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The Tax Reform Roller Coaster Ends - Summary of Provisions Affecting Public Finance.

On December 22, 2017, the President signed the Tax Cuts and Jobs Act (the “Final Bill”) into law, bringing an end to the nearly two-month rollercoaster ride that had the public finance industry white-knuckled and a little green in the face.

At the end of the day, the Final Bill is a far cry from the initial assurances that tax reform “won’t touch tax-exempt bonds.” However, given the rather shocking provisions initially included in the House Bill, the end result could have been a lot worse. The Final Bill ultimately will affect the municipal bond market with some ups and downs as things settle, but hopefully the transition will be more carousel and less roller coaster.

Corporate and Individual Tax Rates Reduced

The most prominent feature of the Final Bill is the reduction of the corporate tax rate from a maximum rate of 35% to a flat rate of 21%. On the individual side, the top tax rate was reduced from 39.6% to 37%, although this reduction expires at the end of 2025. Potentially offsetting this benefit to taxpayers is the change to certain deductions available under current law; most notably the reduction of the mortgage interest deduction from \$1 million to \$750,000 for married filers and the capping of the deduction of state and local taxes at \$10,000. While it may be too early to quantify with any precision how the rate reductions will affect the public finance industry, it is likely that the result will be increased interest rates on tax-exempt bonds due to the decrease in the value of the tax-exemption (especially in the case of corporate bond purchasers).

Alternative Minimum Tax (AMT) - Eliminated for Corporations; Exemption Increased for Individuals

In the past, despite being “tax-exempt,” interest earnings on PABs were treated as an item of tax preference includable in alternative minimum taxable income for purposes of determining the AMT imposed on individuals and corporations. As a result, purchasers of PABs generally demanded higher interest rates than they would for governmental bonds.

The Final Bill significantly changes the AMT in a number of ways. For corporations, the AMT is repealed in its entirety for tax years beginning after December 31, 2017. For individuals, both the AMT exemption amount and the exemption amount phaseout thresholds are increased and indexed for inflation for tax years beginning after December 31, 2017 but before January 1, 2026. With the repeal of the AMT for corporations and the increased exemptions (albeit temporary) for individuals, the typically higher interest rates associated with PABs (compared to non-AMT bonds) may be reduced – however, any benefit from this change in law will likely be tempered by the overall reduction in the tax rates discussed above.

Private Activity Bonds Live On (At Least for Now)

The Final Bill retains all categories of tax-exempt private activity bonds (PABs), which include, among others, bonds issued for projects owned by section 501(c)(3) organizations; low-income multifamily housing developments; single-family mortgage bonds; airports; docks, wharves, and ports; sewage and solid waste facilities; mass commuting facilities and facilities for the furnishing of water. While there had been last minute rumors that the price of retaining PABs might be the elimination of an issuer's ability to carry forward PAB volume cap, no such provision was included in the Final Bill. This is particularly good news for projects reliant on the coordination of multiple sources of financing – such as affordable housing developments – where the carry forward of volume cap is more common.

The lower corporate tax rate (discussed above) enacted under the Final Bill will decrease the value of tax-exempt interest to corporate investors, which will likely negatively affect issuers in the pricing of tax-exempt bonds. Potentially offsetting this bad news for PABs, however, is the repeal of the corporate AMT (also discussed above), which some have predicted will decrease the interest rate spread between governmental bonds and PABs.

Despite the favorable result for PABs in the Final Bill, now is not the time to rest easy. After the passage of the Final Bill, members of Congress have continued to question whether the scope of projects financeable by PABs should be reduced to include only projects that are related to “national infrastructure,” the intended scope of which is unclear. With the promise that infrastructure is the next big ticket item on the agenda, PABs may be in line for another roller coaster ride. Thus, those interested in the continued existence of PABs should continue to extol their benefits to decision-makers in Washington.

Advance Refundings Eliminated

The Final Bill eliminates the ability of governmental issuers and issuers of qualified 501(c)(3) bonds to benefit from issuing advance refunding bonds (i.e. bonds issued more than 90 days before the redemption of the refunded bonds) on a tax-exempt basis. Unfortunately, the Final Bill does not reflect the robust efforts to lobby Congress to include transition rules. As a result, as of January 1, 2018, issuers are unable to issue tax-exempt advance refunding bonds.

The elimination of advance refundings significantly limits the flexibility of issuers and borrowers to lock-in debt service savings, restructure debt service, or to achieve relief from unfavorable financing terms. We anticipate that players in the municipal bond market will develop alternative synthetic financing arrangements to mimic the economics of an advance refundings. However, these alternative arrangements likely will not be as efficient for issuers as a simple advance refunding would have been.

Professional Stadium Financings Continue to Play Ball

The Final Bill retains the ability to issue tax-exempt bonds for facilities to be used as stadiums or arenas for professional sports, which is undoubtedly welcome news for those involved in projects across the country that are in the works. Despite the favorable treatment in the Final Bill, however, it is worth noting that both Democrats and Republican legislators have questioned whether professional sports stadiums should be financeable with tax-exempt bonds. This apparent bipartisan support may cause some governmental issuers with potential stadium financings in the pipeline to accelerate the projects in order to ensure that bonds are issued before any future legislation eliminates this ability.

Tax Credit Bonds Eliminated

The Final Bill eliminates future issuances of “qualified tax credit bonds,” including qualified school construction bonds, qualified zone academy bonds, and qualified energy conservation bonds, among others. Although interest on tax credit bonds is not tax-exempt, these types of bonds have nevertheless allowed issuers to achieve a lower cost of capital on infrastructure projects by entitling the holder to a federal tax credit or, in certain cases, the issuer to receive a subsidy payment directly from the federal government. Mitigating this otherwise negative aspect of the Final Bill is the fact that many of these projects can still be financed on a tax-exempt basis with governmental bonds and/or PABs.

While no new tax credit bonds can be issued after December 31, 2017, holders and issuers of tax credit bonds issued before 2018 will continue to be eligible to receive the federal tax credit or federal subsidy payment, as applicable.

Low-income Housing Tax Credit (LIHTC) Intact

The affordable housing industry need not worry about how to pronounce “AHTC” (i.e. the “affordable housing tax credit”), as no changes – including name changes – were made to the provisions in the Code relating to the LIHTC. Had provisions eliminating PABs been passed, it would have been a severe blow to what are known as “4% tax credits,” as they are required to be coupled with PABs issued for qualified residential rental housing. With PABs safe, affordable housing developers can rest assured that the 4% tax credits will live to see another syndication. However, the reduction in the corporate tax rate (discussed above), as well as the ability to only partially offset the new “base erosion and anti-abuse tax” with the LIHTC, will likely affect the value of the LIHTC to tax credit investors, in turn affecting the feasibility of certain projects.

Mortgage Credit Certificates (MCCs) Preserved

In another win for affordable housing, the Final Bill retains MCCs, which allow qualifying homebuyers to claim a tax credit for a portion of the mortgage interest paid during a tax year, making home ownership more affordable for first time homebuyers of low and moderate incomes. Issuers that receive volume cap for single-family mortgage bonds can “trade in” volume cap for the ability to issue MCCs, allowing these issuers to provide an array of products to assist first-time homebuyers depending on the homebuyers’ needs and preferences.

PAYGO Problem Solved

[As we previously reported](#), there was a concern that due to the projected estimated increase in the federal deficit caused by the Final Bill, the provisions of the “Pay-As-You-Go Act of 2010” (the “PAYGO Act”) would result in the “zeroing out” (i.e., a 100% reduction) in subsidy payments paid to issuers of tax credit bonds (including build America bonds, qualified school construction bonds, qualified zone academy bonds and qualified energy conservation bonds, among others). Despite initial threats by Democrats to withhold support for waiving the PAYGO Act, a short-term funding bill was eventually passed with enough votes to avoid the mandatory sequestration. As a result, issuers of direct pay tax credit bonds will continue to receive the associated federal subsidy payments, albeit in an amount reduced under the sequestration imposed by the Budget Control Act of 2011.

So, Now What?

It is unlikely that the signing of the Final Bill will be the end of the ride. In fact, as was the case in 1986, there may very well be one or more pieces of legislation in the future that include technical corrections to address any unintended consequences of the Final Bill. It remains to be seen whether

any of these corrections will relate to public finance (including whether the scope of projects financeable with tax-exempt PABs will be narrowed). In addition, the President's long-awaited infrastructure plan could include various features that would incentivize public finance and public-private partnerships in new ways.

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