



IRS Issues Much-Anticipated Guidance on Build America Bonds

Among the new kinds of taxable bonds introduced by the American Recovery and Reinvestment Act of 2009 (ARRA) are Build America Bonds (BABs). BABs are tax credit bonds with a twist: in lieu of allowing investors to receive the tax credits, issuers may elect to receive direct federal subsidy payments as of each interest payment date to offset a portion of their interest expense.

On April 3, 2009, the Internal Revenue Service (IRS) issued Notice 2009-26 to provide interim guidance on the method for electing to issue BABs and the procedures issuers must follow to receive direct federal subsidy payments and report information on BABs to the IRS. The following information is intended to serve as a general overview of the interim guidance and does not constitute an exhaustive discussion or legal advice.

Three Kinds of BABs

ARRA introduced three kinds of BABs that are referred to in this overview as Investor Credit BABs, Direct Payment BABs, and Recovery Zone BABs (a sub-species of Direct Payment BABs).

Investor Credit BABs provide investors with a tax credit worth 35% of the total coupon interest payable by the issuer (at a rate expected to be lower than the interest rate payable on otherwise comparable Direct Payment BABs), constituting a federal subsidy of municipal borrowing equal to approximately 25% of the investor's total return. Investor Credit BABs are available, subject to a December 31, 2010 sunset, for any purpose for which an issuer could issue tax-exempt bonds, other than private activity bonds.

Direct Payment BABs provide issuers with a refundable tax credit equal to 35% of the total coupon interest payable by the issuers, constituting a deeper federal subsidy. Direct Payment BABs are subject to the same general and sunset requirements as Investor Credit BABs, but may be used only to finance capital expenditures (subject to allowances for issuance costs and reasonably required reserves).

Recovery Zone BABs also provide issuers with a refundable tax credit, but in an amount equal to 45% of the interest payable by the issuer. Recovery Zone BABs are subject to similar requirements as Direct Payment BABs, but may only be used to finance property in and having a nexus to issuer-designated recovery zones.

Electing to Issue BABs

In connection with an issuance of any BABs, the issuer must make an irrevocable election on its books and records (for example, in its bond resolution or tax certificate) to have the applicable section of the Internal Revenue Code (the Code) apply. For Investor Credit BABs, the applicable section is 54AA(d); for Direct Payment BABs and Recovery Zone BABs, section 54AA(g). The issuer must make the election on or before the issue date of the BABs. Notice 2009-26 states that this guidance is subject to "updated IRS reporting forms or procedures."

Direct Payment Procedures

In order to receive their federal subsidy payments, issuers of Direct Payment BABs and Recovery Zone BABs must make filings of Form 8038-CP, *Return for Credit Payments to Issuers of Qualified Bonds*, with the IRS (Form 8038-CP and corresponding instructions are available at www.irs.gov). Filings must be made with respect to each interest payment date, and payment timelines vary depending on whether the bonds are fixed rate or variable rate.

For fixed rate bonds, the issuer must file the Form 8038-CP at least 45 days but no more than 90 days before the applicable interest payment date. If the issuer makes a timely filing, the issuer can expect to receive the credit amount within 45 days after the date on which a processible Form 8038-CP is received by the IRS.

For variable rate bonds, federal payments *reimburse* the issuer for interest costs on a quarterly basis. Issuers must file a Form 8038-CP no more than 45 days after the last interest payment date within the quarterly period for which reimbursement is requested. The IRS will pay the credit amount to reimburse the issuer for interest paid during that quarterly period. If the issuer makes a timely filing, the issuer can expect to receive the credit amount within 45 days after the date on which a processible Form 8038-CP is filed with the IRS.

With respect to fixed rate and variable rate bonds, the IRS expects to be ready to accept filings of Form 8038-CP by May 1, 2009. The IRS and Treasury Department expect to be ready to make payments beginning on or after July 1, 2009. The IRS will send the payments to the "last known address" (as defined in certain Treasury Regulations and Revenue Procedures) of the issuer or another entity authorized by the issuer (e.g., a trustee bank) on the Form 8038-CP.

The IRS states in Notice 2009-26 that it is "actively" pursuing direct payment procedures for BABs based on an electronic platform similar to the one the Bureau of Public Debt uses to make recurring electronic payments on Securities of the State and Local Government Series (SLGS) and other U.S. Treasury Securities. BAB payment procedures based on such a platform, if introduced, will likely involve periodic information returns on BABs at least once per year.

Information Reporting Procedures

Reporting procedures for Investor Credit BABs are different from those applicable to Direct Pay BABs and Recovery Zone BABs.

For Investor Credit BABs, issuers must report the issuance on Form 8038-G. Notice 2009-26 provides more detailed guidance with respect to using this form in connection with Investor Credit BABs and states that the guidance is subject to updated IRS information on reporting forms or procedures.

For Direct Payment BABs and Recovery Zone BABs, issuers must likewise report the issuance on Form 8038-G, following the detailed guidance provided in Notice 8038-G. The Form 8038-G must be filed at least 30 days before the issuer files its first Form 8038-CP; provided, however, that for Direct Payment BABs or Recovery Zone BABs issued before July 1, 2009, the Form 8038-G may be filed fewer than 30 days before the filing of the first Form 8038-CP, as long as the former is filed "separately from and prior to" the latter. Issuers of Direct Payment BABs and Recovery Zone BABs must also provide the IRS with a debt service schedule attached to the Form 8038-G. The information that must be included in such debt service schedules for both fixed rate and variable rate bonds is also set forth in Notice 2009-26.

Additional Tax Characteristics of the Refundable Tax Credit

In Notice 2009-26, the IRS points out that Direct Payment BABs and Recovery Zone BABs are subject to various requirements applicable to overpayments of tax generally, including, among others, existing tax provisions governing interest on overpayments of tax, and limitations on credits or refunds of overpayments of tax.

For more information about Build America Bonds and related interim guidance provided by the IRS, please contact any of the following Dorsey attorneys:

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