

Municipal Securities Provisions of H.R. 1, the “Tax Cuts and Jobs Act”

The following is an overview of municipal securities provisions of H.R. 1, the “Tax Cuts and Jobs Act,” enacted December 22, 2017.

REPEAL OF ADVANCE REFUNDING BONDS

The Tax Cuts and Jobs Act essentially eliminates advance refunding for municipal bonds issued after 2017 by making interest on advance refunding bonds taxable. Interest on current refunding bonds would remain tax-exempt.

About Advance Refunding

A refunding is a new borrowing that pays off an old borrowing. The purpose of refundings is to achieve debt service savings, restructure debt service or free up existing funds. A refunding is similar to refinancing a mortgage to obtain a better interest rate or to restructure payment amounts and dates for budget flexibility.

Two types of refundings common to the municipal marketplace are *advance refundings* and *current refundings*. In an advance refunding, the issuer is able to refund or pay off a prior bond issue more than 90 days in advance of its first call date.¹ In a current refunding, the prior bonds are refunded within 90 days of the first call date.

Proceeds from the sale of refunding bonds are deposited into escrow accounts pending use to pay debt service on the prior bond issue. The deposited proceeds are irrevocably pledged to pay off the prior bonds and invested in government securities for the sole benefit of bondholders, subject to arbitrage restrictions, until prior bonds are called.² Bonds issued after the Tax Reform Act of 1986 may be advance refunded only once.

Given the financial flexibility they offer municipal securities issuers, advance refundings make up a significant portion of municipal bonds issued each year. The volume of bonds issued for new projects (“new money”) has, in recent years, roughly matched the volume representing refundings that often replace existing debt with lower interest rate debt.

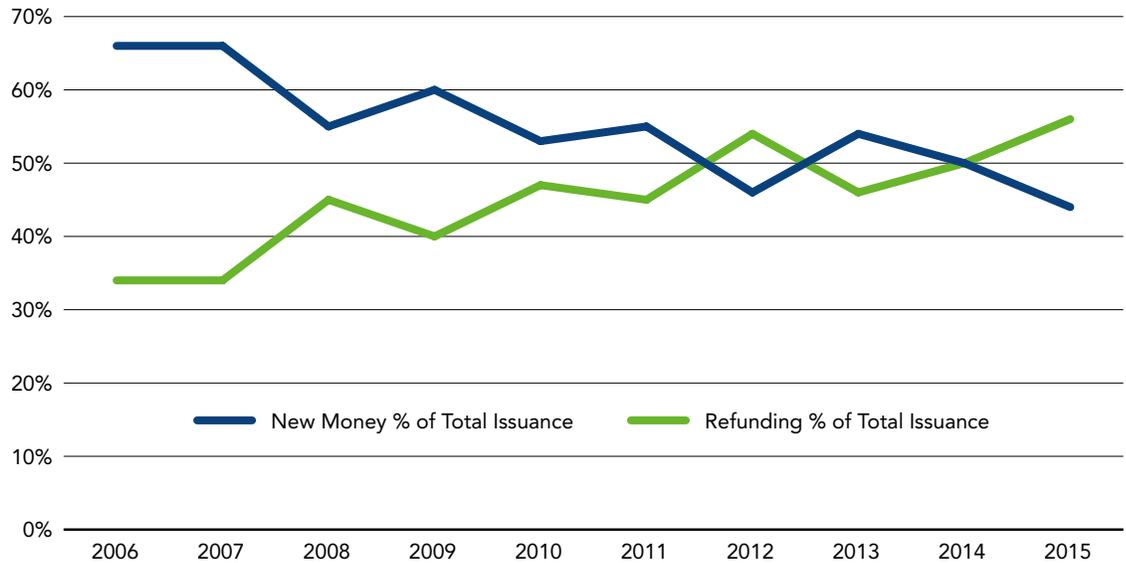
¹ A call date is a date after which the issuer has the opportunity to redeem the bond prior to maturity.

² Under arbitrage restrictions, if the yield on securities purchased with bond proceeds exceeds the yield on the refunding bonds, the excess interest earnings would generally be rebated to the IRS to avoid taxation on the interest on the refunding bonds.

A refunding is a new borrowing that pays off an old borrowing.

Due to a variety of economic conditions, the recent volume for new projects has lagged significantly behind the volume seen prior to the fiscal crisis of 2008, as reflected in Figure A.³

Figure A: Issuance of Tax-Exempt Municipal Securities: New Money vs. Refunding



Source: Internal Revenue Service Statistics of Income (SOI) studies

REPEAL OF TAX CREDIT BONDS

The Tax Cuts and Jobs Act prohibits the issuance of new tax credit bonds.

About Tax Credit Bonds

Tax credit bonds generally provide investors with tax credits in lieu of interest payments from the issuer, or can be issued as bonds that are taxable to the investor while a direct federal subsidy is paid to the issuer to offset a portion of the interest paid to the investor. These programs generally included a cap on the amount of bonds that could be issued. While the authority to issue some types of tax credit bonds has expired and the volume caps have generally been expended, there remains outstanding volume cap and issuance authority for certain tax credit bonds, such as New Clean Renewable Energy Bonds.

³ Chart derived from IRS Statistics of Income (SOI) studies of tax-exempt bonds that include data on "public purpose" (governmental) bonds and tax-exempt "private-activity" bonds. This data is obtained from the Forms 8038-G, *Information Return for Tax-Exempt Governmental Obligations*, and Forms 8038, *Information Return for Tax-Exempt Private Activity Bonds*, filed and processed by the Internal Revenue Service after the bonds are issued.

Tax credit bonds generally provide investors with tax credits in lieu of interest payments from the issuer.

For more information and data about the municipal securities market, contact the MSRB at 202-838-1330 or MSRBsupport@msrb.org.

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