Final Version of Tax Cuts and Jobs Act Revealed

Special Report December 19, 2017

After weeks of winding its way through the House and Senate, the Tax Cuts and Jobs Act appears one step closer to the finish line. The bill represents the largest changes to the U.S. tax code since 1986 and represents a key Republican campaign promise to enact significant tax reform. Late on Friday, December 15, the congressional reconciliation committee wrapped up its work resolving differences between the House and Senate versions of the bill which included a number of provisions impacting municipal markets. As of today, December 19, the House has passed the bill and the Senate is expected to vote later this evening. Below is a summary of some of the key provisions impacting municipal bond issuers:

- **Advance Refundings Eliminated.** Advance Refundings have been a significant feature of the municipal market, allowing public issuers to realize the benefit of lower interest rates, resulting in significant debt service savings. Unfortunately, despite the strong push to preserve this interest cost saving tool, the final bill eliminates tax-exempt Advance Refundings. Moreover, no transition provisions were included in the bill to grandfather existing bonds or delay implementation, making this change effective for bonds issued after December 31, 2017.

- **Tax Credit Bond Authorization Repealed**. Congress also repealed the authority to issue tax credit bonds, which include new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds. The authority to issue direct-pay bonds is also included in this repeal, affecting potential Recovery Zone bonds or reauthorization of Build America Bonds (BABs). While the issuance volume of these bonds is relatively low compared to Private Activity Bonds (PABs) and Advance Refundings, this bill raises other implications for previously issued American Recovery and Reinvestment Act of 2009 (ARRA) subsidy and tax credit bonds, as the Pay-As-You-Go Act of 2010 (PAYGO Act) could lead to significant reductions in federal spending related to these bond programs, as discussed in greater detail below.

- **Private Activity Bonds Preserved**. The House version of the bill repealed the tax-exempt status of qualified PABs issued after December 31, 2017. This provision would have held severe implications for infrastructure projects undertaken by governmental and nonprofit entities from seaports to hospitals. After effective advocacy efforts from state and local governments, finance associations, the higher education, transportation and hospital sectors, lawmakers preserved the current rules on all PABs.

- **Sports Stadiums Remain Tax-Exempt**. Despite early reports pointing to consensus for the elimination or scaling back of tax exemption for financing professional sports stadiums, these projects will continue to enjoy tax exemption.

- **State and Local Tax Deduction Capped.** One of the more controversial provisions contained in the House bill was the significant restriction of the State and Local Tax Deduction (SALT). SALT allows individuals to deduct local income, sales and property taxes on their federal returns without limit. After intense lobbying from residents and representatives of high-tax states, lawmakers preserved SALT with some restrictions. Moving forward, taxpayers still will be permitted this itemized deduction, but it is now capped at $10,000.

Looking Forward

The Tax Cuts and Jobs Act has passed the House and Senate passage is expected to follow within hours on December 19. Republican leadership remains confident that it has the necessary votes for passage, with the goal of having the bill signed by President Trump before Christmas. The signing of the bill will mark the next stage of the tax reform process. With so many significant changes, the various government agencies implicated by the bill must create and update their regulations to reflect the new order. While the bill is expected to take effect at the end of the year, it will likely be months, if not longer, before these regulations are fully enacted.

Possible Additional Cuts Related to the Pay-As-You-Go Act of 2010

Another area deserving the attention of the municipal market is the mandatory spending cuts required by the PAYGO Act, which could be triggered by the tax reform legislation, absent any further legislative action.

The PAYGO Act requires Office of Management & Budget (OMB)-directed spending cuts to offset any deficit increase over the ensuing ten years resulting from newly enacted legislation. As the current tax reform bill is calculated to increase the deficit by approximately $1.5 trillion, this could trigger significant programmatic spending cuts, including the elimination of direct payment subsidies of outstanding ARRA Bonds (including BABs, QSCBs, QZABs, QECBs and CREBs). The math of these required spending cuts does not bode well for the future of ARRA Bond subsidies scheduled to be paid by the federal government to municipal issuers of these bonds. While there are legislative and procedural alternatives which allow for a full or partial waiver of these cuts, such a maneuver requires prompt congressional action — no small feat in the current political climate.

Given the market uncertainty resulting from the current 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 finances and financing plans.