Tax Cuts and Jobs Act (H.R. 1) Offers First Look at a Detailed Tax Reform Plan

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Since the introduction of the U.S. House of Representatives' tax reform plan – the "Tax Cut and Jobs Act (H.R. 1)," PFM has been working to understand the potential impact that the various proposals could have on our clients. While the 429-page tax plan contains many areas of interest for state and local governments and non-profit institutions, one area that may have a disproportionate impact on our clients' finances is the section related to Bond Reform. As previewed earlier this year, Congress has taken action to scale back tax benefits related to certain municipal bonds and bond refundings, although it has preserved tax-exemption on outstanding municipal bonds and many types of future governmental bond issues.

Below is a brief overview of the proposed changes impacting state and local government bond financing and the bond financing activities of non-profit institutions included in the version introduced November 2, 2017.

H.R. 1 Eliminates the Interest Exclusion for Private Activity Bonds (PABs)

While tax-exemptions for outstanding municipal and qualified non-profit bonds have been preserved, the current legislation eliminates the interest exclusion for qualified PABs issued after 2017. Under current law, the interest earned on qualified PABs is exempt from the taxation and the bonds typically command a correspondingly lower interest rate than taxable securities. Under the provisions of H.R. 1, the interest earned on future PABs would be taxable.

H.R. 1 Repeals the Advance Refunding Exemption & Tax Credit Bonds (TCBs)

Other proposed bond reforms include the repeals of the Advance Refunding Exemption and TCBs.

- **Advance Refunding Bonds.** Under current law, interest on advance refunding bonds — bonds issued more than 90 days before the redemption date of the refunded bonds — generally is not taxable for governmental bonds. The proposed legislation would keep the tax-exemption for interest on current refunding bonds, but eliminate the exemption for interest on advance refunding bonds.

- **Tax-Credit Bonds.** In contrast to tax-exempt bonds, which exclude interest paid to the bondholder from taxation, most TCBs allow the bondholder to claim a federal tax credit equal to a percentage of the bond's par value for a limited number of years. The issuers of TCBs typically pay no interest to bondholders, which can result in a larger federal subsidy to the issuer than a traditional municipal bond. Under the proposed legislation, the rules relating to TCBs would be repealed. While holders and issuers would continue receiving tax credits and payments for previously issued TCBs, no new bonds could be issued after 2017.

H.R. 1 Subjects Bonds Issued for Professional Sports Stadiums to Federal Tax

The proposed tax reform bill provides that interest on bonds issued to finance the construction of, or capital expenditures for, a professional sports stadium would be subject to Federal tax. Unlike the other bond reform proposals, this provision would take effect for bonds issued after the date of introduction (i.e., November 2nd, 2017).

Conclusion

These are only the proposals related to bond issuances – there are a number of other major changes proposed in the bill which impact individual taxpayers, business, and state and local governments. As a vivid example, a provision in Title V of the bill would impose a revised excise tax (at a rate of 1.4%) on the net investment income of certain private higher education institutions that have at least 500 students and assets (other than those used directly in carrying out the institution's educational purposes) of at least $100,000 per full-time student.

The ultimate legislative outlook for H.R. 1 remains unclear, but the House Ways and Means Committee is scheduled to begin marking the bill up on Monday, November 6th. As groups affected by these changes comb through the details of the legislation and engage their constituencies and media on certain elements of the legislation, timely comments and near-term negotiations will be critical for the tax reform proposal.

PFM has begun engaging in communication with key trade associations representing clients and tracking their responses to the legislation. We continue to monitor developments as they arise and will provide additional updates as the package continues to evolve.

Given the market uncertainty resulting from the proposed tax legislation, we encourage you to reach out to your advisor at PFM to discuss any concerns you may have or to better understand the potential impact on your financing plans and finances. Ultimately, the most effective way to share any comments you may have on the proposed federal legislation is to reach out directly to your local Congressional representatives.

Resources

Tax Cuts and Jobs Act, H.R. 1, 115th Cong., Ways and Means Committee Majority Tax Staff (2017). available at https://waysandmeansforms.house.gov/uploadedfiles/tax_cuts_and_jobs_act_section_by_section_hr1.pdf

"Lifeline or Loophole? Municipal Bond Tax Exemption Faces a Year of Scrutiny." *Issuer Insight* June 2017. https://www.pfm.com/docs/default-source/default-document-library/issuer-insight---lifeline-or-loophole-municipal-bond-tax-exemption---june-2017.pdf?sfvrsn=0