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Tax Cuts and Jobs Act (TCJA) Changes to Tax-Advantaged Bonds

The president signed the Tax Cuts and Jobs Act (the 2017 Tax Legislation) into law on Dec. 22, 2017. The 2017 Tax Legislation made direct changes to the tax rules for tax-advantaged bonds, including eliminating advance refunding bonds and tax-credit bonds, and made other changes that will indirectly effect tax-advantage bonds, including reducing corporate tax rates and eliminating alternative minimum tax on corporations. This legislation is the most comprehensive tax legislation since 1986. Congress' expedited passage of this significant legislation set precedent: the legislation went from first introduction of the House bill to enactment in just over seven weeks. As a result, the legislation left significant unanswered questions. There is speculation about tax legislation in 2018, including a technical corrections bill to address some of these open issues and an infrastructure bill that may include additional changes to the tax-advantaged bond rules. Putting this potential legislation aside, this GT Alert addresses certain implications and questions that arise from the enacted 2017 Tax Legislation.

Trap for the Unwary: Possible Reissuances. The 2017 Tax Legislation has significantly lowered corporate tax rates, which may trigger changes to the payment terms of some outstanding debt. Documents that have been negotiated with owners (especially bank and other private placements) often contain provisions that would (or, may, at the option of the holder) cause an interest rate change with respect to these obligations because of this corporate tax rate change. Some holders have already notified issuers or borrowers of a change. Depending on the language of the relevant provision, actions taken to modify the rate of interest on an obligation or waive such a modification can cause a "reissuance" (current refunding) of the obligation. In this case, at the least, a new Form 8038 or 8038-G will need to be filed based on when the reissuance is treated as occurring. A filing must be made by May 15, if the change occurs this quarter, by Feb. 15, if the change occurred on the date the law was signed or otherwise before January 1, 2018. The change may also affect rebate expectations and other provisions in existing transactions.

Tax Credit Bonds. The 2017 Tax Legislation prohibits tax credit bonds from being issued after Dec. 31, 2017. No transition rules have been provided, such as rules that would permit current refundings of existing tax-credit bonds. Modifying existing documents in any significant way, therefore, presents a problem because such a modification may cause a "reissuance" that would be treated as a current refunding for federal income tax purposes. The reissued tax credit bonds would be treated as issued after Dec. 31, 2017, and, therefore, owners of the bonds would no longer receive tax credits with respect to the bonds. In addition, any unused allocation to issue tax credit bonds, including unused allocations of new clean renewable energy bonds, cannot be used to issue new bonds.

No Advance Refundings; *What does this Mean? Alternatives*? The 2017 Tax Legislation modified Section 149(d) of the Internal Revenue Code to provide: "Nothing 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." This statement is, as written, an absolute prohibition on the use of tax-exempt bonds to advance refund "bonds," which term clearly includes all tax-exempt and taxable debt of governmental entities and, perhaps, debt of nongovernmental entities, including 501(c)(3) organizations. Was this prohibition intended simply to assure that two sets of tax-exempt bonds could not be outstanding for more than 90 days for the same purpose, or does the prohibition mean that using tax-exempt debt for any long-term defeasance is contrary to tax policy? The speed of enactment of the 2017 Tax Legislation means that almost no legislative history exists. It will be interesting to see how the law develops.

- *Advance Refunding Taxable Debt*? Existing advance refunding regulations treat the advance refunding of certain taxable debt as not "counting" as an advance refunding. The change to Section 149(d) enacted as part of the 2017 Tax Legislation has raised questions as to whether these regulations can be applied now to continue to allow advance refundings of such taxable debt, including build America bonds for which the direct subsidy payment will no longer be available. Tax policy prior to the enactment of the 2017 Tax Legislation, which generally disfavored tax-exempt advance refundings only where two sets of tax-advantaged bonds were outstanding at the same time, lead to the existing regulatory relief. Given the uncertainty as to what policy underlies the new prohibition, the continued applicability of the existing regulations is unclear.
- *Current Refunding Advance Refunding Debt*? Another question that has arisen is whether it is permissible to issue taxable debt, prepayable at any time, to advance refund a tax-exempt bond and then to current refund the taxable debt once the original tax-exempt bonds have been redeemed (or within 90 days of the redemption date). Prior to the enactment of the 2017 Tax Legislation, this series of transactions generally would not have been considered problematic, but the new absolute prohibition against advance refundings suggesst that any circumvention may be against some unstated policy underlying the change in law. No real guidance exists on this point. We note that issuing the tax-exempt current refunding bonds to pay taxable refunding debt any earlier than 90 days before the original tax-exempt bonds are redeemed would be viewed as a prohibited indirect advance refunding under the existing regulations.
- *Other Ways to Lock in Savings*. If an advance refunding is no longer possible, other tools might be used to lock in savings now for a later current refunding. More robust rate lock and forward purchase markets may emerge that would provide some relief. Time will tell.

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