Sequestration Cuts Direct Payments on Build America Bonds and Tax Credit Bonds by 8.7%

Pursuant to the Balanced Budget and Emergency Deficit Control Act, as amended, the President of the United States has ordered that certain automatic spending cuts be implemented pursuant to calculations provided by the United States Office of Management and Budget (OMB) in its Report to the Congress on sequestration dated March 1, 2013. These cuts include automatic across-the-board cuts in certain categories of federal spending for the period from March 1, 2013 until the end of the government’s current fiscal year on September 30, 2013. The cuts include mandatory reductions in the amounts scheduled to be paid by the federal government to issuers of Build America Bonds, Qualified Zone Academy Bonds, Qualified School Construction Bonds, New Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds (collectively, “Direct-Pay Bonds”) under Section 6431 of the Internal Revenue Code.

The OMB indicates that, because these cuts must be achieved over only seven months instead of 12, the effective percentage reduction for fiscal year 2013 for non-exempt nondefense programs, such as payments for Direct-Pay Bonds, will be approximately 9%. The Internal Revenue Service (IRS) announced on March 4, 2013, that payments to issuers of Direct-Pay Bonds from the budget accounts associated with these bonds are subject to a reduction of 8.7% of the amount budgeted for such payment. The sequester reduction rate will be applied to amounts claimed by an issuer on any IRS Form 8038-CP filed with the IRS that results in a payment to such issuer on or after March 1, 2013. Accordingly, unless Congress acts to change the sequester percentage or otherwise changes the application of the cuts, issuers of Direct-Pay Bonds can expect to see an 8.7% reduction in amounts they are otherwise expecting to receive after March 1, 2013 for fiscal year 2013, resulting in a corresponding increase in interest costs that must be paid from an issuer’s other revenue sources.

The procedure for claiming payments for Direct-Pay Bonds has not changed. The IRS has indicated that issuers should continue to file an IRS Form 8038-CP in the manner provided in the form’s instructions (i.e., claiming a refund for the full amount due). Issuers affected by the cuts will be notified through correspondence that a portion of their requested payment was subject to the sequester reduction. Issuers should use the correspondence received by the IRS to identify and track the portion of amounts requested that were subject to the sequester reduction. Below is a link to the IRS website containing more information:

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Please contact your GT Public Finance lawyer if you have concerns or questions about how sequestration may affect your Direct-Pay Bonds, including any particular concerns about redemption provisions or continuing disclosure obligations.

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