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Tax Cuts and Jobs Act (H.R. 1) – Private Activity Bonds

By *Thomas Gray*

After months of negotiating and much speculation, on November 2 the House released its proposed tax reform legislation in the form of the Tax Cuts and Jobs Act (H.R. 1) (the “Act”). While far from final, the 429-page document includes certain expected changes that would reduce federal tax burdens for some, for example, the reduction of the corporate tax rate to 20 percent, but also includes various revenue raisers. The revenue raisers are needed to balance the \$1.5 trillion net tax cut allowed for in the House budget resolution.

One revenue raiser provides that interest income from private activity bonds issued after 2017 will no longer be excluded from federal income taxes. In justifying the repeal, the House Ways and Means Committee noted that the federal government should not subsidize the borrowing costs of private businesses. This practice has allowed these businesses to pay lower interest rates, while competitors with similar creditworthiness that are not able to avail themselves of private activity bonds must pay a higher interest rate on the debt they issue. The legislation does not prevent local and state governments from issuing private activity bonds, but it eliminates the tax-exempt status of the interest associated with bonds issued after 2017.

Another revenue raiser would change how undistributed income of a foreign corporate subsidiary, which is classified as a “controlled foreign corporation” (CFC) for U.S. federal income tax purposes, is included in its domestic parent’s gross income. A regulated investment company may invest in a wholly owned foreign corporate subsidiary for the purpose of engaging in commodity transactions. Such a wholly owned foreign corporation would be considered a CFC. The Internal Revenue Code provides special rules for the inclusion of a CFC’s undistributed income in the gross income of a U.S. shareholder of such a CFC. Historically, though, CFCs engaged in commodity transactions have distributed all their income to their regulated investment company parents. Regulated investment companies should be aware, however, that where all the income of such a subsidiary is not being distributed, changes are being proposed that could affect the determination of what amounts attributable to a CFC are included in the gross income of the regulated investment company parent.

This legislation is far from final and the Senate will be taking its own approach to tax reform, with the two chambers reconciling their proposals. We will be following developments as they occur.

For more information on the Tax Cuts and Jobs Act (H.R. 1), or federal income taxes in general, please contact the author named below or the Drinker Biddle Investment Management Group lawyer with whom you regularly work.

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