States of calculating this required suballocation, the IRS has performed the calculation in connection with the release of Notice 2009-50, and has posted the results on the IRS website (http://www.irs.gov/taxexemptbond/index.html).

Qualified School Construction Bonds

The ARRTA authorizes the issuance of $11 billion of Qualified School Construction Bonds ("QSCBs") in 2009 and $11 billion of QSCBs in 2010. Notice 2009-35 sets forth the maximum amount of the $11 billion of QSCBs that may be issued by each State and local educational agency for 2009 and provides interim guidance with respect to the issuance of QSCBs, including the maximum maturity and credit rate, sinking fund yield calculation, information reporting, eligible expenditures, and eligible issuers.

Eligible issuers of QSCBs include States, political subdivisions, large local educational agencies that are State or local government entities and entities empowered to issue bonds on behalf of any such entity. An eligible issuer may reallocate QSCB volume cap by transferring it to other issuers in a manner similar to that described in the Recovery Zone Economic Development Bonds section of this advisory.

An issuer of QSCBs must use 100% of available project proceeds of the issue for eligible costs, which include construction, rehabilitation or repair of a public school facility or the acquisition of land on which such facility is to be constructed, with a portion of the proceeds of the QSCBs. For this purpose, the costs of acquisition of equipment to be used in the construction, rehabilitation or repair of public school facilities is included as "eligible proceeds."

The maximum maturity and credit rate for QSCBs are determined as of the date there is a binding contract to purchase the bonds. These maturities and rates can be found daily on the Bureau of Public Debt website (www.treasurydirect.gov/govt/apps/slgs/slgs_irstax.htm). Further, an issuer may invest a related sinking fund at 110 percent of the long-term adjusted applicable federal rate, compounded semiannually, for the month in which the QSCB is sold. These rates are also published on the Bureau of Public Debt website.

Qualified Zone Academy Bonds

The ARRTA increases the national bond volume cap for Qualified Zone Academy Bonds ("QZABs") to $1.4 billion for each of calendar years 2009 and 2010. Notice 2009-30 sets forth the maximum amount of the $1.4 billion of QZAB volume that may be issued for each State for each of the calendar years 2008 and 2009. In addition, the notice provides interim guidance with respect to the maximum maturity and credit rate for QZABS and permitted sinking fund yield related to proceeds of QZABs, each of which are generally established in the same manner as described in the Qualified School Construction Bonds section of this advisory.

New Clean Renewable Energy Bonds

The ARRTA increases the national bond volume cap for New Clean Renewable Energy Bonds ("New CREBs") by $1.6 billion to a total of $2.4 billion. Notice 2009-33 solicits applications for allocations of the national New CREBs volume cap. The notice also provides guidance on the eligibility requirements for projects, the application requirements, the allocation methodology of the IRS and Treasury, and certain other interim guidance. Qualified issuers must submit a volume cap application (a copy of which is attached to Notice 2009-33) by August 4, 2009.

Qualified issuers of New CREBs include governmental bodies, cooperative electric companies, and public power providers, as well as New CREBs lenders (cooperative companies which are owned by, or have outstanding loans to at least 100 cooperative electric companies) and not-for profit electric utility companies that have received a loan or loan guarantee under the Rural Electrification Act. The total volume cap will be allocated, up to one-third each to qualified projects owned by governmental bodies, cooperative electric companies, and public power providers. Allocations of New CREBs volume cap, if not used, will expire 3 years after the date of allocation.

Projects to be financed with the proceeds of New CREBs must meet the requirements of a "qualified renewable energy facility," which is a facility that produces electricity from renewable resources, is owned by a public power provider, a governmental body, or a cooperative electric company, and which is entitled to a renewable electricity production credit under the Internal Revenue Code. Additionally, 100% of available project proceeds of New CREBs must be used for "qualified costs" to finance capital expenditures for qualified renewable energy facilities. Qualified costs do not include proceeds used for a reserve, sinking, or replacement fund, or in most cases, proceeds used to acquire or refinance an existing facility.

The credit rate and permitted sinking fund yield related to proceeds of New CREBs are generally established in the same manner described in the Qualified School Construction Bonds section of this advisory (although the applicable credit rate for new CREBs is reduced to 70% of the rate otherwise provided from time to time for other types of qualified tax credit bonds).

The maximum maturity and credit rate for QSCBs are determined as of the date there is a binding contract to purchase the bonds. These maturities and rates can be found daily on the Bureau of Public Debt website (www.treasurydirect.gov/govt/apps/slgs/slgs_irstax.htm).

Qualified Energy Conservation Bonds

The ARRTA increases the national bond volume cap for Qualified Energy Conservation Bonds ("QECBs") from $800 million to $3.2 billion. Notice 2009-29 sets forth the maximum face amount of the $3.2 billion QECBs volume that may be issued by each State and large local government. In addition, the notice provides guidance as to the use of QECB proceeds and interim guidance relating to establishment of the credit rate, calculating the permitted sinking fund yield for QECBs proceeds, and with respect to information reporting.

As directed by the ARRTA, Treasury allocated QECB volume cap to each State. These allocations must be suballocated to large local governments within each State. Under the terms of the notice, eligible issuers of QECBs include States, political subdivisions, and entities empowered to issue bonds on behalf of States and political subdivisions. Issuers of conduit financing issues are also considered eligible issuers. An eligible issuer of QECBs may reallocate volume cap by transferring it to other eligible issuers in a manner similar to that described in the Recovery Zone Economic Development Bonds section of this advisory.

The credit rate and permitted sinking fund yield related to proceeds of QECBs are generally established in the same manner described in the Qualified School Construction Bonds section of this advisory (although the applicable credit rate for QECBs is reduced to 70% of the rate otherwise provided from time to time for other types of qualified tax credit bonds).

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 ARRTA or the notices that provide guidance relating to the ARRTA, or to request a copy of any of the notices discussed in this Advisory.

As directed by the ARRTA, Treasury allocated QECB volume cap to each State. These allocations must be suballocated to large local governments within each State.

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