



AMERICAN RECOVERY AND REINVESTMENT ACT: Provisions Applicable to IDAs

This memorandum provides a summary of certain provisions contained in the American Recovery and Reinvestment Act of 2009 (“ARRA”), which may be of interest to Industrial Development Agencies (“IDAs”) in New York state.

I. Temporary Expansion of Manufacturing Facility Definition for Qualified Small Issue Bonds

Existing Law: Qualified small issue bonds are tax-exempt bonds that can be issued to finance manufacturing facilities. Prior to the enactment of ARRA, the definition of “manufacturing facilities” for which qualifying small issue bonds could be issued was limited to facilities used in the manufacture or production of tangible personal property, but could include facilities directly related and ancillary to a manufacturing facility, provided (i) they are located on the same site as a manufacturing facility, and (ii) not more than 25 percent of the net proceeds of a bond issue are used to finance such related and ancillary facilities.

ARRA Amendment: For qualified small issue bonds issued in 2009 and 2010, the definition of manufacturing facility is expanded to include facilities used for the creation or production of certain intangible property, including patents, copyrights, formulas and processes. Specifically, the expanded definition covers the development of computer software and intellectual property associated with bio-tech and pharmaceutical facilities. In addition, for bonds issued in 2009 and 2010, the 25 percent of net proceeds limitation applicable to ancillary facilities is eliminated. Instead, any “functionally related and subordinate facilities” that are located on the same site as a manufacturing facility are treated as a qualifying manufacturing facility. Thus, under this temporary rule, up to 100 percent of the net proceeds of a qualified small issue bond can be applied to finance functionally related and subordinate facilities, such as warehouse space, loading docks, training facilities, office space, or R&D facilities, among others, so long as these facilities are located at the same site as the actual manufacturing operations to which they relate.

Impact on IDAs: This amendment will broaden the type of facilities for which IDAs can issue tax-exempt manufacturing facility bonds. Under the temporary change in law, IDAs will be able in 2009 and 2010 to issue tax-exempt bonds for software development facilities and other types of facilities that solely produce intangible or intellectual property. In addition, existing businesses that need to expand support facilities at a manufacturing site, such as warehouse or packaging areas, R&D facilities, offices, parking areas or loading docks, would now be eligible to be financed on a tax-exempt basis, even if no portion of the bonds is to be applied to improve core manufacturing facilities.



2. Temporary Expansion of Bank Qualified Bonds

Existing Law: As a general rule, banks are not allowed a tax deduction for the interest they pay on borrowed moneys that are used to invest in tax-exempt bonds. This general rule, however, does not apply to a bank's interest expense allocable to what is commonly referred to as a "bank qualified bond" and is instead replaced with a special rule that allows banks to deduct 80 percent of their interest expense allocable to a bank qualified bond. A "bank qualified bond" is a governmental or qualified 501(c)(3) bond issued by a "qualified small issuer," which is defined as an issuer that reasonably anticipates it will not issue more than \$10 million in governmental and qualified 501(c)(3) bonds in a given calendar year. For purposes of determining compliance with this \$10 million limitation, all bonds issued by an issuer, any of its subordinate entities, and any entities that can issue bonds on behalf of that issuer, will be taken into account. Current refundings of bank qualified bonds are generally eligible to be deemed bank qualified bonds, even if the issuer will otherwise issue more than \$10 million in bonds in the current calendar year.

ARRA Amendment: For tax-exempt bonds issued in 2009 and 2010, the \$10 million limitation on qualified small issuers is raised to \$30 million. Further, in the case of conduit financings (which includes almost all IDA financings) the determination of whether the \$30 million limitation is satisfied is made at the conduit borrower level, rather than at the issuer level. Thus, during 2009 and 2010, a 501(c)(3) borrower can qualify to have bank qualified bonds issued on its behalf, so long as it reasonably anticipates that the aggregate tax-exempt bonds to be issued for its benefit in the current calendar year will not exceed \$30 million. In addition, during these two years, the actual issuer of the conduit bonds will generally be able to issue bank qualified bonds for multiple qualifying 501(c)(3) borrowers without any aggregate limitation.

Impact on IDAs: Assuming the IDA civic facility statute is re-enacted, this amendment would, through the end of 2010, significantly enhance the attractiveness of tax-exempt IDA financing for 501(c)(3) not-for-profit organizations. Expanding the annual ceiling on bank qualified bonds to \$30 million and shifting the limitation from the IDA to the not-for-profit organization will substantially reduce the up-front closing costs on many more qualified 501(c)(3) bonds by potentially eliminating the need to engage professionals typically used on larger transactions, such as underwriters, trustees and credit providers and their respective counsels, as well the need to incur certain related costs such as rating agency fees, accountant fees and printing costs.

3. Temporary Repeal of Alternative Minimum Tax ("AMT") Provisions for Tax-Exempt Bonds

Existing Law: As a general rule, interest on tax-exempt private activity bonds other than qualified 501(c)(3) bonds (often referred to as "AMT Bonds") is an "item of tax preference" that is included in the calculation of the federal alternative minimum tax liability of corporations and individuals. In addition, as a general rule, a portion of the interest on all tax-exempt bonds (both AMT Bonds and non-AMT Bonds) is included in the "adjusted current earnings" of certain corporations for purposes of calculating such corporation's alternative minimum tax liability. A permanent exception to both these general rules was enacted last year as part of the Housing Assistance Tax Act of 2008 for tax-exempt bonds issued for certain multi-family housing projects.

ARRA Amendment: Under the ARRA amendments, interest on all tax-exempt private activity bonds issued in 2009 and 2010 will not be treated as an item of tax preference for purposes of the alternative minimum tax, and interest on all tax-exempt bonds issued in 2009 and 2010 will not be included in adjusted current earnings for purposes of determining a corporation's alternative minimum tax liability. Further, interest on refunding bonds issued after 2010 of tax-exempt bonds originally issued during 2009 or 2010 will similarly qualify for these exclusions. Lastly, interest on tax-exempt bonds issued in 2009 and 2010 to refund bonds issued in 2004 through 2008 (including even bonds that were themselves refunding bonds) will likewise qualify for both these exclusions.

Impact on IDAs: These amendments should generally enhance the benefit of tax-exempt IDA financing for all types of projects for which IDAs can issue tax-exempt bonds. By eliminating the inclusion of tax-exempt interest from the federal alternative minimum tax, the universe of potential investors of tax-exempt bonds is expanded, thereby increasing investor demand and reducing interest rates (at least in theory).

4. Recovery Zone Facility Bonds (Exempt Facility Bonds)

ARRA creates a new type of tax-exempt exempt facility bond, termed "recovery zone facility bonds." In order to qualify as a recovery zone facility bond (i) the bond has to be issued in 2009 or 2010, (ii) the bond has to be designated as such by the issuer, and (iii) at least 95 percent of the net proceeds of the bond must be used for "recovery zone property." "Recovery zone property" is defined as property subject to depreciation, which was constructed, reconstructed, renovated or purchased from an unrelated party after the date on which the "recovery zone" designation took effect. Additionally, the original use of such property in the recovery zone must commence with the taxpayer, substantially all of the use of such property must be within the recovery zone, and must be in the active conduct of a "qualified business" within the recovery zone. A qualified business is one which (i) does not involve the rental of residential real property (defined for this purpose as real property at least 80 percent of the rental income of which is from dwelling units), and (ii) does not include the operation of a private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store of which the principal purpose is the sale of alcoholic beverages for off-site consumption.

The national limitation on the amount of recovery zone facility bonds that can be issued is \$15 billion. This limitation is allocated among the states based upon the reduction in employment in each state between December 31, 2007 and December 31, 2008 (referred to as the "2008 employment decline"), with each state being allocated a minimum of 0.9 percent of the national limitation (\$135 million). Each state must then reallocate all of its allocation among its counties and "large municipalities" (defined as municipalities with populations of more than 100,000) in proportion to the 2008 employment declines in such counties and municipalities.

"Recovery zones" are defined as including: (i) any area designated by an issuer as having significant poverty, unemployment, rate of home foreclosures, or general distress, (ii) any area designated by the issuer as economically distressed due to the closure or realignment of a military installation pursuant to the Defense Base Closure and

Realignment Act of 1990, or (iii) any area which has been designated as an empowerment zone (e.g., Syracuse, Yonkers and New York City) or a renewal community (e.g., Buffalo-Lackawanna, Jamestown, Niagara Falls, Rochester, and Schenectady). Since the designation of recovery zones is largely to be made by each individual issuer, there is a fair amount of flexibility as to where and what types of projects can be financed with these bonds.

While it appears that IDAs likely will have authority to issue recovery zone facility bonds, there are many details of the program that will need further clarification from IRS guidance, including how a county or large municipality can assign its allocation to an issuer, such as an IDA.

For more information on the American Recovery and Reinvestment Act of 2009 and its impacts on IDAs, please feel free to contact the Harris Beach attorney with whom you usually work, or the members of the Public Finance & Economic Development practice group below:

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