Lesson 14

Miscellaneous Bonds

Overview

Introduction

Certain types of bonds listed in the Code may not be issued as often as other types of bonds thus creating confusion for an agent. The bond types described herein are governed by very specific provisions and a correct analysis of these bond types requires an agent to correctly identify the bond type in order to apply the necessary Code provisions when analyzing enterprise facility bonds, volunteer fire department bonds, qualified green building and sustainable design project bonds or recovery zone facility bonds.

Objectives

At the end of this lesson, you will be able to:

- Identify and define enterprise zone facility bonds
- Identify and define volunteer fire department bonds
- Identify and define qualified green building and sustainable design projects bonds
- Identify and define recovery zone facility bonds
- Identify rules found in other sections of the Code that apply to enterprise zone facility, volunteer fire department, qualified green building and sustainable design projects bonds, and recovery zone facility bonds

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Overview, Continued

Contents

This lesson contains the following topics:

Section 1

Enterprise Zone Facility Bonds

Introduction

Enterprise zone facility bonds enable a qualified business to finance commercial or similar facilities located in federally-designated empowerment zones and enterprise communities on a tax-exempt basis.

Contents

This section contains the following topics:

Definitions

IRC § 1394(a) provides that, for purposes of IRC § 141, the term "exempt facility bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are used to provide any enterprise zone facility.

IRC § 1394(b)(1) provides that the term "enterprise zone facility" means any qualified zone property the principal user of which is an enterprise zone business, and any land which is functionally related and subordinate to such property.

Treas. Reg. § 1.1394-1(i) generally provides that the term "principal user" means the owner of the financed facility.

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Qualified Zone Property

Under IRC § 1397D, as modified by section 1394(b)(2), the term "qualified zone property" means any property to which § 168 applies (or would but for § 179) that:

- was acquired by the taxpayer by purchase (as defined in IRC § 179(d)(2)) after the effective date of the zone designation;
- the original use of which in the zone commences with the taxpayer; and
- substantially all of the use of which is in an empowerment zone and is in the active conduct of a qualified business by the taxpayer in such zone

Treas. Reg. § 1.1394-1(h) provides that the term "original use" means the first use to which the property is put within the zone. For this purpose, if property has been vacant for at least a 1-year period including the date of zone designation, use prior to that period is disregarded. De minimis incidental use is also disregarded.

Qualified business is defined in § 1397C(d)

IRC § 1397D provides special rules for substantial renovations and sale-leasebacks.

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Enterprise Zone Business

Under IRC § 1397C, as modified by section 1394(b)(3), the term “Enterprise zone business” means:

- any qualified business entity (as defined in IRC § 1397C(b)) and
- any qualified proprietorship (as defined in IRC § 1397C(c))

Treas. Reg. § 1.1394-1(e) provides further guidance on the resident employee requirements of IRC §§ 1397C(b)(6) and (c)(5).

Meaning of Substantially All

For purposes of enterprise zone facility bonds, Treas. Reg. § 1.1394-1(l) provides that in applying the rules governing qualified zone property and enterprise zone businesses, the term “substantially all” means 85 percent.

Period of Compliance

The rules governing the periods of compliance with certain requirements applicable to enterprise zone facility bonds, as set forth in IRC §§ 1394, 1397C, and 1397D, are set forth in Treas. Reg. § 1.1394-1(b) and (c).

Limitation on Amount of Bonds

IRC § 1394(c) prohibits the aggregate amount of outstanding enterprise zone facility bonds allocated to any person from exceeding:

- $3,000,000 with respect to any 1 empowerment zone or enterprise community; or
- $20,000,000 with respect to all empowerment zones and enterprise communities.

Acquisition of Land

Under IRC § 1394(d), the restrictions on the acquisition of land and existing property under §§ 147(c)(1)(A) and (d) do not apply to enterprise zone facility bonds.

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Failure to Meet Requirements

IRC § 1394(e) and Treas. Reg. § 1.1394-1(n) provide correction procedures and penalty provisions relating to noncompliance with applicable rules.

Current Refundings

Under Treas. Reg. § 1.1394-1(o)(1), when current refunding bonds are issued after the zone designation period, both the prior issue and the refunding issue, if treated as a single combined issue, must meet all of the requirements for enterprise zone facility bonds, except for the requirements of IRC § 1394(c).

Pooled Financings

Treas. Reg. §§ 1.1394-1(f), (g)(2), and (m)(2)(ii) provide specific rules applicable to certain pooled financing bond programs and loan recycling programs relating to enterprise zone facilities.

Empowerment Zone Facilities

IRC § 1394(f) describes how these rules apply to bond-financed facilities located in empowerment zones designated under IRC § 1391(g), including a limitation on the aggregate face mount of bonds designated with respect to each empowerment zone.

Amendments

The 1993 Act was significantly amended by the 1997 Act and the 2000 Act including definitions.

Section 2

Qualified Volunteer Fire Department Bonds

Introduction

Qualified volunteer fire department bonds enable qualified volunteer fire departments to finance the construction of fire stations or the purchase of fire trucks on a tax-exempt basis.

Contents

This section contains the following topics:

Definitions

Pursuant to IRC § 150(e), a bond of a volunteer fire department is treated as a bond of a political subdivision of a State if the following criteria are met:

- the department is a "qualified volunteer fire department" with respect to an area within the jurisdiction of such political subdivision and
- ninety-five percent or more of the net proceeds of the bond issue are used for the acquisition, construction, reconstruction, or improvement of a firehouse (including land which is functionally related and subordinate thereto) or fire trucks to be used by such department

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Definitions (continued)

"Qualified volunteer fire department" means, with respect to a political subdivision of the State, any organization:

- organized and operated to provide firefighting or emergency medical services for persons in an area (within the jurisdiction of such political subdivision) which is not provided with any other firefighting services and
- which is required by written agreement with the political subdivision to furnish firefighting services in such area.

Other firefighting services provided in the area shall be disregarded in determining whether an organization is a qualified volunteer fire department if such other firefighting services are provided by a qualified volunteer fire department that has been providing firefighting services to the area continuously since January 1, 1981.

Other Requirements

Qualified volunteer fire department bonds are treated as private activity bonds only for purposes of IRC §§ 147(f) (public approval) and 149(d) (advance refunding).

IRC § 147(f)(4)(B) provides that with respect to any volunteer fire department which meets the requirements of IRC § 150(e), the political subdivision described in IRC § 150(e)(2)(B) will be considered the governmental unit on behalf of which the bonds were issued for purposes of the public approval requirement.

Section 3

Qualified Green Building and Sustainable Design Projects Bonds

Introduction

Qualified green building and sustainable design project bonds enable qualified organizations to finance the development of polluted land that is underutilized or underdeveloped on a tax-exempt basis.

Contents

This section contains the following topics:

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Definitions

IRC § 142(a)(14) provides that the term “exempt facility bond” means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide qualified green building and sustainable design projects.

IRC § 142(l)(1) provides that the term “qualified green building and sustainable design projects” means any project designated by the Secretary of the Treasury (“Secretary”), after consultation with the Administrator of the Environmental Protection Agency (“EPA Administrator”), as a qualified green building and sustainable design project that meets the application requirements.

Bonds issued for qualified green building and sustainable design projects are also called “Green Bonds.”

Local Nomination and Project Application

A project may not be designated pursuant to IRC § 142(l) unless:

- the project is nominated by a State or local government within 180 days of October 22, 2004, and
- such State or local government provides written assurances that the project will satisfy the application eligibility criteria

The application for the project proposal must :

- describe the energy efficiency, renewable energy, and sustainable design features of the project and
- demonstrate that the project satisfies the eligibility criteria required by to IRC § 142(l)(4)

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Qualified Green Building and Sustainable Design Projects Bonds, Continued

Project Description

Each application for a qualified green building and sustainable design project shall contain the following information:

- the amount of electric consumption reduced as compared to conventional construction,
- the amount of sulfur dioxide daily emissions reduced compared to coal generation,
- the amount of the gross installed capacity of the project's solar photovoltaic capacity measured in megawatts, and
- the amount, in megawatts, of the project's fuel cell energy generation.

Project Eligibility Criteria

IRC §142(l)(4)(A) sets forth the eligibility criteria required for qualified green building and sustainable design projects that shall be included in the project application..

- Green building and sustainable design

  At least 75 percent of the square footage of commercial buildings which are part of the project is registered for United States Green Building Council's LEED certification and is reasonably expected (at the time of the designation) to receive such certification.

- Brownfield redevelopment
  The project includes a brownfield site as defined by section 101(39) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601).

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Qualified Green Building and Sustainable Design Projects Bonds, Continued

Project Eligibility Criteria (continued)

- <u>State and local support</u>
  The project receives specific State or local government resources which will support the project in an amount equal to at least $5,000,000.

- <u>Size</u>
  The project includes at least 1,000,000 square feet of building or at least 20 acres.

- <u>Use of tax benefit</u>
  The project proposal includes a description of the “net benefit of the tax-exempt financing” (hereafter defined) which will be allocated for financing of one or more of the following:
  1) The purchase, construction, integration, or other use of energy efficiency, renewable energy, and sustainable design features of the project
  2) Compliance with certification standards required by LEED certification
  3) The purchase, remediation, and foundation construction and preparation of brownfield site

- <u>Prohibited facilities</u>
  Proceeds of a qualified green building and sustainable design project issue shall not be used for any facility the principal business of which is the sale of food or alcoholic beverages for consumption on the premises.

- <u>Employment</u>
  Project is projected to provide permanent employment of at least 1,500 full time equivalents (150 full time equivalents in rural States) when completed and construction employment of at least 1,000 full time equivalents (100 full time equivalents in rural States).

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Qualified Green Building and Sustainable Design Projects Bonds, Continued

Federal Project Designations and Objectives

Within 60 days after the end of the application period, the Secretary, (after consultation with the EPA Administrator), shall designate qualified green building and sustainable design projects as follows:

- at least one of the projects designated shall be located in, or within a 10-mile radius of, an empowerment zone (pursuant to IRC § 1391),
- at least one of the projects designated shall be located in a rural State.
- no more than one project shall be designated in a State and
- a project shall not be designated if such project includes a stadium or arena for professional sports exhibitions or games

The Secretary, after consultation with the EPA Administrator, shall ensure that a designated qualified green building and sustainable design project which is under consideration shall:

- reduce electric consumption by more than 150 megawatts annually as compared to conventional generation,
- reduce daily sulfur dioxide emissions by at least 10 tons compared to coal generation power,
- expand by 75 percent the domestic solar photovoltaic market in the United States (measured in megawatts) as compared to the expansion of that market from 2001 to 2002, and
- use at least 25 megawatts of fuel cell energy generation

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Qualified Green Building and Sustainable Design Projects Bonds, Continued

Post Completion Tax Benefit Certification

No later than 30 days after the completion of the project, each project must certify to the Secretary that the "net benefit of the tax-exempt financing" was used for the purposes described in the project application.

The term "net benefit of tax-exempt financing" means the present value of the interest savings (determined by a calculation established by the Secretary) which result from the tax-exempt status of the bonds.

Issuance Limitations

An issue of bonds will not be treated as qualified green building and sustainable design projects bonds if the aggregate face amount of bonds issued by the State or local government for a project (when added to the aggregate face amount of bonds previously so issued for such project) exceeds an amount designated by the Secretary as part of the designation.

The Secretary may not allocate authority to issue qualified green building and sustainable design project bonds in an aggregate face amount exceeding $2,000,000,000.

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Qualified Green Building and Sustainable Design Projects Bonds, Continued

Termination of Issuance Authority

IRC § 142(l)(8) provides that qualified green building and sustainable design project bonds shall not be issued after September 30, 2012.

Treatment of Current Refundings

In the event of a current refunding of qualified green building and sustainable design project bonds issued before October 1, 2012 issuers are not bound by IRC § 142(l)(8) (i.e. allowed to refund green building and sustainable design project bonds after September 30, 2012) and IRC § 142(l)(7)(B) (i.e. Limitation Amount does not apply) if:

- the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date (see IRC § 147(b)(2)(A)) of the bonds to be refunded by such issue,
- the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and
- the net proceeds of the refunding bond are used to redeem the refunded bond not later than 90 days after the date of the issuance of the refunding bond

Functionally Related and Subordinate Facilities

Treas. Reg. § 1.103-8(a)(3) provides that an exempt facility includes any land, building, or other property functionally related and subordinate to such facility. To be considered functionally related and subordinate, the property should be of a character and size commensurate with the character and size of the facility.

After the 1986 Act, functionally related and subordinate facilities specifically do not include certain facilities that are used in private business use. See H.R. Rep. No. 99-426, 99th Cong., 1st Sess., December 7, 1985, page 529.

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Qualified Green Building and Sustainable Design Projects Bonds, Continued

Limitation on Office Space

Under IRC § 142(b)(2), an office is not included in the definition of a qualified green building and sustainable design project under IRC § 142(a) unless:

- it is located on the premises of the facility and
- not more than a de minimis amount of the functions performed at the office are unrelated to the day-to-day operations of the facility

Other Requirements

The private activity bond rules stated in IRC §§ 147(a) through (g), and 150(b)(4) are applicable to bonds issued to finance qualified green building and sustainable design projects under IRC § 142(a)(14). The arbitrage and rebate rules of IRC § 148 and the rules of IRC § 149 also apply to these bonds.

These rules are discussed in other lessons of this text.

Section 4

Recovery Zone Facility Bonds

Introduction

Section 1401 of Title I of Division B of the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009), added §§ 1400U-1 and 1400U-3 to the Code authorizing State and local governments to issue Recovery Zone Facilty Bonds. Notice 2009-50 also provides guidance and further information on Recovery Zone Facility Bonds.

Recovery Zone Facility Bonds allow State and local governments to borrow funds at lower costs to promote job creation and economic recovery in areas affected by severe unemployment and economic distress. Recovery Zone Facility Bonds must be issued before January 1, 2011.

Contents

This section contains the following topics:

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Recovery Zone Facility Bonds (RZFB)

IRC §1400U-3 (1)(b) provides that the term "recovery zone facility bond" means any bond issued as part of an issue if—

- 95 percent or more of the net proceeds (as defined in IRC §150(a)(3)) of such issue are to be used for recovery zone property,
- such bond is issued before January 1, 2011, and
- the issuer designates such bond for purposes of IRC §1400U-3

Section 1400U-3 (c)(1) defines the term "recovery zone property" to mean any property to which IRC §168 applies (or would apply but for IRC §179) if—

- such property was constructed, reconstructed, renovated, or acquired by purchase (as defined in IRC §179 (d)(2)) by the taxpayer after the date on which the designation of the recovery zone took effect,
- the original use of which in the recovery zone commences with the taxpayer, and
- substantially all of the use of which is in the recovery zone and is in the active conduct of a qualified business by the taxpayer in such zone

Section 1400U-3 (c)(2) defines he term "qualified business" as any trade or business except that—

- the rental to others of real property located in a recovery zone shall be treated as a qualified business only if the property is not residential rental property (as defined in IRC §168 (e)(2)), and
- such term shall not include any trade or business consisting of the operation of any facility described in IRC §144 (c)(6)(B)

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Recovery Zone Facility Bonds (RZFB) (continued)

Rules similar to the rules of subsections (a)(2) and (b) of IRC § 1397D shall apply for purposes of IRC §1400U-3 (c) when dealing with substantial renovations and sale-leasebacks.

IRC §146 (relating to volume cap) and IRC §147(d) (relating to acquisition of existing property not permitted) shall not apply to any recovery zone facility bond.

The maximum aggregate face amount of bonds which may be designated by any issuer as RZFBs shall not exceed the national recovery zone facility bond limitation of $15 billion allocated under IRC §1400U-1.

Allocation of Recovery Zone Bonds

IRC §1400U-1(a)(4), provides that the national bond limitations are as follows:

- recovery zone facility bonds have a national limitation of $15,000,000,000

For purposes of IRC §1400U(1), the term "recovery zone" means—

- any area designated by the issuer as having significant poverty, unemployment, rate of home foreclosures, or general distress,
- any area designated by the issuer as economically distressed by reason of the closure or realignment of a military installation pursuant to the Defense Base Closure and Realignment Act of 1990, and
- any area for which a designation as an empowerment zone or renewal community is in effect

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Allocation of Recovery Zone Bonds (continued)

The Secretary shall adjust the allocations under IRC §1400U-1(1)(A) for any calendar year for each State to the extent necessary to ensure that no State receives less than 0.9 percent of the national recovery zone facility bond limitation.

For purposes of IRC §1400U-1(1), the term "2008 State employment decline" means, with respect to any State, the excess (if any) of—

- the number of individuals employed in such State determined for December 2007, over
- the number of individuals employed in such State determined for December 2008

Each State with respect to which an allocation is made under paragraph IRC §1400U-1 (a)(1) shall reallocate such allocation among the counties and large municipalities in such State in the proportion to each such county's or municipality's 2008 employment decline bears to the aggregate of the 2008 employment declines for all the counties and municipalities in such State. A county or municipality may waive any portion of an allocation.

For purposes of IRC §1400U-1 (a)(3)(A) Section 1400U-1, the term "large municipality" means a municipality with a population of more than 100,000.

For purposes of IRC §1400U-1 (a)(3), the employment decline of any municipality or county shall be determined in the same manner as determining the State employment decline under IRC §1400U-1 (a)(2), except that in the case of a municipality any portion of which is in a county, such portion shall be treated as part of such municipality and not part of such county.

The allocations are set forth in Notice 2009-50.

Summary

Review of Lesson 14

- IRC § 1394(a) provides that, for purposes of IRC § 141, the term “exempt facility bond” means any bond issued as part of an issue 95 percent or more of the net proceeds of which are used to provide any enterprise zone facility.

- IRC § 150(e) provides that a bond of a volunteer fire department is treated as a bond of a political subdivision of a State if such department is a qualified volunteer fire department and 95% or more of the net proceeds of the bond are used for the acquisition, construction, reconstruction, or improvement of a firehouse.

- IRC § 142(a)(14) provides that the term “exempt facility bond” means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide qualified green building and sustainable design projects.

- IRC §§ 1400U-1 and 1400U-3 provides for Recovery Zone Facility Bonds that State and local governments issue to borrow funds at lower costs to promote job creation and economic recovery in areas affected by severe unemployment and economic distress.

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