Tax-Exempt Bond Essentials







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Tax-Exempt Bonds - In General

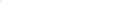
- ► Tax Reform Act of 1986 established current statutory rules for tax-exempt bonds by enacting Secs. 141-150
- ▶ Intended to encourage socially worthwhile projects by providing an indirect government subsidy in Sec. 103
- ▶ Sec. 103(a) provides an exclusion from gross income of interest on any state or local bond
- Exclusion from income will not apply to any bond that is a private activity bond which is not a qualified bond
- ► Seven types of 'qualified bonds', including Qualified Section 501(c)(3) Bonds and Governmental Bonds





Tax-Exempt Bonds - In General (cont.)

- ▶ Why use tax-exempt bonds?
 - Lower interest rates, primarily due to the exclusion from income under Sec. 103
 - Better transaction terms availability of fixed interest rates, and bonds can be issued for a longer term
- ▶ Who uses tax-exempt bonds?
 - Charitable, educational, healthcare, cultural organizations
- ▶ Eligible uses of tax-exempt bond proceeds:
 - (1) capital expenditures
 - (2) refinancing prior debt
 - (3) reimbursing prior capital expenditures
 - (4) financing costs







Qualified Sec. 501(c)(3) Bonds (IRC Sec. 145)

- ▶ Prior to issuance, bonds must be approved by the governmental entity issuing the bonds (public approval requirement)
- ▶ Bond proceeds must be used to finance property owned by a Sec. 501(c)(3) organization
- ▶ Not more than 5% of the net proceeds of the bond issue can be used for any private business use
- ➤ The weighted average maturity of the bonds may not exceed 120% of the weighted average useful life of the capital assets being financed, excluding land (Sec. 147(b).

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Private Business Use

- ➤ The 5% private business use limit is measured over the entire term of the bond issue, not annually
- ▶ Private business use (PBU) is use of tax-exempt bondfinanced property by persons other than Sec. 501(c)(3) organizations or governmental entities
- ▶ Use by a related, non-501(c)(3) is PBU and a frequent trap
- ▶ In addition, use of bond-financed property by a Sec. 501(c)(3) organization in an unrelated trade or business will result in PBU
- ▶ PBU can be avoided if bond proceeds are allocated away from potential trouble areas

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