

## **Frequently Asked Questions on Qualified Tax Credit Bonds and Specified Tax Credit Bonds**

Tax legislation enacted in 2008, 2009 and 2010 created several new types of tax credit bonds under the Internal Revenue Code. Below are the answers to the most frequently asked questions regarding qualified zone academy bonds (QZABs); qualified school construction bonds (QSCBs); qualified energy conservation bonds (QECBs); and new clean renewable energy bonds (New CREBs). This set of Questions and Answers is offered to assist issuers with questions regarding qualified tax credit and specified tax credit bonds, but it is not formal guidance. The Questions and Answers will be updated periodically and may be changed by subsequent IRS or Treasury guidance or Congressional action.

### **Tax Credit Bonds under IRC section 54A**

#### **Q-1. What are qualified tax credit bonds?**

A-1. Qualified tax credit bonds are bonds issued under section 54A that allow a credit to investors that hold such bond on one or more of the quarterly credit allowance dates.

#### **Q-2. What are the new types of qualified tax credit bonds under IRC section 54A?**

A-2. This Q & A addresses four new qualified tax credit bonds under IRC section 54A: Two are school bonds: QZABs and QSCBs. Two are energy bonds: New CREBs and QECBs.

#### **Q-3. What are specified tax credit bonds?**

A-3. Specified tax credit bonds are QZABs, QSCBs, New CREBs, and QECBs that are qualified tax credit bonds under section 54A(d) and are issued after March 18, 2010, and for which the issuer makes an irrevocable election to apply section 6431(f) to receive a direct payment subsidy instead of a tax credit allowed to investors. For more information on specified tax credit bonds, see [Notice 2010-35](#).

#### **Q-4. For what purposes can tax credit bonds be issued?**

A-4. Each of the tax credit bonds may be issued for different qualified purposes. In addition to complying with IRC section 54A, issuers of tax credit bonds must also comply with the IRC section that relates to each bond: for QZABs, section 54E; for QSCBs, section 54F; for New CREBs, section 54C; and, for QECBs, section 54D.

**Q-5. What is the Federal subsidy for qualified tax credit bonds?**

A-5. Holders of QZABs and QSCBs receive a tax credit equal to 100% of the credit rate on the bonds. Holders of New CREBs and QECBs receive a tax credit equal to 70% of the credit rate on the bonds. The credit rate under section 54A(3)(b) that applies to all four types of tax credit bonds issued under IRC section 54A is set at a rate the Secretary of the Treasury estimates will allow the issuer to sell the tax credit bonds at par, without interest. That tax credit rate is published by the Bureau of Public Debt at: [www.treasurydirect.gov](http://www.treasurydirect.gov). The issuer applies the credit rate in effect on the first day there is a binding, written contract to sell the bonds, generally the date the bond purchase agreement is signed. This Federal subsidy reduces borrowing costs to the issuer. (For more information on how the Secretary sets the tax credit rate, see [Notice 2009-15](#).)

**Q-6. How does the investor benefit from the tax credit?**

A-6. The investor receives a tax credit, for QZABs and QSCBs equal to 100% of the credit rate on the bonds under section 54A(3)(b), and for New CREBs and QECBs equal to 70% of the credit rate under section 54A(3)(b) on the bonds. The amount of the tax credit is includable in the investor's gross income. The tax credit is generally allowed against both regular and alternative minimum tax. If the credit allowable exceeds the investor's limitation for that taxable year, the unused credit may be carried forward until used. There are no restrictions on the type of investor who can purchase tax credit bonds.

**Q-7. What is the Federal subsidy for specified tax credit bonds?**

A-7. For each interest payment date the issuer is allowed a direct pay refundable credit under section 6431(f) of the Code. For QZABs and QSCBs the subsidy is equal to the lesser of the interest payable on the bonds or the interest which would have been payable if such interest were determined at the credit rate under IRC 54A(3)(b). For New CREBs and QECBs the subsidy is equal to the lesser of the interest payable on the bonds or 70% of the interest which would have been payable if such interest were determined at the credit rate under IRC 54A(3)(B).

**Q-8. For specified tax credit bonds, what is the benefit to the investor?**

A-8. The investor receives taxable interest income on specified tax credit bonds that is includable in the investor's gross income.

**Q-9. Is there a maximum maturity for qualified tax credit bonds and specified tax credit bonds?**

A-9. Yes. The maximum term for these tax credit bonds is the term that the Secretary estimates will result in the present value of the obligation to repay the bond principal being equal to 50 percent of the face amount of the bond. This present value is determined using a discount rate equal to the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month. Currently, the maximum maturity is approximately 15 to 17 years. The maximum maturity is published by the Bureau of Public Debt at: [www.treasurydirect.gov](http://www.treasurydirect.gov). The issuer applies the maximum maturity in effect on the first day there is a binding written contract, generally when the bond purchase agreement is signed.

**Q-10. Previous tax credit bonds have a requirement that 95% of proceeds be used for a qualified purpose; does that rule apply to the new qualified tax credit bonds and to specified tax credit bonds?**

A-10. No, the rules under IRC section 54A are very strict. The issuer must spend 100% of “available project proceeds” for a qualified purpose for the type of tax credit bond being issued. Available project proceeds are the sales proceeds the issuer receives from the bonds minus proceeds spent on costs of issuance (up to 2%), plus proceeds from investment earnings. Thus, investment earnings on tax credit bonds must also be spent for the qualified purpose.

**Q-11. May proceeds of the qualified tax credit bonds and specified tax credit bonds be used to fund a reserve?**

A-11. No, the issuer must spend 100% of available project proceeds on a qualified purpose. Funding a reserve is not a qualified purpose. However, the issuer may fund a reserve from other sources. See the following question.

**Q-12. Will the arbitrage rules under IRC 148 apply to an issue of qualified tax credit bonds and specified tax credit bonds?**

A-12. Yes, issues of qualified tax credit bonds and specified tax credit bonds are subject to section 148 of the Code. A special arbitrage rule applies to a reserve fund funded from sources other than available project proceeds of the tax credit bond. The reserve may be funded no more rapidly than in equal annual installments; in a manner reasonably expected to result in an amount not greater than necessary to repay the bonds; and the yield on such fund is restricted to the “permitted sinking fund rate.” The “permitted sinking fund rate” is set by the Secretary and is published by the Bureau of Public Debt at: [www.treasurydirect.gov](http://www.treasurydirect.gov).

**Q-13. Are there special expenditure rules for the proceeds of qualified tax credit bonds and specified tax credit bonds?**

A-13. Yes, as of the issue date issuers of tax credit bonds must reasonably expect that 100% of the available project proceeds will be spent for one or more qualified purposes within the 3-year period beginning on the date the bonds are issued. In addition, the issuer must reasonably expect as of the issue date that a binding agreement will be entered into with a third party so that at least 10% of the expenditures are incurred within the 6-month period beginning with the issue date of the bonds. If the issuer does not meet the 3 year expenditure requirement, the issuer must redeem all of the nonqualified bonds (determined under section 142 of the IRC) within 90 days of the end of the 3-year period. The issuer may request, in instances where the failure is due to reasonable cause, an extension of the 3-year period.

**Q-14. Are qualified tax credit bonds and specified tax credit bonds subject to volume cap?**

A-14. Yes, qualified tax credit bonds and specified tax credit bonds are subject to separate volume caps for each category of tax credit bond. Qualified tax credit bonds and specified tax credit bonds are not subject to section 146.

**Q-15. How are qualified tax credit bonds and specified tax credit bonds reported for purposes of section 54A(d)(3)?**

A-15. The IRS has released new [Form 8038-TC](#), *Information Return for Tax Credit Bonds and Specified Tax Credit Bonds*. Both tax credit bonds and specified tax credit bonds must be reported on [Form 8038-TC](#). If an issuer has reported a specified tax credit bond on [Form 8038](#), it must refile its report on [Form 8038-TC](#).

**Q-16. How does the issuer of specified tax credit bonds apply to receive the cash payment subsidy from the Federal government?**

A-16. The issuer of specified tax credit bonds must file revised [Form 8038-CP](#), *Return for Credit Payments to Issuers of Qualified Bonds*. For fixed rate bonds, and for variable rate bonds when the issuer knows the amount of interest, [Form 8038-CP](#) must be filed 45 days before the related interest payment date but not earlier than 90 days prior to the interest payment date. For variable rate bonds, when the issuer does not know the amount of interest, issuers are reimbursed quarterly. Issuers must aggregate all credit payments for each quarter and file [Form 8038-CP](#) no later than 45 days after the last interest payment date of the quarter to be reimbursed. NOTE: [Form 8038-TC](#) must be filed at least 30 days prior to filing a request for the cash subsidy on [Form 8038-CP](#). The IRS will process [Form 8038-CP](#) for interest payments relating to specified tax credit bonds on or after September 1, 2010. See [Notice 2010-35](#).

**Q-17. Because section 148 of the Code applies to specified tax credit bonds, how is calculation of the yield affected by the Federal subsidy cash payment allowed to the issuer under section 6431(f) of the Code?**

Q-17. The yield on specified tax credit bonds is calculated by reducing the amount of interest paid on the bonds by the amount of the Federal subsidy payments allowed to the issuer under section 6431(f) of the Code, without regard to amounts offset for delinquent debts owed to Federal and state government agencies.

**Q-18. How does an issuer “designate” the type of tax credit bond issued?**

A-18. Prior to issuing tax credit bonds, the issuer must indicate on its books and records its designation of the bonds as QZABs, QSCBs, New CREBs or QECBs.

**Q.-19. How does the issuer elect to issue specified tax credit bonds under section 6431(f)(3)(B)?**

A-19. The issuer of specified tax credit bonds must make an irrevocable election to issue the bonds on its books and records on or before the issue date of the bonds.

**Q-20. What is the conflict certification required for tax credit bonds and specified tax credit bonds?**

A-20. An issuer of tax credit bonds must certify that it has met the requirements of State and local law governing conflicts of interest with respect to the bond issue.

**Q-21. Do Davis-Bacon labor standards apply to all projects financed by qualified tax credit bonds and specified tax credit bonds?**

A-21. Yes, Davis-Bacon labor standards apply to all projects financed by these new tax credit bonds. The Davis-Bacon contract clauses stated in 29 CFR 5.5(a)(1) through (10) must be incorporated into covered contracts for construction, alteration, or repair work. Additional information regarding the application of Davis-Bacon labor standards is available at the U.S. Department of Labor Wage and Hour Division website at: [www.dol.gov/whd/recovery/index.htm](http://www.dol.gov/whd/recovery/index.htm).

## **Qualified Zone Academy Bonds under IRC section 54E**

### **Q-22. For what purposes can QZABs be issued?**

A-22. QZABS may be issued to rehabilitate or repair the public school facility in which the academy is established; to provide equipment for use at such academy; to develop course materials for education to be provided at such academy; and, to train teachers and other school personnel in such academy. QZABS may not be used for new construction.

### **Q-23. Who can issue QZABs?**

A-23. Qualified Zone Academy Bonds may be issued by a State or local government within the jurisdiction of which a qualified zone academy is located.

### **Q-24. What is a qualified zone academy?**

A-24. A qualified zone academy is any public school or program established and run by an eligible local education agency to educate and train below the post secondary level if: (1) the school or program is designed together with business to enhance the curriculum, increase graduation and employment, and prepare students for the workforce; (2) the students will be subject to the same academic standards and assessments as other students in the eligible local education agency; (3) the comprehensive education plan is approved by the eligible local education agency; and (4) such public school is located in an empowerment zone or enterprise community or there is a reasonable expectation that at least 35% of students will be eligible for free or reduced-cost lunches .

### **Q-25. What is the private business contribution required by QZABs?**

A-25. QZABs require the issuer to certify that it has satisfied the “private business contribution.” To satisfy the private business contribution, the issuer must have received written commitments from private entities having a present value of not less than 10% of the proceeds of the bonds. A qualified contribution consists of: equipment for use in the qualified zone academy (including state-of-the-art technology and vocational equipment); technical assistance in developing curriculum or in training teachers in order to provide appropriate market driven technology in the classroom; services of employees as volunteer mentors; internships, field trips, or other educational opportunities outside the academy for students; or, any other property or service specified by the eligible local educational agency.

**Q-26. How is QZAB volume cap allocated?**

A-26. The QZAB volume cap is allocated by the Secretary. The national allocation to States and territories of \$400 million for 2008 and of \$1.4 billion for 2009 is set forth in [Notice 2009-30](#). The national allocation to States and territories of \$1.4 billion for 2010 is set forth in [Notice 2010-22](#).

**Q-27. Can unused volume cap allocation for QZABs be carried forward?**

A-27. Yes, but only for two years, then any unused allocation expires.

**Qualified School Construction Bonds under IRC Section 54D**

**Q-28. For what purposes can QSCBs be issued?**

A-28. QSCBs may be issued to construct, rehabilitate, or repair a public school facility. With the exception of BIA-funded schools, QSCB proceeds may be used to acquire land provided that the facility to be constructed with the same issue of QSCBs will be located on the land. Proceeds may also be used to acquire equipment or furniture provided that the equipment or furniture is to be used in the portion of the public school facility that is being constructed, rehabilitated or repaired with part of the proceeds.

**Q-29. Who can issue QSCBs?**

A-29. QSCBs may be issued by a State or local government within the jurisdiction of which the public school facility is located. An Indian tribal government that receives an allocation from the Department of the Interior may issue QSCBs for a BIA-funded school. Bond proceeds must be spent for a facility located within the jurisdiction of the issuer.

**Q-30. How is QSCB volume cap allocated?**

A-30. Generally, the QSCB volume cap is allocated by the Department of the Treasury. The national volume cap allocation of \$11 billion for 2009 to States and large local educational agencies is set forth in [Notice 2009-35](#). The national volume cap allocation of \$11 billion for 2010 to States and large local educational agencies is set forth in [Notice 2010-17](#). Additionally, a volume cap allocation to construct, rehabilitate and repair schools funded by the Bureau of Indian Affairs of \$200,000,000 for calendar year 2009 and \$200,000,000 for calendar year 2010 is allocated by the Secretary of the Interior to Indian Tribal governments.

## **New Clean Renewable Energy Bonds under IRC section 54C**

### **Q-31. For what purposes can New CREBs be issued?**

A-31. New CREBs may be issued for capital expenditures for a qualified renewable energy facility. Qualified renewable energy facilities are facilities that generate electricity from wind, closed-loop biomass; open-loop biomass; geothermal or solar; small irrigation, hydro electric; gas from biodegradation of municipal solid waste; marine and hydrokinetic renewable; and trash combustion facilities. Bond proceeds may not be used to acquire existing facilities.

### **Q-32. Who can own a qualified renewable energy facility financed by New CREBs?**

A-32. A qualified renewable energy facility financed by New CREBs must be owned by governmental bodies, public power providers and cooperative electric companies.

### **Q-33. Who can issue New CREBs?**

A-33. New CREBs may be issued by a public power provider, a cooperative electric company, a governmental body, a clean renewable energy bond lender or a not-for-profit electric utility which has received a loan or loan guarantee under the Rural Electrification Act.

### **Q-34. How is New CREB volume cap allocated?**

A-34. The current national volume cap allocation for New CREBs of \$1.6 billion is allocated by the Department of Treasury. Applications and requirements for New CREB volume cap allocations were solicited in [Notice 2009-33](#). Based on the criteria and applications received, the volume cap allocations were awarded to the successful applicants by letter.

### **Q-35. Can unused volume cap be carried forward?**

A-35. An allocation of New CREB volume cap is valid for three years after the date of the letter issuing the allocation. The IRS plans to reallocate any unallocated or unused relinquished volume cap.

## **Qualified Energy Conservation Bonds under IRC section 54F**

### **Q-36. For what purpose can QECBs be issued?**

A-36. QECBs may be issued for capital expenditures incurred for reducing energy consumption in publicly owned buildings by at least 20%; implementing green community programs (including the use of loans, grants or other repayment mechanisms to implement such programs); rural development involving the production of electricity from renewable energy resources; or any qualified facility including facilities that generate electricity from wind, closed-loop biomass; open-loop biomass; geothermal or solar; small irrigation, hydroelectric; gas from biodegradation of municipal solid waste; marine and hydrokinetic renewable; and trash combustion facilities without regard to any placed in service date. QECB purposes are very broad and also include expenditures for certain research facilities and grants, mass commuting facilities, demonstration projects and public education campaigns to promote energy efficiency.

### **Q-37. Who can issue QECBs?**

A-37. QECBs may be issued by a State or local government, including Indian tribal governments. The eligible costs for qualified conservation purposes financed with the proceeds of an issue of QECBs must relate to qualified conservation purposes that are located within or attributable to both the jurisdiction of the issuer of the QECBs and the jurisdiction of the entity authorized to allocate volume cap to an issue of QECBs. See [Notice 2009-29](#).

### **Q-38. How is QECB volume cap allocated and reallocated?**

A-38 The national volume cap allocation for QECBs is \$3.2 billion. [Notice 2009-29](#) allocates the national limitation to States and territories. Under section 54D(e)(2)(A), States must further allocate a portion of their allocation to large local governments based on population. The eligible costs for qualified conservation purposes financed with the proceeds of an issue of QECBs must relate to qualified conservation purposes that are located within or attributable to both the jurisdiction of the issuer of the QECBs and the jurisdiction of the entity authorized to allocate volume cap to an issue of QECBs.

Under section 54D(e)(2)(B), the amount of volume cap for QECBs allocated to a large local government may be reallocated by such local government to the State in which such local government is located. The IRS will defer to any reasonable process under applicable State law by which a large local government, acting through its governing body or a duly authorized official of a large local government, voluntarily reallocates its volume cap for QECBs back to the State in which such large local government is located. The IRS will defer to any reasonable manner in which the State, in good faith and in its discretion, may allocate such reallocated volume cap, subject to the requirement of section 54D(e)(3) that not less than 70 percent of the reallocation be used for bonds other than private activity bonds.

**Q-39. Can unused QECB volume cap be carried forward?**

A-39. Unused QECB volume cap may be carried forward indefinitely.

**Q-40. Can QECBs be private activity bonds?**

A-40. Yes, QECB volume cap must be allocated by State and large local governments so that no more than 30% of the allocation is used for private activity bonds. Bonds issued for providing loans, grants or other repayment mechanisms for capital expenditures to implement green community programs are exempted from this requirement. All proceeds for private activity QECBs must be spent on capital expenditures.

**Q-41. May state and local government entities use tax-credit bond or Build America Bond issuance proceeds to purchase SLGS securities?**

A-41. Yes. Proceeds of bonds issued under Internal Revenue code (IRC) sections:

- 54 (Clean Renewable Energy Bonds),
- 54A (New Clean Renewable Energy Bonds, Qualified Energy Conservation Bonds, Qualified Zone Academy Bonds (issued after October 3, 2008), and Qualified School Construction Bonds),
- 1397E (Qualified Zone Academy Bonds issued after December 20, 2006, and on or before October 3, 2008, with respect to an allocation arising after 2005),
- 1400N(I) (Midwestern Disaster Area Tax Credit Bonds), and 1400U-2 (Recovery Zone Economic Development Bonds),

all of which are subject to the rules imposed by section 148, including yield restriction, may be used to purchase SLGS securities.

Proceeds of such bonds may be used to acquire SLGS for any situation in which the yield on the invested bond proceeds must be restricted, to include investments of proceeds in construction funds, reserve funds, and sinking funds under section 54A(d)(4)(C).

For more information about the Treasury's State and Local Government Series Securities Program (SLGS) click [here](#).

For more information on tax-credit bonds or Build America Bonds, contact the Internal Revenue Service's Office of Associate Chief Counsel (Financial Institutions & Products) at (202) 622-3980.

**Supplemental Round for Awarding Volume Cap to Cooperative Electric Companies**

**Q-42. May any qualified issuer, as defined in IRC section 54C(d)(6), apply for the unallocated portion of the New CREBs cooperative electric company volume cap allocation originally authorized under [Notice 200933](#)?**

A-42. Yes. However, a cooperative electric company must own the project for which the bond proceeds are spent.

Section 54C authorized \$2.4 billion volume cap for New CREBs with no more than \$800 million of the \$2.4 billion total volume cap allocated to qualified projects owned by public power providers, governmental bodies, and cooperative electric companies. The allocations awarded for projects owned by public power providers and governmental bodies each met the \$800 million statutory allocation limit. However, the allocations awarded for projects owned by cooperative electric companies did not reach the \$800 million limit. An additional \$190.7 million in volume cap is available for allocation awards. [Announcement 2010-54](#) provides additional details concerning the supplemental round of allocations.

Interested qualified issuers must submit applications, in accordance with the instructions in [Notice 2009-33](#), by November 1, 2010. See Appendix A to [Notice 2009-33](#) for a copy of the application.

**Q-43. Are qualified issuers, as defined in IRC section 54C(d)(6), that received an allocation of New CREBs volume cap in the previous allocation, authorized to issue either qualified tax credit New CREBs or direct pay New CREBs?**

A-43. Yes. Qualified issuers that received letters awarding New CREBs volume cap allocation, but have not issued bonds as of March 18, 2010, could issue either qualified tax credit or direct pay New CREBS up to the amount of allocation awarded. Qualified issuers of direct pay New CREBs, whether issued from the first or second round of allocations, must make an irrevocable election to apply this option before issuing their bonds.

**Q-44. [Notice 2009-33](#) provides that qualified issuers awarded an allocation of New CREBs are allowed three years, from the date of the letter awarding such allocation, to issue their bonds. Does the same requirement apply to New CREBs allocations awarded pursuant to [Announcement 2010-54](#)?**

A-44. Yes. The rules set forth in [Notice 2009-33](#) would apply to applications submitted pursuant to [Announcement 2010-54](#). Qualified issuers awarded an allocation for a qualified project owned by a cooperative electric company will also have three years, from the date of the letter awarding such allocation, to issue their bonds.