State and Local Government Bond Provisions in the American Recovery and Reinvestment Act of 2009

The American Recovery and Reinvestment Act of 2009 (the "Act") has been signed into law by President Obama. The Act provides new tools for state and local governments to finance basic infrastructure, public schools, economic development and renewable energy assets. The Act also extends the availability of small manufacturing facility financings to the production of intangibles. In addition, the Act also improves market access by providing new incentives to financial institutions which purchase tax-exempt bonds and repealing the alternative minimum tax on private activity bonds issued in 2009 and 2010. Below are a few of the key provisions:

Recovery Zone Economic Development Bonds

This is a new category of tax credit bond, Recovery Zone Economic Development Bonds. These may be issued in 2009 and 2010 to finance economic development purposes in certain designated recovery zones (this appears broadly defined). These bonds are subject to a separate nationwide volume cap limitation of $10 billion.

A new category of tax-exempt facility bond, Recovery Zone Facility Bonds may be issued in 2009 and 2010 to finance depreciable property to be used in recovery zones (this appears to be broadly defined) in the active conduct of a trade or business, subject to certain exceptions. These bonds are subject to another separate nationwide volume cap limitation of $15 billion.

Tax Credit Bonds for Public Schools

This is a new category of tax credit bond and may be issued in 2009 and 2010 to finance the construction, rehabilitation and repair of public school facilities or for the acquisition of land on which a public school facility will be constructed. These are similar to existing QZABs. These bonds are subject to a separate nationwide volume cap limitation of $11 billion for each of 2009 and 2010. There are specific requirements as to how the national limit is to be allocated among the states, with a specified portion to be allocated to certain large school districts.

Taxable Interest/Credit Bond Option

State and local government issuers can elect that any bond (other than a private activity bond) that would qualify for tax exemption under Section 103 of the Code could instead be issued as a taxable bond with the bondholder receiving a tax credit equal to 35% of the interest on the bond. The bonds pay taxable interest but the bondholder claims a credit. These are referred to as the "Build America Bonds."

In 2009 and 2010, an issuer electing this option may further elect to receive direct payments from the federal government in the amount of 35% of the interest payable on the bond, in lieu of the tax credit provided to bondholders. This direct payment provision is only available for new money bond issues where 100% of the proceeds (i.e., sale proceeds less up to 2% costs of issuance and an allowance for a debt service reserve fund) are used for capital expenditures. Note that a 2% cost of issuance limitation is being applied to governmental issuers.

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Build America Bonds may be issued only for those purposes for which tax-exempt governmental bonds may be issued under existing law. Thus the rules that apply to tax-exempt governmental bonds (e.g., private-use restrictions, arbitrage, etc.) also apply to Build America Bonds. If an issuer has made the election to receive the 35% interest payment, the proceeds may only be used for capital expenditures, issuance costs and reserve funds.

Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds

$1.6 billion of new clean renewable energy bonds is authorized for certain renewable energy generation projects. A new requirement is added specifying that the volume cap is equally allocated between state and local governments, municipal utilities and electric cooperatives.

$2.4 billion of qualified energy conservation bonds is authorized to finance programs designed to reduce greenhouse gas emissions including light rail, research grants, demonstration projects and green community programs.

Qualified Zone Academy Bonds

$1.4 billion of qualified zone academy bonds is authorized in 2009 and 2010 for the repair and rehabilitation of public school facilities.

Tribal Economic Development Bonds

Indian tribal governments are authorized to issue up to $2 billion of tax-exempt bonds to finance any purpose that can be financed by a state or local government on a tax-exempt basis, except gaming facilities and facilities located outside the government's reservation.

Manufacturing Facilities

At present, certain manufacturing facilities may be financed with tax-exempt private-activity bonds. In addition, facilities that are directly related and ancillary to a manufacturing facility may be eligible for financing, but only if not more than 25% of the net proceeds of a bond issue are used to provide such facilities.

The Act expands the definition of manufacturing facilities to include facilities that are used in the manufacturing, creation, or production of intangible property (that is, any patent, copyright, formula, process, design, know-how, format, or other similar item). The Act also permits the financing of facilities that are functionally related and subordinate to a manufacturing facility by providing that such facilities are treated as a manufacturing facility and the 25%-of-net-proceeds restriction does not apply to such facilities.

The modifications to the manufacturing definition only apply to bonds issued after the date of enactment through the end of 2010.

Provisions Relating to Bonds held by Financial Institutions

The safe harbor under which corporations generally my invest up to 2% of their assets in tax-exempt bonds without a portion of their interest expense deduction being disallowed under Section 265 of the Code is extended to apply to financial institutions.

The requirements for bonds to be "bank qualified" (not subject to the interest deduction disallowance rule for financial institution holders under Section 291) has been modified. The prior $10 million annual issuance limitation on issuers of bank qualified bonds has been increased to $30 million. In addition, Section 501(c)(3) conduit borrowers are treated as direct issuers for purposes of the qualification requirements.

These amendments apply to obligations issued in 2009 and 2010.

Temporary Repeal of AMT for Private Activity Bonds

Interest on private activity bonds is no longer treated as a preference item for purposes of the alternative minimum tax and also would not be included in the current earnings adjustment under the corporate alternative minimum tax. Last year, this change was made only to Housing Bonds.

These amendments apply to new money obligations issued in 2009 and 2010 and to current refundings of obligations issued in calendar years 2004 through 2008.

Application of Federal Prevailing Wage Requirements to Tax-Credit Bonds

Federal prevailing wage requirements under the Davis-Bacon Act apply to projects financed with the following types of tax-credit bonds:

New Clean Renewable Energy Bonds

Energy Conservation Bonds

Qualified Zone Academy Bonds

Qualified School Construction Bonds

Recovery Zone Economic Development Bonds

For more information about how Stevens & Lee may assist you, please contact Ramiro M. Carbonell at 610-478-2275 or rmca@stevenslee.com, Brian P. Koscelansky at 570-969-5364 or bpk@stevenslee.com, Peter T. Edelman at 610-478-2168 or pte@stevenslee.com, David A. Vind at 610-478-2173 or dav@stevenslee.com, Edward A. Fedok at 610-997-5063 or eaf@stevenslee.com, or John W. Espenshade at 610-478-2103 or jwe@stevenslee.com.