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INSIGHTS

State/Local Bond Proposals in Administration's 2016 Budget

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Several proposals affecting tax-exempt bonds were included in the Obama Administration's Budget for FY 2016. As usual, the overall budget proposal has immediately been declared DOA by political pundits. Nonetheless, taking a look at individual proposals can help one get a feel for what's on some government policymakers' minds. Also, don't be surprised if some of these proposals pop up in whatever tax legislative vehicle might start moving forward later in the year (e.g., corporate tax reform).

Here's a quick rundown of the Administration's proposals affecting tax-exempt bonds—

- **QPIBs.** The 2016 budget includes a new proposal to create a new type of tax-exempt private activity bond called a "qualified public infrastructure bond" ("QPIB") that would encompass airports, docks and wharves, mass commuting facilities, water furnishing facilities, sewage facilities, solid waste disposal facilities, and qualified highway or surface transport facilities. These QPIB-eligible facilities are types of facilities that already qualify for tax-exempt private activity bond ("PAB") financing. The most significant "new advantage" of QPIBs over traditional tax-exempt PABs would be exemption from alternative minimum tax ("AMT") treatment. QPIB treatment for water, mass community, and sewage facilities would also provide the added advantage of exemption from the state volume cap rules. (Tax-exempt PABs for government-owned airports, docks and wharves, and solid waste facilities already enjoy a state volume-cap exemption).

- To qualify for QPIB status, financed facilities would have to be governmentally owned (a requirement that already exists for tax-exemptPAB-financed airports, docks and wharves, and mass commuting facilities). The proposal would extend safe-harbor "ownership" standards currently applicable to airports, docks and wharves and mass commuting facilities to all QPIB-eligible facilities.

- Significantly, the proposal would *eliminate* tax-exemptPAB financing for *privately owned* water, sewage, and solidwaste disposal facilities, although the proposal notes that Congress "could consider continuing" tax-exempt PAB financing for privatelyowned facilities within these categories subject to state volume caps. This is a departure from the last couple of budget proposals, which had nothing along the lines of a QPIB proposal, but did include a proposal to do away with the government-ownership requirement for airports, docks and wharves, and mass commuting facilities—in other words to permit tax-exempt PAB financing available for those types of facilities *even if privately owned*. The 2016 budget appears to have dropped that proposal.

- **"Bank Qualified" Bonds.** On the demand side of the equation, the budget includes a proposal to resurrect some provisions that were added temporarily to the Code by the 2009 stimulus bill that have now expired—namely, increasing the qualified-small-issuer limit for "bank qualified" bonds from $10 million to $30 million and extending to financial institutions (banks, et. al.) the ability to avail themselves of the so-called "2% de-minimis exception" to the rule that reduces financial institutions interest deductions for indebtedness that is deemed allocable to their tax-exempt bond holdings. Both these provisions would increase financial institutions' appetite for tax-exempt bonds.

- **Pro Sports Stadiums.** Taking a shot across the bow of professional-sports-team owners, the 2016 budget includes a proposal that would effectively eliminate state and local governments' ability to finance stadiums for professional sports teams with tax-exempt bonds. In "tax-speak," the proposal does so by testing whether there are impermissible levels of private activity solely on the basis of private business use without regard to the absence of private payments.

- **America Fast Forward Bonds (BABs Revisited).** The budget renews a proposal in previous budgets to create a permanent (but optional) bond program similar to direct-pay build America bonds (BABs) (i.e., taxable bonds with a federal interest subsidy paid directly to issuers)—for most types of bonds that qualify for "traditional" tax-exempt status.. The subsidy – proposed to be 28% of interest paid - would be shielded from sequestration. The name given to the program is America Fast Forward Bonds.

- **Current Refundings.** A "generic current-refunding" proposal is included that would apply to all State and local bond programs for which current refundings are not allowed or are not expressly addressed in the rules (e.g., BABs), and would allow continued tax-advantaged treatment if the current refunding bonds do not increase the outstanding amount of bonds and do not extend the remaining weighted average maturity of the refunded bonds.

- **Repeal $150mm Limit.** The budget renews a proposal in previous budgets to repeal the $150 million non-hospital limitation on qualified 501(c)(3) bonds.

- **Highway/Surface Freight Transfer PABs.** The budget includes a proposal to increase by $4 billion the amount of "qualified highway or surface freight transfer facility bonds" allowed to be issued as tax-exempt PABs.

- **Qualified Public Education Facility PABs.** A proposal is included that allows private persons or private entities to own and/or operate public school facilities that otherwise qualify for tax-exempt PAB financing as "qualified public educational facilities." Existing law allows only ownership by a "private, for profit corporation" that agrees to "construct, rehabilitate, refurbish, or equip a school facility."

- **Facilities for Research.** A proposal is included to allow greater flexibility in the use of facilities in connection with privately-sponsored basic research without giving rise to private business use that would adversely affect the facilities' tax-exempt financing eligibility.

- **Indian Tribal Governments' Bonds.** The budget also includes a proposal that makes several changes (too comprehensive to summarize here) to Indian tribal governments' ability to issue tax-exempt bonds.

- **Taxing Top-Bracket Taxpayers' Tax-Exempt Interest.** Last, but not least, this budget renews the proposal included in previous Obama Administration budgets to include tax-exempt interest in a list of tax items whose taxbenefit would be limited to the benefit enjoyed by a 28% taxpayer. For example, under this proposal a 39.6% taxpayer would pay an 11.6% tax on his/her tax-exempt interest.

Anyone who would like to discuss any of these proposals should feel free to call ***Todd Greenwalt*** (713-221-1138).