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A Publication of Bowditch & Dewey's Estate, Financial & Tax Planning Group

Tax Act Could Impact Tax-Exempt Bonds

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One of the key components of the recently passed Tax Cuts and Jobs Act is the reduction in the corporate tax rate from 35 percent to 21 percent for tax years beginning after December 31, 2017. Banks, financial institutions, and other purchasers of tax-exempt bonds will receive less of a benefit from holding tax-exempt bonds due to this significant tax rate decrease, which could lead to volatility in the tax-exempt bond market. Additionally, borrowers and lenders should be aware that their existing bond documents may provide for the adjustment of the interest rate on their outstanding tax-exempt bonds in connection with the change in the corporate tax rate. In some circumstances, changes to the interest rate, and thus the yield of your tax-exempt bonds may trigger a reissuance of the bonds for tax purposes, possibly jeopardizing the tax-exempt status of the bonds. Additionally, waivers of or amendments to corporate tax rate gross up provisions in your existing bond documents may similarly result in an unintended reissuance of the bonds.

Client Tip: Borrowers and lenders should consult bond counsel to review the corporate tax rate provisions in their existing documents to discuss the possible impact of the new tax law changes.