

State and local governments continue to see a reduction in credits available for Direct Pay Bonds

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As a result of federal sequestration, state and local governments who have issued certain direct pay bonds have seen a reduction in tax subsidy payments since March 1, 2013. Sequestration is a result of Congress' failure to meet its own deadlines to reduce the federal deficit. Pursuant to the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, certain automatic reductions will continue to occur until Congress takes affirmative action to reduce the deficit.

The reductions include cuts to tax credits to "Direct Pay Bond" issuers who elected to receive a direct credit subsidy under Section 6431 of the Internal Revenue Code, including Build America Bonds, Recovery Zone Economic Development Bonds, Qualified School Construction Bonds, Qualified Zone Academy Bonds, New Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds.

What is the sequestration rate for fiscal year 2016?

The rate of reduction to the subsidy payments has changed each year since the sequestration has been in effect. For the fiscal year ending 2016 (i.e. October 1, 2015 through September 30, 2016), the credits available for Direct Pay Bonds will be reduced by 6.8 percent. Issuers should continue to timely submit the Form 8038-CP claiming 100 percent of the allowable credit amount. At that time, the Internal Revenue Service will likely notify the issuer that, in fiscal year 2016, only 93.2 of the allowable credit amount will be paid. This sequestration reduced rate will be applied until September 30, 2016 or intervening Congressional action, whichever is sooner.

Depending on a number of factors, including the call provisions of a particular Direct Pay Bond issue, certain issuers have found that there is a benefit to reducing their Direct Pay Bonds on a current basis. If you have any questions regarding this alert or are an issuer of Direct Pay Bonds and would like to discuss refunding those bonds, please contact us.

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