MARCH 2009

Public Finance Legal Update

Summary of Public Finance Provisions Included in the American Recovery and Reinvestment Tax Act of 2009

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Tax Act of 2009 (the "Act"). The Act contains provisions which, among other things, enhance the marketability of tax-exempt obligations, create new types of bonds for financing school construction, recovery zones and infrastructure, and extend and increase existing programs for school construction and energy projects. The Act also expands financing programs contained in the Energy Improvement and Extension Act of 2008 (the "Energy Act") enacted by Congress in October 2008.

Enhanced Market for Tax-Exempt Bonds

- ***Financial Institutions.*** The Act excludes tax-exempt bonds issued in 2009 and 2010 from the calculation imposed on financial institutions which reduces their interest deduction. The exclusion is limited to 2% of a financial institution's assets and treats the excluded amount as a "financial institution preference item".

- ***Bank Qualification.*** The Act also increases the small issuer limit for "bank qualified" obligations from $10 million to $30 million for the calendar years 2009 and 2010. For 501(c)(3) organizations and governments that borrow tax-exempt bond proceeds, the increased limit is applied at the borrower level.

- ***Alternative Minimum Tax.*** Interest on governmental bonds issued during 2009 and 2010 is not included in adjusted current earnings for purposes of calculating the alternative minimum tax on corporations. This exclusion applies to refunding bonds as long as the refunded bond was issued after December 31, 2003 and before January 1, 2009. Interest on private activity bonds (e.g., bonds for airports, sewage facilities, solid waste disposal facilities, and affordable housing) issued during 2009 and 2010 is not treated as a preference item for purposes of calculating the alternative minimum tax.

These revisions should make tax-exempt obligations more attractive for 2009 and 2010, especially for financial institutions. More issues and more borrowers will benefit from bank qualification, which should reduce interest rates. Private activity bonds for large infrastructure projects should be easier to sell.

New Types of Bonds

- ***Qualified School Construction Bonds.*** The Act adds several new kinds of tax credit bonds, which are bonds designed to provide a tax credit to the holder in lieu of tax-exempt interest. QSCBs finance the construction, rehabilitation, and repair of public school facilities or land acquired for public school facilities. QSCBs are subject to a national limit of $11 billion annually in 2009 and 2010 and are to be allocated to the States and large local school agencies by the Treasury Secretary based on the number of disadvantaged school children.

- ***Build America Bonds.*** For bonds issued after the date of enactment of the Act and before January 1, 2011, issuers are given an option to issue a governmental bond that otherwise qualifies for tax-exemption as a taxable bond which provides the holder with a tax credit equal to 35% of the interest payable on such bond. Original issue premium on BABs is limited and arbitrage rules are imposed on the proceeds using a yield net of the credit allowed. If 100% of the available project proceeds of a BAB is used for capital expenditures, the issuer may elect to receive a direct payment from the Treasury in lieu of giving the credit to the investor.

- ***Recovery Zone Bonds.*** The Act creates two new categories of bonds for recovery zones for issuance in 2009 and 2010: recovery zone economic development bonds (RZEDBs) and recovery zone facility bonds (RZFBs). A recovery zone is an area having significant poverty, unemployment, home foreclosures or general distress, or an area designated as an empowerment zone or renewal community. RZEDBs (limited to $10 billion nationally) are tax credit bonds which allow for a 45% credit of the interest payable. Proceeds of RZEDBs are used to finance economic development purposes in a recovery zone. RZFBs (limited to $15 billion nationally) are treated as exempt facility bonds and the proceeds are used to finance property used in the conduct of a qualified business in a recovery zone. RZEDBs and RZFBs are allocated to the States by the Treasury Secretary based on the decline in 2008 employment.

- ***Qualified Energy Conservation Bonds.*** QECBs are another form of tax credit bond originally established under the Energy Act and used to finance a variety of projects and activities which conserve energy, including those that reduce energy consumption in publicly-owned buildings, green buildings and communities, research in non-fossil fuels, carbon dioxide reduction, and battery technology. Funding for QECBs has been increased under the Act to $2.4 billion from $800 million.

Robinson & Cole has extensive experience with tax credit bonds. These bonds are typically privately placed with financial institutions. Bond purchase agreements and other bond documents for these transactions need to be carefully negotiated in order for issuers to retain the tax benefit of these types of bonds.

Existing Programs

- ***CREBs.*** Clean renewable energy bonds are tax credit bonds used to finance facilities producing energy from renewable sources, such as wind, biomass, geothermal, solar, and landfill gas. The term of the bond and the credit rates are established by the Treasury Secretary. The new version of CREBs established under the Energy Act has been increased to $1.6 billion by the Act.

- ***Qualified Zone Academy Bonds.*** QZABs are the original form of tax credit bonds used to finance public school projects. The Act increases the allocation for QZABs from $400 million to $1.4 billion for 2009 and extends the program to 2010 for another $1.4 billion.

- ***Small Issue Bonds.*** Small issue bonds are a type of tax-exempt private activity bond used to finance manufacturing facilities. The Act expands the definition of "manufacturing facility" by adding intangible property. It also replaces the directly related and ancillary test for supporting structures with the functionally related and subordinate standard generally used for exempt facility bonds, but without regard to the 25% limitation.

- ***New Market Tax Credits.*** New market tax credits are tax credits for qualified equity investments in qualified community development entities. This program gives investors a 39% credit on the amount invested over a seven year period. The Act increases the amount of credits from $3.5 to $5 billion for the calendar years 2008 and 2009, with the increase for 2008 being allocated to 2008 applicants that did not receive NMTCs or received less than requested.

- ***Tribal Bonds.*** Indian tribal governments may issue up to $2 billion of tax-exempt tribal economic development bonds which are exempt from the "essential governmental function" requirement. The IRS has previously interpreted the essential governmental function requirement to prohibit the financing of commercial activities, such as golf courses, hotels and convention centers. None of the proceeds of TEDBs can be used to finance buildings or property used for gaming or located off-reservation. TEDBs will be allocated by the Treasury Secretary, upon consultation with the Secretary of Interior.

Robinson & Cole has served as bond counsel for several QZAB issues and the State's only CREB issue to date. We have also advised many of our municipal clients on the use of new market tax credits and serve as bond counsel to several Indian tribal governments.

Other Provisions

- ***Prevailing Wage.*** The Act applies Davis Bacon prevailing wage requirements to projects financed with QSCBs, RZEDBs, QECBs, CREBs, and QZABs.

- ***Mutual Funds.*** Regulated investment companies are permitted to pass through tax credits on tax credit bonds to shareholders.

- ***Withholding on Government Contractors.*** The Act postpones a 3% withholding requirement imposed on certain federal, state and local government agency payments to contractors to 2012.

We expect the Treasury Department to publish notices and other guidance regarding how the new bonding programs will be administered soon. If you are interested in any of these programs, please contact a member of Robinson & Cole's Public Finance Practice Group.

If you have any questions regarding the topics covered above, please do not hesitate to call any member of Robinson & Cole's Public Finance Practice Group.

David M. Panico
(860) 275-8390
dpanico@rc.com

S. Frank D'Ercole
(860) 275-8246
sdercole@rc.com

Glenn A. Santoro
(860) 275-8322
gsantoro@rc.com

Sandra D. Dawson
(860) 275-8238
sdawson@rc.com

Matthew S. Spaeder
(860) 275-8356
mspaeder@rc.com

Susan Kreutzer
Analyst
(860) 275-8273
skreutzer@rc.com

Teri McGehan
Paralegal
(860) 541-2624
tmcgehan@rc.com