



May 2009, VOL 6

# InfoSeries

## The American Recovery and Reinvestment Act of 2009 and its Impact on Tax-Exempt Financings by Section 501(c)(3) Organizations

Generally, the focus of the American Recovery and Reinvestment Act of 2009 (the "Stimulus Bill") was to create new methods for State and local governments to finance renewable energy and governmental infrastructure. However, as described below, changes made by the Stimulus Bill may significantly reduce the borrowing costs of Section 501(c)(3) organizations that borrow less than \$30 million in 2009 or 2010.

### **Pre-Stimulus Bill Disincentives for Banks to Purchase Tax-Exempt Bonds**

The tax law has historically penalized banks for holding tax-exempt bonds. Other than for Bank Qualified Bonds (as defined and discussed below), banks have been denied a deduction for the portion of their interest expense allocable to the purchase of tax-exempt bonds. As an economic matter, this rule generally eliminates any incentive for a bank to purchase a tax-exempt obligation instead of a taxable obligation.

There is one exception to this rule limiting the deductibility of interest allocable to tax-exempt bonds— bonds designated as bank qualified bonds ("Bank Qualified Bonds"). Before the Stimulus Bill, a bond could only be designated by an issuer as a Bank Qualified Bond if it was a governmental bond (i.e., a bond issued for other than a Section 501(c)(3) organization) and the governmental issuer expected to issue no more than \$10 million of bonds in the calendar year. With respect Bank Qualified Bonds, banks get the economic benefits of tax-exempt interest and the ability to deduct 80% of the interest expense associated with the purchase of such bonds (in effect, tax arbitrage). As a result, Bank Qualified Bonds placed with a bank will generally be sold at a lower coupon than comparable non-Bank Qualified Bonds.

### **Expansion of Bank Qualified Bond Rules for Certain Bonds Issued in 2009 and 2010**

The Stimulus Bill greatly increases the number of obligations that may qualify as Bank Qualified Bonds and benefit from the interest rate savings generally afforded such bonds.

First, the maximum annual issuance amount is increased from \$10 million to \$30 million for bonds issued in 2009 and 2010.

Second, the types of bonds that may now qualify as Bank Qualified Bonds has been expanded to include obligations issued on behalf of Section 501(c)(3) organizations. Importantly, for purposes of this rule, the Section 501(c)(3) borrower is viewed as the "issuer" of the bonds. Thus, a health care or higher education issuer during 2009 and 2010 could issue an unlimited amount of Bank Qualified Bonds on behalf of Section 501(c)(3) obligors provided that the amount allocable to each such obligor organization is less than \$30 million in the calendar year.

Continued on back

About the Author

### **Edwin G. Oswald**

Ed Oswald, a partner in the ORRICK Washington, D.C. office, is a member of the Tax Group. Mr. Oswald's practice concentrates in the taxation of municipal finance including healthcare, public power, university and nonprofit issues, student loan and single and multi-family housing financing, refinancing and arbitrage matters.

He served in the Office of Tax Legislative Counsel at Treasury, where he developed policy, legislative initiatives and regulations affecting public finance and structured finance.

#### **For More Information**

Edwin G. Oswald  
ORRICK  
Partner  
Tax  
Washington D.C. Office

(202) 339-8438  
eoswald@orrick.com

### Examples of New Rule Applied to Section 501(c)(3) Organizations

Assume health care issuer (X) is approached by Section 501(c)(3) hospital (Y) in May of 2009 to finance capital improvements with tax-exempt bonds of less than \$30 million. Provided that the aggregate of X's bonds issued for the benefit of Y and any other tax-exempt borrowings that benefit Y in 2009 are not in excess of \$30 million, such bonds are eligible for bank qualified status.

Assume instead that Y is one of eight hospitals each seeking to borrow \$25 million in a pool bond financing in 2009. Although the aggregate amount of debt to be issued by X in the pool financing is \$200 million, each \$25 million tranche of bonds is eligible for bank qualified status provided that the individual hospital does not expect to borrow more than \$30 million on a tax-exempt basis in 2009.



Edwin G. Oswald

### Private Placement Versus Public Underwriting

The inclusion of bonds issued on behalf of Section 501(c)(3) organizations and viewing each such organization as an "issuer" for purposes of Bank Qualified Bond rules provide such organizations with an effective new tool in 2009 and 2010. Section 501(c)(3) organizations that seek to finance less than \$30 million in calendar year 2009 or 2010 (or both) are encouraged to work with issuers in determining the buy-side appetite of banks (and related pricing) in directly purchasing such bonds as Bank Qualified Bonds as compared to the pricing afforded by a traditional public underwriting.

#### Printed by

National Association of Health and Educational  
Facilities Finance Authorities

#### Reprint requests for more copies:

Idaho Health Facilities Authority  
1607 W. Jefferson St.  
Boise, Idaho 83702  
(208) 342-8772