Public Finance Alert: American Recovery and Reinvestment Act Opens Door to Tax-Exempt Financing for Producers of Intangibles

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Introduction

The recently enacted American Recovery and Reinvestment Act of 2009 (the "Recovery Act") opens the door for a much wider range of capital investment to be financed with lower cost tax-exempt bonds. The Recovery Act offers the benefits of low interest tax-exempt financing to producers of intangible property, expanding prior law which was restricted to traditional manufacturing and certain processing activities. However, companies interested in such financing need to act quickly as the opportunity is only available for bonds issued in 2009 or 2010.

Prior Law

Prior law limited use of tax-exempt "qualified small issue" bonds, sometimes called industrial development bonds or IDBs, to traditional manufacturing facilities that produced tangible personal property[1] and certain processing activities. Such bonds, issued by state or local governments, could be used to finance the acquisition and improvement of land or construction or reconstruction of property only if the facilities produced a tangible product or processing that resulted in a change in condition of property.

The New Law

The Recovery Act expands the kinds of facilities that can be financed by broadening the definition of manufacturing facilities to include facilities that are used in the creation or production of intangible personal property and facilities that are functionally and subordinately related thereto (and located on the same site).[2] For purposes of the Recovery Act, intangible personal property includes any patent, copyright, formula, process, design, pattern, know-how, format, or other similar items.[3] The expanded definition also includes computer software. As with prior law, land and depreciable property, including new equipment, are eligible to be financed. The new law provides a great opportunity to obtain low-cost financing for important sectors of the "new economy." For example:

- A company working in research and development for the creation of pharmaceutical patents or formulas might consider such financing to build out new laboratory and research space.
- A company developing computer software might acquire and rehabilitate the building in which it currently leases space.
- A company seeking research space with particular technical requirements might finance the construction of a specially designed building.

There appears to be no requirement that the intangibles be commercially sold. Thus, while the company could sell or license the intangibles produced at the bond-financed facilities, the company also could merely use such intangibles in its other business activities.

Of course, eligibility for tax-exempt financing does not guarantee access to capital in the tax-exempt market. However, companies may be able to use their existing banking relationships to credit enhance and thus gain access to this market.

General Compliance Requirements of Small Issue Industrial Development Bonds

Tax-exempt financing requires compliance with certain provisions of the Internal Revenue Code that include some of the following considerations:

- Qualified small issue bonds must be issued through a governmental entity.
- Such bonds require an allocation of "volume cap," a mechanism that limits the total overall issuance of certain tax-exempt bonds.
- Such bonds require a public hearing and approval.
- Used property (excluding used equipment) is subject to a 15% rehabilitation requirement over a two-year period.
- Qualified small issue bonds are limited to $10 million in size and are subject to a $20 million capital expenditure limit within a six-year window within the jurisdiction where the bond-financed facility is located.
- Borrowers and related persons are also limited to a national $40 million cap including their tax-exempt financings in all jurisdictions.

If you are interested in finding out if your project is eligible for tax-exempt financing, understanding the requirements for tax-exempt financing or discussing structuring options for accessing capital, please call your attorney contact at Mintz Levin or any member of Mintz Levin's Public Finance Section.

Endnotes

[1] I.R.C. § 144(a)(12)(c).

[2] H.R. 1-230, § 1301.

[3] I.R.C. § 197(d)(1)(c)(iii).

For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.

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