Frequently Asked Questions on Build America Bonds and Recovery Zone Economic Development Bonds

The American Recovery and Reinvestment Act of 2009 (ARRA) created several new types of tax-exempt bonds and qualified tax credit bonds under the Internal Revenue Code (the "Code"). Below are the answers to the most frequently asked questions regarding some of these new types of bonds.

Build America Bonds & Recovery Zone Economic Development Bonds - IRC Section 54AA

Q-1. What are build America bonds?

A-1. Build America bonds or ("BABs") are governmental bonds eligible for certain tax advantages under the Code. BABs must qualify as tax-exempt governmental bonds under section 103 of the Code.

Q-2. Is interest on BABs tax-exempt?

A-2. No, even though BABs must qualify as tax-exempt under section 103 of the Code, interest paid on BABs is taxable to investors.

Q-3. Are all BABs the same?

A-3 No. There are three types of BABs: BABs (Tax Credit), BABs (Direct Pay) and recovery zone economic development bonds. Each type has a different subsidy, a different purpose for which it may be issued and other varying rules.

Q-4. How does the issuer make an "irrevocable election" to have BABs apply?

A-4. Prior to issuing bonds, the issuer must elect on its books and records to apply the BAB provisions under section 54AA of the Code.

Q-5. Does the reporting requirement of 149(e) that applies to tax-exempt bonds apply to BABs?

A-5. Yes, for 2009 and before the publication of Form 8038-B, the issuer was required to report the issuance of BABs on Form 8038-G, *Information Return for Tax-Exempt Governmental Obligations.* Even if the issue was less than $100,000, Form 8038-G was used instead of Form 8038-GC. The IRS has now introduced new Form 8038-B, *Information Return for Build America Bonds and Recovery Zone Economic Development Bonds*, to be used to report all BABs and recovery zone economic development bonds.

Q-6. Do sections 103, 141 and 148 of the Code apply to BABs?

A-6. Yes, section 103 of the Code (including the private activity bond tests under section 141 of the Code) and the arbitrage yield restriction and rebate requirements under section 148 of the Code apply to BABs.

Q-7. What does it mean that BABs may not be issued with more than a de minimis amount of premium?

A-7. BABs may be issued at par plus a de minimis amount of premium. Section 1273 of the Code provides that a de minimis amount of premium is an amount that is not greater than 1/4 of 1 percent of the stated redemption price at maturity for the bond, multiplied by the number of complete years to the earlier of the maturity date for the bond or the first optional redemption date for the bond, if applicable. Generally, up to 2.5 percent of premium over the stated principal amount of the bond may be considered to be de minimis premium for bonds that mature in 10 or more years.

Q-8. Can BABs be issued for private conduit borrowers?

A-8. No. BABs may be issued for governmental purposes only excluding all private activity bonds.

Q-9. Do BABs sunset?

A-9. Yes, unless extended by future legislation, BABs must be issued before January 1, 2011.

Build America Bonds (Tax Credit)

Q-10. For what purposes can BABs (Tax Credit) be issued?

A-10. BABs (Tax Credit) may be issued for any governmental purpose for which tax-exempt governmental bonds (excluding private activity bonds) could be issued under section 103 of the Code. For example, BABs (Tax Credit) may be issued to finance capital expenditures, working capital, current refundings, and one advance refunding.

Q-11. Who can issue BABs (Tax Credit)?

A-11. BABs (Tax Credit) can be issued by any State or political subdivision (as defined for purposes of section 103 of the Code), as well as entities authorized to issue bonds on their behalf.

Q-12. What is the Federal subsidy for BABs (Tax Credit)?

A-12. BABs (Tax Credit) provide a Federal subsidy through Federal tax credits to investors equal to 35% of the total interest payable by the issuer to investors.

Q-13. For BABs (Tax Credit) what is the benefit to the investor?

A-13. The investor receives taxable interest income on BABs (Tax Credit) as well as the tax credit equal to 35% of that interest. Both the interest and the tax credit are includable in the investor's gross income. The tax credit is generally allowed against both regular and alternative minimum tax. If the credit allowable exceeds the investor's limitation for that taxable year, the unused credit may be carried forward until used.

Q-14. Do BABs (Tax Credit) require volume cap?

A-14. No. BABs (Tax Credit) do not require national volume cap, but may require volume cap under section 141(b)(5) of the Code.

Q-15. Because section 148 of the Code applies to BABs (Tax Credit), how is calculation of the yield affected by the tax credit?

A-15. The yield on BABs (Tax Credit) is calculated without an adjustment for the tax credit.

Q-16. Do the prevailing wage labor standards of Davis-Bacon apply to construction projects financed by BABs (Tax Credit)?

A-16. No. Davis-Bacon does not apply to construction projects financed with proceeds of BABs (Tax Credit).

Build America Bonds (Direct Pay)

Q-17. For what purposes can BABs (Direct Pay) be issued?

A-17. BABs (Direct Pay) may be issued for the same general governmental purposes as BABs (Tax Credit) except that BABs (Direct Pay) may only be issued to finance capital expenditures. Specifically, 100 percent of the excess of "available project proceeds" must be used only for capital expenditures. Available project proceeds are the sale proceeds the issuer receives from the bonds minus proceeds it is allowed to spend on costs of issuance (up to 2%), minus proceeds it is allowed to spend to fund a reasonably required reserve (generally up to 10%), plus proceeds from investment earnings. Thus, investment earnings on BABs (Direct Pay) must also be spent on project capital expenditures. Generally, BABs (Direct Pay) cannot be used to refinance capital expenditures in refunding issues.

Q-18. Who can issue BABs (Direct Pay)?

A-18. BABs (Direct Pay) can be issued by any State or political subdivisions (as defined for purposes of section 103 of the Code), as well as entities authorized to issue bonds on their behalf.

Q-19. What is the Federal subsidy for BABs (Direct Pay)?

A-19. BABs (Direct Pay) are qualified bonds that provide a Federal subsidy through a refundable tax credit allowed under section 6431 of the Code equal to 35% of the interest payable by the issuer to investors. This cash payment is paid by the Federal government directly to the issuer or to the authorized agent for the issuer that pays interest on the bonds.

Q-20. How does the issuer elect BABs (Direct Pay) as qualified bonds?

A-20. Prior to issuing the bonds, the issuer must make an election on its books and records that it intends to apply section 54AA(g) of the Code, the qualified BABS (Direct Pay) provisions. This election for BABs (Direct Pay) is in addition to the election described above under section 54AA of the Code to elect to apply the provisions of BABs.

Q-21. For BABS (Direct Pay) what is the benefit to the investor?

A-21. The investor receives taxable interest income on BABs (Direct Pay) that is includable in the investor’s gross income.

Q-22. Do BABs (Direct Pay) require volume cap?

A-22. No, BABs (Direct Pay) do not require national volume cap, but may require volume cap under section 141(b)(5) of the Code.

Q-23. How does the issuer of BABS (Direct Pay) apply to receive the cash payment subsidy from the Federal government?

A-23. The issuer of BABs (Direct Pay) must file Form 8038-CP, *Return for Credit Payments to Issuers of Qualified Bonds.* For fixed rate bonds, and for variable rate bonds when the issuer knows the amount of interest, Form 8038-CP must be filed 45 days before the related interest payment date but not earlier than 90 days prior to the interest payment date. For variable rate bonds, when the issuer does not know the amount of interest, issuers are reimbursed quarterly. Issuers must aggregate all credit payments for each quarter and file Form 8038-CP no later than 45 days after the last interest payment date of the quarter to be reimbursed. NOTE: Form 8038-B must be filed at least 30 days prior to filing a request for the cash subsidy on Form 8038-CP.

Q-24. Because section 148 of the Code applies to BABs (Direct Pay), how is calculation of the yield affected by the Federal subsidy cash payment allowed to the issuer under section 6431 of the Code?

A-24. The yield on BABs (Direct Pay) is calculated by reducing the amount of interest paid on the bonds by the amount of the Federal subsidy payments allowed to the issuer under section 6431 of the Code, without regard to amounts set off for Federal or other tax liability.

Q-25. Do the prevailing wage labor standards of Davis-Bacon apply to construction projects financed by BABs (Direct Pay)?

A-25. No, Davis-Bacon does not apply to construction projects financed with proceeds of BABs (Direct Pay).

Recovery Zone Economic Development Bonds IRC section 1400U-2

Q-26. For what purposes can recovery zone economic development bonds ("RZEDBs") be issued?

A-26. Issuers of RZEDBs must spend 100% of the "available project proceeds" for one or more qualified economic development purposes. A qualified economic development purpose means expenditures for promoting development or other economic activity in a recovery zone, including capital expenditures and working capital expenditures paid or incurred in such zone, expenditures for public infrastructure and construction of public facilities, and expenditures for job training and educational programs. Available project proceeds are the sale proceeds the issuer receives from the bonds minus proceeds it is allowed to spend on costs of issuance (up to 2%), minus proceeds it is allowed to spend to fund a reasonably required reserve (generally up to 10%), plus proceeds from investment earnings. Thus, investment earnings on RZEDBs must also be spent on a qualified economic development purpose. Generally, RZEDBs cannot be used to refinance capital expenditures in refunding issues.

Q-27. Who can issue RZEDBs?

A-27. RZEDBs can be issued by any State or political subdivision (as defined for purposes of section 103 of the Code), as well as entities authorized to issue bonds on their behalf. All proceeds of RZEDBs must be used within the jurisdiction of the issuer.

Q-28. What constitutes a recovery zone?

A-28. A recovery zone is any area designated by the issuer as having significant poverty, unemployment, rate of home foreclosures, or general distress; any area designated by the issuer as economically distressed by reason of the closure or realignment of a military installation under the Defense Base Closure and Realignment Act of 1990; or, any area for which a designation as an empowerment zone or renewal community is in effect as of February 17, 2009.

Q-29. What is the Federal subsidy for RZEDBs?

A-29. All RZEDBs are direct pay qualified bonds that provide a Federal subsidy through a refundable tax credit allowed under section 6431 of the Code equal to 45% of the interest payable by the issuer to investors. This cash payment is paid by the Federal government directly to the issuer or to the authorized agent for the issuer that pays interest on the bonds.

Q-30. How does the issuer designate RZEDBs?

A-30. Prior to issuing the bonds, the issuer must designate on its books and records that it intends to issues qualified RZEDBs under section 1400U-2 of the Code.

Q-31. For RZEDBs what is the benefit to the investor?

A-31. The investor receives taxable interest income on RZEDBs which is includable in the investor's gross income.

Q-32. Do RZEDBs require volume cap?

A-32. Yes, the national volume cap limitation for RZEDBs is $10,000,000,000. For allocations by State, see Notice 2009-50.   All proceeds of RZEDBs must be used within the jurisdiction of the entity allocating volume cap to the RZEDBs. Additionally, RZEDBs may require volume cap under section 141(b)(5) of the Code.

Q-33. How does the issuer of RZEDBs apply to receive the cash payment subsidy from the Federal government?

A-33. The issuer of RZEDBs must file Form 8038-CP, *Return for Credit Payments to Issuers of Qualified Bonds.* For fixed rate bonds Form 8038-CP must be filed 45 days before the related interest payment date but not earlier than 90 days prior to the interest payment date. For variable rate bonds, issuers are reimbursed quarterly. Issuers must aggregate all credit payments for each quarter and file Form 8038-CP no later than 45 days after the last interest payment date of the quarter to be reimbursed. NOTE: Form 8038-B must be filed at least 30 days prior to filing a request for the cash subsidy on Form 8038-CP.

Q-34. Because section 148 of the Code applies to RZEDBs, how is calculation of the yield affected by the Federal subsidy cash payment allowed to the issuer under section 6431 of the Code?

A-34 The yield on RZEDBs is calculated by reducing the amount of interest paid on the bonds by the amount of the Federal subsidy payments allowed to the issuer under section 6431 of the Code without regard to any amounts set off for federal or other tax liability.

Q-35. Do the prevailing wage labor standards of Davis-Bacon apply to construction projects financed by RZEDBs?

A-35. Yes, Davis-Bacon labor standards apply to construction projects financed with proceeds of RZEDBs. The Davis-Bacon contract clauses stated in 29 CFR 5.5(a)(1) through (10) must be incorporated into covered contracts for construction, alteration, or repair work. Additional information regarding the application of Davis-Bacon labor standards is available at the U.S. Department of Labor Wage and Hour Division website at www.dol.gov/esa/whd/recovery/index.htm.