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NABL Proposes “Enhanced Infrastructure Bonds” (or Build America Bonds 2.0)

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The National Association of Bond Lawyers submitted eight legislative proposals to Treasury on August 22 with the stated purpose of improving the efficiency of tax-advantaged financing of much-needed public infrastructure projects (here is a link to the proposals). The proposals would broaden the availability and simplify the existing forms of tax-exempt bonds as well as create new forms of tax-advantaged bonds. One of the new forms would be Enhanced Infrastructure Bonds (“EIBs”), which could just as easily be called new and improved Build America Bonds (“BABs”). EIBs and direct-pay BABs share many characteristics, including generating federal payments to the issuer while paying taxable interest to holders, with the differences intended to make EIBs an even more attractive financing option and to eliminate the shortcomings of BABs that were discovered over the course of issuing more than $185 billion of direct-pay BABs during the brief period they were available – April 2009 through December 2010. The similarities and differences in EIBs and BABs are identified and explained below.

To begin with the most attractive difference between EIBs and BABs, EIBs would provide a federal government payment to issuers (like direct pay BABs) equal to 40 percent of EIB interest payments while direct-pay BABs generated a 35 percent payment. However, only EIBs issued through the end of 2028 would be entitled to this generous payment rate. EIBs issued thereafter would produce payments at the revenue neutral 28 percent of interest (i.e., the rate that is believed to equate the direct payment subsidy to the tax-exemption subsidy). The higher rate is intended to temporarily supercharge infrastructure spending.

The permitted uses of EIBs would be significantly broader than those of BABs. EIBs could be issued for any purpose for which tax-exempt bonds can be issued, except advance refundings. Thus EIBs could be issued for qualified 501(c)(3) bond purposes or any other qualified private activity bond purposes, subject to the same volume cap limits that apply to certain qualified private activity bonds if the EIBs are issued for the same purposes for which those qualified private activity bonds could be issued. In addition, EIBs would not be subject to the 100 percent capital expenditure requirement that applied to direct-pay BABs.

Finally, two improvements over BABs are aimed squarely at problems that were discovered with BABs. First, federal payments to EIB issuers would be protected from sequestration by a specific statutory provision. Of course, this provision could be overridden by subsequent legislation, but that is also true of any provision of the tax-exempt bond rules, including the tax exemption itself.

Second, a glitch in the reissuance rules applicable to BABs would be eliminated for EIBs. The Office of Chief Counsel reported in its Advice Memorandum Number AM 2014-009 (released Dec. 19, 2014) that, under Treas. Reg. 1.1001-3, because BABs (like EIBs) are taxable bonds, their legal defeasance triggers their reissuance. For BABs, this would be a disaster because BABs cannot be issued for a refunding purpose, and reissued bonds, including BABs, are treated as current refunding bonds (not to mention BABs can no longer be issued). Thus, a reissuance ends the availability of BABs for the financed project. While a reissuance of EIBs would not have the disastrous consequences of a reissuance of BABs because EIBs could be issued for current refunding purposes, a reissuance of EIBs would at a minimum result in increased transaction costs, would create the proverbial trap for the unwary and, in the case of a change of law prohibiting the tax-advantage refunding, could eliminate the availability of tax-advantaged financing for the project.

The proposed EIB rules are intended mercifully and rationally to eliminate this artificial distinction between tax-exempt bonds and EIBs through the following statutory provision: "The Secretary shall apply the rules and regulations applicable to tax-exempt bonds to [EIBs] except where doing so would conflict with the purposes of this section." It is presumed that this provision would have its intended effect of ending this reissuance concern.

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