# Current provisions of House Tax Bill and potential impact on borrowing 501(c)3 organizations

On Thursday, November 2, 2017, The House Committee on Ways and Means released its initial draft of the tax reform bill. The Bill, as currently written, has significant implications on the Municipal Bond Market in general, and on 501(c)3 organizations in particular.

The proposed changes would become effective December 31, 2017 as currently written and will affect 501(c)3s in a variety of ways, but chiefly among them are several related, yet distinct, proposed provisions that would significantly alter **both the way in which, and the rate at which 501(c)3s borrow**. Some of the key provisions and their possible effects are discussed below.

**PROVISION: The Elimination of Private Activity Bonds (including 501(c)3 Public Bonds)**

**EFFECT: Increases Cost of Capital for 501(c)3 Borrowers**

Private Activity Bonds (PABs), and more specifically a subset of PABs referred to as Qualified 501(c)3 Bonds, are the mechanism through which 501(c)3s borrow at lower rates than their for-profit peers via tax-exempt debt, consisting mostly of tax-exempt fixed rate bonds and tax-exempt bank loans.

The current House Bill proposes eliminating PABs, thereby shutting off access of 501(c)3s to financing at lower interest rates. This would eliminate the ability of not-for-profit nursing homes, hospitals, Life Plan communities, colleges, universities and other nonprofits to issue tax-exempt debt.

One anticipated side-effect is that any "draw-down" tax-exempt loans already issued would need to be fully drawn before January 1, 2018 to not jeopardize the tax-exempt status of the debt. Therefore, any 501(c)3 that currently has a draw down tax-exempt loan that is not fully drawn down by the end of the year should arrange to have that loan fully funded by the end of the year.

Another anticipated side-effect is that any tax-exempt bank loans that are already issued may become taxable when the loan is renegotiated on the reset date. If the current rate increases by more than 25 basis points, the loan would be considered a new issue. As a new issue, it would not qualify as a tax-exempt loan under the proposed bill. Therefore, if borrowers have existing bank loans with short reset dates, they should arrange before the end of the year to extend the reset date as long as possible.

**PROVISION: Reduction in Corporate Tax Rate**

**EFFECT: Increases Rates on Existing and Future Tax-Exempt Bank Obligations**

Even if the earlier provision discussed is eliminated from the Bill, the Bill has a provision to decrease corporate tax rates from their current levels, which will directly impact Directly Placed Tax-Exempt Bank Bought Bonds (Tax-Exempt Bank Loans), both existing and future.

When banks make tax-exempt loans, they are effectively passing the benefit of a tax-rule on to the borrower in the form of a lower interest rate. Simply put, the bank can deduct a portion of the cost of a loan, and can therefore make the same profit on a tax-exempt loan with a lower rate as they do on a traditional (taxable) loan. The size of that tax benefit to the bank (and therefore to the borrower) is tied directly and proportionately to the prevailing corporate tax rate. If the corporate tax rate is reduced, the bank's benefit is reduced.

**For Existing Tax-Exempt Loans**: Since the loan has already been made, the bank would now be left with a loan that is less profitable than originally anticipated. Banks are generally uncomfortable with this "tax risk", and as a result pass that risk to borrowers in the form of "gross up provisions" in the legal documents, which allow the bank to change your interest rate (upward) on existing loans if the corporate tax rate falls. The rights of the bank to pass on the cost of the effects of the change of the corporate tax rate will depend on the particular language in your documents.

**For Future Tax-Exempt Loans**: Rates will be higher to reflect the diminished benefit that the bank will receive as result of holding tax-exempt obligations. Again, the rights of the bank to pass on the cost of the effects of the change of the corporate tax rate will depend on the particular language in your documents.

**PROVISION: Elimination of Advance Refunding Bonds**

**EFFECT: Reduces Flexibility to Lower Cost of Existing Debt**

The Bill seeks to remove the ability to issue Advance Refunding Bonds across all Municipal Bond Borrowers, including borrowers that issue PABs. Under current tax law, both 501(c)3 organizations AND government borrowers are allowed to advance refund previous bond issues one time, tracing back to the original asset financed. The elimination of advance refunding bonds would require 501(c)3 organizations AND governmental entities to keep their bonds outstanding to the call date, thereby eliminating the opportunity to refinance at lower interest rates in advance of the call date – potentially locking borrowers out of realizing significant savings prior to the stated call date.

## Conclusion

501(c)3s are negatively affected should the above provisions go through, via increased costs and diminished flexibility.

**There are several actions you may consider pursuing to mitigate the effects of the proposed legislation**.

1. For existing tax-exempt bank loans, consult your documents to determine the effects of any "gross up" language in the loan documents. For contemplated loans, consider negotiating the terms of the gross up language the banks will attempt to include. In addition, consider renegotiating the length of the bank commitment to a much longer date.
2. For any contemplated financings including advance refundings, consider the benefits and costs of accelerating those endeavors to close prior to year-end.
3. If you have recently issued any "draw-down" tax-exempt loans, consult your tax counsel regarding the need to fully draw on those obligations prior to year-end.

### WHAT IS BB&T DOING ON YOUR BEHALF?

As a member of the American Securities Association (ASA), BB&T is signing a letter that will be sent to congress asking that provisions that negatively impact 501(c)3s be eliminated from the Bill.

### WHAT CAN YOU DO?

Please consider calling your Congressional Representatives to ask that the provision eliminating the tax-exempt status of private activity bonds be eliminated from the Bill. To find out who your state representative is and to get their contact information, please click here or visit https://www.house.gov/representatives/find.

Tell your Senators and Representatives that you feel strongly they should vote against any tax bill that eliminates the ability for 501(c)3s to access tax-exempt debt.


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