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KEY PUBLIC FINANCE PROVISIONS OF THE Tax Cuts and Jobs Act (TCJA)

Tax-Exempt Interest				
Proposal	**Senate Bill**	**House Bill**	**Conference Committee (TCJA)**	**I.R.C. Sections**
Private Activity Bonds (PABs)	-No change to rules for Qualified Private Activity Bonds (PABs). -Last-minute changes to retain the corporate and individual alternative minimum tax (AMT), including a corporate "minimum" tax at the "maximum" corporate tax rate of 20%, on a base that includes interest on qualified PABs (other than AMT-exempt 501(c)(3) bonds and housing bonds ("AMT-exempt bonds"), may tend to increase the value of AMT-exempt bonds relative to other PABs, which would invariably be subject to the AMT in the hands of corporate taxpayers.	-Tax Exemption for PABs eliminated for bonds issued after 2017. -No transition relief so interest on PABs issued after 2017 would be taxable to bondholders, including (1) outstanding PABs that are subsequently deemed reissued because of significant modifications to the terms of the bonds, (2) bonds issued to refund outstanding tax-exempt PABs, and (3) draws made after 2017 on outstanding PABs issued as bonds draw-down bonds. Effective after 12/31/2017.	-PABs are expressly preserved in Republican Leadership's *Policy Highlights of the Tax Cuts and Jobs Act Conference Report*. - House Speaker Paul Ryan lists one of the TCJA's signature accomplishments as "[r]etaining the tax-preferred status of private-activity bonds that are used to finance valuable infrastructure projects," despite his chamber's efforts to terminate all PABs after 2017. - Retention of PABs obviates the market's scramble to fully-fund projects scheduled for post-2017 draw downs.	I.R.C. § 103(b)(1), §§ 141–150. (Not included in the Final Bill).

Observations:

Section 103 of the Internal Revenue Code (the "Code") establishes two broad categories of tax-exempt state and local bonds: (i) bonds issued by a state or political subdivision thereof to finance government facilities or to be repaid with governmental funds ("governmental bonds"); and (i) "qualified private activity bonds"

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(PABs) in which the state or local government serves as a conduit providing financing for specified purposes to persons other than state political subdivisions (including private individuals and businesses, 501(c)(3) nonprofit organizations and the federal government). While interest paid on governmental bonds is generally excluded from gross income, the exclusion from gross income for state and local bonds does not apply to PABs, unless the bonds are issued for certain qualified purposes authorized under the Code's rules for exempt facility bonds and qualified mortgage, veterans' mortgage, small issue, student loan, redevelopment and 501(c)(3) bonds.

Given President Donald Trump's infrastructure initiative, and Treasury Secretary Steve Mnuchin's experience overseeing Goldman Sachs's trading in municipal bonds, the GOP tax reform bill that passed the House on November 16 surprised many by providing for the complete repeal of tax-exempt PABs. Exempt facility bonds include bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed rail facilities); multifamily housing projects; privately-owned or privately-operated utility facilities (sewage, water, solid waste disposal and local district heating and cooling facilities); public and private educational facilities; and qualified highway facilities. Indeed, Treasury Secretary Mnuchin suggested *expanding* access to exempt facility bonds during his confirmation hearing as a way to spur U.S. infrastructure growth, which made the policy behind the House bill's termination of tax exemptions for interest on bonds used to rebuild America's "crumbling" infrastructure, housing and transportation all the more confusing.

The House bill's approach generated substantial uncertainty in the municipal bond market and controversy, even among Republicans. On December 2, 2017, the Senate released its amendment to the House bill, which deleted the provision repealing PABs and House Budget Committee Chair Diane Black (R-TN) openly questioned the wisdom of PAB repeal during the Conference Committee's hearing on December 13, 2017. After several Democrats focused on the issue, Representative Black appeared to agree with them, stating, in describing the TCJA's goals, that "private activity bonds are . . . one of the tools that is [sic] used for capital improvements." By week's end, the compromise bill was published without a repeal of the private activity bonds and a two-month frenzy to issue PABs before 2017 and avoid post-2017 draw-downs suddenly dropped off.

It is worth noting that Congress's mere threat to terminate PABs at year's end, without a transition rule, was itself a costly enterprise. The House Ways and Means Committee's threatened repeal of PABs after 2017, without a transition rule, generated extraordinary economic waste as market participants scrambled to protect themselves from potentially devastating consequences at year's end. The rejection of the House's proposed repeal just 16 days before the House plan's repeal would have taken effect, while welcome, hardly makes up for the precipitous repeal effort that appears not to have been well vetted by House Republicans before its release last month. Moreover, while PABs survived tax reform, their near repeal suggests that PABs may still be under threat when Republicans take up infrastructure next year.

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Tax-Exempt Interest				
Proposal	**Senate Bill**	**House Bill**	**Conference Committee (TCJA)**	**I.R.C. Sections**
Advance Refunding Bonds	- Eliminates the exclusion from gross income of interest on a bond issued to advance refund another tax-exempt bond (including governmental and qualified 501(c)(3) bonds). - Effective for bonds issued after December 31, 2017.	Same	- Follows the House and Senate bills. - No advance refundings of governmental bond or qualified private activity bonds after December 31, 2017. - Effective for bonds issued after December 31, 2017.	I.R.C. § 149(d) TCJA § 13,532

Observations:

As expected, interest on advance refunding bonds issued after December 31, 2017, will not be tax exempt. Section 13532 of the Conference Committee's bill is identical to the same section in the Senate's bill and section 3602 of the House bill. Like the earlier bills, the final version of the Tax Cuts and Jobs Act provides no transition relief for issuers and conduit borrowers whose obligations are already issued and outstanding. Both bills accomplish this by striking the general rule that advance refunding bonds (other than those described in in Sections 149(d)(2), (3) and (4)) may be tax-exempt bonds under Section 103(a) and instead generally providing that "[n]othing in section 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond issued to advance refund another bond." In addition, the Act removes authority to advance refund bonds issued prior to 1986 more than once.

A refunding is an issuance of bonds for the purpose of redeeming outstanding bonds and a refunding is an advance refunding if the refunding bond is issued more than 90 days before the redemption of the bond it refunds. Advance refunding allows governmental issuers and 501(c)(3) organizations (and no other obligors on private-activity bonds) to restructure eligible tax-exempt debt by refinancing outstanding debt at a lower rate or spreading debt service payments over a longer period of time. This technique allows governmental and 501(c)(3) organizations to obtain the benefit of lower interest rates when the outstanding bonds are not currently callable but may be redeemed prior to maturity with proceeds of bonds issued at a lower interest rate. The federal tax expenditure arises from the fact that both the refunded bonds and the refundings are outstanding and generating interest income that is exempt from federal taxation for the same project.

Since savings from advance refunding are a function of prevailing interest rates and the particular redemption features of an obligor's outstanding debt, the ability of governmental and tax-exempt entities to quickly change advance refunding schedules in response to tax policy is fairly limited. Moreover, the GOP tax bill, if enacted Friday, would come just four business days before year's end, effectively foreclosing any further tax planning around advance refunding repeal.

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The lack of transition relief for advance refunding bonds is a key feature of all three GOP tax plans, which many participants in the municipal bond market consider unduly harsh. Transition rules are routine where new tax laws unsettle expectations and advance refundings have been explicitly authorized under Section 149(d) for 31 years. While it is true that Congress has gradually chipped away at advance refundings, so that they are now available only to governmental issuers and 501(c)(3) borrowers, those organizations were not warned before November 2, 2017, that their longstanding ability to advance refund a tax-exempt bond once during its life would end as of December 31, 2017. That has created havoc at the end of this year for 501(c)(3) organizations, elected officials, bidding and escrow agents, underwriters, issuers and their respective representatives, all scrambling to get advance refunding deals closed before the ball drops in Times Square.

Proposal	Senate Bill	House Bill	Conference Committee (TCJA)	I.R.C. Section
Stadium Bonds	- No change to existing treatment of tax exempt status of interest on bonds issued to build sports stadiums.	-Repeals tax exemption for all bonds, the proceeds of which are used to build “professional sports stadiums.” - Defines a “professional sports stadium,” subject to the rule, as any facility that is used as a stadium or arena for professional sports exhibitions, games or training for at least five days in any calendar year. Effective for bonds issued after November 2, 2017.	- No change to existing treatment.	I.R.C. § 103(b) (Not included in the Final Bill)

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Observations:

On November 16, 2017, the House passed a bill that included a retroactive repeal of the tax-exempt status of bonds financing "professional sports stadiums" as of November 2, 2017 (the date the House Ways and Means Committee promulgated the original text of the House tax bill). On December 2, 2017, the Senate passed an amended version of The Tax Cuts and Jobs Act without the special rule for tax-exempt-financed sports stadiums. The Conference Committee ultimately rejected the House bill's special rule excluding professional use of tax-exempt-bond financed stadiums, perhaps because of its breadth and retroactive effect.

The House bill's retroactive effective date of November 2, 2017, for otherwise tax-exempt bonds used to build sports stadiums was unusual, and potentially applied not only to abusive planning around the private business use test but also to a wide variety of colleges and universities with state-of-the-art athletic facilities that go unused for several months a year. Under this provision, tax-exempt bonds would no longer be available to build any facility, including a state or private college athletic stadium, used for professional sports exhibitions, games, or training for five days in any calendar year. This is a broad provision, encompassing not only governmental bonds issued with general taxes repaying the debt, but also apparently picking up facilities financed by 501(c)(3) bonds issued by colleges and universities to finance their athletic facilities that may rent the facilities to professional sports organizations on days when they are not being used for college athletic events.

The Senate bill rejected this new limit on governmental and private activity bonds and so did the Conference Committee. It will therefore not become part of the GOP tax reform bill expected to be enacted this week.

Tax-Credit Bonds				
Proposal	**Senate Bill**	**House Bill**	**Conference Committee (TCJA)**	**I.R.C. Section**
Tax-Credit Bonds	- No change to authority to issue certain types of taxable bonds providing a tax credit to holders or an interest subsidy payment to the issuer from the federal government in cases where statutory authority still exists to issue bonds and there is still unused volume cap.	-Termination of the authority to issue new tax credit bonds after December 31, 2017, including federal subsidies for bonds used to renovate, develop or equip private/public schools (qualified zone academy bonds (QZABs) and qualified school construction bonds (QSCBs))	- Follows the House bill by repealing the authority to issue new tax credit bonds after December 31, 2017. - Federal tax credits for issued and outstanding tax credit bonds are not affected by the TCJA. These include QZABs, QSCBs, new CREBs , CREBs, QECBs, Build America Bonds and Recovery Zone Economic Development Bonds.	I.R.C. § 54–54AA TCJA § 13,404

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		and bonds used to promote energy efficiency and to finance renewable energy facilities (new clean renewable energy bonds (new CREBs) and qualified energy conservation bonds (QECBs)).		

Observations:

Qualified tax credit bonds ("QTCBs") are taxable bonds that incentivize investment by delivering federal tax credits to bondholders rather than paying tax-exempt interest. Holders of QTCBs receive quarterly allocations of credits, which may be used to offset federal income and alternative minimum taxes. The amount of the bondholder's credit is determined by multiplying the bond's applicable credit rate by the face amount of the holder's bond and the Treasury Department determines the applicable credit rate as of the date a binding commitment is made to purchase the bonds. Therefore, since the repeal of tax credit bonds is expressly limited to bonds issued after December 31, 2017, the repeal should not affect taxpayers' right to receive tax credits generated by QTCBs issued and outstanding as of that date, including tax credits from qualified zone academy bonds (QZABs), qualified school construction bonds (QSCBs), new clean renewable energy bonds (new CREBs) and qualified energy conservation bonds (QECBs).

The authority to issue Build America Bonds and recovery zone economic development bonds expired on January 1, 2011, so these bonds are not directly affected by this legislation. However, like QZABs, QSCBs, new CREBs and QECBs, other QTCBs, Build America Bonds and Recovery Zone Economic Development Bonds that remain outstanding will continue to pay credits as before.

Proposal	Senate Bill	House Bill	Conference Committee (TCJA)	I.R.C. Sections
Repeal of Mortgage Credit Certificates	No provision	Repeals authority to issue mortgage credit certificates in lieu of qualified mortgage bonds after December 31, 2017.	Rejects the House proposal to repeal state and local governments' authority to issue mortgage credit certificates.	I.R.C. § 25 (No provision)

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Observations:

States and political subdivisions can issue mortgage credit certificates in lieu of tax-exempt qualified mortgage bonds under Section 143(a)(1) of the Internal Revenue Code. Qualified mortgage bonds, like mortgage credit certificates, must make at least 20% of the proceeds of an issue available to finance mortgagors for at least one year in "targeted areas" where 70 percent or more of the families have income that is 80 percent or less of the statewide median family income. The mortgage credit certificate gives the holder a federal tax credit of between 10% and 50% of the mortgage interest paid.

Qualified mortgage interest bonds are private activity bonds, which the House sought to repeal entirely. In that context, it made sense to also repeal mortgage interest certificates, which provided a similar tax benefit under Section 25 as the qualified mortgage bonds proposed to be repealed by the House. Since both the Senate and the Conference Committee rejected that approach to PABs, the authority of state and local governments to establish a qualified mortgage credit certificate program is left unchanged.

The Effect of Other New Tax Rules on Public Finance Provisions

Proposal	**Senate Bill**	**House Bill**	**Conference Committee**	**I.R.C. Sections**
Low-Income Housing Tax Credits (LIHTC)	- LIHTC ceiling would continue to be available for low-income housing projects at least 50% financed with the proceeds of tax-exempt private activity bonds. - Would increase LIHTC for certain new buildings located in rural areas (as defined in Section 520 of the Housing Act of 1949) and would reduce the offset of basis for buildings in high-cost areas to 125% from 130%. - Would strike exception from general public use requirement because of occupancy restrictions	- No 4% LIHTC would be available to projects at least 50% financed by § 142(d) exempt facility bonds. - No increase in LIHTC ceilings allocated to states and the District of Columbia, which would be the only method of obtaining tax credits to pay for affordable-housing projects.	- No change to LIHTC provisions or PAB provisions, so current-law applies. - LIHTC Volume Cap will be indexed to Chained CPI-U (discussed below).	I.R.C. §42(h)(3)(H)(i)(II) (LIHTC Cap) TCJA § 11002

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	for preferences that favor tenants enagaged in artistic or literary activities and replace it with an exception available for occupancy restrictions for veterans.			

Observations: Low-income housing tax credits (LIHTCs) under section 42 of the Internal Revenue Code generally are accessed in one of two ways. First, each state and the District of Columbia has an LIHTC ceiling, which, as of 2017, was equal to the greater of (a) $2.35 multiplied by the state's population or (b) $2.71 million. Second, low-income housing projects automatically qualify for a 4% LIHTC allocation over 10 years (the 4% LIHTC) without regard to the state housing credit ceiling if at least 50% of the project's aggregate basis is financed by tax-exempt residential rental facility bonds under section 142(d). For calendar year 2017, each state and the District of Columbia had a tax-exempt private activity bond cap for all private activity bonds of at least $100 per person (or 42 times the LIHTC ceiling for credits allocated through the housing authority).

As a result, many jurisdictions met their affordable housing needs by relying on the 4% LIHTC available to developers using private activity bonds to finance projects, which the House bill would make unavailable. The Council of Development Finance Agencies estimated that the House bill's proposed elimination of PABs would have eliminated approximately 50% of the U.S. affordable housing market and the Texas Affiliation of Affordable Housing Providers called potential PAB repeal "a massive crisis" for low- and moderate-income housing in America.

In the end, Republicans in Congress who have been touting their retention of the affordable housing tax credit as a progressive feature of their tax bill decided not to test the limits of an affordable housing market unable to access 4% tax credits through tax-exempt financing. It kept PABs but rejected all proposed changes to the LIHTC in the House and Senate bills and imposed a new cost-of-living adjustment throughout the Code that will likely reduce the availability of the LIHTC over time (as discussed below).

Proposal	**Senate Bill**	**House Bill**	**Revenue Effect**	**I.R.C. Section**
Repeal of alternative minimum tax (AMT)	- Retains the corporate and individual AMT but includes higher exemptions amounts for individuals subject to the AMT. - **Corporate AMT**: The final version of the Senate bill retained the corporate alternative minimum tax at 20%,	- Repeals the Corporate and Individual AMT.	- The Conference Committee ultimately repealed the corporate AMT and left the individual AMT at the same rates but with higher exemption and phase-outs available to high-net-worth individuals through December 31, 2025. - Beginning on January 1, 2026, individual	I.R.C. § 57(a)(5) TCJA § 12003

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	while lowering the maximum corporate tax rate to 20%. The AMT is imposed on a broader base, which includes tax-exempt interest on PABs (other than 501(c)(3) bonds, 142(d) low-income housing bonds and certain mortgage bonds), so the interest exemption would become worthless to corporate holders of AMT bonds because they would always pay AMT rather than regular tax if both taxes are imposed at a 20% rate. - **Individual AMT**: Retains current rates of 26% on amount not exceeding $175,000 and in excess of increased exclusions amounts ($109,400 for married filing jointly; $70,300 for single taxpayers; increased phase-outs apply as well), so through 2025 fewer individuals will pay AMT.		AMT will reset to current exemption/phaseouts. - Corporate AMT repeal will be permanent for tax years beginning after December 31, 2017.	

Observations:

Repeal of the corporate Alternative Minimum Tax (AMT) and increasing the exemption amounts for the individual AMT may (i) make outstanding PABs (other than AMT-exempt 501(c)(3) bonds, 142(d) housing bonds and mortgage bonds) more valuable because income derived from such bonds will no longer be included by corporations in computing AMT (or as many individuals) and (ii) may produce lower interest rates on newly-issued PABs more competitive because the market will not add an automatic increase to the rate because of the potential a holder may be subject to AMT.

At the same time, other features of the GOP bill, including, most importantly, a 47.5% cut in the maximum

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corporate tax rate from 35% to 20%, may undercut the value of municipal bonds generally, since the value of the tax exemption under section 103 is a function of the tax rate. For instance, $10 of tax-exempt interest income is $1.50 more valuable under a 35% rate ($3.50) than a 20% rate ($2.00) (compared the after-tax value of interest on taxable securities), a difference of 43%, which AMT repeal may not fully offset.

Proposal	Senate Bill	House Bill	Conference Committee (TCJA)	I.R.C. Section
- Chained CPI-U (C-CPI-U) Indexing for Cost-of-Living Adjustments used in calculating PAB Volume Cap under 146 and LIHTC Cap under 42.	- Indexes Cost-of-Living Adjustments under the following Sections:		Indexes Cost-of-Living Adjustments under the following Sections:	I.R.C. § 1(f)(3) (C-CPI-U Indexing); § 146(d)(2)(B) (PAB Volume Cap); §42(h)(3)(H)(i)(II) (LIHTC Cap). TCJA § 11002

Observations:

It is hard to argue with economists at the Bureau of Labor Statistics (BLS) who argue that the Internal Revenue's old method of adjusting volume caps was outdated. BLS contends that its newer method, the Chained Consumer Price Index for All Urban Consumers (C-CPI-U), does not suffer from the same flaws, like ignoring potential substitution of goods, as its counterpart, the Consumer Price Index for All Urban Consumers (CPI-U), which now governs adjustments to LIHTC and PAB volume caps under Section 42 and 146 of the Code.

At the same time, however, BLS economists predict that C-CPI-U, which will determine PAB volume caps and LIHTC volume caps beginning on January 1, 2018, consistently measures the cost-of-living adjustment 0.25% lower than the current CPI-U index. That means that beginning in 2018, those volume caps will gradually get lower and lower over time, which is why the TCJA's tax revenues from the switch to C-CPI-U increase linearly over time. Whether economists are right about the most appropriate tool for measuring inflation, there is no argument about what choosing a more conservative cost-of-living adjustment will do to LIHTC and PAB volume caps: it will decrease them over time and make them less available over time.

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Proposal	Senate Bill	House Bill	Conference Committee (TCJA)	I.R.C. Section
Grants and other Nonshareholder Contributions by Governmental Entities (Section 118)	No Provision	- Contributions to the capital of a corporation would be included in the corporation's gross income unless exchanged for stock (repealing Section 118). - Effective for contributions made and transactions entered into after the effective date of the TCJA. .	- Generally follows House bill's repeal of Section 118. - Would provide that term "contributions to capital" does not include (1) any contribution in aid of construction or any other contribution as a customer or potential customer, and (2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such). Would modify, but preserve Section 118, which would continue to only apply to corporations (i.e., to contributions by governmental entities (as a shareholder) to C-corporations and S-corporations).	I.R.C. § 76 (new), §118 TCJA § 13312

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Observations

In general, individuals and businesses pay US tax on income, from whatever source derived, unless a specific exemption or exclusion applies. In the case of a corporation, however, gross income does not include "any contribution to the capital of the taxpayer" under Section 118.

Section 118 applies only to a corporation (including any C-corporation or S-corporation). It does not apply to capital contributions to partnerships and entities taxed as pass-through entities (including most state-law partnerships, LPs, LLPs and LLCs, which are not publically-traded partnerships). To address this concern it has been common for developers using tax-exempt financing (TIF) moneys to utilize this rule (i.e., by having the governmental TIF contribution be made to an affiliated corporation and not to a partnership) to keep the TIF contribution from being treated as income to the developer.

The pending tax bill (section 13,312) would modify Section 118 to provide that, for purposes of the section 118 exclusion, "any contribution by a governmental entity or civic group (other than a contribution made by a shareholder as such)" will not be treated as a contribution to capital. The effective date rules provide generally that the change applies to contributions made after the date of enactment of the act. There is a transition rule that provides that the new rule does not apply to any contribution after the date of enactment that (i) is made by a governmental entity, and (ii) which is made pursuant to a master development plan that has been approved prior to such date by a governmental entity.

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