

Public Finance Tax Update

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IRS Provides New Financial Restructuring Resources on Its Website

The Tax Exempt Bonds function of the IRS has updated its website to provide new educational resources for issuers and conduit borrowers of tax-exempt and tax-advantaged bonds. These new resources are available on the website at www.irs.gov by clicking on the link "Tax Exempt Bond Community."

The new educational resources include an informational article entitled "Sale of Assets Financed with Tax-Exempt Bonds by State and Local Governments and 501(c)(3) Organizations," which provides basic information concerning remedial actions for the sale of bond-financed assets and specific examples involving entities in financial need. Also included is a link to "TEB Financial Restructuring Compliance," which provides informational articles and other resources on reissuance of tax-exempt and tax-advantaged obligations and information on the sale or lease of bond-financed property. In addition, as part of its education and outreach efforts, the IRS is sending to some issuers a reissuance contact letter, which summarizes some of the causes and consequences of inadvertent reissuance. The letter is for educational purposes and does not require an issuer to take any specific action.

The IRS has indicated that it is continually updating information on its website for the tax-exempt bond community to provide additional educational resources.

Joint Committee on Taxation Releases Report on State and Local Government Finance

The Joint Committee on Taxation recently released a report summarizing tax-exempt and tax-credit bond provisions, provisions that allow a deduction for certain State and local taxes and certain background data relating to State and local bonds and revenues.

The report generally describes the present law structures to deliver Federal borrowing subsidies on State and local governmental bonds. These include:

1. tax-exempt bonds (for which the State and local governmental borrowing cost is lower because the interest income is tax-exempt to the investor and thus the investor is willing to accept a lower interest rate);
2. tax-credit bonds (for which the State and local governmental borrowing cost is lower because investors receive Federal tax credits to replace a prescribed portion of the interest cost on the taxable bonds); and
3. tax-credit bonds issued as "direct-pay bonds" (for which the State or local governmental borrowing cost is lower because the Federal government makes direct payments to issuers to cover a prescribed portion of the interest cost on the taxable bonds, for example, the now-expired build America bonds program and certain specified tax-credit bonds).

The report provides that over the period 2002 through 2011, State and local governments have issued on average \$384 billion in tax-exempt bonds. The report includes an overview of tax-exempt bonds, tax-credit bonds and tax-credit bonds issued as direct-pay bonds. As further described in the report, interest paid on bonds issued by State and local governments generally is excluded from gross income for Federal income tax purposes. Because the income is excludable, investors generally are willing to accept a lower rate of interest on tax-exempt bonds than they might otherwise accept on a taxable investment. This lower rate of interest, in turn, lowers the borrowing cost for the beneficiaries of such financing. The report explains that tax-credit bonds provide tax credits to investors to replace a prescribed portion of the interest cost. The borrowing subsidy generally is measured by reference to the credit rate set by the Treasury Department. Current or recently expired tax-credit bonds include qualified tax-credit bonds, recovery zone economic development bonds, and build America bonds. Qualified tax-credit bonds, which have certain common general requirements, include new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds. As described in the report, the Federal subsidy for tax-credit bonds is economically equivalent to the Federal government directly paying the interest on a taxable bond issue on behalf of the State or local government benefiting from the bond proceeds. An issuer may opt to issue certain tax-credit bonds as "direct-pay bonds." Instead of a credit to the holder, with a "direct-pay bond" the Federal government pays the issuer a percentage of the interest on the bonds. For tax-credit bonds and direct-pay bonds, the depth or extent of the Federal borrowing subsidy has varied among programs.

The complete report is available on the Joint Committee of Taxation website at www.jct.gov under "Publications."

[IRS Releases Guidance Addressing Qualified Energy Conservation Bonds](#)

The IRS recently released Notice 2012-44 (the "Notice"), which provides guidance concerning qualified energy conservation bonds ("QECBs"). QECBs are taxable bonds that can be issued by State or local governments to finance certain energy conservation projects, including: (i) reducing energy consumption in publicly-owned buildings by at least 20 percent; and (ii) implementing green community programs (described below). QECBs may also be issued to finance certain electricity-producing facilities, such as wind facilities and solar facilities.

QECBs may be issued to (i) provide the holders of QECBs with a Federal tax credit instead of a portion of the interest payable on the bonds or (ii) provide the issuer with a direct Federal cash subsidy from the U.S. Treasury representing a portion of the interest paid by the issuer to holders of QECBs. Congress authorized \$3.2 billion in nationwide volume cap for QECBs in 2009, and approximately \$2 billion of such nationwide volume cap is still unused. Volume cap was first allocated to a State and then allocated to large local governments within the State. Large local governments are any municipality or county having a population of 100,000 or more. Accordingly, municipalities and counties with a population of 100,000 or more were allocated volume cap that authorizes the issuance of QECBs in certain amounts.

Energy Reduction in Publicly-owned Buildings

QECBs can be issued to reduce energy consumption in publicly-owned buildings by at least 20 percent. The Notice provides guidance on how to measure such energy reduction. The Notice permits the issuer to measure the reduction in energy consumption in: (i) a single publicly-owned building; (ii) multiple publicly-owned buildings; (iii) one or more building system components of one or more publicly-owned buildings; or (iv) a combination of (i), (ii) and (iii). A building system includes a system that serves one of the following functions: heating, ventilation, and air conditioning; hot water system; lighting; building envelope (*e.g.*, windows, roof, walls, insulation); or electricity "plug load" (*e.g.*, items plugged into electric outlets, such as computers and refrigerators).

The Notice provides a reasonable expectations standard as of the issue date of the bonds for purposes of determining reductions in energy consumption. Issuers must use reasonable and consistently applied methods to measure energy savings. The Notice also provides that the reduction of energy consumption may be measured over measurement time periods of not less than one year and provides examples of measurement periods.

Issuers may rely on an independent expert to establish reasonable expectations, if, no earlier than sixty days before the issue date of the issue, an independent, licensed professional engineer or other independent expert certifies under penalty of perjury that the capital expenditures to be incurred with respect to the measurement unit are reasonably expected to result in at least a 20 percent reduction of energy consumption during the measurement time periods. An issuer may rely on this certification only if the actual capital expenditures from the QECB proceeds are substantially the same as the

expected capital expenditures of such proceeds on which the certification was based. The Notice provides an example of an engineer's certification.

Green Community Programs

QECBs may be issued to finance certain green community programs. In general, the Notice states that the term "green community program" means a program that meets the following two requirements:

(i) *Program Purpose.* The purpose of a green community program is to promote one or more of the purposes of energy conservation, energy efficiency, or environmental conservation initiatives relating to energy consumption, broadly construed. Eligible program purposes include, among others, promotion of energy savings through retrofitting initiatives for heating, cooling, lighting, water-saving, storm-water reducing, or other efficiency measures; distributed generation initiatives; or transportation initiatives that conserve energy and/or support alternative fuel infrastructure (which may include, for example, improvements to public bicycle paths or mass transit systems).

(ii) *General Public Use or Broad Public Availability.* A green community program must: (1) involve property that is available for general public use (using standards similar to standards for distinguishing general public use from private business use under the treasury regulations); or (2) involve a loan (or other repayment mechanism) or grant program that is broadly available to members of the general public, including individuals or businesses. A green community program need not affect the entire geographical area or all the residents and businesses within the jurisdiction of the State or local governmental unit that implements the program, provided that the program broadly benefits the general public, residents, or businesses in the affected area of the State or local governmental unit. Examples of programs that are available for general public use include programs to make improvements to public infrastructure that enhances proximity and connectivity between community assets and public transit in order to reduce motor vehicle use and promote energy conservation. An example of a loan or grant program that is broadly available to the general public would be a program for residential housing or private building energy efficiency initiatives that provides grants or loans that are broadly available for homeowners or businesses.

Strategic Alliance Agreement Does Not Create Private Business Use

In Private Letter Ruling 201216009, the IRS determined that a strategic alliance agreement entered into between a public hospital district and a public university and entities managed or controlled by the university did not result in private business use of bond-financed facilities. The IRS noted that the district, the university and the component entities of the university are each either a governmental entity or an instrumentality of a governmental entity. However, the IRS explained that if the strategic alliance agreement created a partnership between the district and the university, and the partnership is viewed as an entity, then the partnership would cause private business use of the bond-financed facilities. While the IRS did not express an opinion as to whether a partnership was created as a result of the strategic alliance agreement, the IRS determined that, if a partnership had been created, the purposes of the private business use restrictions would be furthered by treating such partnership as an aggregate of the separate entities entering into the agreement, rather than as a separate entity. Therefore, under the aggregate approach, the persons using the facilities (*i.e.*, the hospital district, the university and the component entities of the university) under the agreement are all governmental persons.

Private Letter Ruling 201216009 highlights the importance of taking into consideration whether actions among state or local governmental units or instrumentalities, such as intergovernmental agreements, could create partnerships. Under general partnership tax provisions, a partnership is considered for various purposes to be either an aggregate of its partners or an entity independent of its partners. Under the aggregate approach, each partner is treated as an owner of an undivided interest in partnership assets and operations. Under the entity approach, the partnership is a separate entity in which partners have no direct interest in the partnership's assets and operations. There is no exclusive rule as to when a partnership will be viewed as an entity or an aggregate, and this determination is generally dependent on the question to be resolved. With respect to tax-exempt bond-financed assets, if governmental units form a partnership, and the partnership is viewed as a separate entity, private business use would result. However, in Private Letter Ruling 201216009, the IRS determined that the purposes of the private business use restrictions would not be served by treating any possible partnership between the university and the hospital district resulting from the strategic alliance agreement as a separate entity.

If you would like to discuss any of the issues addressed in this Client Alert, please contact Jeffrey D. Berry at (312) 845-3713 or berry@chapman.com; David J. Cholst at (312) 845-3862 or cholst@chapman.com; Anthony R. Rosso at (312) 845-3913 or rosso@chapman.com; or Brent L. Feller at (312) 845-3822 or feller@chapman.com. To learn more about Chapman, please visit us online at chapman.com

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