

March 3, 2009

# Alert

## More Bond Opportunities for Tribes in the Recovery Act: Build America Bonds and Bank Qualified Debt Provisions Can Be Effective Debt Tools for Tribes

Randy DelFranco

### Build America Bonds

The American Recovery and Reinvestment Act of 2009 (the Act) creates a class of debt called “Build America Bonds” that may provide unique opportunities for governments, including tribes. Build America Bonds are taxable bonds that may be issued only in 2009 and 2010. Tribes may opt to issue Build America Bonds in lieu of tax-exempt bonds to finance “essential governmental functions” or projects qualifying under the Tribal Economic Development Bond provisions of the Act. [\(Please see our discussion of the Tribal Economic Development Bond provisions of the Act.\)](#) Build America Bonds must satisfy the usual requirements of the tax law for tax-exempt status, even though the bonds are not tax-exempt.



### How Build America Bonds Work

Build America Bonds offer a unique opportunity for tribes to take advantage of benefits provided by the Act by issuing taxable bonds at a tax-exempt equivalent cost of capital. A tribe will be able to pay a tax-exempt equivalent rate agreed upon by the tribe and the bondholder by passing on to the bondholder a federal income tax credit on an annual basis in an amount equal to 35 percent of the interest on the bond. The amount of the tax credit is included into income of the bondholder.

The following example is provided in the legislative history of the Build America Bonds. If a taxable bond of comparable risk pays an annual \$1,000 coupon and sells at par, then if a tribe issues an equal sized bond with an annual coupon of \$741, such a bond should also sell at

par. The taxpayer who acquires the bond will receive an annual interest payment of \$741 and may claim a credit of \$259 (35 percent of \$741). The credit and the interest payment are both included in the taxpayer’s income. Thus, the taxpayer’s annual taxable income from this instrument would be \$1,000. This is the same annual taxable income that the taxpayer would recognize from holding the comparable taxable bond. Consequently, according to the legislative history, the issuer’s bond should sell at the same price as would the taxable bond but the tribe would get the benefit of a “below-market” interest rate of 7.41 percent.

### The Unique Aspect of Build America Bonds

In lieu of the bondholder receiving a tax credit, the tribe may elect to receive a payment from the U.S. federal government in an amount equal to 35 percent of the interest paid. Thus, while the tribe would pay the bondholders a fully taxable interest rate in this case, as opposed to the example in the preceding paragraph, after the tribe receives the 35 percent payment from the government its real borrowing cost would approximate a tax-exempt rate (*i.e.*, 65 percent of the taxable rate for an equivalent loan). The bondholder is indifferent as to whether the loan is tax-exempt or not, since the rate of interest is adjusted accordingly. Going back to the previous example, the bondholder receives \$1,000 in interest but the tribe receives \$350 from the federal government. The provision described in this paragraph only applies to bonds issued to finance capital expenditures, a reasonable debt service reserve and costs of issuance up to 2 percent of the issue size.

### ***Use of the Federal Subsidy Is Up to the Tribe***

An added benefit of Build American Bonds is that there are no restrictions on what the tribal borrower does with the 35 percent subsidy payments. The subsidy payments can be spent freely, or if the bondholders are looking for additional collateral on the Build America Bonds, the subsidy can be used as additional collateral.

### ***Two Important Restrictions for Build America Bonds***

The two restrictions for Build America Bonds are as follows: (1) they cannot be private activity bonds (meaning the facilities financed with the bond proceeds may not be used by private parties), and (2) the 35 percent federal subsidy may be used only for new money projects and not for refinancings.

### **“Bank Qualified” Debt**

Bank qualified (BQ) tax-exempt debt is attractive to banks because in addition to the tax-exemption on such debt, banks may deduct 80 percent of the interest expense incurred to invest in BQ debt.

Prior to the Act, governments, including tribes, that issued more than \$10 million of tax-exempt debt in a calendar year could not designate any of that debt as being bank-qualified. The Act increases the \$10 million threshold to \$30 million with respect to debt issued in 2009 and 2010. Note that while the provisions only apply to bonds issued in 2009 and 2010, once issued, the favorable tax status of the bonds remains in place until the bonds are discharged. That is, the debt does not lose its BQ status in 2011.

The Act applies to both refunding debt and new money debt. Thus, customers of a bank that have incurred non-BQ debt due to the application of the \$10 million limit may be able to modify or refinance that debt on more favorable bank qualified terms. In other words, an existing non-BQ loan could be designated as BQ and the interest rate lowered.

### **Combining Bank Qualified Debt With Build America Bonds**

Using Build America Bonds in combination with the \$30 million BQ threshold may be an attractive way to finance larger projects since Build America Bonds are taxable, have no limit on the principal amount and would not count against the \$30 million limitation. Put another way, this combination allows a tribe to issue, in the same calendar year, \$30 million of tax-exempt BQ debt and an unlimited amount of additional Build America Bonds with an effective tax-exempt borrowing cost.

### **Application of the Community Reinvestment Act Could Make BQ Debt Even More Attractive**

Certain BQ debt will meet the definition of “qualified investments” under the Community Reinvestment Act (the CRA), allowing banks to receive positive consideration for these securities under the CRA investment test. To be considered a qualified investment under CRA, BQ debt must have community development as its primary purpose. Examples of BQ debt that are originated for community development purposes include bonds that finance the following types of activities: economic development in low-and-moderate income areas; projects eligible for low-income housing tax credits; and affordable housing rehabilitation and construction. Tribes can take advantage of the CRA to make their BQ debt even more attractive to banks, thereby potentially lowering the interest costs to the tribe. ([Please see our article on applicability of the CRA to Indian Country.](#))

### ***For more information, contact:***

***Randy DelFranco***

*212.513.3282*

*randy.delfranco@hkllaw.com*

*toll free: 1.888.688.8500*

---

## **About the Author**

### **Randy DelFranco**

Randolph A. DelFranco practices in the areas of corporate, public and tribal finance, securities, mergers and acquisitions, and investment management funds. Mr. DelFranco has extensive experience in high-yield (Rule 144A) privately-placed debt offerings, IPO and secondary equity offerings, domestic and cross-border mergers and acquisitions, tender offers and other Securities Act and Exchange Act matters. He also is experienced in the formation of domestic and offshore investment management funds.

## INDIAN LAW PRACTICE GROUP

### WASHINGTON, D.C.

202.955.3000 • FAX: 202.955.5564

Shenan R. Atcitty • [shenan.atcitty@hkklaw.com](mailto:shenan.atcitty@hkklaw.com)

Philip Baker-Shenk • [philip.bakershenk@hkklaw.com](mailto:philip.bakershenk@hkklaw.com)

Senator (Ret.) Ben Nighthorse Campbell •  
[ben.campbell@hkklaw.com](mailto:ben.campbell@hkklaw.com)

Lynn G. Cutler • [lynn.cutler@hkklaw.com](mailto:lynn.cutler@hkklaw.com)

Kathryn L. Dando • [kate.dando@hkklaw.com](mailto:kate.dando@hkklaw.com)

David Devendorf • [david.devendorf@hkklaw.com](mailto:david.devendorf@hkklaw.com)

Kimberlee M. Dunlop • [kimberlee.dunlop@hkklaw.com](mailto:kimberlee.dunlop@hkklaw.com)

Timothy Q. Evans • [timothy.evans@hkklaw.com](mailto:timothy.evans@hkklaw.com)

Ashley Fingarson • [ashley.fingarson@hkklaw.com](mailto:ashley.fingarson@hkklaw.com)

Stephen J. McHugh • [steve.mchugh@hkklaw.com](mailto:steve.mchugh@hkklaw.com)

Telly Meier • [telly.meier@hkklaw.com](mailto:telly.meier@hkklaw.com)

Jennifer “Gigi” Modrich • [gigi.modrich@hkklaw.com](mailto:gigi.modrich@hkklaw.com)

Kathleen M. Nilles • [kathleen.nilles@hkklaw.com](mailto:kathleen.nilles@hkklaw.com)

Gerry E. Sikorski • [gerry.sikorski@hkklaw.com](mailto:gerry.sikorski@hkklaw.com)

Beth Viola • [beth.viola@hkklaw.com](mailto:beth.viola@hkklaw.com)

### LOS ANGELES, CA

213.896.2400 • FAX: 213.896.2450

Rory E. Dilweg • [rory.dilweg@hkklaw.com](mailto:rory.dilweg@hkklaw.com)

Brian R. Guth • [brian.guth@hkklaw.com](mailto:brian.guth@hkklaw.com)

Dion Killsback • [dion.killsback@hkklaw.com](mailto:dion.killsback@hkklaw.com)

Frank R. Lawrence • [frank.lawrence@hkklaw.com](mailto:frank.lawrence@hkklaw.com)

Jerome L. Levine • [jerome.levine@hkklaw.com](mailto:jerome.levine@hkklaw.com)

Teri Poust • [teresa.poust@hkklaw.com](mailto:teresa.poust@hkklaw.com)

Allyson G. Saunders • [allyson.saunders@hkklaw.com](mailto:allyson.saunders@hkklaw.com)

William Wood • [william.wood@hkklaw.com](mailto:william.wood@hkklaw.com)

Zehava Zevit • [zehava.zevit@hkklaw.com](mailto:zehava.zevit@hkklaw.com)

## About Our Indian Law Practice

With a deep understanding and respect for the traditional values that set tribes apart, Holland & Knight’s Indian Law Practice Group is committed to providing tribal governments with the same high quality of legal representation demanded by other governments and international corporations – the kind of service tribes require to protect their sovereignty and to prosper in today’s and tomorrow’s world. Our Indian Law Practice Group utilizes the diverse talents of our attorneys and other professionals to protect tribal sovereignty and resources, develop reservation economies and infrastructure, preserve basic human rights, such as access to health care, and enhance tribal governance and business structures. We understand the challenges tribes face, and are able to provide full-service, “one-stop” legal and strategic advice and counsel on all of the critical issues.

## About Holland & Knight

Holland & Knight is a global law firm with more than 1,100 lawyers in 17 U.S. offices as well as Abu Dhabi, Beijing and Mexico City. Representative offices are located in Caracas and Tel Aviv. Holland & Knight is among the nation’s largest law firms, providing representation in litigation, business, real estate and governmental law. Interdisciplinary practice groups and industry-based teams provide clients with access to attorneys throughout the firm, regardless of location.

To ensure compliance with Treasury Regulations (31 CFR Part 10, §10.35), we inform you that any tax advice contained in this correspondence was not intended or written by us to be used, and cannot be used by you or anyone else, for the purpose of avoiding penalties imposed by the Internal Revenue Code.

[www.hkklaw.com](http://www.hkklaw.com)

Holland & Knight LLP

Copyright © 2009 Holland & Knight LLP All Rights Reserved

*Information contained in this alert is for the general education and knowledge of our readers. It is not designed to be, and should not be used as, the sole source of information when analyzing and resolving a legal problem. Moreover, the laws of each jurisdiction are different, and are constantly changing. If you have specific questions regarding a particular fact situation, we urge you to consult competent legal counsel.*