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New Opportunities in Financing Public School Improvements

ARRA Provisions Executive Summary



The American Recovery and Reinvestment Act of 2009 (ARRA) has two tax provisions designed to benefit public education in particular, as well as other provisions designed to benefit local government in general, all of which may prove useful to schools districts needing to finance capital improvements and other property.

The ARRA includes the following two provisions addressed specifically to school finance.

- **Qualified School Construction Bonds.** A new class of tax credit bonds (paying no interest) very similar to QZABs with volume cap of \$11 billion each year for 2009 and 2010.
- **QZABs.** An expansion of volume cap for Qualified Zone Academy Bonds (“QZAB”), an existing class of tax credit bond (paying no interest) to \$1.4 billion each year for 2009 and 2010, which, coupled with the October 2008 simplification provisions, may make QZABs a more attractive financing tool.

The ARRA also includes a new type of taxable governmental bonds called “build America bonds” (“BABS”).

- **BABS.** Governmental bonds that pay interest at taxable rates and either the taxpayer receives a tax credit or the issuer receives a direct interest subsidy from the Treasury. No Volume Cap is needed.

The **Chart** on the next page offers a quick comparison of the three types of bonds. A more detailed summary follows:

Federal Tax Comparison of Different Types of Bonds for Schools at a Glance

Type of Bond	Interest	Credit	Use of Proceeds	Arbitrage and Rebate	Volume Cap	Other
Qualified School Construction Bonds	None	<ul style="list-style-type: none"> Set by Treasury Taxable Can be stripped and sold separately 	Construction, rehabilitation or repair and acquisition of land in connection with financed construction	Applies but exceptions for sale proceeds during 3 year spending period and for sinking fund	\$11,000,000,000 for each of 2009 and 2010; carryforward contemplated	Any public school can benefit
QZABs	None	<ul style="list-style-type: none"> Set by Treasury Taxable Can be stripped and sold separately 	Renovating, equipping, developing course materials, teacher training for technology	Applies but exceptions for sale proceeds during 3 year spending period and for sinking fund	\$1,400,000,000 for each of 2009 and 2010; carryforward contemplated	Only for qualifying schools
Bondholder Credit BABs	Taxable	<ul style="list-style-type: none"> 35% of interest payable to holder Taxable Can be stripped and sold separately 	Any use for which governmental bonds could be issued	<p>General rules apply</p> <p>Credit ignored in calculating yield</p>	None needed	Simplest of credit bond options
Direct Pay BABs	Taxable	<ul style="list-style-type: none"> None to holder Issuer gets 35% of interest on each interest payment date 	Capital costs that would qualify for governmental bond financing	<p>General rules apply</p> <p>Yield on bonds reduced by payments due to issuer from Treasury</p>	None needed	Treasury has promulgated an initial procedure to deliver subsidy to issuer

Qualified School Construction Bonds

Purpose: Encourage Construction

Finance (with 100% of available project proceeds) construction, rehabilitation or repair of public school facilities or the acquisition of land on which such a facility is to be constructed with part of the proceeds of the same issue.

Type of Bond: Tax credit only - no interest paid.

Mechanism for Issuance

- **Volume Cap.** \$11,000,000,000 for 2009 nationally; \$11,000,000,000 for 2010 nationally.
- **Allocation for Large Local Educational Agencies.**
 - Treasury allocates 40% of annual cap among “large local educational agencies” in proportion to the respective amounts each agency is eligible to receive under Section 1124 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 6333) (the “Education Act”) for the most recent fiscal year ending before the calendar year of the volume cap. See attached Appendix B, for allocations to Florida agencies.
 - An agency may reallocate its cap (including any unused portion) to its State for allocation as described below. States can carryforward allocation, but there is no provision for Agencies to carryforward allocation. Reallocation of unused cap to the State, absent clarifying regulations, will be needed in order to preserve the cap for the next year.
 - **“Large local educational agency”** includes:
 - The 100 local educational agencies with the largest numbers of children aged 5 through 17 from families living below the poverty level, as determined by the Treasury using most recent data available from the Department of Commerce that are satisfactory to the Treasury; see Appendix B for a list of these agencies in Florida; and
 - No more than 25 local educational agencies (not described in (i) above) that the Secretary of Education determines (or the most recent satisfactory data) are in particular need of assistance. The Secretary of Education determined not to name any such agencies for 2009.



- **Allocation for States**
 - In addition, the Treasury allocates sixty percent (60%) of the cap among the States (reduced by amounts allocated to possessions on a slightly different formula) in proportion to the respective amounts of education grants each State is eligible to receive under the Education Act for the most recent fiscal year ending before the calendar year of the volume cap being allocated.
 - A State must allocate the volume cap allocated to it to issuers within the State.
 - Florida has \$106,806,000 to allocate for 2009.
- **Carryforward**
 - The unused volume cap of a State for a given year is added to its volume cap for the following calendar year, which effectively means that the current volume cap allocations will allow bonds to be issued as late as 2011. The ability of issuers to use cap later than this will need to be addressed by the IRS or Congress before one can say with certainty that carryforward beyond 2011 will be possible.
- **Issuers**
 - Qualified school construction bonds must be issued by a State or local government within the jurisdiction of which the school to be financed is located.
- **Designation**
 - The issuer must designate bonds as “qualified school construction bonds.”

How the Credit Works

As with present-law tax credit bonds, the taxpayer holding qualified school construction bonds on a credit allowance date (March 15, June 15, September 15 and December 15) is entitled to a tax credit. The credit rate on the bonds is set by the Treasury at a rate that is 100 percent of the rate that would permit issuance of such bonds without discount and interest cost to the Issuer.

- The amount of the tax credit is determined by multiplying the bond’s credit rate by the face amount on the holder’s bond. The credit accrues quarterly, is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability. Unused credits may be carried forward to succeeding taxable years.
- In addition, credits may be separated from the ownership of the underlying bond in a manner similar to the manner in which interest coupons can be stripped from interest-bearing bonds.
- The amount of credit allowance for any quarter generally equals 25% of the annual credit allowance.

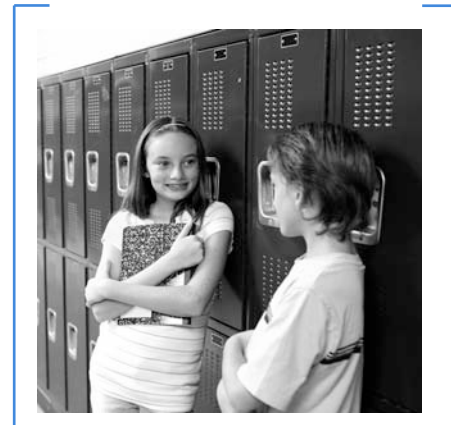
Applicable Rules Concerning Spending and Investing and Related Rules

See [Appendix A](#).

Qualified Zone Academy Bonds (“QZABs”)

Purpose: Assist Qualifying Public Schools

- Finance (with 100% of the available project proceeds) for renovating, providing equipment to, developing course materials for use at, or training teachers for a qualified zone academy.
- Issuer must certify that it has written assurances that a “private business contribution” requirement will be met. This requirement will be met if the eligible local education agency that established the qualified zone academy has written commitments from private entities to make qualified contributions having a present value (as of the issue date) of not less than 10% of the proceeds of the issue. See “Definitions” and Definition of “Qualified Contribution” and “Mechanism for Issuance – Designation and Certification Required of Issuers” below.



Type of Bond: Tax credit only - no interest paid.

Definitions

- Definition of Qualified Zone Academy. A “qualified zone academy” is a school that:
 - is a public school (below college level);
 - operates a special academic program in cooperation with business to enhance the academic curriculum and increase graduation and employment rates;
 - is either located in an empowerment zone or enterprise community or is reasonably expected to be a school at which at least 35% of the students will be eligible for free or reduced cost lunches under the school lunch program under the National School Lunch Act;
 - has the same academic standards and assessments as other students in the district/state; and
 - the comprehensive educational plan of the school is approved by the district (or the State approval body where applicable).
- Definition of Qualified Contribution. Any contribution of a type and quality acceptable to the eligible local education agency (i.e., the district or other applicable supervisory agency) of the following types:
 - Equipment for use at the school;
 - Technical assistance in developing curricula or training teachers to provide appropriate market driven technology in the classroom;
 - Services of employees as volunteer monitors;
 - Internships, fieldtrips or other educational opportunities outside the school; or
 - Any other property or service specified by eligible local education agency.

Mechanism for Issuance

- **Volume Cap:** \$1,400,000,000 for 2009 and 2010 nationally.
 - **Allocation of Volume Cap**
 - The national QZAB volume cap for a calendar year is allocated by the Treasury among the States on the basis of their respective populations of individuals below the poverty line (as defined by the Office of Management and Budget). The volume cap allocated to a State under the preceding sentence is then allocated by the State education agency to qualified zone academies within such State.
 - Florida has been allocated \$75,623,000 for 2009.
 - **Carryforward of Unused Limitation**
 - The unused volume cap for a State for a given year is added to the volume cap for the following calendar year.
 - **Limitation on Carryforward**
 - Any carryforward of volume cap amount may be carried only to the first 2 years following the unused limitation year.
- **Issuers**
 - Issuer can be a State or local government.
- **Designation and Certification Required of Issuers**
 - Designates such bond for purposes of this Section.
 - Certifies that it has written assurances that the private business contribution requirement will be met with respect to such academy.
 - Certifies that it has the written approval of the eligible local education agency for such bond issuance.

How the Credit Works

The credit works the same way as for qualified school construction bonds.

Applicable Rules Concerning Spending and Investing and Related Rules.

See Appendix A.

Build America Bonds



Purpose: Give a New Finance Tool with a more Efficient Tax Subsidy

Build America Bonds are a new type of tax credit bond to be issued before January 1, 2011 that, unlike other tax credit bonds, bear actual taxable interest and either the bondholder receives a credit of 35% of the amount of interest payable by the issuer (the "Bondholder Credit BAB") or (for certain bonds) the issuer may elect to receive an ongoing subsidy from the federal Treasury of 35% of the interest payable on the bond (the "Direct Pay BAB").

What can be Financed - Bondholder Credit BABs

Build America Bonds include any obligation of a governmental issuer (including school districts) (other than a private activity bond) if the following are true:

- The interest on the bond, absent this new program, would have been tax exempt; and
- The issuer makes an irrevocable election for those obligations to be a Build America Bond.

What can be Financed - Direct Pay BABs

In addition to meeting the requirements specified under "What can be Financed - Bondholder Credit BABs", the following requirements apply to Direct Pay BABs:

- 100% of the available project proceeds (i.e., sale proceeds less no more than 2% of the sale proceeds for costs of issuance plus investment earnings on such sale proceeds) are either used to fund a reasonably required reserve with respect to the BABs or are used for capital expenditures (whereas Bondholder Credit BAB's can be used to finance working capital and for refinancings); and
- The issuer irrevocably elects for those BABs to be Direct Pay BABs.

Applying Arbitrage Rules to BABs

- The arbitrage and rebate rules of Section 148 of the Code apply to all BABs.
- The yield on a Bondholder Credit BAB is determined without regard to the credit allowed to the bondholder (i.e., it includes all of the interest payable).
- The yield on a Direct Pay BAB is reduced by the payments due to the issuer from the federal Treasury.
- A bond will not be treated as a BAB if it is sold with more than a de minimis amount of premium over the stated principal amount of the bond.

Applying Reimbursement Rules to BABs

- General tax-exempt bond reimbursement rules (e.g., official intent, reimbursement deadlines) under Treas. Reg. §1.150-2 apply to BABs.

- Direct Pay BABs may be used to reimburse otherwise eligible (under Treas. Reg. §1.150-2Z) capital expenditures that were paid or incurred after February 17, 2009.
- Treasury guidance suggests that direct pay BABs may not be used to finance costs paid or incurred on or prior to February 17, 2009, even if such costs would otherwise be permitted to be financed under Treas. Reg. §1.150-2.

How the Issuer receives the Federal Subsidy on Direct Pay BABs

- Treasury has promulgated an initial procedure for delivery of the interest subsidy on Direct Pay BABs which the Treasury has indicated it is prepared to implement beginning May 1, 2009.
- See [Appendix C](#) hereto for more details.

How the Credit works in Bondholder Credit BABs

- Set at 35% of the amount of interest payable by the Issuer.
- Taxable to the holder.
- Can be separated (“stripped”) from the bond and sold separately.
- Unused credit can be carried over to succeeding tax years.

APPENDIX A

APPLICABLE RULES CONCERNING SPENDING AND INVESTING AND RELATED RULES APPLICABLE TO QZABS AND QUALIFIED SCHOOL CONSTRUCTION BONDS

General

Qualified school construction bonds and QZABs are generally subject to the same rules under Code Section 54A. These rules are summarized below.

Available Project Proceeds

- The provision applicable to qualified school construction bonds and QZABs requires the issuer to reasonably expect that (i) 100 percent of the available project proceeds of the bonds will be used within the three-year period that begins on the date of issuance, and (ii) it will have in place a binding commitment from a 3rd party that 10% of the proceeds will be spent within 6 months of the issue date.
- "Available project proceeds" are proceeds from the sale of the issue less issuance costs (not to exceed two percent) and any investment earnings on such sale proceeds.
- To the extent less than 100 percent of the available project proceeds are used to finance qualified purposes during the three-year spending period, bonds will continue to qualify as qualified school construction bonds or QZABs if unspent proceeds are used within 90 days from the end of such three-year period to redeem bonds.
- The three-year spending period may be extended by the Treasury upon the issuer's request demonstrating that the failure to satisfy the three-year requirement is due to reasonable cause and the projects will continue to proceed with due diligence.

Reimbursement

- Available project proceeds of an issue of QZABs or qualified school construction bonds shall be treated as spent for a qualified purpose if such proceeds are used to reimburse the issuer for amounts paid for a qualified purpose after the date that the Treasury makes an allocation of bond volume cap with respect to such issue, but only if:
 - prior to the payment of the original expenditure, the issuer declared its intent to reimburse such expenditure with the proceeds of a qualified tax credit bond;
 - not later than 60 days after payment of the original expenditure, the issuer adopts an official intent to reimburse the original expenditure with such proceeds; and
 - the reimbursement is made not later than 18 months after the date the original expenditure is paid.

Reporting

- The issuer of an issue of QZABs or qualified school construction bonds is required to file an information return. Current rules require use of the form 8038-G.

Applicable Arbitrage Rules

- **General.** Qualified school construction bonds and QZABs generally are subject to the arbitrage requirements of Section 148, but with significant and useful exceptions:
- **Spending Exception.** Available project proceeds invested during the three-year spending period are not subject to the arbitrage restrictions (i.e., yield restriction and rebate requirements).
- **Sinking Fund Exception.** Amounts invested in a "reserve fund" (i.e. really more like a sinking fund) are not subject to the arbitrage restrictions to the extent: (1) such fund is funded at a rate not more rapid than equal annual installments; (2) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (3) the yield on such fund is not greater than the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the qualified school construction bonds or QZABs are issued.
- **Treasury Set Maturity.** The maturity of qualified school construction bonds and QZABs is the term that the Treasury estimates will result in the present value of the obligation to repay the principal on such bonds being equal to 50 percent of the face amount of such bonds, using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month the bonds are issued.

Conflicts of Interest Certifications

Issuers of qualified school construction bonds and QZABs are required to certify that the financial disclosure requirements and applicable State and local law requirements governing conflicts of interest are satisfied with respect to such issue, as well as any other additional conflict of interest rules prescribed by the Secretary with respect to any Federal, State or local government official directly involved with the issuance of qualified school construction bonds.

APPENDIX B

2009 ALLOCATIONS TO LARGE LOCAL EDUCATIONAL AGENCIES OF VOLUME CAP FOR QUALIFIED SCHOOL CONSTRUCTION BONDS FOR FLORIDA

State	Large Local Educational Agency	Allocation
Florida	Broward County School District	\$ 49,913,000
Florida	Dade County School District	104,855,000
Florida	Duval County School District	27,220,000
Florida	Hillsborough County School District	40,633,000
Florida	Lee County School District	12,701,000
Florida	Orange County School District	35,824,000
Florida	Palm Beach County School District	33,643,000
Florida	Pasco County School District	11,028,000
Florida	Pinellas County School District	24,352,000
Florida	Polk County School District	20,543,000
Florida	Volusia County School District	11,941,000

APPENDIX C

SCOPE AND APPLICATION OF REFUNDABLE CREDIT PROCEDURES FOR
DIRECT PAY BUILD AMERICA BONDS

(Taken from Treasury Notice 2009-26)

Refundable Credit Implementation Plans for 2009

- **General.** The IRS and the Treasury Department plan to implement the initial refundable credit payment procedures for 2009 for Building America Bonds (Direct Payment) and Recovery Zone Economic Development Bonds (Direct Payment) as promptly as possible to enable state and local governments to begin issuing these bonds for authorized purposes to promote economic recovery and job creation. The IRS and the Treasury Department have released an IRS form for requesting the Federal share of interest on these bonds, new IRS "Form 8038-CP, *Return for Credit Payments to Issuers of Qualified Bonds*," available on the IRS website. The IRS will be prepared to accept such forms for processing by May 1, 2009, and the IRS and Treasury Department will be prepared to make timely payments with respect to interest payment dates beginning on or after July 1, 2009, as further described below.
 - In particular, the initial refundable credit procedures will require an issuer to submit a Form 8038-CP to request payment of the amount of the credit within a prescribed time before or after each applicable interest payment date, depending on whether the bonds are fixed rate bonds or variable rate bonds, as described below. Issuers should expect to receive requested payments with 45 days of the date that a processible Form 8038-CP is filed with the IRS. See § 6611(g).
 - When credit payments are made, the IRS will send the payments to the requested recipients "last known address," as that phrase is defined and determined under Treas. Reg. § 301.6212-2 and Reg. Proc. 2001-18, 2001-1 C.B. IV, or any successor guidance. In the case of credit payments sent to a person other than the issuer, the last known address may not be the address the issuer provided on the Form 8038-CP. The instructions to the Form 8038-CP will provide instructions on how an issuer or trustee can verify and update the address of record.
- **Fixed Rate Bonds.** In general, for fixed rate bonds, upon receipt of a timely filed Form 8038-CP requesting payment of the credit, such amount will be paid on a contemporaneous basis by the applicable interest payment date. For fixed rate bonds, the due date for an issuer to file a Form 8038-CP is the 45th day before the applicable interest payment date with respect to the bonds. This return, however, may not be filed earlier than the 90th day before the relevant interest payment date.
- **Variable Rate Bonds.** In general, for variable rate bonds, upon receipt of a timely filed Form 8038-CP requesting payment of the credit, such amount will be paid quarterly on a reimbursement basis for interest paid by the issuer during the quarter, including the interest payment date with respect to which the return requesting payment relates. For variable rate bonds, the due date for an issuer to file a Form 8038-CP is the 45th day after the last interest payment date within the quarterly period for which reimbursement is requested.

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