# MEMORANDUM

**To:** United States Congress

**From:** Toby Rittner, President & CEO
Council of Development Finance Agencies

**Date:** March 19, 2013

**Re:** The American Manufacturing Bond Finance Act

Perhaps nothing is more pressing than the plight of American manufacturers over the past decade. Since 2001, nearly 5.7 million[1] manufacturing jobs have disappeared due to a variety of reasons. Low-cost, affordable, flexible, and efficient capital access, however, remains the number one concern for manufacturers. For small- to mid-sized manufacturers, access to capital remains elusive and problematic.

The **American Manufacturing Bond Finance Act** is a comprehensive reform package that will modernize and revolutionize **Qualified Small Issue Manufacturing Bonds**, more commonly known as Industrial Development Bonds (IDBs) or simply manufacturing bonds. Manufacturing bonds are a type of Private Activity Bond (PAB) that allow the public sector to pass considerable interest rate reductions on to private companies through the issuance of tax-exempt bonds.

This bedrock tools is the single most actively used bond tool for financing the small- to mid-sized manufacturing sector and are a key economic development tool for state and local economic development agencies. The seven reforms will expand the capacity and usability of manufacturing bonds to help create American jobs immediately.

The eight reforms are as follows:

1. **Expand the Definition of Manufacturing to Include both Tangible and Intangible Manufacturing Production for Manufacturing Bonds**
2. **Eliminate the Restrictions on "Functionally Related and Subordinate Facilities" for Manufacturing Bonds**
3. **Increase the Maximum Bond Size Limitation from $10M to $30M for Manufacturing Bonds**
4. **Increase the Capital Expenditure Limitation from $20M to $40M for Manufacturing Bonds**
5. **Expand and Raise the Limits for Bank Deductibility to $30M for Manufacturing Bonds and 501(c)(3) Bonds**
6. **Eliminate the Restriction on the Use of Accelerated Depreciation by Manufacturers Using Manufacturing Bonds**
7. **Expand the 2% De Minimis Rule to Financial Institutions for Manufacturing Bonds and 501(c)(3) Bonds**
8. **Allow Qualified Small Issue Manufacturing Bond volume cap allocation to be carried forward in accordance with other bonds subject to volume cap**

Manufacturing bonds have not been reformed in nearly thirty years, and this lack of reform has caused stagnation and decline in issuance. Over $3.1 billion in manufacturing bonds were issued nationwide in 2007. In 2010, just $666 million in manufacturing bonds were issued. The drop in manufacturing bond issuance is directly related to the outdated rules and regulations that govern these bonds. Improved tax policy will enable manufacturers to access bond financing again.

These eight recommended reforms would expand access to capital for manufacturers, support America's most productive industry, and create jobs now.

The **Council of Development Finance Agencies** is a national association dedicated to the advancement of development finance concerns and interests. CDFA is comprised of the nation's leading and most knowledgeable members of the development finance community representing public, private and non-profit entities. For more information concerning the American Manufacturing Bond Finance Act, contact Toby Rittner (trittner@cdfa.net) or go to www.cdfa.net.

[1] AFL-CIO

# The American Manufacturing Bond Finance Act

**Qualified Small Issue Manufacturing Bonds** are a type of Private Activity Bond (PAB) that allows the public sector to pass considerable interest rate reductions on to private companies through the issuance of tax-exempt bonds in the capital markets. These bonds have many informal names, such as manufacturing bonds, Industrial Development Bonds (IDBs), or simply small issue bonds. Regardless of the terminology, they are all the same tool and are used extensively throughout the country to support American manufacturers.

Qualified Small Issue Manufacturing Bonds are the single most actively used bond tool for financing the small- to mid-sized manufacturing sector and are a key economic development tool for many state and local economic development agencies. These bonds are issued for qualified manufacturing projects, with limitations and regulations governing the use of the tool. These bonds can support expansion and investment in existing manufacturing facilities, as well as the development of new facilities and the purchase of new machinery and equipment. Throughout the country, state and local economic developers have used Qualified Small Issue Manufacturing Bonds over the past thirty years to support manufacturing investment and job creation.

The last substantive improvements to Qualified Small Issue Manufacturing Bonds occurred in the mid-1980s as part of tax reform. Since that time, the manufacturing sector in the United States has changed and evolved rapidly. Manufacturing, a historically low-tech endeavor, has revolutionized over the past two decades, and today's manufacturing is focused on high-tech efficiency, innovative production models, and cutting-edge science.

Manufacturing in the United States has also become highly competitive, both within and outside the country. Within the United States, state and local communities compete daily in company attraction and recruitment using a variety of economic incentives. Outside the U.S., national interests work tirelessly to attract U.S. manufacturers by lowering the cost of business for overseas operations. The result has been two decades of economic decline in the manufacturing sector as thousands of companies have relocated overseas into more cost-efficient environments.

Perhaps nothing is more pressing than the plight of American manufacturers over the past decade. Since 2001, nearly 5.7 million[1] manufacturing jobs have disappeared due to overseas competition, industry contraction, poor public policy, lack of capital, and the general downturn in the nation's economy.

The changing manufacturing landscape has prompted a renewed effort to provide expanded support for American manufacturers here in the United States. At the forefront of this movement is an effort to unlock access to capital for small- to mid-sized manufacturers. Low-cost, affordable, flexible, and efficient capital access is the number one concern for the manufacturing sector. For large, credit-worthy manufacturers, low-cost financing is easily attainable. Commercial banks and Wall Street are eager to support these companies.

[1] AFL-CIO

# The American Manufacturing Bond Finance Act

For small- to mid-sized manufacturers, access to capital remains elusive and problematic.

Unfortunately, Qualified Small Issue Manufacturing Bonds have not been reformed in nearly thirty years, and this lack of reform has caused stagnation and decline in the bond finance industry. Take the past several years as a prime example. Over $3.1 billion in manufacturing bonds were issued nationwide in 2007, one of the highest years on record. The picture was much different in 2010, with just $666 million in manufacturing bonds issued nationwide. The drop in manufacturing bond issuance is not only connected to the national economy, but also to the outdated rules and regulations that govern the use of these bonds.

As the economy has begun to stabilize and improve, many economists and business leaders have pointed to a potential resurgence of manufacturing in the United States. In fact, many believe improved tax policy and regulations could enable the manufacturing sector to rebound considerably over the next decade.

To support this resurgence, CDFA is proposing a set of efficient and effective reforms to the laws governing Qualified Small Issue Manufacturing Bonds. These eight simple fixes would expand access to capital for manufacturers throughout the country and support America's most productive industry.

The eight reforms in "The American Manufacturing Bond Finance Act" would revolutionize one of the most beneficial tools provided by the federal government. Qualified Small Issue Manufacturing Bonds are limited by the national volume cap established by Congress; these reforms would therefore come at a nearly negligible cost to the federal treasury. In fact, the positive impact of these common sense and timely reforms on the manufacturing sector would outweigh any negative impact on the federal treasury.

The eight recommended reforms with written legislative language follow:

## REFORM #1

**Expanding the Definition of Manufacturing to Include both Tangible and Intangible Manufacturing Production for Qualified Small Issue Manufacturing Bonds**

***Issue Brief:***
Qualified Small Issue Manufacturing Bonds are the bedrock financing tool for small- to mid-sized manufacturers. This financing tool has been providing affordable capital to our nation's most important industry for over three decades. Current federal law defines a "manufacturing facility" as one that produces tangible property. However, manufacturing processes, production, and technology have changed significantly since this definition was established. Today's manufacturers encompass more modern, high-tech, and intangible manufacturing practices such as bio-technology, energy generation, food processing, software, design and formula development, and intellectual property. In relationship to Qualified Small Issue Manufacturing Bonds (commonly known as Industrial Development Bonds or IDBs), the current definition as

outlined in the tax code reflects an old philosophy and outdated approach to manufacturing. This outdated definition of manufacturing has resulted in the increasingly limited use of this job-generating economic development tool.

***Recommendation:***

CDFA proposes updating the definition of manufacturing as it relates to Qualified Small Issue Manufacturing Bonds to allow for companies who produce both tangible and intangible property to access the capital markets. The measure would broaden the definition to include facilities that manufacture, create, or produce intangible property. The expanded definition would be sufficiently broad to cover software, patents, copyrights, formulas, processes, designs, patterns, know-how, format, and similar intellectual property. Under this new definition, knowledge-based businesses could access low-cost, tax-exempt IDB financing. This updated definition would align the growing high-tech manufacturing sector with the tools necessary to finance industry growth and expansion. This change will make an immediate difference throughout the country to help retain and create jobs, spur manufacturing investment, and accelerate the nation's economy.

***Legislative Language:***

Internal Revenue Code Section 144(a)(12)(C) is amended to read as follows:

**SEC. 2. MANUFACTURING EXPANDED TO INCLUDE BOTH TANGIBLE AND INTANGIBLE MANUFACTURING PRODUCTION; ELIMINATION OF RESTRICTIONS ON FUNCTIONALLY RELATED AND SUBORDINATE FACILITIES.**

(a) IN GENERAL.—Subparagraph (C) of section 144(a)(12) of the Internal Revenue Code of 1986 is amended to read as follows:

''(C) MANUFACTURING FACILITY.—For purposes of this paragraph—

''(i) IN GENERAL.—The term 'manufacturing facility' means—

''(I) any facility that is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of that property),

''(II) any facility that is used in the creation or production of intangible property that is described in section 197(d)(1)(C)(iii), and

''(III) any facility that is functionally related and subordinate to a facility (determined without regard to this subclause) described in subclause (I) or (II) if the functionally related and subordinate facility is located on the same site as the manufacturing facility.

''(ii) CERTAIN FACILITIES INCLUDED.—The term 'manufacturing facility' includes facilities that are directly related and ancillary to a manufacturing facility (determined without regard to this clause) if—

‘‘(I) those facilities are located on the same site as the manufacturing facility, and

‘‘(II) not more than 25 percent of the net proceeds of the issue are used to provide those facilities.

‘‘(iii) LIMITATION ON OFFICE SPACE.—A rule similar to the rule of section 142(b)(2) shall apply for purposes of clause (i).

‘‘(iv) LIMITATION RELATING TO INTANGIBLE PROPERTY.—Clause (i)(II) shall not apply to any bond issued before January 1, 2013, or to any bond issued to refund a bond issued before that date, either directly or in a series of refundings.’’.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to obligations issued after the date of the enactment of this Act.

## REFORM #2

**Eliminate the Restrictions on “Functionally Related and Subordinate Facilities” for Qualified Small Issue Manufacturing Bonds**

***Issue Brief:***

Qualified Small Issue Manufacturing Bonds are burdened by unnecessary and cumbersome limitations on the percentage of manufacturing facilities that can be financed for a given project. First, is the concept of “functionally related and subordinate facilities.” To qualify under this standard, “functionally related and subordinate facilities” generally must be part of the core manufacturing process. Such items as short-term warehousing of raw materials, temporary warehousing of finished materials, and labs for testing raw materials are all integral to the manufacturing process and are eligible for Qualified Small Issue Manufacturing Bond financing but are unduly restricted under current law.

Conversely, “directly related and ancillary facilities” are activities carried out at the facility that are deemed not integral to the manufacturing process. These activities are considered secondary or supplemental to the manufacturing process. Facilities such as offices, locker rooms, and cafeterias are deemed “directly related and ancillary facilities” and thus are limited to a 25% use of net bond proceeds requirement.

In other words, Qualified Small Issue Manufacturing Bonds are limited to only core manufacturing elements despite that fact that “functionally related and subordinate facilities” elements are very much integral to the manufacturing operation. Only 25% of bond proceeds from the issuance can be used to support the “directly related and ancillary facilities” additional elements of the project. These limitations have hindered the use of the tool for small- to mid-sized manufacturers, thus further retarding the tool's use.

Over the years, these arcane rules have caused mass confusion within the tax-exempt bond community, causing projects to be dissected and financed using complex and cumbersome methodologies. Ultimately, these burdens, which are both outdated and unnecessary, have caused many manufacturers to abandon Qualified Small Issue Manufacturing Bonds for more expensive private financing offerings.

***Recommendation:***

CDFA proposes the elimination of the restriction for "functionally related and subordinate facilities" using Qualified Small Issue Manufacturing Bonds. This change would allow manufacturers to develop projects that support modern business practices, provide for a better quality-of-life work environment, and diminish the complexity of using low-cost bond financing. This change would also expand project possibilities and give manufacturers the resources to think about long-term capital improvements, investment, workforce development, and job creation.

***Legislative Language:***

Internal Revenue Code Section 144(a)(12)(C) is amended to read as follows:

**SEC. 2. MANUFACTURING EXPANDED TO INCLUDE BOTH TANGIBLE AND INTANGIBLE MANUFACTURING PRODUCTION; ELIMINATION OF RESTRICTIONS ON FUNCTIONALLY RELATED AND SUBORDINATE FACILITIES.**

(b) IN GENERAL.—Subparagraph (C) of section 144(a)(12) of the Internal Revenue Code of 1986 is amended to read as follows:

''(C) MANUFACTURING FACILITY.—For purposes of this paragraph—

''(i) IN GENERAL.—The term 'manufacturing facility' means—

''(I) any facility that is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of that property),

''(II) any facility that is used in the creation or production of intangible property that is described in section 197(d)(1)(C)(iii), and

''(III) any facility that is functionally related and subordinate to a facility (determined without regard to this subclause) described in subclause (I) or (II) if the functionally related and subordinate facility is located on the same site as the manufacturing facility.

''(ii) CERTAIN FACILITIES INCLUDED.—The term 'manufacturing facility' includes facilities that are directly related and ancillary to a manufacturing facility (determined without regard to this clause) if—

''(I) those facilities are located on the same site as the manufacturing facility, and

''(II) not more than 25 percent of the net proceeds of the issue are used to provide those facilities.

''(iii) LIMITATION ON OFFICE SPACE.—A rule similar to the rule of section 142(b)(2) shall apply for purposes of clause (i).

''(iv) LIMITATION RELATING TO INTANGIBLE PROPERTY.—Clause (i)(II) shall not apply to any bond issued before January 1, 2013, or to any bond issued to refund a bond issued before that date, either directly or in a series of refundings.''.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to obligations issued after the date of the enactment of this Act.

## REFORM #3

**Increase the Maximum Bond Size Limitation from $10M to $30M for Qualified Small Issue Manufacturing Bonds**

***Issue Brief:***

Qualified Small Issue Manufacturing Bonds are the primary economic development tool for supporting small- to mid-sized manufacturers in the United States. However, outdated limitations in the tax code are preventing this tool from being maximized. The $10M maximum bond size limit, imposed by Congress over thirty years ago, is arbitrary and fixed. The $10M limitation has not been increased since 1979, and has never been adjusted for inflation.

In today's terms, the $10M bond size limit has the spending power of less than a third of what it had when the limit was set. Many companies simply cannot complete a project that otherwise would fit into this category for less than $30M. Staying under the $10M bond limit is arbitrary and places an unnecessary burden on manufacturers to piecemeal projects.

As a result of this limitation, many manufacturers turn away from this low-cost financing and settle for more expensive alternatives. More often, projects are simply abandoned or significantly reduced, which effectively chokes economic development and job creation. Raising the bond limit to $30M would provide relief for thousands of manufacturers nationwide searching for affordable capital to grow their operations and create jobs.

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***Recommendation:***
CDFA recommends increasing the maximum Qualified Small Issue Manufacturing Bonds size limitation from $10M to $30M. This relatively small change would have virtually no impact on the federal treasury as Qualified Small Issue Manufacturing Bonds remain under the national volume cap and cannot exceed total nationwide issuance beyond the total cap. In other words, this change will give manufacturers a new and improved resource for making investments and creating jobs for an investment already accounted for by the federal government.

***Legislative Language:***

Internal Revenue Code Section 144(a)(4) is amended to include new (H) to read as follows:

**SEC. 3. INCREASE THE MAXIMUM BOND SIZE LIMITATION AND IN THE CAPITAL EXPENDITURE LIMITATION.**

(a) IN GENERAL.—Paragraph (4) of section 144(a) of the Internal Revenue Code of 1986 is amended by adding

at the end the following new subparagraph:

''(H) $30,000,000 LIMIT IN CERTAIN CASES.—With respect to bonds issued after December 31, 2012, subparagraph (A)(i) shall be applied by substituting '$30,000,000' for '$10,000,000'.''.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to obligations issued after December 31, 2012.

## REFORM #4

**Increase the Capital Expenditure Limitation from $20M to $40M for Qualified Small Issue Manufacturing Bonds**

***Issue Brief:***
The $20M capital expenditure limitation is a separate test from the $10M bond dollar amount limit. The $20M capital expenditure limitation says that the par amount of proposed bonds in the same jurisdiction, as well as other capital expenditures (also in the same jurisdiction), may not exceed a $20M capital expenditure limitation. These include capital expenditures that were paid or incurred during a six year period, beginning three years before the date of the proposed new bond issue and ending three years after the date of such proposed new bond issue.

The intent of this regulation is to control and limit the total amount of tax-exempt bonds that a manufacturer can access over a given period of time. This regulation is prudent and necessary, and provides for a safety measure that reduces the potential for abuse and mitigates risk. However, the limitation was originally established in the 1980s and was not adjusted for inflation. Increasing the limit to $20M in 2006 was only a short-term remedy that continues to limit project development.

Plain and simple, manufacturers today have long-term capital expenditure plans and projects. By limiting the capital expenditures to just $20M, manufacturers are unable to plan for long-term expansion. This limitation causes manufacturers to avoid low-cost bond financing in favor of higher cost traditional loans. The net effects are smaller projects, reduced investments, and often more expensive capital. In today's competitive economic environment, cost of capital and ease of access to such capital are critical components of a manufacturer's expansion strategy.

In 2006, CDFA was successful in working with Congress to increase the capital expenditures limitation for Qualified Small Issue Manufacturing Bonds. The capital expenditure limitation was increased modestly from $10M to $20M to reflect the changing manufacturing investment landscape. Today, this provision is again in need of expansion, as the current $20M limit is not sufficient to support ongoing manufacturing expansion and investment needs.

***Recommendation:***
CDFA proposes increasing the capital expenditure limitation for Qualified Small Issue Manufacturing Bonds from $20M to $40M to reflect the 21st century manufacturing industry. This modest change will align this important limitation with the realities of the economy and cost of doing business in the United States. This change will open the door for hundreds of new manufacturing projects that have long-term expansion objectives, and will spur ongoing investment and create jobs.

***Legislative Language:***

Internal Revenue Code Section 144(a)(4) is amended to include new (H) to read as follows:

**SEC. 3. INCREASE THE MAXIMUM BOND SIZE LIMITATION AND IN THE CAPITAL EXPENDITURE LIMITATION.**

(a) IN GENERAL.—Paragraph (4) of section 144(a) of the Internal Revenue Code of 1986 is amended by adding
at the end the following new subparagraph:
''(H) $30,000,000 LIMIT IN CERTAIN CASES.—With respect to bonds issued after December 31, 2012, subparagraph (A)(i) shall be applied by substituting '$30,000,000' for '$10,000,000'.''.
(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to obligations issued after December 31, 2012.

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## REFORM #5

**Expand and Raise the Limits for Bank Deductibility to $30M for Qualified Small Issue Manufacturing Bonds and Qualified 501(c)(3) Bonds**

***Issue Brief:***
Qualified Small Issue Manufacturing Bonds have struggled significantly due to outdated and obsolete limitations on bank purchasing of tax-exempt bonds. If the issuer of the bonds issues less than $10M in bonds in a calendar year, bonds purchased by a bank may be designated "bank qualified." "Bank qualified" means that the bank is allowed to deduct 80 percent of the interest on monies that the bank borrows to purchase the bond.

However, if the issuer of the bonds issues more than $10M of bonds in a calendar year, the bonds are then termed "non-bank qualified," and the bank is not allowed to deduct any of the interest on monies that the bank borrows to fund the bond. Historically, the interest rate pricing difference between a "bank qualified" bond and a "non-bank-qualified" bond has been notably higher for a "non-bank qualified" bond.

The $10M limit was created in 1986 and has not been adjusted for inflation since. "Bank qualified" bonds allow small issuers to directly involve local and community banks in the financing process by exempting them from otherwise having a portion of their interest expense disallowed, as currently required under the IRC. In order to keep pace with demand, economic development goals, and manufacturing need, many communities issue more than $10M in bonds in a calendar year, making many bonds "non-bank qualified." The real world effect of the above treatment of Qualified Small Issue Manufacturing Bonds is that similar projects in urban and in many rural areas are treated differently.

Moreover, construction costs have risen substantially since 1986, making the average project size for a manufacturer twice as expensive today. As a result, even very small communities are no longer able to issue "bank qualified" bonds, thus limiting their investor pool and ability to attract lower interest rates. In the end, the lack of flexibility as it relates to "bank qualified" bonds results in less economic development, higher borrowing costs for manufacturers, and the potential loss of job-generating investments.

***Recommendation:***
CDFA proposes that Congress expand and raise the small issuer limit for bank deductibility to $30M for Qualified Small Issue Manufacturing Bonds and Qualified 501(c)(3) Bonds. CDFA also proposes that Congress allow "bank qualified" debt to be applied on a borrower-by-borrower basis, rather than aggregating all "bank qualified" bonds issued by an issuer. This targeted change will open the financial markets for manufacturing deals by giving borrowers and issuers the ability to place their bonds with their local community banks. This change will significantly ease the complexity and cost of smaller manufacturing bond transactions.

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These changes will level the playing field and allow small and mid-sized manufacturers access to an economic development tool that most have not been able to access cost effectively since 1986. These two simple changes would allow thousands of manufactures to more easily access the capital markets and sell debt in an efficient, less costly manner, which will ultimately result in investment and job creation.

***Note:*** CDFA has recommended this reform for both Qualified Small Issue Manufacturing Bonds and Qualified 501(c)(3) Bonds. Qualified 501(c)(3) Bonds provide low-cost financing to non-profit institutions such as hospitals, schools, and cultural facilities throughout the country. Issuers regularly issue both types of bonds and this limitation hinders these efforts for both instruments. CDFA believes these changes go hand-in-hand and will help to further broaden issuers' ability to access the capital markets on behalf of job generating borrowers and has recommended that both manufacturing and non-profit bonds received this expanded treatment.

***Legislative Language:***

Internal Revenue Code Section 265(b)(3)(B)(ii)(I), Internal Revenue Code Section 265(b)(3)(C)(ii)(I), Internal Revenue Code Section 265(b)(3)(H), Internal Revenue Code Section 265(b)(7), and Internal Revenue Code Section 265(b)(7)(A) are amended to read as follows:

**SEC. 4. DEDUCTIONS FOR EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME.**

(a) EXCEPTIONS FROM PRO RATA ALLOCATION RULE FOR QUALIFIED SMALL ISSUE BONDS.—

(1) TAX EXEMPT OBLIGATION RULE.—Clause (ii) of section 265(b)(3)(B) of the Internal Revenue Code of 1986 is amended by striking ''or'' at the end of subclause (I), by redesignating subclause (II) as subclause (III), and by inserting after subclause (I) the following new subclause:

''(II) any qualified small issue bond (as defined in section 144(a)) issued after December 31, 2012, or''.

(2) QUALIFIED SMALL ISSUER RULE.—Clause (ii) of section 265(b)(3)(C) of such Code is amended by redesignating subclauses (II) and (III) as subclauses (III) and (IV), respectively, and by inserting after subclause (I) the following new subclause:

''(II) any qualified small issue bond (as defined in section 144(a)) issued after December 31, 2012, or''.

(3) DE MINIMIS EXCEPTION FOR BONDS ISSUED DURING 2009, 2010 OR AFTER 2012.—So much of paragraph (7) of section 265(b) of such Code as precedes subparagraph (B) thereof is amended to read as follows:

''(7) DE MINIMIS EXCEPTION FOR BONDS ISSUED DURING 2009, 2010 OR AFTER 2012.—

‘‘(A) IN GENERAL.—In applying paragraph (2)(A), there shall not be taken into account—

‘‘(i) tax exempt obligations issued during 2009 or 2010, or

‘‘(ii) obligations issued after 2012 that constitute a qualified 501(c)(3) bond (as defined in section 145) or a qualified small issue bond (as defined in section 144(a)).’’.

(b) SPECIAL RULES FOR SMALL ISSUE AND TAX EXEMPT OBLIGATIONS ISSUED AFTER 2012.—Paragraph (3) of section 265(b) of the Internal Revenue Code of 1986 is amended by adding at the end the following:

‘‘(H) SPECIAL RULES FOR OBLIGATIONS ISSUED AFTER 2012.—

‘‘(i) INCREASE IN LIMITATION.—In the case of obligations issued after December 31, 2012, that constitute a qualified 501(c)(3) bond (as defined in section 145) or a qualified small issue bond (as defined in section 144(a)), subparagraphs (C)(i), (D)(i), and (D)(iii)(II) shall each be applied by substituting ‘$30,000,000’ for ‘$10,000,000’.

‘‘(ii) QUALIFIED 501(C)(3) BONDS AND QUALIFIED SMALL ISSUE BONDS TREATED AS ISSUED BY CONDUIT BORROWER.—In the case of an obligation issued after December 31, 2012 that constitutes a qualified 501(c)(3) bond (as defined in section 145) or a qualified small issue bond (as defined in section 144(a)), this paragraph shall be applied by treating the organization for whose benefit such bond was issued as the issuer.

‘‘(iii) SPECIAL RULE FOR QUALIFIED FINANCINGS.—In the case of a qualified financing issue issued after December 31, 2012—

‘‘(I) subparagraph (F) shall not apply, and

‘‘(II) any obligation issued as a part of such issue shall be treated as a qualified tax-exempt obligation if the requirements of this paragraph are met with respect to each qualified portion of the issue (determined by treating each qualified portion as a separate issue which is issued by the qualified borrower with respect to which such portion relates).

‘‘(iv) QUALIFIED FINANCING ISSUE.— For purposes of this subparagraph, the term ‘qualified financing issue’ means any composite, pooled, or other conduit financing issue the proceeds of which are used directly or indirectly to make or finance loans to 1 or more ultimate borrowers each of whom is a qualified borrower.

''(v) QUALIFIED PORTION.—For purposes of this subparagraph, the term 'qualified portion' means that portion of the proceeds which are used with respect to each qualified borrower under the issue.

''(vi) QUALIFIED BORROWER.—For purposes of this subparagraph, the term 'qualified borrower' means a borrower which is a State or political subdivision thereof, an organization described in section 501(c)(3) and exempt from taxation under section 501(a) and for qualified small issue bonds (as defined in section 144(a)), the conduit borrower.''.

(c) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to obligations issued after December 31, 2012.

## REFORM #6

**Eliminate the Restriction on the Use of Accelerated Depreciation by Manufacturers Using Qualified Small Issue Manufacturing Bonds Financing**

***Issue Brief:***

Under current law, manufacturers utilizing the Qualified Small Issue Manufacturing Bond program are restricted from using accelerated depreciation and are relegated to the straight line depreciation method. This means they cannot front-load tax deductions on assets in early years when profits are scarce, but must deduct the same amount of depreciation each year. Accelerated depreciation gives manufacturers relief from large investments, allowing them to absorb the period of low profits while new machinery and equipment is being installed, tested, and fine-tuned. Accelerated depreciation can add considerable after-tax savings for companies making large capital investments. However, Congress prohibits manufacturers from using the accelerated depreciation method when the asset is financed using a Qualified Small Issue Manufacturing Bond. This is counterintuitive and illogical. By using the bond market, manufacturers could considerably lower costs with the accelerated method, especially when interest rates are low.

***Recommendation:***

CDFA proposes eliminating the restriction on the use of accelerated depreciation by manufacturers using Qualified Small Issue Manufacturing Bonds. This very small, but significant, change would allow small- to medium-sized manufacturers to access the bond markets for more affordable rates while also benefiting from depreciation tax-savings in the early years of the investment. This change would encourage manufacturers to explore bond financing as an affordable and cost-effective way to make investments and ultimately create jobs.

***Legislative Language:***

Internal Revenue Code Section 168(g)(5)(A) is amended to read as follows:

**SEC. 5. ELIMINATION OF RESTRICTION ON USE OF ACCELERATED DEPRECIATION BY MANUFACTURERS USING QUALIFIED SMALL ISSUE MANUFACTURING BONDS FINANCING.**

(a) IN GENERAL.—Subparagraph (A) of section 168(g)(5) of the Internal Revenue Code of 1986 is amended by inserting ''before January 1, 2013,'' after ''obligation''.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

## REFORM #7

**Expand the 2% De Minimis Rule to Financial Institutions for Qualified Small Issue Manufacturing Bonds and Qualified 501(c)(3) Bonds**

***Issue Brief:***
Currently, only non-financial institutions can take advantage of deduction allowances for tax-exempt bonds. Non-financial institutions may deduct 80% of their interest deductions as long as their share of tax-exempt bonds does not exceed 2% of their assets. Financial institutions, such as banks, are prohibited from benefiting from this valuable investment option. Financial institutions, particularly small local banks, are a critical piece of the Qualified Small Issue Manufacturing Bonds process. These institutions are intimately familiar with local manufacturers and would be in a strong position to purchase Qualified Small Issue Manufacturing Bonds issued in their community. Under current law, they are discouraged from making this local investment.

***Recommendation:***
CDFA recommends expanding the 2% de minimis rule for Qualified Small Issue Manufacturing Bonds and Qualified 501(c)(3) Bonds so that financial institutions are permitted to purchase new money tax-exempt bonds issued in an aggregate amount not to exceed 2% of their adjusted bases of assets. This change would allow small, local lenders to purchase Qualified Small Issue Manufacturing Bonds that directly support manufacturing investment and job creation in their communities.

***Note:*** CDFA has recommended this reform for both Qualified Small Issue Manufacturing Bonds and Qualified 501(c)(3) Bonds. Qualified 501(c)(3) Bonds provide low-cost financing to non-profit institutions such as hospitals, schools, and cultural facilities throughout the country. Issuers regularly issue both types of bonds and this limitation hinders these efforts for both instruments. CDFA believes these changes go hand-in-hand and will help to further broaden issuers' ability to access the capital markets on behalf of job generating borrowers and has recommended that both manufacturing and non-profit bonds received this expanded treatment.

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***Legislative Language:***

Internal Revenue Code Section 265(b)(7)(A) is amended to read as follows:

**SEC. 4. DEDUCTIONS FOR EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME.**

(a) EXCEPTIONS FROM PRO RATA ALLOCATION RULE FOR QUALIFIED SMALL ISSUE BONDS.—

(1) TAX EXEMPT OBLIGATION RULE.—Clause (ii) of section 265(b)(3)(B) of the Internal Revenue Code of 1986 is amended by striking ''or'' at the end of subclause (I), by redesignating subclause (II) as subclause (III), and by inserting after subclause (I) the following new subclause:

''(II) any qualified small issue bond (as defined in section 144(a)) issued after December 31, 2012, or''.

(2) QUALIFIED SMALL ISSUER RULE.—Clause (ii) of section 265(b)(3)(C) of such Code is amended by redesignating subclauses (II) and (III) as subclauses (III) and (IV), respectively, and by inserting after subclause (I) the following new subclause:

''(II) any qualified small issue bond (as defined in section 144(a)) issued after December 31, 2012, or''.

(3) DE MINIMIS EXCEPTION FOR BONDS ISSUED DURING 2009, 2010 OR AFTER 2012.—So much of paragraph (7) of section 265(b) of such Code as precedes subparagraph (B) thereof is amended to read as follows:

''(7) DE MINIMIS EXCEPTION FOR BONDS ISSUED DURING 2009, 2010 OR AFTER 2012.—

''(A) IN GENERAL.—In applying paragraph (2)(A), there shall not be taken into account—

''(i) tax exempt obligations issued during 2009 or 2010, or

''(ii) obligations issued after 2012 that constitute a qualified 501(c)(3) bond (as defined in section 145) or a qualified small issue bond (as defined in section 144(a)).''.

(b) SPECIAL RULES FOR SMALL ISSUE AND TAX EXEMPT OBLIGATIONS ISSUED AFTER 2012.—Paragraph (3) of section 265(b) of the Internal Revenue Code of 1986 is amended by adding at the end the following:

''(H) SPECIAL RULES FOR OBLIGATIONS ISSUED AFTER 2012.—

''(i) INCREASE IN LIMITATION.—In the case of obligations issued after December 31, 2012, that constitute a qualified 501(c)(3) bond (as defined in section 145) or a qualified small issue bond (as defined in section 144(a)), subparagraphs (C)(i), (D)(i), and (D)(iii)(II) shall each be applied by substituting '$30,000,000' for '$10,000,000'.

''(ii) QUALIFIED 501(C)(3) BONDS AND QUALIFIED SMALL ISSUE BONDS TREATED AS ISSUED BY CONDUIT BORROWER.—In the case of an obligation issued after December 31, 2012 that constitutes a qualified 501(c)(3) bond (as defined in section 145) or a qualified small issue bond (as defined in section 144(a)), this paragraph shall be applied by treating the organization for whose benefit such bond was issued as the issuer.

''(iii) SPECIAL RULE FOR QUALIFIED FINANCINGS.—In the case of a qualified financing issue issued after December 31, 2012—

''(I) subparagraph (F) shall not apply, and

''(II) any obligation issued as a part of such issue shall be treated as a qualified tax-exempt obligation if the requirements of this paragraph are met with respect to each qualified portion of the issue (determined by treating each qualified portion as a separate issue which is issued by the qualified borrower with respect to which such portion relates).

''(iv) QUALIFIED FINANCING ISSUE.— For purposes of this subparagraph, the term 'qualified financing issue' means any composite, pooled, or other conduit financing issue the proceeds of which are used directly or indirectly to make or finance loans to 1 or more ultimate borrowers each of whom is a qualified borrower.

''(v) QUALIFIED PORTION.—For purposes of this subparagraph, the term 'qualified portion' means that portion of the proceeds which are used with respect to each qualified borrower under the issue.

''(vi) QUALIFIED BORROWER.—For purposes of this subparagraph, the term 'qualified borrower' means a borrower which is a State or political subdivision thereof, an organization described in section 501(c)(3) and exempt from taxation under section 501(a) and for qualified small issue bonds (as defined in section 144(a)), the conduit borrower.''.

(c) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to obligations issued after December 31, 2012.

## REFORM #8

**Allow Qualified Small Issue Manufacturing Bond volume cap allocation to be carried forward in accordance with other bonds subject to volume cap**

***Issue Brief:***

# The American Manufacturing Bond Finance Act

In contrast to other bonds that use “volume cap” (solid waste, housing, student loans), volume cap for Qualified Small Issue Manufacturing Bond that is unexpended at the end of a calendar year cannot be “carried forward” for projects in future years. In the past this was a manageable problem because the volume cap for each bond issue was deemed “used” in the year the bond was issued, regardless of whether the borrower had actually expended or “drawn down” all of the bond issue in that same year. It is not unusual for a borrower to draw down their bond proceeds over time as they construct their facility, so that they are only paying interest on the amount actually borrowed.

In 2011, a problem developed as a result of a new IRS interpretation that volume cap would only be deemed used in each of the years in which it was “drawn down”. Because Qualified Small Issue Manufacturing Bond cannot have volume cap carried over to future years, the IRS determined that subsequent years’ drawdowns would need to come from new volume cap allocations made in those future years, which cannot be guaranteed. The net effect is to create risk, uncertainty and additional compliance costs, discouraging both bank bond purchasers and manufacturing companies from using the program. Beyond the draw down issue, allowing volume cap to be carried forward for Qualified Small Issue Manufacturing Bond would encourage states to commit volume cap to manufacturers because they would have comfort that they could carry it forward if a closing couldn’t be accomplished in the current year.

***Recommendation:***
CDFA proposes a simple legislative fix to allow volume cap to be carried forward for IDBs and allow the IRS to revise their interpretation. Alternatively, one could simply have the statute indicate that bonds which close and spend funds in a given year can be issued using volume cap from that year for the entire issue. This approach is consistent with the way counsel had treated bonds prior to the IRS issuing a contrary interpretation.

***Legislative Language:***

Internal Revenue Code Section 146 is amended to include new (o) to read as follows:

**SEC. 6. TREATMENT FOR DRAWDOWN LOANS.**

(a) IN GENERAL.—Section 146 of the Internal Revenue Code of 1986 is amended by adding at the end the following new subsection:

‘‘(o) DRAWDOWN LOANS.—For purposes of this section, an issue issued in the form of a drawdown loan is treated as issued on the first date on which the aggregate draws under the loan exceed the lesser of—

‘‘(1) $50,000, or

‘‘(2) 5 percent of the issue price of such loan.’’.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take apply to obligations issued after December 31, 2012.