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House Tax Reform Bill Contains Provisions Adversely Impacting Public Finance: Holland & Knight

HIGHLIGHTS:

- The Tax Cuts and Jobs Act introduced in the U.S. House of Representatives on Nov. 2, 2017 – now in markup by the House Ways and Means Committee – has a number of provisions that would likely have a negative impact on the public finance sector.
- The bill would eliminate tax exemption of interest paid on private activity bonds, advance refunding bonds and bonds that finance stadium facilities used by professional sports teams, as well as certain tax credit and subsidy bonds.
- The bill also would eliminate the alternative minimum tax and reduce corporate tax rates, two items that can affect the public finance bond markets.

Rep. Kevin Brady (R-Texas), Chairman of the House Ways and Means Committee, on Nov. 2, 2017, introduced H.R. 1, the Tax Cuts and Jobs Act, and released a section-by-section summary of the bill. A markup of the bill by the Committee started on Nov. 6. The bill, as introduced, would eliminate tax exemption of interest paid on: 1) private activity bonds (including 501(c)(3) bonds), 2) advance refunding bonds and 3) bonds financing stadium facilities used by professional sports teams. The bill would also eliminate certain tax credit and subsidy bonds. In addition, the bill would eliminate the alternative minimum tax and reduce corporate tax rates from 35 percent to 20 percent – two items that are relevant to the public finance bond markets.

Prohibition on Issuing Tax-Exempt Private Activity Bonds

Provision: Bonds issued by a state or local government are generally classified as private activity bonds if more than 10 percent (in most cases) of the financed project is used by non-governmental entities (including 501(c)(3) institutions). Section 3601 of the House plan would remove the present tax exemption of interest paid on various types of private activity bonds. This would eliminate tax-exempt financing of most airports, most seaports, multifamily housing projects, non-governmental solid waste disposal facilities, manufacturing facilities, single-family housing loans, student loans and several other types of projects. In addition, tax-exempt financing of facilities owned by Section 501(c)(3) organizations would be eliminated. That would prevent future tax-exempt financing of private 501(c)(3) hospitals, colleges and universities, K-12 schools, nursing homes and affordable housing facilities. The bill would also adversely impact the issuance of tax-exempt private activity bonds by Indian tribal governments, including previously allowed private activity bonds for certain reservation-based manufacturing facilities. This prohibition on issuing tax-exempt private activity bonds would apply to bonds issued after Dec. 31, 2017.

Comment: These changes would result in higher financing costs for Section 501(c)(3) organizations that own or operate hospitals, colleges and universities, K-12 schools, retirement homes and housing facilities. These changes would also increase the cost of financing needed infrastructure at airports and seaports. Further, by eliminating tax-exempt financing of student loan programs, the bill, if enacted, would increase the cost of a college education. Still further, by eliminating tax-exempt financing for qualifying multifamily housing projects and single-family housing loan programs, the changes could reduce access to both types of housing.

Prohibition on Issuing Tax-Exempt Advance Refunding Bonds

Provision: Advance refunding bonds are bonds that are issued to refinance outstanding tax-exempt debt more than 90 days prior to the date the refinanced debt is repaid. Current law allows bonds issued for governmental projects and for 501(c)(3) entities to be advance refunded once. The bill would eliminate the ability to issue tax-exempt bonds to advance refund outstanding bonds. This prohibition would apply to advance refunding bonds issued after Dec. 31, 2017.

Comment: This change would limit the ability of states, local governments and Section 501(c)(3) organizations to lock in interest rate savings while rates are low and avoid the risk of rates having increased by the time the outstanding bonds are permitted to be repaid.

Prohibition on Issuing Certain Tax Credit or Interest Subsidy Bonds

Provision: State and local governments are currently permitted to finance certain types of projects by issuing tax-favored bonds carrying a taxable interest rate. They are able to reduce their borrowing costs either by receiving interest subsidy payments from the federal government or through the assignment of federal income tax credits that are provided to the holders of these bonds. The bill would prohibit the issuance of these types of tax-favored bonds.

Comment: The change would eliminate new clean renewable energy bonds, qualified school construction bonds, qualified forestry conservation bonds, qualified energy conservation bonds and qualified zone academy bonds. This prohibition would apply to bonds issued after Dec. 31, 2017.

Prohibition on Issuing Tax-Exempt Professional Stadium Bonds

Provision: Current law allows the use of tax-exempt governmental bonds to finance professional stadiums in limited circumstances. The bill would prohibit the issuance of any tax-exempt bonds to finance professional sports stadiums. “Professional sports stadium” would be defined as a facility (or appurtenant real property) that, over at least five days during any calendar year, is used as a stadium or arena for professional sports, games or training.

Comment: Unlike the other prohibitions, this one would apply to bonds issued after Nov. 2, 2017.

Elimination of Alternative Minimum Tax

Provision: The bill would eliminate the alternative minimum tax. That tax currently has a highest marginal rate of 28 percent. The interest on most tax-exempt private activity bonds currently is subject to the alternative minimum tax. Exceptions from the alternative minimum tax are provided for interest on bonds that finance projects owned or operated by a Section 501(c)(3) organization and for bonds financing certain types of housing programs. The elimination of the alternative minimum tax would be effective for tax years beginning after Dec. 31, 2017.

Comment: This would benefit current holders of private activity bonds subject to the alternative minimum tax who have previously paid that tax on the interest they received.

Reduction of Corporate Tax Rates

Provision: The bill would reduce the general corporate marginal tax rate from 35 percent to 20 percent. The reduction of the corporate tax rates would be effective for tax years beginning after

Dec. 31, 2017.

Comment: The corporate tax rate reduction would reduce the value of interest on tax-exempt bonds not being taxable and, as a result, may reduce demand. Also, it is common when a bank directly purchases tax-exempt bonds from the issuer for the loan documents to provide for an automatic increase in the interest rate on the bonds if the corporate tax rates fall to compensate for the reduction in the value of the bonds. Many states, local governments and Section 501(c)(3) organizations that previously privately placed tax-exempt bonds with a bank could see their borrowing costs increase as of Jan. 1, 2018.

Considerations for Bond Issuers and Borrowers

Holland & Knight attorneys are assisting a number of issuers in analyzing the impact of H.R. 1 on both future and prior capital plans and financings. Holland & Knight also has a robust government affairs practice with key relationships in both the executive and legislative branches in Washington, D.C. If you have any questions regarding the tax reform bill currently being drafted in the House of Representatives, please contact a member of our Public Finance Team.

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