

**MEMO# 23275**

February 25, 2009

# **Tax Credit Bond Provisions In Recently-Enacted Tax Legislation**

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TO: TAX MEMBERS No. 6-09  
FIXED-INCOME ADVISORY COMMITTEE No. 4-09  
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 5-09  
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 4-09  
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 5-09      RE: TAX CREDIT BOND  
PROVISIONS IN RECENTLY-ENACTED TAX LEGISLATION

The American Recovery and Reinvestment Act of 2009 (the "Act"), signed into law last week by President Obama, includes several tax provisions of interest to regulated investment companies ("RICs") and their shareholders. [\[1\]](#) These provisions include:

1. a new Code section permitting RICs that hold tax credit bonds to flow through the associated credits to their shareholders;
2. a new Code section allowing for a new type of tax credit bond (the "build America bond") that pays taxable interest and provides a tax credit equal to 35 percent of the interest paid;
3. a new Code section providing state and local governmental issuers with the ability to receive payments from the Federal government equal to 35 percent of the interest payable on a subset of the build America bond – called "qualified bonds" – for which the issuer elects not to provide holders with a tax credit;
4. increases in the issuance limits for other tax credit bonds; and
5. a temporary exemption from the alternative minimum tax ("AMT") limitations on tax-exempt bonds for bonds issued in 2009 and 2010 that otherwise would be private activity bonds.

## **New Code Section 853A -Flow Through to RIC Shareholders of Credits on Tax Credit Bonds**

The Act provides a statutory mechanism (new Code section 853A) under which a RIC may elect to flow through to its shareholders the tax benefit of any “tax credit bonds” held by the RIC on one or more “applicable dates.” [2] Specifically, a RIC that elects to flow through credits on tax credit bonds will: (1) include in gross income (as interest) the amount of the credits it would have received (but for the election to flow through the credits) and (2) increase its dividends paid deduction by the amount of such income. Shareholders in an electing RIC will (1) include in income their proportionate share of the income attributable to the credits and (2) be entitled to claim their share of such credits against their tax liabilities. A shareholder’s share of such credits may not exceed the amounts so designated by the RIC in a written notice mailed to shareholders no later than 60 days after the close of the RIC’s taxable year.

A “tax credit bond” is defined to include a qualified tax credit bond (as defined in Code section 54A), a build America bond (as defined in new Code section 54AA), and any other bond for which a credit is allowable. The “applicable date” is defined, in the case of any tax credit bond other than a build America bond, as a “credit allowance date” (as defined in Code section 54A(e)(1)) and, in the case of a build America bond, as any “interest payment date” (as defined in Code section 54AA(e)). The Act also provides that, if a tax credit bond is stripped (i.e., if ownership of the bond is separated from the credit with respect to such bond), the credit flow-through provisions shall be applied by reference to the instruments evidencing entitlement to the credit, rather than the tax credit bond.

## **Build America Bonds -- New Code Sections 54AA and 6431**

The Act also allows state and local governments to issue a new type of tax credit bond – the “build America bond.” [3] Unlike other tax credit bonds, which provide only for “tax credits,” the build America bonds both pay taxable interest and provide for a tax credit (the amount of which also is treated as taxable income). The amount of the credit, on any interest payment date, is 35 percent of the amount of interest payable by the issuer on that date. The Act defines a build America bond as an obligation (other than a private activity bond) issued after December 31, 2008 and before January 1, 2011, the interest on which would be excludable from gross income under Code section 103, for which the issuer has irrevocably elected to have this section apply. An obligation shall not qualify as a build America bond, however, if the issue price includes more than a de minimis amount of market premium. Among the other important aspects of the build America bond, (1) there generally is no limit on the amount of such bonds that may be issued by state and local governments, and (2) the tax credit shall not cause the bond to be treated as federally guaranteed.

The Act also provides an alternative regime (under which an issuer may elect to receive cash from the Federal government) for any build America bond that is a “qualified bond.” One requirement for such a bond is that the bond proceeds are used for capital expenditures. Under new Code section 6431, [4] if the issuer elects “qualified bond” treatment for an eligible bond, the Treasury Secretary shall pay to the issuer, contemporaneously with each interest payment date of the qualified bond, 35 percent of the interest payable on such date.

Finally, the issuer of a recovery zone economic development bond (issued under Code section 1400U-2) – which also is a subset of the build America bond – that elects “qualified bond” status under new Code section 6431, will receive from the Treasury Secretary, on any interest payment date, an amount equal to 45 percent (rather than 35 percent) of the interest payable by the issuer on that date. [5]

## **Other Tax Credit Bonds**

The Act also increases the limits on the amounts of various tax credit bonds that may be issued. These bonds include new clean renewable energy bonds (issued under Code section 54C), [6] qualified energy conservation bonds (issued under Code section 54D), [7] qualified zone academy bonds (issued under Code section 54E), [8] recovery zone economic development bonds (issued under Code section 1400U-2), and recovery zone facility bonds (issued under Code section 1400U-3). [9] The Act also creates another new type of tax credit bond – the qualified school construction bond (issued under Code section 54F). [10]

## **Temporary Suspension of AMT Limits for Bonds Issued in 2009 and 2010 (that Otherwise would be Private Activity Bonds)**

The Act also provides (in Code section 57(a)(5)(C)(vi)) that any bond issued after December 31, 2008 and before January 1, 2011 shall not be treated as a private activity bond. [11] Moreover, a refunding bond (whether a current or advance refunding) shall be treated as issued on the date that the refunded bond is issued (unless the refunding bond is issued to refund a bond issued after December 31, 2003 and before January 1, 2009).

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### **endnotes**

[1] The Act can be found at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111\\_cong\\_bills&docid=f:h1enr.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h1enr.pdf)

[2] See Section 1541 of the Act, pages 246 - 248 of H.R. 1.

[3] See Section 1531(a) of the Act, pages 244 -245 of H.R. 1.

[4] See Section 1531(b) of the Act, pages 245 -246 of H.R. 1.

[5] See Section 1401 of the Act, pages 234 - 237 of H.R. 1.

[6] See Section 1111 of the Act, page 208 of H.R. 1.

[7] See Section 1112 of the Act, page 208 of H.R. 1.

[8] See Section 1522 of the Act, page 244 of H.R. 1.

[\[9\]](#) See Section 1401 of the Act, pages 234 – 237 of H.R. 1.

[\[10\]](#) See Section 1521 of the Act, pages 241 – 243 of H.R. 1.

[\[11\]](#) See Section 1503 of the Act, pages 240 - 241 of H.R. 1.

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