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PUBLIC FINANCE ALERT

Squire, Sanders & Dempsey L.L.P.

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STIMULUS LEGISLATION

TABLE 1 – Comparison of Legislative Provisions

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Temporary expansion of "qualified tax-exempt obligation" (QTEO) provisions. **Effective for bonds issued after 12/31/08, through 2010.**	Increases the QTEO limit from $10 million to $30 million for tax-exempt bonds issued in 2009 and 2010 (new money or refunding).	[SAME.]
	In applying the $30 million limit to qualified 501(c)(3) bonds issued during 2009 and 2010, the bonds are treated as though issued by the 501(c)(3) borrower, not by the actual issuer. Thus, each 501(c)(3) is subject to its own $30 million limitation and qualified 501(c)(3) bonds do not count against the issuer's limit.	[SAME.]
	For pooled financings,[1] the limit is applied to the "qualified borrower"[2] (from the pool) rather than to the pool issuer.[3]	[SAME.]
Temporary extension of *de minimis* (2 percent) safe harbor to investment interest of financial institutions. **Effective for bonds issued after 12/31/08, through 2010.**	Financial institutions are generally not allowed to deduct that portion of their interest expense that is allocable to tax-exempt interest received on bonds that are not QTEOs. The allocation is generally made by multiplying the bank's interest expense by the ratio of tax-exempt bonds (other than QTEOs) to total assets of the bank. Under the proposal, a financial institution can exclude from the numerator of that fraction tax-exempt obligations owned by the financial institution issued during 2009 and 2010, up to a limit of 2 percent of the financial institution's assets.	[SAME.]
	However, tax-exempt obligations excluded from the numerator under the above are treated as "financial institution preference items," and any interest deduction attributable to them is reduced by 20 percent in the case of financial institutions that are banks.[4]	[SAME.]
	Current or advance refunding bonds are treated as having been issued on the date of the original refunded bond.	[SAME.]

[1] For example, any issue the proceeds of which are used directly or indirectly to make or finance loans to two or more ultimate borrowers, all of whom are qualified borrowers.
[2] "Qualified borrower" means: (1) a State or political subdivision of a State; or (2) an organization described in Internal Revenue Code of 1986 as amended (Code) Section 501(c)(3) and exempt from tax under Code Section 501(a).
[3] The Joint Committee on Taxation's Explanation of the House bill provides the following example: "Thus, for example, a $100 million pooled financing issue that was issued in 2009 could qualify for the section 265(b)(3) exception if the proceeds of such issue were used to make four equal loans of $25 million to four qualified borrowers. However, if (1) more than $30 million were loaned to any qualified borrower, (2) any borrower were not a qualified borrower, or (3) any borrower would, if it were the issuer of a separate issue in an amount equal to the amount loaned to such borrower, fail to meet any of the other requirements of section 265(b)(3), the entire $100 million pooled financing issue would fail to qualify for the exception."
[4] Code Section 291(e); this is done by treating bonds excluded under the proposal as issued on Aug. 7, 1986, for purposes of Code Section 291(e) only.

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Temporary relief from AMT. **Effective for bonds issued after 12/31/08, through 2010.**	Interest on tax-exempt private activity bonds issued in 2009 and 2010 is not subject to the alternative minimum tax. Interest on all tax-exempt bonds issued in 2009 and 2010 is not included in the corporate AMT adjustment based on adjusted current earnings. For these purposes, refunding bonds are treated as issued on the date the original (new money) bonds were issued.	[SAME.]
Qualified School[5] Construction Bonds **Effective for bonds issued after 12/31/08, through 2010.**	Qualified School Construction Bonds (QSCBs) are treated as "qualified tax credit bonds" under Code Section 54A.	[SAME.]
	The credit rate on QSCBs is set by the Treasury Secretary at a rate that is **50 percent** of the rate that would permit issuance of such bonds without discount or interest cost to the issuer.	The credit rate on QSCBs is set by the Treasury Secretary at a rate that is **100 percent** of the rate that would permit issuance of such bonds without discount or interest cost to the issuer.
	The maturity of QSCBs is the term that the Treasury Secretary estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the QSCBs are issued.	[SAME.]
	General Requirements: (1) 100 percent of the available project proceeds (sale proceeds and investment earnings on sale proceeds less up to 2 percent of issuance costs) must be used for the "construction, rehabilitation or repair of a public school facility or for the acquisition of land on which such a bond-financed facility is to be constructed." (2) QSCBs must be issued by a State or local government within which the school is or will be located. (3) The issuer must designate the bonds as QSCBs.	[SAME.]

[5] Note that this refers to primary and secondary education facilities, not higher education facilities.

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Continued– Qualified School Construction Bonds **Effective for bonds issued after 12/31/08, through 2010.**	**National limitation** – $11 billion may be issued in each of 2009 and 2010.[6] (1) States[7] get 60 percent of the $11 billion issuance authority ($6.6 billion). $6.6 billion is allocated among the States based on their populations of children 5 through 17 (irrespective of economic status). This $6.6 billion of issuance authority may be reduced by allocations to US possessions (other than Puerto Rico) based on a State's population below the poverty line. States that do not use all of their allocations can carry them forward to the next calendar year. Thus, QSCBs could be available in 2009 and 2010, and also in 2011 and beyond for any issuance authority carried forward from 2010. Each State is free to suballocate this issuance authority to political subdivisions to the extent and in the manner it chooses. (2) The remaining 40 percent of issuance authority ($4.4 billion) is allocated among "large local educational agencies."[8] It is made in proportion to the respective amounts each agency received for Basic Grants under subpart 2 of Part A of Title I of the Elementary and Secondary Education Act of 1965 for the most recent fiscal year ending before the year of allocation.[9] If a large, local educational agency has issuance authority left over at the end of a calendar year, it may "suballocate" the remaining issuance authority to its State. **Under this allocation, described specifically in the footnotes, between 100 and 125 large local educational agencies would receive this 40-percent allocation.** (3) The Treasury Secretary must adjust States' allocations to ensure that any allocations under (1 above) plus the allocations to any "large local educational agencies" in the State are greater than a floor amount, equal to: 1.68 x [minimum "percentage" from 20 U.S.C. 6333][10]	**National limitation –** $5 billion may be issued in each of 2009 and 2010.[11] (1) [SAME, except with respect to amount of issuance authority.] (2) The Senate Finance Committee's markup omits this provision. Presumably, this means that the States will receive the issuance authority otherwise granted to large local educational agencies.

[6] The House proposal allows for $200 million of issuance authority for school construction bonds in 2009 and 2010 to construct, rehabilitate or repair schools funded by the Bureau of Indian Affairs. This allocation does not reduce the amount of QSCB issuance authority otherwise available for allocation.
[7] Including Washington DC and US possessions.
[8] A "large local education agency" meets **either** of two criteria: (i) the agency is "among the 100 local educational agencies with the largest numbers of children 5 through 17 from families below the poverty level, **or** (ii) one of no more than 25 local educational agencies (not in (i) above) that the Secretary of Education determines are in need of assistance.
[9] 20 U.S.C. § 6333.
[10] Note that the usage of the term "percentage" is a bit strained, since the result under 20 U.S.C. § 6333(d) does not yield a percentage, but rather an amount. This "percentage" is the **lesser of** the following two numbers: (1) [(0.25 percent x (the total amount allocated to **all** the States under 20 U.S.C. § 6333 (Title I)) + (0.35 percent x (the excess actually allocated in the most recent calendar to all the states under 20 U.S.C. § 6333 in excess of the historic 2001 allocation)))], **or** (2) the average of (1) and (the number of children in the relevant State counted under 20 U.S.C. § 6333(c)) x 150 percent of the national average per-pupil payment made with funds available under 20 U.S.C. § 6333 for the year in question.
[11] The Senate proposal allows for $200 million of issuance authority for school construction bonds in 2009 and 2010 to construct, rehabilitate or repair schools funded by the Bureau of Indian Affairs. This allocation does not reduce the amount of QSCB issuance authority otherwise available for allocation.

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Continued– Qualified School[12] Construction Bonds **Effective for bonds issued after 12/31/08, through 2010.**	The three-year spending rule applicable to other qualified tax credit bonds applies (i.e., must spend all proceeds within three years or use unspent proceeds to redeem bonds within 90 days).[13]	[SAME.]
	The special arbitrage rules applicable to other tax credit bonds apply.[14]	[SAME.]
	The credits may be stripped (i.e., assigned by the bondholder to another party) from the bonds.	[SAME.]
Qualified Zone Academy Bonds **Effective for bonds issued after 12/31/08 and before 1/1/11.**	Authorizes the issuance of up to $1.4 billion of qualified zone academy bonds in each of 2009 and 2010. Current law permits $400 million in 2009, and none thereafter (except possible carryover).	[SAME.]
	The credits may be stripped from the bonds.	[SAME.]
"Taxable Bond" Option for Governmental Issuers **Effective for all bonds, new money or refunding, issued after enactment.**	**General –** Allows governmental issuers to irrevocably elect, at or before issuance, to treat bonds that would be tax exempt and would not be private activity bonds as taxable bonds that provide a tax credit to holders equal to 35 percent of the interest payable. Credits accrue as of the date of the interest payments. Credits can be used to offset regular tax or AMT liability. Unused credits can be carried forward to future taxable years. To be eligible for election, bonds must not have more than a *de minimis* amount of OIP.[15]	[Referred to as "Build America Bonds"] [SAME.]
	Interest on a taxable governmental bond and the related credit are includible in gross income to the holder for Federal tax purposes. The bill provides that until a State requires otherwise, the interest and credit on any taxable governmental bond is treated as exempt from federal income tax for purposes of State income tax laws.	[SAME.]
	Yield on taxable governmental bonds is determined without regard to the credit for arbitrage purposes.	[SAME.]

[12] Note that this refers to primary and secondary education facilities, not higher education facilities.
[13] 100 percent of the available project proceeds (i.e., sale proceeds (and investment earnings on sale proceeds) less issuance costs (capped at 2 percent)) of qualified school construction bonds must be used within the three-year period that begins on the date of issuance. After three years, bonds will continue to qualify as qualified school construction bonds only if unspent proceeds are used within 90 days from the end of such three-year period to call bonds. The three-year spending period may be extended by the Treasury Secretary upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence. Note that this option is probably of limited utility because it will require the issuer to obtain a private letter ruling from the IRS, which is a costly and time-consuming process.
[14] Available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements). In addition, amounts invested in a reserve fund are not subject to the arbitrage restrictions to the extent: (1) such fund is funded no faster than a rate of equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the QSCBs are issued.
[15] The legislative language notes that whether a bond has more than a *de minimis* amount of OIP is to be determined under "rules similar to the rules" of Code Section 1273(a)(3).

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Continued– "Taxable Bond" Option for Governmental Issuers **Effective for all bonds, new money or refunding, issued after enactment.**	The credits may be stripped from the bonds.	[SAME.]
	Special Rule Allowing Credit to the *Issuer* rather than the Holder. This election is available only for bonds of which 100 percent of "available project proceeds" (sale proceeds and investment earnings on sale proceeds less up to 2-percent issuance costs) are spent for capital expenditures. The special issuer-credit taxable bond option is applicable to **bonds issued** after the date of enactment of the provision and before 1/1/11. The credit is available for the full term of bonds issued before 1/1/11; it does not terminate on 1/1/11 for bonds issued before that date.	[SAME.]
	The IRS pays the amount of the credit to the issuer. The payment by the Treasury Secretary is to be made contemporaneously with the interest payment made by the issuer, and may be made either in advance or as reimbursement. In lieu of payment to the issuer, the payment may be made to a person making interest payments on behalf of the issuer. For purposes of the arbitrage rules, the yield on a qualified bond is reduced by the amount of the credit/payment.	[SAME.]
Clean Renewable Energy Bonds or CREBs **Effective for bonds issued after the date of enactment.**	The proposal authorizes issuance of up to an additional $1.6 billion of CREBs.	[SAME.]
	The credits may be stripped from the bonds.	[SAME.]
Qualified Energy Conservation Bonds **Effective for bonds issued after the date of enactment.**	(1) The proposal expands the present-law qualified energy conservation bond program by authorizing issuance of an additional $2.4 billion of qualified energy conservation bonds, expanding the limitation from $800 million to $3.2 billion. (2) Bonds can be issued to fund loans and grants for green community programs without causing such bonds to be treated as private activity bonds for purposes of the private activity bond restrictions in the qualified energy conservation bond rules.	(1) [SAME.] (2) [NO PROVISION.]
	The credits may be stripped from the bonds.	[SAME.]

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Expanded Small-Issue IDBs **Effective for bonds issued after the date of enactment, but before 1/1/2011.**	[NO PROVISION.]	Expands the definition of "manufacturing facilities" in the small-issue IDB provisions[16] to include any facility that is used in the manufacturing, creation or production of tangible property or intangible property (meaning any patent, copyright, formula, process, design, know-how, format or other similar item).[17] Facilities that are functionally related and subordinate to the manufacturing facility are treated as a manufacturing facility and any amount of the net proceeds (rather than the current law 25 percent) of the bonds can be used to finance such subordinate facilities.
Exempt Facility Bonds for High-Speed Intercity Rail Facilities **Effective for bonds issued after the date of enactment.**	[NO PROVISION.]	Provision modifies definition of "high-speed" train to include trains that are reasonably expected to attain a **top speed** of 150 mph, rather than "operating" at speeds above 150 mph between stops.

[16] Code Section 144(a)(12)(C).
[17] Code Section 197(d)(1)(C)(iii).

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Recovery Zone Economic Development Bonds (RZEDBs) and Recovery Zone Facility Bonds **Effective for bonds issued after the date of enactment and before 1/1/11.**	Authorizes both Recovery Zone Economic Development Bonds ($10 billion limit) and Recovery Zone Facility Bonds ($15 billion limit).	[SAME.]
	The Treasury Secretary allocates the Recovery Zone Bond issuance authority among the States in the proportion that each State's 2008 employment decline[18] bears to the aggregate 2008 employment declines for all States. Each State is then required to suballocate issuance authority among counties and large municipalities based on proportional employment decline. When calculating county employment decline, the decline in any large municipality located in that county is ignored.	Each State is guaranteed at least 1 percent of total issuance authority. Then, the remaining authority is allocated as in the House proposal. [OTHERWISE, SAME.]
	After receiving a suballocation from the State, the local government issuer designates one or more areas as recovery zones. To qualify as a recovery zone, an area must have: (i) significant poverty, unemployment or rate of home foreclosures; (ii) be designated as an empowerment zone or renewal community; or (iii) be an area of "general distress."[19]	Lacks the "general distress area" zone designation option for the issuer.
Recovery Zone Economic Development Bonds (RZEDBs) (taxable, "issuer-credit" governmental bonds)	RZEDBs are taxable governmental bonds issued as part of an issue, if: (1) 100 percent of available project proceeds are to be used for one or more **qualified economic development purposes;** and (2) Such bonds are designated by the issuer as RZEDBs. **"Qualified economic development purpose"** means: Promoting development or other economic activity in a recovery zone including: (i) capital expenditures paid or incurred with respect to property located in such zone; and (ii) expenditures for public infrastructure and construction of public facilities located in such zone.	[SAME.]
	Entitles the issuer of RZEDBs to receive an advance tax credit equal to **55 percent** of the interest payable on an interest payment date.	Entitles the issuer of RZEDBs to receive an advance tax credit equal to **40 percent** of the interest payable on an interest payment date.
	The credit may be stripped from the bonds.	[SAME.]

[18] Measured by comparing December 2007 employment to December 2008 employment.
[19] Code Section 1392(a)(2).

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Recovery Zone Facility Bonds[20]	New category of exempt facility bonds which are tax-exempt private activity bonds.	[SAME.]
	Although the legislation is not specific, presumably recovery zone facility bonds can be issued only by a county or large municipality after receiving a mandatory suballocation from the State.	[SAME.]
	At least 95 percent of the net proceeds of the issue of Recovery Zone Facility Bonds must be used for **recovery zone property,** and the issuer must designate the bonds as qualified recovery zone facility bonds.	[SAME.]
	"Recovery zone property" is defined as depreciable property[21], if: (1) Such property was purchased after the date the recovery zone was designated; (2) The original use of the property commences with the user; (3) Substantially all of the use of the property is within the recovery zone; and (4) The bond-financed property is used in the active conduct of a **qualified business.**[22]	[SAME.]
	Recovery Zone Facility Bonds are private activity bonds, so all the private activity bond rules apply, except: (1) Recovery Zone Facility Bonds do not count against the aggregate annual State private activity bond volume limits; and[23] (2) The restriction on acquisition of existing property does not apply.[24]	[SAME.]

[20] Unlike Recovery Zone Economic Development Bonds, which are a special type of qualified taxable governmental bonds, Recovery Zone Facility Bonds are an additional type of "exempt facility" bonds, governed by Code Section 142.
[21] The legislation specifically defines such depreciable property as property "to which Code Section 168 applies," or to which Code Section 168 would apply, but for the operation of Code Section 179.
[22] Both the House and Senate bills define a "qualified business" as "any trade or business except that the rental to others of real property located in a recovery zone shall be treated as a qualified business only if the property is not residential rental property (as defined in Code Section 168(e)(2) and does not include any trade or business consisting of the operation of any facility described in Code Section 144(c)(6)(B) (i.e., any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal purpose of which is the sale of alcoholic beverages for consumption off premises."
[23] Code Section 146.
[24] Code Section 147(d). However, as stated above, the definition of "recovery zone property" still requires the initial use of the bond-financed property to commence with the user under the Recovery Zone Facility Bond financing.

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Tribal Economic Development Bonds (TEDBs) **Effective for bonds issued after the date of enactment.**	National limitation of $2 billion, allocated by the Treasury Secretary after consultation with the Secretary of the Interior.	[SAME.]
	TEDBs are treated as issued by a State, but volume cap under Code Section 146 does not apply.	[SAME.]
	TEDBs are any bonds: (1) Issued by an Indian tribal government; (2) That would be tax-exempt if issued by a State but would be taxable under Code Section 7871(c); and (3) That are designated by the Indian tribal government as a TEDB.	[GENERALLY, SAME.]
	Cannot be used for casinos, and can only be used for property on the issuer's reservation.	[SAME.]
Extension of "Prevailing Wage" Requirement to Projects Financed by Qualified Tax Credit Bonds **Effective for bonds issued after the date of enactment.**	Subchapter IV of Chapter 31 of Title 40 of the United States Code (prevailing wage requirements) applies to projects financed with the proceeds of (i) CREBs, (ii) QECBs, (iii) QZABs, (iv) QSCBs, and (v) RZEDBs.	[SAME.]
Expansion of New Markets Tax Credit Program **Effective for calendar years 2008 and 2009.**	[NO PROVISION.]	Increases the maximum amount of "qualified equity investments" from $3.5 billion to $5 billion each year. The additional amount for 2008 must be allocated to qualified CDEs that submitted an allocation application for 2008 and either: (1) Did not receive an allocation for 2008, or (2) Received an allocation for 2008 in an amount less than requested. The proposal also provides alternative minimum tax relief for equity investment allocations subject to the 2009 annual limitation.

Legislative Provision	House Bill (As passed on 1/28/09)	Senate Bill (After committee markup on 1/27/09)
Delay of Onset of Withholding on Payments to Government Contractors **Effective on the date of enactment.**	Delays for an additional year (from 12/31/10 to 12/31/11) the onset of a provision requiring that government payors under certain programs withhold 3 percent of the payment.	[SAME.]

TABLE 2 – Credit Rates for Tax-Credit Bonds in Stimulus Legislation

Provision	House Bill Credit Rate	Senate Bill Credit Rate
CREBs	70 percent	70 percent
Qualified Energy Conservation Bonds	70 percent	70 percent
Recovery Zone Economic Development Bonds	55 percent	40 percent
Qualified School Construction Bonds	50 percent	100 percent
Qualified Zone Academy Bonds	100 percent	100 percent
Build America Bonds (Taxable Governmental Bonds)	35 percent	35 percent[25]

[25] The credit under these bonds flows either to the holder of the bonds or, if certain conditions are met, the issuer can elect to take the credit.

TABLE 3 – Effective Dates of Relevant Provisions

Provisions Effective Until 1/1/2011	Provisions Effective Indefinitely
Extension of *de minimis* (2-percent) safe harbor to investment interest of financial institutions.	Taxable Governmental Bonds
Modifications to "qualified small issuer" exception from disallowance of investment interest deduction for financial institutions.	Clean Renewable Energy Bonds
Temporary modification of alternative minimum tax limitations on tax-exempt bonds.	Qualified Energy Conservation Bonds
Qualified School Construction Bonds.	Exempt Facility Bonds for High-Speed Intercity Rail Facilities
Qualified Zone Academy Bonds.	Tribal Economic Development Bonds
Expanded Small-Issue IDBs	Extension of "Prevailing Wage" Requirement to Projects Financed by Qualified Tax Credit Bonds
Recovery Zone Bonds.	
Taxable bond option for governmental issuers, where the issuer makes an irrevocable election to take the tax credit, instead of the holder taking such credit.	

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