

## MEMORANDUM

To: Bond Dealers of America

RE: Tax Reform State of Play

From: ACG

Date: November 28, 2017

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### **Overview**

The tax reform legislation now moving through Congress preserves the general tax exemption for interest earned on municipal bonds, the Bond Dealers of America's top legislative priority. However, the tax legislation passed by the House of Representatives would repeal private activity bonds (PABs) and advance refundings, while the legislation approved by the Senate Finance Committee would repeal advance refundings.

The Bond Dealers of America (BDA) has strongly opposed repeal of both PABs and advance refundings. The fate of both provisions remains uncertain, though BDA's position on PABs seems to be gaining support. Less progress has been made with respect to the proposed repeal of advance refundings. Though advocacy efforts continue on both issues, and no alternative positions are being considered with respect to the proposed repeal of PABs, a time may come when it is appropriate to consider proposing efforts to mitigate the impact of repeal of advance refundings, rather than continuing to oppose repeal altogether.

### **Discussion**

#### ***Status of Tax Reform Legislation***

On November 16<sup>th</sup>, as Congress prepared to leave for the Thanksgiving holiday, tax reform legislation cleared two key milestones:

- First, the full House of Representatives passed its version of the tax reform bill, [H.R. 1, the "Tax Cuts and Jobs Act"](#), by a comfortable [227-205](#) margin. Only Republicans voted for the bill, and 13 Republicans joined 192 Democrats in opposition.
- Second, the Senate Finance Committee approved, on a 14-12 party line vote, [its version of the legislation](#).

The Senate Republican leadership plans to bring the Senate Finance Committee tax reform bill to the Senate floor this week, and hopes to have a final vote prior to the weekend. However, that is by no means certain. Republicans hold a slim 52-48 majority in the Senate (counting two independents who caucus with the Democrats). Thus, Republicans can lose no more than two GOP votes for H.R. 1 to pass—Vice President Pence would vote to break any tie.

To date, two Republican Senators—Senator Ron Johnson (R-WI) and Senator Steve Daines (R-MT)—have stated they are opposed to the bill in its current form, though both are reasonable prospects to vote for the legislation in the end. More problematic are Republican moderates, such as Senator Susan Collins (R-ME), and other GOP Senators who loathe President Trump and have been indifferent to his agenda in the past, such as Senator John McCain (R-AZ), Senator Jeff Flake (R-AZ), and Senator Bob Corker (R-TN). Nonetheless, the tax reform bill’s prospects for Senate passage currently appear slightly better than even, though the situation remains in flux.

Even if tax reform legislation passes the Senate, differences between the House and Senate versions of the bill must be reconciled before the bill is sent to the President for his signature. It is not yet evident whether that would be done through a formal House-Senate Conference Committee, or whether the Senate would seek to work with the House Republican leadership to address House concerns prior to passage by the Senate. In that case, the House could simply vote to accept the Senate bill that already incorporated bicameral compromises.

### *Status of BDA’s Legislative Priorities*

The tax reform process presented several serious risks to tax-exempt bond financing.

The first, and most consequential, risk—a broad initiative targeting tax-exempt state and local government bonds—appears to have been averted. In the months leading up to release of the tax reform bills, state and local tax-exempt bonds were criticized by a number of sources, including a document prepared by the Senate Republican Policy Committee that characterized tax-exempt financing generally as distorting markets and conferring unfair advantages. However, neither the House nor Senate Finance Committee versions of the tax reform bill target state and local government bonds generally, and the legislation is highly unlikely to do so as it continues to evolve.

The second most consequential risk, possible repeal of private activity bonds, remains, though significant progress has been made to avert that risk as well. H.R. 1 as passed by the House includes repeal of PABs. The bill approved by the Senate Finance Committee, however, does not. We have been advised by a senior Republican member of the Ways and Means Committee that he expects PAB repeal not to be included in the final tax reform legislation. That comment was borne out a few days later by the statement of Senator John Cornyn (R-TX), that he will work to oppose repeal of PABs. A Senator as savvy and as in the loop as Senator Cornyn presumably would not seek to establish himself as the champion of a position unless he was reasonably confident that position would prevail. However, BDA is still working to protect PABs, and will continue to do so until the tax reform legislation reaches the President’s desk. This is critically important because the Joint Committee on Taxation (JCT) estimates that repealing PABs will raise close to \$40 billion over ten years. That is a meaningful amount of revenue, even in the context of a bill that is estimated to lose \$1.5 trillion over the next decade.

Replacing the revenue gain that would result from repeal of PABs will be problematic, yet necessary for the tax reform bill to fit within budget parameters. Therefore, BDA will continue to advocate forcefully on this issue until this legislative process is complete.

At present, the most vulnerable component of the tax-exempt bond markets is advance refundings. Both the House tax reform bill and the Senate Finance Committee tax reform bill include repeal of advance refundings. The revenue that would be raised by repeal of advance refundings would be less than that raised by repeal of PABs, but still meaningful. JCT revenue estimates for advance refundings repeal differ slightly—\$17.3 billion for the House bill, and \$16.8 billion for the Senate Finance Committee bill. Though the JCT's scoring methodology is deliberately opaque, our guess is that the modest difference in revenue estimates for the House and Senate bills is due to how repeal is affected by other components of the respective bills.

BDA remains very focused on opposing repeal of advance refundings bonds. Nonetheless, BDA may be required to determine at what point, if any, to shift its focus from outright opposition to repeal and instead seek to mitigate repeal's impact.

If some form of repeal appears likely, BDA is focused on several possible options to mitigate that impact. BDA is considering requesting:

1. ***Delayed effective date.*** This option has the merit of being the simplest, and has a solid policy basis. The proposed effective date would be, at most, days before enactment, and perhaps even retroactive. The proposed effective date would not allow State and local governments to manage their obligations responsibly, and would disrupt or prevent transactions *already* underway. *Taxpayers* should be able to realize the savings provided by advance refunding bonds as State and local adapt in the near term to an abrupt change in law amidst a rising interest rate environment. Also, there is at least some precedent for this type of relief. For example, the Senate Finance Committee tax bill, when initially released, provided selected transition relief for up to two years.
2. ***Transition relief for small issues.*** The proposal under consideration would permit issuers of government-purpose bonds up to \$50 million of advance refundings per year, either permanently or during a transition period of one or two years. Although that proposal would affect a modest percentage of advance refundings by volume, it still would benefit the great majority of issuers and issues.
3. ***Revising the definition of current refundings.*** This option, which would revise the current 90-day limitation on current refundings, would permit Congress

to state that they have repealed advance refundings, yet the impact of repeal could be blunted somewhat. For example, permitting transactions up to 365 days prior to the date of issuance of the refunding issue to be characterized as current refundings would afford issuers much greater flexibility in adjusting to repeal of advance refundings.

4. **Requiring reinvestment of advance refundings proceeds into tax exempt securities.** This option, which would condition the availability of advance refundings on the reinvestment of proceeds into tax exempt securities, could address interest arbitrage issues while also allaying possible concerns about using the proceeds for disfavored purposes.

Among these options, BDA has determined, after close consultation with its members, that permanent relief is most preferable, though transition relief also would be quite beneficial.

In developing these options, BDA considered, and set aside, several other alternatives, such as providing relief for certain uses of the bond proceeds. The latter option was viewed as problematic because identifying a hierarchy of “worthy” uses for bonds could imperil PABs to the extent it suggested that certain current uses of PAB proceeds had less merit than municipal bonds.

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BDA and ACG will continue to remain very engaged in the tax reform process, and to advocate BDA’s positions with respect to both PABs and advance refundings. BDA and ACG also will continue to report on any meaningful tax reform developments.