

## The Effect of Tax Reform on Michigan Charter Schools

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Many recent press reports have warned of the negative affect tax reform could have on charter schools around the country. These reports focus on the proposed elimination of private activity bonds (“PABs”) under the House tax reform plan and the effect it would have on charter schools.

PABs are tax-exempt bonds which may be issued under the current federal law by a governmental authority to finance private projects which have a public benefit. PABs are also issued to finance capital projects for non-profit 501(c)(3) organizations. Examples of typical PAB-financed projects include capital improvement projects for hospitals, non-profit universities and colleges, airports, economic development authorities, certain charter schools and other non-profit entities.

Charter schools that are organized as non-profit 501(c)(3) organizations regularly issue tax-exempt PABs to finance long-term facilities, equipment, and other capital needs. Without the ability to issue tax-exempt PABs these charter schools could only finance its capital needs with taxable debt at presumably higher borrowing costs to the charter school. Many charter schools in states outside of Michigan operate as non-profit 501(c)(3) organizations and could be adversely affected by the elimination of PABs.

The good news in Michigan is that our charter schools operate as governmental units and would not be affected by the elimination of PABs. Under both the current House and Senate tax reform plans the issuance of tax-exempt municipal bonds has not been directly affected. Although the ability of Michigan charter schools to issue tax-exempt debt has so far been retained, there are several other provisions in the current tax reform plans which could negatively impact the issuance of tax-exempt debt generally. The following is a summary of these other proposed changes in the tax reform plans that could affect the issuance of tax-exempt municipal bonds by Michigan charter schools:

Reduction of Individual and Corporate Tax Rates: Both the House and Senate tax reform plans provide significant reductions to individual and corporate tax rates. These lower rates would reduce the value of the tax exemption for municipal bonds. This could cause a reduction in the demand for tax-exempt debt which may result in higher interest rates for tax-exempt bonds. The reduction of rates would not affect current outstanding fixed-rate debt but could cause an increase in the long-term borrowing costs for future borrowings by charter schools.

Elimination of Advance Refunding Bonds: Most bonds are issued with a 10-year optional redemption call date and current law allows an issuer to refund/refinance those existing bonds without restriction within 90 days of the optional redemption call date. Bonds issued for this type of refunding/refinancing are called current refunding bonds and are typically issued to lower debt service payments thereby reducing future borrowing costs. Under current law, an issuer may also issue advance refunding bonds, which are bonds issued to refund/refinance existing bonds before the 90-day window prior to the designated optional redemption call date. This allows issuers to lower debt service payments and reduce borrowing costs earlier than with current refunding bonds, but advance refunding bonds can only be issued one-time. Both the House and Senate tax reform plans eliminate this type of advance refunding bond, thus limiting a charter schools’ ability to get a jump start on lowering debt service payments. Charter schools would still have the ability to issue current refunding bonds within the 90 day period prior to the designated optional redemption call date (e.g., 10 years from the date of issue). Any negative effect from the elimination of advance refunding bonds may potentially be mitigated by issuing future bonds with shorter optional redemption call dates (e.g., less than ten years).

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Elimination of Tax Credit Bonds: The House tax reform plan eliminates tax credit bonds. These types of bonds provide a tax credit to the bondholders in lieu of interest or a direct interest rebate payment to the issuer. The purpose of tax credit bonds is to provide a low or zero interest rate financing mechanism for various qualified projects. These types of bonds currently include Qualified Zone Academy Bonds ("QZAB"), Qualified Energy Conservation Bonds ("QECB") and Clean and Renewable Energy Bonds ("CREB"). For a period after the recession in 2008, federal law also allowed the issuance of Qualified School Construction Bonds ("QSCB") and Build America Bonds ("BAB"). Charter schools in Michigan and around the country have not been able to take advantage of tax credit bonds for various reasons, and therefore the elimination of these bonds probably will not have much of an effect on charter schools.

The above analysis is based on the current versions of the House and Senate tax reform plans which are subject to the legislative reconciliation process. We will keep you updated with any changes affecting charter schools. If you have any questions, please feel free to contact us.