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Guidance on Build America Bonds

April 30, 2009 - Front Section

The Internal Revenue Service recently provided guidance on Build America Bonds, which were authorized by the American Recovery and Reinvestment Act of 2009. State and local governments may issue the new Build America Bonds as taxable bonds in 2009 and 2010, in lieu of issuing tax-exempt bonds. There are two types of Build America Bonds: tax credit bonds and direct payment bonds.

Tax credit bonds provide a federal tax credit to the bondholder equal to 35% of the taxable interest. Tax credit bonds can be used to finance any government purpose for which tax-exempt governmental bonds can be issued, including financing capital expenditures and working capital expenditures.

On the other hand, direct payment bonds provide state and local governments with a federal subsidy equal to 35% of the interest paid by them to the bondholder. Direct payment bonds can be used to finance capital expenditures that could be financed with tax-exempt governmental bonds. Direct payment bonds may not be issued to finance working capital expenditures.

The Internal Revenue Service intends to begin making interest payments on these bonds as early as July 1st. Interest payments on fixed rate direct payments bonds will be paid on a contemporaneous basis by the interest payment date of the particular bond. The federal government will reimburse governments on a quarterly basis for interest that they pay on variable rate direct payment bonds.

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New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540