



Build AMERICA BONDS

QUICK TAKE

- BABs are a new way to stimulate the economy
- BABs offer investors an opportunity to diversify risk into historically stable bonds
- BABs can be issued in 2009 and 2010

In case you haven't heard, there is a new option for governmental financing called "Build America Bonds," or BABs. BABs were included in The American Recovery and Reinvestment Act of 2009 (the "Act").

WHAT ARE BABS?

BABs are state or local governmental bonds that could be issued as tax-exempt bonds, but which the issuer elects to treat as BABs. Interest on BABs is taxable to the bondholder, but tax credits are provided in lieu of the tax-exemption.

There are two types of BABs. The basic form provides the bondholder with a non-refundable federal income tax credit of 35% of the interest paid on the bond in each tax year. If the bondholder lacks sufficient tax liability in any year to fully utilize that year's credit, the excess credit can be carried forward to future years. To date, it appears that none of this basic form of BABs have been issued.

The second form, "direct-pay BABs," provides no credit to the bondholder; instead the issuer of the BABs receives payments from the Federal Treasury equal to 35% of the interest paid by the issuer. No more than 2% of direct-pay BABs proceeds may be used to pay costs of issuance and, with this type of BABs, only new money projects for capital purposes qualify. Because the credit is paid to the issuer, and BABs are taxable obligations, the purchasers of these bonds need not be taxpayers. This opens a new market for the debt of state or local governmental units, including tax-exempt entities like pension plans and foreign entities.

Unless extended, BABs can be issued only through 2010.

WHO CAN ISSUE BABS AND WHAT CAN BE FINANCED?

BABs can be issued by any state or local governmental issuer of tax-exempt bonds. The proceeds can be used for any purpose for which tax-exempt financing is generally available to governmental borrowers. BABs must satisfy all the rules applicable to tax-exempt financing generally, including limits on private use, arbitrage limitations and rebate requirements. The issuer structures a transaction in the manner of a tax-exempt bond, but elects to exchange the tax-exemption for the tax credits, paid either to the bondholder or the issuer. BABs treatment is not available for any financing which benefits private parties, including 501(c)(3) organizations.



CAN BONDS BE ISSUED AS PART BABS AND PART TAX-EXEMPT BONDS?

Yes. The statutory language allows BABs treatment to be elected for selected bonds constituting a portion of a financing (for example, the later maturing bonds in the issue). Because of the differing tax treatment it is necessary to split the overall issue into identifiable separate series, one consisting of tax-exempt bonds and the other made up of BABs.



IS THE INTEREST PAYABLE ON BABS EXEMPT FROM STATE TAXATION?

The state law treatment of interest on the BABs is uncertain. The Act is drafted to maximize the likelihood that states that exempt interest from income tax based on a federal exemption would treat BABs as tax-exempt for state law purposes. The Act allows states to specifically overrule this position.

ARE BABS AUTHORIZED UNDER STATE LAW?

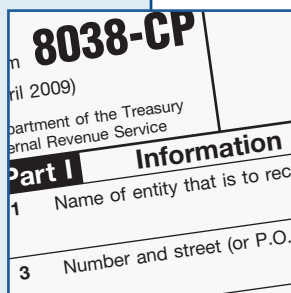
As with all bond issues, the borrower must have the independent power to issue for particular purposes under state law. As interest bearing bonds, BABs should comply with existing state law. However, some legislative amendments may be necessary in order to properly receive and apply the tax credits payable to issuers of direct-pay BABs.

WHAT REMAINS TO BE CLARIFIED REGARDING BABS?

Several issues affecting the issuance and effect of BABs will require federal or state guidance or possibly legislative changes. Preliminary guidance has been provided by the IRS. Additional guidance is expected from regulators in the near future.

The open issues or unknowns include:

- Whether there are limitations or restrictions regarding the use of credit payments to issuers of direct-pay BABs.
- The optimum structure for BABs, including call provisions and maturities. Nonetheless, the volume of direct-pay BABs is large and growing.
- Whether BABs are good deals for issuers? Issuers should check with their financial advisors and underwriters for help evaluating the overall cost of a financing using either of the BABs types as compared to traditional tax-exempt financing.
- Disclosure for BABs may be more substantial, if the experience in the taxable bond market generally is applicable.
- The nature and extent of required legal opinions regarding BABs, and their credits, is not yet fully known.
- Procedures that might be imposed by the IRS regarding enforcement in the area are also unknown.



Public Finance
Brant A. Freer 313.496.7559



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