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Congress Extends QZABs, New Markets Tax Credits; Continuing Effect of Sequestration: McGuire Woods

On Dec. 19, 2014, President Barack Obama enacted the Tax Increase Prevention Act of 2014 (the "Act"), commonly referred to as the tax extenders bill (H.R. 5771), which you may read here. Generally, the Act extends many programs that expired at the end of 2013. This Client Alert focuses on the extension of Qualified Zone Academy Bonds (QZABs), New Markets Tax Credits (NMTCs), and empowerment zone employment credits and on the enduring impact of sequestration on direct-pay bonds.

Qualified Zone Academy Bonds

The Act authorizes the Secretary of the Treasury to allocate an additional $400 million in QZABs for 2014. Prior to the Act, no additional allocations of QZABs were to be available to the states after Dec. 31, 2013. The 2014 round of QZABs allocations will expire if not issued on or before Dec. 31, 2016. QZABs issued under the 2014 allocations are eligible only for the tax credit and may not use the direct-pay option. This limitation also applies to QZABs issued under the 2013 allocations that expire at the end of 2015.[1]

As a reference, QZABs benefit a "qualified zone academy" (typically, a public school) that is designated as such by the "applicable local education agency," which is oftentimes the governing local school board or district. As more fully described in Section 54A of the Internal Revenue Code of 1986, as amended, a holder of a QZAB receives a credit against federal income taxes.

New Markets Tax Credits

The Act also authorizes $3.5 billion in allocations for the New Markets Tax Credit program. This authorization is for 2014. Prior to the Act, the last round of allocation related to 2013. The 2014 allocations must be used by Dec. 31, 2019.

The New Markets Tax Credit program is designed to encourage investment in qualifying low-income communities. An investor receives a tax credit in return for equity investments in community development entities that use those invested funds for eligible purposes aimed at targeted populations and low-income areas. The credit is 39 percent, taken over seven years. Many states have programs similar to the federal New Markets Tax Credit program.

Empowerment Zones

Moreover, the Act extends the benefits of empowerment zone designation by providing that any existing empowerment zone will remain designated as such until Dec. 31, 2014. Previously, the designation of existing empowerment zones expired on Dec. 31, 2013.

The benefits of empowerment zone status include the empowerment zone employment credit, which provides employers a federal tax credit equal to 20 percent of qualified zone wages paid during a calendar year. Qualified zone wages are wages paid to an employee who lives in an empowerment

zone and performs substantially all of his or her employment in that empowerment zone. Other tax benefits include increased deductions for equipment placed in service in empowerment zones and delayed recognition of any gains on the sale of qualifying empowerment zone assets.

Federal Sequestration and Direct-Pay Bonds

All direct-pay bonds, including QZABs, Build America Bonds, Qualified School Construction Bonds, New Clean Renewable Energy Bonds, Qualified Energy Conservation Bonds and Recovery Zone Economic Development Bonds, remain subject to the ongoing effects of federal sequestration. For fiscal year 2015 (which ends on Sept. 30, 2015), the direct-pay subsidy for those bonds issued as direct-pay bonds is subject to a 7.3 percent reduction.

Unless a law is enacted that cancels or otherwise amends the sequestration, the existing subsidy reduction will remain in effect through the end of fiscal year 2024.

1. Included as Title II of H.R. 5771 is the "Tax Technical Corrections Act of 2014." See Section 202(d) for the above-mentioned provisions relating to QZABs.

December 22, 2014

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