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March 17, 2010

Congress Enacts New Qualified Tax Credit Bond Provisions

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TO: TAX MEMBERS No. 8-10
FIXED-INCOME ADVISORY COMMITTEE No. 3-10
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 8-10
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 5-10 RE: CONGRESS ENACTS NEW QUALIFIED TAX CREDIT BOND PROVISIONS

The Hiring Incentives to Restore Employment ("HIRE") Act of 2010 (H.R. 2847) [1] expands provisions included in the American Recovery and Reinvestment ("ARR") Act of 2009 [2] that permit state and local governments to issue bonds that are taxable to investors but for which tax credits are provided. The HIRE Act provisions apply, as discussed below, to new clean renewable energy bonds (issued under Code section 54C), qualified energy conservation bonds (issued under Code section 54D), qualified zone academy bonds (issued under Code section 54E), and qualified school construction bonds (issued under Code section 54F).

Background

Congress in 2009 provided alternative tax regimes for certain state and local government bonds. A newly-created type of bond – the "build America bond" [3] – pays interest that is taxable to investors (rather than exempt from tax under Code section 103); in contrast to traditional state and local bonds, however, investors holding build America bonds receive a tax credit, equal to 35 percent of the interest received. A specified subset of build America bonds – the "qualified bond" [4] – provides another type of tax treatment; specifically, if the issuer elects not to provide holders with a tax credit, the issuer instead receives a payment from the Federal government equal to 35 percent of the interest paid.

Qualified Tax Credit Bonds

The HIRE Act expands the tax credit bond regime to allow state and local governments to issue a new type of tax credit bond – the "specified tax credit bond." A specified tax credit bond is limited to those new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds for which the issuer makes an irrevocable election to have the tax credit bond provision apply. Unlike the build America bonds, which must be issued before the end of 2010 to receive the tax treatment provided by the RRA Act of 2009, specified tax credit bonds issued at any point after date of enactment receive the tax treatment provided by the HIRE Act of 2010.

As amended by the HIRE Act, Code section 6431 provides that the issuer of a specified tax credit bond will receive from the Treasury Secretary, on any interest payment date, an amount equal to 45 percent of the interest payable by the issuer on that date. The payment is 65 percent, rather than 45 percent, if the specified tax credit bond is issued by a "qualified small issuer." For these purposes, a qualified small issuer is defined as an issuer that, with respect to any calendar year, is not reasonably expected to issue tax-exempt bonds (other than private activity bonds) and specified tax credit bonds during such calendar year in an aggregate face amount exceeding $30 million.

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endnotes

[1] For the text of the HIRE Act, click here.

[2] See Institute Memorandum [#23275] 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, and Inst. Money Market Funds Advisory Committee No. 5-09, dated February 25, 2009.

[3] The RRA Act of 2009 defined 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 does 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.

[4] One requirement for a "qualified bond," under new Code section 6431 is that the bond proceeds are used for capital expenditures.