Obama Budget Adds Muni Programs, Contains 28% Cap.

WASHINGTON – The $4 trillion fiscal 2016 budget request unveiled by President Obama on Monday includes several proposals applauded by muni market participants, including: a six-year, $478 billion transportation infrastructure plan; the creation of tax-exempt qualified public infrastructure bonds; America Fast Forward direct-pay bonds; and an increase in the annual issuer bond limit for bank-qualified bonds.

On the other hand, his renewed push to limit the value tax-exempt bond interest to 28% of a taxpayer's income, a new proposal to eliminate the use of tax-exempt bonds to help finance professional sports stadiums and a plan to impose a fee on big banks and broker-dealers, are drawing some opposition.

Ultimately the budget request, the first that Obama has had to release with Republicans in control of both chambers of Congress, may not matter.

House Ways and Means Committee chairman Paul Ryan, R-Wis., said the budget contains $2.1 trillion in new taxes and would add $8.5 trillion in more debt. "This is simply unacceptable," he said.

Sen. David Vitter, R-La. said, "The only positive thing about [the budget] is that it has a zero percent chance of becoming law."

But Micah Green, chair of the financial services and tax policy practice group at Squire Patton Boggs, said that while the budget is unlikely to be warmly embraced on Capitol Hill, it puts forward ideas.

The budget makes infrastructure a priority. Obama's six-year transportation plan, proposed as the current temporary transportation funding program is set to expire on May 31, would be funded with $278 billion from a new tax rate on corporate foreign earnings and $240 billion of gasoline tax revenues.

The proposal would increase federal surface transportation funding to almost $80 billion annually over the six years, from fiscal 2015's $54 billion.

"These investments would be paid for by closing tax loopholes as part of reforming the business tax rules to level the playing field and make sure everyone pays their fair share," the White House said in a fact sheet.

"The proposal would allow us to repair existing roads and bridges and modernize our infrastructure with new investments in highways, freight networks, and bus, subway, rapid transit, light rail, and passenger rail systems," the fact sheet said.

Obama would establish an independent national infrastructure bank to leverage public and private capital to fund large infrastructure projects. The infrastructure bank, which Obama has been pushing for since 2011, would be capitalized with $7.7 billion over the next 10 years.

The six-year plan would provide $317 billion for roads and bridges and more than $143 billion for transit and passenger rail. The budget also includes $28.6 billion for high-performance and other passenger rail projects, and $18 billion for multimodal freight programs.

The plan would provide $7.5 billion to the Transportation Investment Generating Economic Recovery, or TIGER, and make the grant program permanent. The budget also includes $1 billion annually for credit assistance and low-cost loans through the Transportation Infrastructure Finance and Innovation Act Program for nationally or regionally significant transportation projects. A new office for innovative finance would be created to manage these credit programs.

The Transportation Department's proposed $94.7 billion budget for fiscal 2016 covers the first year of the six-year transportation program. The proposed spending plan for 2016 would allocate $51 billion to highways and surface transportation projects, an increase of $10 billion, and $18 billion to transit, an increase of $7 billion.

In a TV interview with NBC News on Feb. 1, Obama said he was open to options from Republican lawmakers on infrastructure funding. "I think Republicans believe that we should be building our infrastructure," Obama said. "The question is how do we pay for it? That's a negotiation we should have.

"My job is to present the right ideas, and if the Republicans think they have better ideas, then they should present them," he said.

The proposed 14% corporate tax rate would be levied on foreign profits even if the money remains overseas. The tax rate on current earnings then would be set at 19% instead of the current 35% rate. The 14% transition tax would mean that multinational companies have to pay U.S. tax right now on the $2 trillion they already have overseas, rather than being able to delay paying any U.S. tax indefinitely at the current 35% rate, the White House said.

"Unlike a voluntary repatriation holiday, which the president opposes and which would lose revenue, the president's proposed transition tax is a one-time, mandatory tax on previously untaxed foreign earnings, regardless of whether the earnings are repatriated," the fact sheet said.

Obama's proposal sets the stage for a serious discussion on long-term, sustainable infrastructure funding, said Bud Wright, executive director of the American Association of State Highway and Transportation Officials.

"We know the hardest conversations will involve how to fund infrastructure investments," Wright said.

The president's proposal is "extremely encouraging" and should be the beginning of debate on how to fund long-term infrastructure needs, said Brian Turmail, director of public affairs at Associated General Contractors of America.

"We expect Congress will take this opportunity to work out a viable deal with the administration," he said.

But Sen. Jim Inhofe, R-Okla., chairman of the Environment and Public Works Committee, was not happy. "The president's budget proposal entangles infrastructure funding with other pet projects that distract from Washington's constitutional responsibility to provide for our nation's roads and bridges," he said. "Efficient investments and common-sense reforms of our nation's surface infrastructure system will be the key to rebuilding a stronger, more robust middle class and to moving our economy forward for the next generation ..... I am working with my colleagues on a long-term reauthorization bill that builds on the reforms in MAP-21 and provides states the certainty needed to deliver the projects most critical to our nation."

Obama would raise to $19 billion from $15 billion the national limit for qualified highway and surface freight transfer facility bonds.

As expected, the budget proposes the creation of tax-exempt QPIBs, which would not be subject to volume caps or the alternative minimum tax, but would have to comply with other private-activity bonds requirements, such as having to obtain public approval.

QPIBs could be issued beginning in 2016 for airports, docks and wharves, mass commuting facilities, water furnishing and sewage facilities, solid waste disposal projects, and qualified highway or surface freight transfer facilities.

Projects financed by QPIBs would have to be owned by a state or local governmental unit and would have to serve a public use or be available on a regular basis for general public use. QPIBs could replace certain PAB categories or could be issued in addition to them and would increase the deficit by $4.83 billion from 2016 through 2025, according to the budget.

The budget once again calls for the creation of a permanent, taxable direct-pay America Fast Forward bond program, with Treasury making subsidy payments to issuers equal to 28% of their interest costs. AFF bonds could be used to finance projects that could be financed with PABs or QPIBs as well as governmental capital projects or current refundings of bonds associated with such projects. They could also be used for working capital financings and projects for 501(c)(3) nonprofit entities.

Mike Nicholas, CEO of Bond Dealers of America, said BDA supports QPIBs and AFF bonds, as long as they are not intended to replace tax-exempts.

As expected, the budget would increase the issuer annual cap to $30 million from $10 million for bank-qualified bonds. Banks could buy the tax-exempt bonds of issuers who sold reasonably expected to issue less than $30 million of munis during the year.

It also proposed modifying the 2% de minimis rule for financial institutions to include banks. That provision would allow banks to deduct 80% of the cost of buying and carrying tax-exempt bonds, to the extent that their tax-exempt holdings do not exceed 2% of their assets. Banks currently are only able to take advantage of that 80% write-off when purchasing bank-qualified bonds.

Dealer groups and issuers were pleased with the increase in the issuer limit for bank-qualified bonds. Michael Decker, a managing director and co-head of munis at the Securities Industry and Financial Market Association, said this proposal is "very welcome" and that, since banks are playing an increasing role as investors in tax-exempts, it's important to encourage that.

Nicholas said BDA is "fully supportive" of the increase, but that the limit should also be indexed for inflation.

Richard Ellis, Utah's Treasurer and former president of the National Association of State Treasurers, said the increase "makes a lot of sense" since the costs of projects has increased over the years due to inflation.

The president proposed expanding a little-known program called Qualified Public Education Facility Bonds. First authorized in 2001, those bonds' issuance is currently capped at the greater of $5 million or $10.00 per capita. The program has not been used much, if at all, because of its problematic requirement that an educational facility be both part of a public elementary or secondary school and owned by a private, for-profit corporation engaged in a public-private partnership with a state or local government. The proposal would eliminate the private corporation ownership requirement and subject QPEFs to state PAB volume caps. But Obama renewed his call for a 28% cap on the value of tax-exempt bond interest, including for bonds already issued, beginning in 2016. Dealer groups complain this would be a tax on municipals.

“A little bit of the value [of QPIBs] is taken back” by the 28% cap, said Green.

“We completely disagree” with the 28% cap, Nicholas said. When muni interest is taxed, it raises issuers’ borrowing costs.

“It’s a direct hit on issuers’ ability to finance capital improvement projects,” he said. If it is more expensive to pay for projects, taxes will go up for people that live in the issuers’ jurisdictions.

For the first time, Obama proposed eliminating tax-exempt financing of professional sports stadiums. “Allowing tax-exempt governmental bond financing of stadiums transfers the benefits of tax-exempt financing to private professional sports teams,” Treasury said in its green book on the budget’s tax proposals. It also “shift[s] more of the costs and risks from the private owners to local residents and taxpayers in general,” it said.

SIFMA stands by the current law. “There’s a well-established and well-seasoned test for determining what projects qualify for tax-exempt bond financing. Stadium financings have been structured to pass this test, and it doesn’t make sense to exclude one type of bond from the regular test,” Decker said.

“Professional sports in certain cities are the core of their economy and their identity,” Green said.

Obama’s proposed fee of seven basis points for banks, broker-dealers and other financial institutions with worldwide assets of more than $50 billion was also criticized.

A SIFMA spokesperson said the group doesn’t support a tax on a single sector and thinks that any tax reform should be comprehensive. A lot of the Dodd-Frank reforms that regulators have finalized or are working on mitigate risk. “The tax code is not the place to address risk,” she said.

THE BOND BUYER

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