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Tax reform update: H.R. 1 proposes significant limits on municipal bonds

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UPDATE: The Tax Cuts and Jobs Act was released on December 15, 2017, and signed into law by President Trump on December 22, 2017. (For more information, read our publication, "Conference agreement on tax reform: Private activity bonds, stadium bonds spared; Advance refundings and tax credit bonds axed.")

UPDATE: In the early morning hours of Saturday, December 2, 2017, the United States Senate, by a vote of 51-49, approved its version of H.R. 1, the Tax Cuts and Jobs Act of 2017, commonly referred to as the Senate's tax bill. The Senate bill, unlike the House's version, does not repeal private activity bonds. However, the Senate bill contains the repeal of the authorization for advance refundings that first appeared in the Chairman's Mark. The Senate and House are expected to attempt to reconcile the two versions this week (week of December 4) in order to produce a single piece of legislation that must pass both chambers of Congress before finding its way to the desk of President.

UPDATE: The House of Representatives passed H.R. 1, the Tax Cuts and Jobs Act, on November 16, 2017, by a vote of 227 to 205. The House bill continues to contain the repeal of private activity bonds and advance refundings. The Senate Finance Committee passed its version of tax reform hours later, 14-12. The Senate bill is silent on private activity bonds but contains the advance refunding repeal. The full Senate is expected to consider its version after Thanksgiving.

UPDATE: On November 9, the Senate Finance Committee released the "Chairman's Mark," which is a summary of what the Senate's version of the Tax Cuts and Jobs Act is expected to contain. Unlike the House's version of tax reform, the tax exemption for private activity bonds is not repealed. However, the repeal of authorization for advance refunding has been included in the Senate version.

Especially with the appearance of the prohibition for advance refundings in both the House and Senates tax bills, modification of financing techniques that provide significant flexibility to governmental issuers and 501(c)(3) entities and help them take advantage of falling interest rates is likely on the horizon.

Original post from November 10, 2017:

On November 2, 2017, the U.S. House of Representatives Ways & Means Committee released its first draft of H.R. 1, known as the Tax Cuts and Jobs Act (the bill). If enacted in its current form, the bill would prohibit the use of a number of funding techniques that use tax exempt bonds. Specifically, the bill would no longer permit private activity bonds to be issued as tax exempt, would forbid the use of tax exempt advance refunding bonds, would eliminate tax credit bonds and would terminate tax exempt bonds for professional sports stadiums.

Termination of private activity bonds
Select private activity bonds, such as 501(c)(3) bonds, which finance facilities for hospitals and private universities, low-incoming housing bonds, and bonds for airport terminals and certain sewer and solid waste disposal facilities, can currently be issued on a tax exempt basis. The bill, however, prohibits the issuance of these and all other private activity bonds issued after December 31, 2017, on a tax exempt basis. Additionally, the bill does not indicate whether current refundings of existing tax exempt private activity bonds can be issued as such. This aspect of the bill is controversial given that it repeals the authority to issue tax exempt private activity bonds entirely.

Prohibition of advance refunding bonds
Under the bill, after 2017, no tax exempt bond can be issued to advance refund (more than 90 days prior to its stated redemption date) any other bond. Current law permits governmental bonds and qualified 501(c)(3) bonds to be advance refunded one time. This prohibition will keep some issuers from refinancing debt to take advantage of falling interest rates.

Repeal of tax credit bonds
The bill provides that no bond issued after December 31, 2017, can be a tax credit bond, regardless of the form in which — and to whom — the bond's subsidy is

delivered. Tax credit bonds issued before December 31, 2017, will retain their status. As with private activity bonds, the bill does not make transition rules clear. But because tax credit bonds cannot be refunded under current law without losing the subsidy, proposed transition rules for tax credit bonds are less contentious.

No tax-exempt bonds for professional stadiums

As of November 3, 2017, the day after the bill was introduced, governmental use bonds issued to finance professional sports stadiums are no longer tax exempt. A governmental use bond is deemed issued for a professional sports stadium if the proceeds are used to finance or refinance a facility that is used for professional sports exhibitions, games or training more than five days in a calendar year.

If enacted as written, the bill will undoubtedly affect nonprofit organizations, colleges and universities, independent living facilities, hospitals and nonprofit health care providers, states and their political subdivisions, as well as public-private partnerships. Such entities will be faced with the reality of financing or refinancing capital projects without access to tax exempt markets, likely leading to increased costs of borrowing. Industry associations have begun significant lobbying efforts toward the removal of these provisions to mitigate the impact, but the ultimate outcome is, for now, uncertain.