Private Activity Bonds

Section 3601 of the Tax Cuts and Jobs Act (H.R. 1) would make several amendments to the Internal Revenue Code for the purpose of eliminating the authority of state and local governments to issue Private Activity Bonds (PABs). This proposal would impose significant new costs on entities such as private, nonprofit hospitals, universities, nursing facilities, low- and middle-income housing, airports, seaports, and similar borrowers. This proposal would also hamper the ability of private entities to play a role in infrastructure development, as many public-private partnership ("P3s") agreements have relied heavily on PABs as a core financing vehicle. We urge that Congress preserve the ability to issue PABs and remove Section 3601 from H.R. 1 as the bill moves through the legislative process.

Background

State and local government are eligible to issue bonds in the capital market where the interest earned by investors is exempt from federal income tax. However, if more than 10 percent of the proceeds of a bond issue are used by a private business and more than 10 percent of the debt service on a bond is paid or secured by a private business, the bond is a PAB and cannot be tax-exempt unless it meets one of the exceptions specified in law. These exceptions were included in the tax code to promote the use of bonds to finance targeted categories of facilities and include, among others:

- Bonds where the borrower is a 501(c)3 organization;
- Bonds where the project being financed is an "exempt facility" such as airports, docks and wharves, mass commuting facilities, water and sewer facilities, solid waste disposal facilities, and others;
- Bonds used to finance qualified home mortgages for low- and middle-income families that meet certain criteria; and
- Bonds issued for the benefit of very small manufacturing companies.

PABs are a popular financing tool among independent charter schools. They are also often used in conjunction with the Low Income Housing Tax Credit, which would remain in place under H.R. 1, to finance low-income rental housing developments. The ability to borrow using tax-exempt bonds saves these qualified entities two percentage points or more on the interest rate on their borrowing. In return, the federal government gets more investment in key public-private infrastructure projects and other targeted facilities.

PAB authority includes significant restrictions on the bonds. For example, most PABs are subject to annual, per state volume limits. The interest on some PABs is subject to the individual Alternative Minimum Tax ("AMT"). Many PABs cannot be "advance refunded." Still, PABs are a successful program that has helped provide many billions of dollars of investment in hospitals, colleges and universities, airports, water and sewer systems and other key infrastructure assets that provide essential services. They are used widely by charitable organizations and as noted above, are often used in the context of public-private partnerships (P3s) for infrastructure projects that would not be completed without the involvement of the private sector.

H.R. 1 Section 3601

H.R. 1 would prohibit any new issuance of PABs after 2017. The Ways and Means Committee argues[1] that "the Federal government should not subsidize the borrowing costs of private businesses, allowing them to pay lower interest rates while competitors with similar creditworthiness but that are unable to avail themselves of PABs must pay a higher interest rate on the debt they issue."

For the most part, however, PABs are not used by borrowers in a way that provides competitive advantages that the borrower's private sector competitors do not also enjoy. The largest segment of PAB borrowers is 501(c)(3) organizations such as universities and hospitals. These borrowers are already recognized by the Internal Revenue Service as charities, and are eligible for a spectrum of tax advantages such as being exempt from taxation on net income and the ability to accept tax-deductible charitable contributions. PABs are one of the least costly tax expenditure benefits that accrues to charitable nonprofits.[2] By reducing borrowing costs, PABs free up resources to allow these charitable organizations to better serve their communities.

In many cases, facilities financed with PABs such as airports have no viable private sector competitors. They are public infrastructure facilities accessible to all, and PABs reduce the cost of government by lowering financing costs for these vital projects.

Moreover, PABs could be a key element in expanding the menu of financing options for P3s for infrastructure projects. President Trump has spoken many times about the need to enhance our ability to finance infrastructure projects, and the administration has often focused the infrastructure discussion on P3s. P3s often employ varied financing structures that may include may equity and senior and subordinated taxable and tax-exempt debt including PABs. Indeed, Treasury Secretary Mnuchin in his Senate confirmation hearing stated he wants to expand the use of PABs for infrastructure.[3] The administration in the context of its FY 2018 budget called for expanding the use of PABs for financing highways.[4] There are bipartisan bills pending in the House to expand the use of PABs in several areas, including general infrastructure (H.R. 3912), public buildings (H.R. 960), water and sewer facilities (H.R. 3009), first-time farmers (H.R. 1750), student loans (H.R. 480), broadband in underserved areas (H.R. 2870), "carbon capture" technology (H.R. 2011) and others. Supporters of these bills recognize that PABs offer an efficient and low-cost financing tool.

Summary

PABs are a key resource for many billions of dollars of investment in infrastructure, hospitals, universities, housing and others that provides benefits to countless communities throughout the United States. Expanding the use of PABs could help facilitate significant investment in new infrastructure.

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[1] U.S. House of Representatives, Committee on Ways and Means, "Tax Cuts and Jobs Act—H.R. 1—Section-by-Section Summary," page 48.

[2] For example, the tax expenditure associated with the deductibility of charitable contributions is estimated to total $313 billion over fiscal years 2016-2020, while the tax expenditure associated with tax-exempt borrowing by charities is estimated at $33 billion. See Staff of the Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2016-2020," January 30, 2017.

[3] Lynn Hume, "Mnuchin Says He'll Work to 'Enhance' PABs for Infrastructure Projects," *The Bond Buyer*, January 25, 2017.

[4] The White House, "Fact Sheet: 2018 Budget: Infrastructure Initiative," February 27, 2017, page 4.

Indeed, the repeal of the individual AMT, also proposed in H.R. 1, would help make PABs an even more efficient financing tool. We urge Congress to preserve the ability to issue PABs and remove Section 3601 from H.R. 1 during Ways and Means Committee consideration.

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