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INITIAL HOUSE PROPOSAL ON TAX EXEMPT BONDS

On Thursday, November 2, 2017, the House leadership released its long-awaited proposed tax bill for consideration by the Ways and Means Committee. Representatives of the tax exempt bond community had previously had discussions with the Administration and with House members who had assured them that tax exempt bonds were not "on the table" in this year's tax legislation. In fact, the Administration had actually proposed expanding the purposes for which tax exempt private activity bonds could be issued as part of the Administration's infrastructure financing initiative.

Much to the surprise of the tax exempt bond community, the House leadership proposal contains sweeping reforms of the existing tax exempt bond rules, including:

- Elimination of the ability to issue any new private activity bonds, including private activity bonds for nonprofits like hospitals and colleges and universities, as well as other types of private activity bonds like solid waste bonds and airport bonds;
- Elimination of all advance refunding bonds; and
- Elimination of tax credit bonds and tax exempt bonds for sports facilities.

These changes would be effective under the House proposal as of December 31, 2017. It also appears that the House proposal would **not** permit current refundings of existing tax exempt bonds after the effective date, which is also a significant departure from prior bond tax legislation.

This change in approach with respect to tax exempt bonds is one of a number of unexpected provisions in the proposal. In addition to the widely discussed limitation on deductions for state and local taxes, and the tax exempt bond changes, other unexpected changes in the proposal include limitations on the deduction of mortgage interest, excise taxes on the endowment income of most colleges and universities, the phase-out of the lowest tax bracket for certain taxpayers, and limitations on the lower tax rates for certain types of pass through entities.

From a legislative standpoint, the proposal has not yet been approved by the House Ways and Means Committee, and likely will be modified as it goes through the Committee process which begins today. After Committee

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approval, any resulting bill would have to be adopted by the House, and substantial debate is expected over many portions of the proposal, including the state and local tax provisions, tax rates and brackets, limitations on mortgage interest and other provisions.

The Senate version of the tax legislation is expected to be introduced by the Senate leadership this week. While there has been coordination between the House and the Senate leadership, no one knows whether the bond provisions in the House proposal will be present in the Senate proposal or whether the Senate proposal will include the other controversial provisions in the House proposal.

Assuming a bill passes each of the House and Senate, the bills would go to a Conference Committee to be resolved and then approved by the House and Senate. The House and Senate leadership hope to have a bill approved in each of the House and Senate by Thanksgiving, which may be very optimistic. In short, there is a lot which has to happen for any proposal to become law.

With all of this uncertainty, what should beneficiaries of private activity bonds or issuers with advance refunding transactions that are "in the money" do? Inevitably, there will likely be some issuers which will want to accelerate financings planned for early 2018 into 2017. While this strategy may work, given the short time period before the effective date (December 31, 2017), and the relatively thin market for tax exempt debt, rates will likely increase during the remainder of the year, potentially eliminating the benefit of the tax exemption or the lowering the economics of an advance refunding. Also, any proposal may also affect the buyers of tax exempt debt in a way that decreases demand for tax exempt bonds at the same time as the volume increases, which would compound the adverse effect.

For issuers which have strong credit ratings and access to capital, particularly bank capacity, one solution being discussed is to issue bonds prior to the end of the current year with long-dated maturities, but which are issued initially in a short-term mode (for example, a bank mode) with a tender date later in 2018 with the expectation that the bonds would be converted and remarketed on the tender date into a more permanent structure. This strategy, however, will likely depend on (i) whether the issuer has access to the bank market for the initial period, and (ii) whether it is even possible to meet the procedural requirements (TEFRA approval and state law issuer approvals) to issue debt by the end of the calendar year unless those approvals are already in place. Issuers with advance refunding opportunities may have even less options because of the need to establish a bond yield for advance refunding escrow purposes.

This is only the beginning of the process. It is likely that if any tax bill ultimately becomes law, it will vary in many respects from the proposal released by the House leadership.