Statement of the

AMERICAN PUBLIC POWER ASSOCIATION,

LARGE PUBLIC POWER COUNCIL,

AND

TRANSMISSION ACCESS POLICY STUDY GROUP

Submitted to the

SENATE FINANCE COMMITTEE

TAX REFORM WORKING GROUPS

on

COMMUNITY DEVELOPMENT AND INFRASTRUCTURE

and

SAVING AND INVESTMENT

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Introduction

The American Public Power Association (APPA)[1], Large Public Power Council (LPPC)[2], and Transmission Access Policy Study Group (TAPS)[3] appreciate the opportunity to submit this statement for consideration by the Senate Finance Committee as it contemplates tax reform. Public power utilities serve some of the nation's smallest towns—roughly four out of five public power utilities serve 10,000 or fewer customers—and largest cities, including Los Angeles and Orlando. Collectively, public power utilities deliver electricity to one of every seven U.S. electricity consumers (approximately 47 million people).

Fundamental income tax reform could have a direct effect on a number of issues of concern to our members, including the treatment of health care expenses and of pension and retirement contributions and accruals. However, given the potential damage that could be done to our members' ability to continue their mission to provide affordable and reliable electricity to their customers, this statement will focus primarily on the effect of tax reform on financing of capital expenditures.

As the Senate Finance Committee debates tax reform, it should consider carefully the effect on state and local governmental entities, including public power utilities, ability to finance the critical infrastructure investments needed to provide for economic growth and our citizens' well-being. Changes to the current law treatment of tax-exempt bonds will increase the price that public power customers pay for electricity, especially affecting small businesses and low- and fixed-income households, and reduce the ability to fund necessary public power infrastructure improvements.

Municipal Bonds

Municipal bonds have been used for more than 200 years[4] by state and local governments to finance a wide range of public infrastructure. They allow state and local governments to build projects with capital provided upfront by bond investors, repaid over the projects' useful life by the citizens and customers benefitting from the project.

Municipal bonds are the largest source of financing for core infrastructure in the U.S.,[5] and are the single most important financing tool for public power, given the capital-intensive and long-lived nature of assets needed by the electric industry. Each year, on average, public power utilities make $11 billion in new investments financed with municipal bonds. Power-related municipal bonds account for roughly 5% of

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[1] APPA is the national service organization representing the interests of over 2,000 municipal and other state- and locally-owned, not-for-profit electric utilities ("public power utilities") throughout the United States (all but Hawaii). All LPPC and all, but two, TAPS members are members of APPA.

[2] LPPC is the national service organization comprised of 26 of the nation's largest public power utilities. LPPC member utilities own and operate more than 86,000 megawatts of generation capacity and over 35,000 circuit miles of high voltage transmission lines. Together, LPPC members control 90% of the public-agency-owned, but non-federal, transmission investment in the nation.

[3] TAPS is an association of transmission-dependent utilities in more than 30 states, promoting open and non-discriminatory transmission access.

[4] The exclusion for municipal bond interest from the federal income tax was first codified in the Revenue Act of 1913, but state and local governments had been issuing bonds to finance infrastructure long before then. For example, the City of New York issued the first general obligation bond to financing the building of a canal in 1812.

[5] Cong. Budget Office, J. Comm. on Taxation "Subsidizing Infrastructure Investment with Tax-Preferred Bonds" (Oct. 2009)(showing that for education, water, and sewer, nearly all capital investments are made by state and local governments and that for transportation most investments are made by state and local governments).

municipal bond issuances every year.[6] (See Appendix A for tabulation of power-related bond issuances, by state, over the last decade).

Public power utilities use municipal bonds to finance investments in power generation (including through renewable and alternative fuels), transmission, distribution, reliability, demand control, efficiency, and emissions controls. While the typical power-related bond issue is relatively small, electric generation and transmission projects often cost hundreds of millions or even billions of dollars and can have as long as a 50-year operational life.

Further, changes in the electric sector—many in response to federal and state energy policies—are expected to require significant additional capital investment in the near term. Replacing retiring older generation, meeting increasing cyber security needs, integrating new renewable resources, and modernizing the electric grid to meet changing demands will all require new infrastructure investment to assure reliable electric service into the future.

Because interest on municipal bonds is exempt from federal income tax, investors accept a lower rate of return than they would otherwise demand from issuers of taxable debt. Investors are also attracted to municipal bonds because of the stability of the municipal bond market and the extremely low rate of default for municipal bonds. Historically, interest rates demanded by investors for tax-exempt municipal bonds have been an estimated average 200 basis points lower than comparable taxable corporate bonds. Savings to the issuer from this reduced cost in borrowing allow further infrastructure investments or are passed through to taxpayers in the form of lower taxes or, in the case of public power customers, reduced utility rates[7].

An added advantage of municipal bonds as a source of state and local financing is that the need for, and terms of, financing are determined by state and local citizens, either directly or through their elected representation. Additionally, significant flexibility is afforded to state and local government issuers compared to issuers of taxable debt, including the term of the issue, the debt structure, and the ability to optionally call fixed rate debt after 10 years to take advantage of any decreases in interest rates by refinancing the debt.

Current Financing Alternatives

Several alternative debt instruments exist that supplement tax-exempt municipal bonds as a means of financing state and local infrastructure investments. However, as explained below, each has its own substantial inefficiencies and none, alone, would be a viable replacement for municipal bonds.

Taxable Bonds

On occasion, state and local governments issue taxable debt to finance infrastructure investments, generally as a supplement to financing provided by tax-exempt debt. Taxable bonds appeal to a different type of investor, typically those less concerned with tax considerations (such as pension funds and foreign investors) and so can expand the potential pool of investors for a larger project. Because investors demand a higher rate of return on taxable bonds than on tax-exempt municipal bonds, their use is limited and could not replace tax-exempt municipal bonds as a means of financing without imposing dramatically increased costs on state and local governments.

[6] The Bond Buyer & Thomson Reuters "2014 Yearbook" (2014); The Bond Buyer & Thomson Reuters "2009Yearbook" (2009).

[7] American Public Power Association "2012-2013 Public Power Annual Directory and Statistical Report" 51 (2012).

Other practical considerations also limit the use of taxable bonds by municipal issuers. As more fully described herein, more than 47,000 state and local governments issue debt in this market. By comparison, roughly 5,000 corporations issue debt in the taxable market. While the taxable market generally only accommodates large financings, the existing tax-exempt market accommodates issues that vary significantly in size and rating. From 2002 to 2011, the median municipal bond issuance was $7 million. In addition, issuers are subject to more restrictions on the terms of debt issued in the taxable market. For example, while the right to optionally call a bond prior to final maturity at par is a component of most fixed-rate tax-exempt municipal bonds, such provisions are rare (and costly to include) in taxable bonds. As a result, state and local government issuers are generally effectively precluded from refinancing taxable debt to take advantage of an interest rate decrease.

Direct Payment Bonds

Direct payment bonds are bonds, the interest on which is taxable to the bond holder, but for which state and local government issuers receive a direct federal payment generally set at a percentage of the interest rate paid to bond holders. Build America Bonds (BABs) were permitted to be issued as direct payment bonds from February 17, 2009, through December 31, 2010. The reimbursement rate for these bonds was set at 35 percent. Of the $843 billion in municipal bonds issued in 2009 and 2010, roughly $181 billion were direct payments BABs. This unprecedented willingness of municipal issuers to issue taxable debt stemmed, in large part, from the reimbursement rate, which generally provided a net borrowing cost that was lower than any alternative. In addition, given the turmoil in all capital markets during the banking crises, expanding the pool of investors through the issuance of taxable debt assisted issuers by providing greater market liquidity. .

The Clean Renewable Energy Bond (CREB) program was intended to provide state and local governments (and rural electric cooperatives) the same incentives to invest in renewable projects as were provided by the production tax credit. The original program was a tax credit bond program, but after very limited success, a new version of the CREB program, New CREBs, was created in 2008 and modified in 2010 to allow issuers the option of receiving a direct payment from Treasury in lieu of providing bond holders a tax credit.

Although direct payment bonds may serve as a complement to the municipal markets that help relieve pressure during market disruptions, these bonds have their own inefficiencies that raise their cost or make them less desirable to issuers and investors and prevent them from being a viable replacement to municipal bonds. First, many issuers have concerns about offsetting payments by amounts potentially owed to the federal government under other programs. Second, sequestration of direct payment bond payments[8] has confirmed concerns that the federal government could change the amount of the subsidy after issuers borrowed in reliance on the expectation of direct subsidy payments.

Tax Credit Bonds

Tax credit bonds are taxable obligations in which the investor receives a tax credit in lieu of tax- exempt interest. BABs, CREBs, and Qualified Energy Conservation Bonds were permitted to be issued as tax credit bonds. They are sophisticated debt instruments that have traditionally been purchased by a small number of banks or other financial institutions for their own accounts.

[8] Office of Mgmt. & Budget, Exec. Office of the President, OMB Report to the Congress on the Joint Committee Sequestration for Fiscal Year 2013 48 (Mar. 1, 2013).

The tax credit rate is set daily by the Treasury Department based on the average "AA" corporate rated debt. This "one-size-fits-all" coupon approach has led to investors either discounting the price of the bond upon issuance or a requirement that issuers pay a "supplemental interest coupon" to increase the return on the bonds in order to attract investors, reducing the efficiency of this financing mechanism.

In 2008, tax credit bonds were modified to allow investors to separate (or "strip") the tax credits from the bond and sell them separately. However, because the logistics of stripping are complex, investors discount the value of both the credits and the remaining bond. Investors further discount the value of tax credit bonds to reflect additional costs and risks, including the risk that the investor may not have a federal tax liability in later years against which to use the credits.

Because of these difficulties, the demand for tax credit bonds has been limited and issuers have been reluctant to rely on them.[9]

Private Activity Bonds

Interest on "qualified" private activity bonds issued by state and local governments for certain permitted facilities are exempt from federal gross income tax, but generally subject to the alternative minimum tax. Such facilities include airports, docks and wharfs, multi-family housing, single family housing, student loans and solid waste disposal facilities

Unlike governmental bonds, these qualified private activity bonds are subject to a wide range of restrictions and limitations including limits on the amount of bond proceeds which may be applied to finance costs of issuance, limits on state bond volume, rules regarding public notice of the bond issue and the purpose to be financed, and limits on the maturity of the bonds. Additional restrictions mean private activity bonds are seldom issued by government-owned utilities to finance energy infrastructure improvements such as generation, transmission and distribution assets.

Municipal Bond Market

While the use of municipal bonds in America predates the birth of our nation, the first recorded general obligation municipal bond was not issued until 1812. Since then, the municipal bond market has been a steady source of financing for state and local governments. Today, there are nearly $3.7 trillion municipal bonds outstanding, with approximately $400 billion in issuances every year.

The policy of "reciprocal immunity"—that the federal government does not tax interest on state and local borrowing and state and local governments do not tax federal borrowing—and the longevity of this exemption have given municipal bond investors and issuers great confidence in its permanency and allowed the market to function efficiently.[10] While changes to the tax code have placed additional requirements and restrictions on the issuance of municipal bonds, interest on government-purpose bonds has always been exempt from federal income tax.

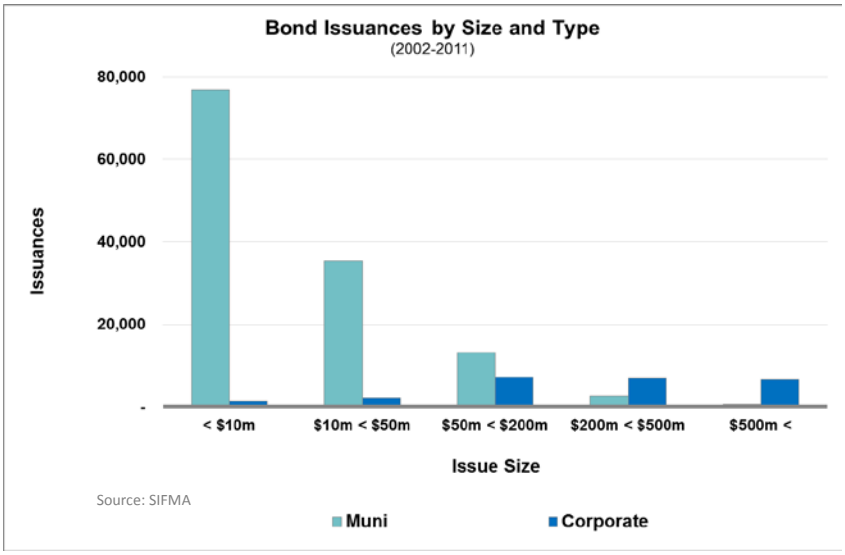
This stability has allowed the market to accommodate a vast number of issuers. As discussed above, more

[9] IRS SOI, "Table 11. Total Tax Exempt, Taxable, Direct Payment, and Tax Credit Bonds, 2010," http://www.irs.gov/file_source/pub/irs-soi/10bd11arra.xls (last visited Mar. 29, 2013) (Of 29,315 municipal bonds totaling $556.9 billion in volume reported to the IRS in 2010, just 199 totaling $1 billion in volume were tax credit bonds.).

[10] Conversely, the threat that Congress might alter this tax treatment caused demonstrable harm to the municipal bond market in 2012, both in terms of higher rates for new borrowings and in the loss of value of tax-exempt holdings in the secondary market (*see*, Janney Capital Markets, "Municipal Bond Market Note: The Threat to Tax Exemption" 3 (Oct. 19, 2012)).

than 47,000 state and local governments issue debt in this market. By comparison, only roughly 5,000 corporations issue debt in the taxable market.

Our members serve some of the nation's smallest towns. Roughly four out of five public power utilities serve 10,000 or fewer customers and all but 43 provide sales to ultimate customers of less than 4 million MWhs (one of several standards for determining whether an electric power utility is "small"). These small utilities provide power to nearly 10 million residences, 1.7 million businesses, and 112,000 industrial customers. All told, nearly 26 million Americans receive their power from these small entities.



Investors purchase municipal bonds, in part, because of tax considerations, accepting a lower rate of return because the interest is exempt from federal income tax. But municipal bonds are also valued for their stability, the low rate of risk of default, and their ability to generate a steady stream of revenue for fixed-income households. In 2010, nearly 60 percent of bond interest paid to individuals was reported on returns for households aged 65 and older.

Also, while municipal bonds are perceived by some as an investment of only the rich, 52 percent of all bond interest paid to individuals went to households with income of less than $250,000;[11] roughly 75 percent went to households with income of less than $1 million.[12] IRS data also show that for those who own municipal bonds, the amount of interest earned actually declines as a percentage of overall income as income increases. In other words, for households holding municipal bonds, the interest paid is more important as a source of income as household income decreases.

Market and Regulatory Safeguards

There is a longstanding and comprehensive federal legislative and regulatory system in place to regulate the tax-exempt bond market. Both the IRS and SEC have active enforcement programs for state and local bonds to help ensure that the applicable rules are satisfied. Federal tax laws significantly limit: the entities that can issue tax-exempt bonds; the purposes for which the bonds may be issued; and the investment of bond proceeds. These rules are particularly restrictive for public power utilities. For example, in the case

[11] Internal Revenue Service, "Statistics of Income—2010: Individual Income Tax Returns" (2012).

[12] *Ibid.*

of public power bond issuances, regardless of the size of the borrowing, no more than $15 million (or 10% of the total bond proceeds, if less than $15 million) can be used for private use. In addition, unlike the rules applicable to other types of governmental bonds, the private use rules also expressly limit the private use applicable to any "output project" to no more than $15 million. Furthermore, the IRS private use rules effectively prevent issuers from using tax-exempt bonds to build larger facilities than are required to meet the needs of their communities or to issue bonds with longer terms than needed.

The SEC and Municipal Securities Rulemaking Board regulate the manner in which state and local governments may sell their bonds and provide rules on the types of disclosure required in connection with the sale of municipal bonds, as well as ongoing annual and material event disclosure.

Significant market-based safeguards also prevent state and local issuers from irresponsibly issuing bonds or using bond financing for ill-advised projects.

Alternatives to the Current-Law Exclusion for Municipal Bond Interest

As Congress considers proposals to reform the federal income tax, it should bear in mind the unique origin of the exclusion for municipal bond interest and the substantial damage that would be done by any of the alternatives currently being advanced. Such proposals would not only affect current bondholders, but would force tax and rate increases on state and local residents to accommodate higher borrowing costs and reduce the amount spent on needed infrastructure by state and local governments.

Some critics say the exclusion for municipal bond interest is inefficient. These arguments come from several sources, including the Joint Committee on Taxation (JCT). However, research over the last decade has called into questioned JCT's conclusions[13] and its methodologies.[14] On the whole, these analyses indicate that inefficiency and revenue lost from the exclusion are dramatically overstated. Even critics of the exclusions agree that at least 80% of the benefit of the exclusion goes to reduce state and local borrowing costs and not as a windfall to investors.[15]

More importantly, there is virtually no disagreement as to who will pay the price if Congress were to upend the 100-year precedent of exclusion to tax municipal bond interest with, for example, a surtax on municipal bond interest.[16] It will <u>not</u> be borne by the bond investor, who will be compensated with a higher interest rate to compensate for any federal surtax. Rather, state and local residents will be forced to pay billions more every year in additional financing costs.

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[13] Francis Longstaff , "Municipal Debt and Marginal Tax Rates: Is There a Premium in Asset Prices?" *NBER Working Paper 14687* 21-22 (Jan. 2009); Andrew Ang, Vineer Bhansali, & Yuhang Xing, "Taxes on Tax-Exempt Bonds" *Journal of Finance*, pp 565-601 (Nov. 11, 2008).

[14] James M. Poterba & Arturo Ramirez Verdugo, "Portfolio Substitution and the Revenue Cost of Exempting State and Local Government Interest Payments from Federal Income Tax" *NBER Working Paper 14439* (Oct. 2008); George Friedlander, Citi, "The Tax Exemption of Municipal Bonds: A Much More Efficient Financing Mechanism Than Government Analyses Suggest" (Jan. 17, 2013).

[15] Frank Sammartino, Congressional Budget Office, Testimony before the U.S. Senate Finance Committee Hearing on "Federal Support for State and Local Governments through the Tax Code" (Apr. 25, 2012).

[16] BLX Group LLC, "Tax Reform Proposal Analysis: Impact on Tax-Exempt Bond Financing," prepared for American Public Power Association 6 (Jan. 28, 2013) (estimating a 77 basis point increase in all-inclusive borrowing costs for large issuers and a 92 basis point increase in all-inclusive borrowing cost for smaller issuers)(Appendix B of these comments includes a summary of this reports findings); George Friedlander, Citi "Muni Issuers and the Current Market Environment: Threats, Challenges and Opportunities" 10 (Mar. 30, 2012)(estimating a yield increase of as much as 75 basis points); and John Hallacy & Tian Xia, Bank of America Merrill Lynch, "Munis & Derivatives Data" 1 (Feb. 13, 2012)(estimating a 40 basis point increase on issuer costs).

As noted above, throwing more than 47,000 state and local issuers into the taxable bond market would be unprecedented, incredibly disruptive, and costly. Each of the proposed alternatives to tax-exempt bonds comes with its own inefficiencies from the perspective of issuers of these bonds. In contrast, the current municipal bond market provides issuers ready access to capital with maximum flexibility. This market charges a premium to issuers who have undertaken unwise projects or borrowed beyond their constituents' willingness (or ability) to repay these bonds.[17] As a result, it should come as no surprise that municipal bonds are second only to Treasury bonds in their stability.[18]

Repeal

An outright repeal of the exclusion for municipal bond interest would both undermine a century of tax-policy precedent and devastate the ability of state and local governments of all sizes to seek financing in an effective, well-regulated, well-understood, and stable market.[19] Estimates of the increased cost to issue taxable debt vary and generally are based on the historic spread between corporate taxable debt and municipal tax-exempt debt that, on average, has been nearly 200 basis points. Recent analysis of the cost of issuing taxable debt in the current market (with its historically low interest rates) showed a nearly 150 basis point increase for a larger municipal issuer and a 166 basis point increase for a smaller issuer.[20] At the historic spread, if proposals to eliminate tax-exempt financing had been in place over the last 10 years, it would have cost state and local governments $495 billion in additional interest expense.

The actual costs would likely be far greater, as roughly 50,000 states and local issuers—60 percent of whom are borrowing less than $10 million—would be forced into a taxable market where the median issue for roughly 5,000 corporate issuers is closer to $200 million. Likewise, flexibility unique to municipal bonds—such as the ability to match bond maturities to match revenues and project life and to optionally call bonds prior to final maturity to take advantage of changes in interest rates—would be lost or would come at a significant premium in the taxable market.

28% "Cap"

A "cap" on the tax value of the exemption for municipal bond interest is, in principle and in effect, a surtax on municipal bond interest. For example, to "cap" the tax value of municipal bond interest at 28%, a tax of up to 11.6% (given the current top marginal income tax rate of 39.6%) would be imposed on municipal bond interest. This "cap" was proposed in President Obama's FY 2014 Budget. While theoretically targeted at upper-income investors, the reality is that such a tax would increase the costs for issuers of new tax-exempt bonds and disrupt the secondary market value of holdings for all outstanding bond-holders.[21]

As a result, all potential investors would demand an interest rate premium on new issuances, either as compensation for the loss of net earnings or to offset the downward pressure on secondary market value

[17] Fitch Ratings, U.S. Public Power Rating Criteria (Dec. 18, 2012).

[18] See, for example, Moody's "U.S. Municipal Bond Defaults and Recoveries: 1970-2011" (Mar. 7, 2011)(showing that of a sample of 17,700 rated issuers, just 71 had defaulted over the 42-year period and, of those, just two were public power issuers).

[19] This statement is primarily concerned with the tax policy considerations of tax reform, but a number of academics have questioned whether federal tax on state and local financing would violate constitutional intent and whether the courts would uphold such a tax.

[20] BLX, *supra* note 18.

[21] ETF Trends "Muni Bond ETFs Tumble on Tax-Break Speculation" (Dec. 14, 2013) (http://finance.yahoo.com/news/muni-bond-etfs-tumble-tax-181300222.html)(last visited Mar. 28, 2013).

caused by the new tax. An additional risk premium would be demanded by the market to compensate for possible future federal tax rate increases, as well as for future downward reductions in the cap rate. Recent analysis shows that a 28% "cap" would increase financing costs for a larger issuer by 77 basis points, while a smaller issuer's costs would increase by 92 basis points.

Individual Ownership of Municipal Bonds		
Income Group	**Exempt Interest Earned**[22]	
	Amount	% of Total
Under $250,000	$34 billion	48%
$250,000 to $999,999	17 billion	24%
$1 million and Above	20 billion	28%
Total	**$71 billion**	**100%**

In addition to increasing the cost of borrowing for state and local government issuers, the notion that the bonds are a "hybrid investment" - that is, depending on the tax status of the purchaser, either all or some of the interest will be excluded from federal gross income - adds complexity to all debt issuances, requires more lengthy and comprehensive disclosure and increases borrowing and transaction costs.

Flat-Dollar Cap

A flat-dollar cap on the amount of deductions and exclusions a taxpayer could claim would essentially amount to a repeal of the current exclusion for municipal bond interest. Under this proposal, taxpayers would be given the option to exclude from income some or all of such interest to the extent other deductions and exclusions are not used to "fill" the cap. It is generally assumed that taxpayers would first fill the cap with non-optional expenses – such as employer-provided health care, retirement investments, education, child and dependent care, and home mortgage interest. As a result, at the dollar levels being discussed, a flat- dollar cap would result in the full taxation of municipal bond interest for most if not all municipal bond holders. The cost in the secondary market to bond holders and to issuers for new issuances would likely be on par with that of a full repeal.

Replacing Municipal Bonds with Tax Credit Bonds

Generally, the tax credit bond market is an illiquid, small market that could not replace the current municipal bond market. The tax credit bond market cannot absorb the average annual debt issuance of tax-exempt bonds, which over the last 10 years has averaged nearly $400 billion per year.

Purchasers of taxable bonds include entities that pay no federal income tax, such as public pension funds, private pension funds and foreign investors. To attract such investors, the tax credits would need to be stripped and sold to entities that pay federal income taxes. In addition to discounting the amounts paid for credits due to the complexity of stripping and selling a stream of tax credits, purchasers will discount the credits to offset the following: (i) transaction costs; (ii) tax risk associated with concerns that the credits might stop in the event the bonds do not meet the federal bond tax rules; (iii) risk that the investor may

[22] Internal Revenue Serv., *Statistics of Income—2012: Individual Income Tax Returns*, (Publication 1304 (Rev. 08-2014)) 40 (2012) (note that roughly 80% of municipal bond interest was paid to individuals either directly or through funds (*Board of Governors of the Federal Reserve*, "Flow of Funds Accounts of the United States" 99 (Dec. 6, 2012)).

not have a federal tax liability in later years to fully utilize the credits; and (iv) default risk and related factors.

Replacing Municipal Bonds with Taxable Direct Payment Bonds

All the concerns regarding cost, access to capital, and flexibility for issuers caused by an outright repeal of the exclusion for municipal bond interest would also apply to a replacement of the exclusion with a taxable direct payment bond. Further, the small issuers that are such an important part of the tax-exempt bond market would be disproportionately affected by having to borrow in the taxable market. A recent analysis shows that replacing municipal bonds with a 25 percent direct payment bond would still result in a net cost increase to a large issuer of 51 basis points and to a smaller issuer of 58 basis points.[23] Further, there is a legitimate question among our members as to whether these direct payment bonds have been forever tarnished by the impact of sequestration. This sequestration cut was not envisioned by the drafters of BABs; it therefore calls into question whether or not more cuts will be forthcoming at some point in the future.

Improvements to Municipal Bonds

While much of Congress's recent discussion of municipal bonds has focused on revenue and tax status, the Committee has also begun discussing how to improve the rules surrounding municipal bonds. A thoughtful discussion of ways to modernize the tax code would be welcome.

We support a recent proposal to repeal the 5 percent unrelated or disproportionate private business use test (Section 141(b)(3) of the Code) to simplify the private business use test applicable to governmental bonds. This test involves vague factual determinations which can lead to a reduction in the otherwise permitted 10 percent private business use participation to 5 percent. We agree with Treasury Department that the 5 percent test creates undue complexity and should be repealed.[24] We also agree that the "the 10 percent private business limit generally represents a sufficient and workable threshold for governmental bond status"[25] and would, as a result, recommend that other unnecessary addenda to the 10 percent limit also be reconsidered.

Code Section 141(b)(4) provides for a $15 million private business use/payments limitation on certain output facilities which are part of the same project. The per-project limitation is a punitive rule which singles out governmentally-owned electric output facilities from other bond financed governmental owned assets and systems. Accordingly, we support the repeal of this provision. At a time in which additional electric output, smart-grid transmission and distribution facilities are needed to meet a rising energy needs, the repeal of this per-project limitation would provide needed operational flexibility.

Code Section 141(b)(5) provides for a maximum $15 million private business use/payments limitation on all tax-exempt governmental bonds unless volume cap is allocated to such excess under Section 146 of the Code. This $15 million limitation, like the $15 million per-project limitation of Section 141(b)(4), creates undue complexity for municipal issuers and interferes with a policy goal of creating a bright line 10 percent private business use test. We support its repeal.

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[23] BLX, *supra* note 18, at 6.

[24] U.S. Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals" at 273 (Feb. 2, 2015).

[25] *Id.*

We would also support a revision in the tax treatment of capital contributions by public power utilities to investor-owned utilities (IOUs) to build facilities (e.g., interconnections and associated facilities, transformers, circuits, etc.) to serve the public power utility's retail demand ("load"). Under current law these payments are treated as taxable "contributions-in-aid of construction" to the IOU.[26] Because the IOU traditionally requires the municipal utility to "gross up" its contribution, the cost of the investment is effectively increased by as much as 35 percent.

Finally, we support the recent proposal to simplify the arbitrage investment restrictions applicable to tax-exempt bonds under Code Section 148. We fully agree with Treasury[27] that the investment yield and arbitrage rebate restrictions are duplicative and that these dual restrictions create an unnecessary compliance burden for state and local governments.

Conclusion

Thank you for the opportunity to provide input as the Committee considers tax reform. For over 100 years, Congress has recognized that the federal government should not interfere with the ability of state and local governments to pursue and finance investments needed in their communities by taxing the interest on municipal bonds. The effect of this recognition has been an efficient, well developed municipal bond market that finances hundreds of billions of dollars in new infrastructure investments each year – the very infrastructure needed to enable economic development and competitiveness in the U.S. As you consider options to simplify and modernize the tax code, we urge you to maintain current law treatment of the municipal bond exemption.

[26] 26 USC 118(b).

[27] *Supra* note 24 at 270.

Appendix A

A Decade of Power-Related Municipal Bonds

Power-related municipal bonds issued in each state from 2004-2013
(By total dollar volume and number of bonds issued)

State	$ Volume (millions)	Bonds Issued
Alabama	1,739	(33)
Alaska	436	(9)
Arizona	6,210	(20)
Arkansas	244	(15)
California	38,306	(237)
Colorado	726	(23)
Connecticut	266	(9)
Delaware	196	(5)
Florida	14,757	(134)
Georgia	10,071	(52)
Hawaii	481	(4)
Idaho	82	(1)
Illinois	2,928	(42)
Indiana	1,985	(41)
Iowa	340	(99)
Kansas	364	(45)
Kentucky	2,574	(42)
Louisiana	1,428	(18)
Maine	7	(2)
Maryland	122	(1)
Massachusetts	382	(21)
Michigan	532	(26)
Minnesota	1,762	(112)
Mississippi	911	(15)
Missouri	2,541	(41)
Montana	22	(6)
Nebraska	8,510	(282)

State	$ Volume (millions)	Bonds Issued
Nevada	154	(5)
New Hampshire	0	(0)
New Jersey	174	(9)
New Mexico	56	(1)
New York	9,963	(46)
North Carolina	5,091	(37)
North Dakota	352	(4)
Ohio	6,969	(54)
Oklahoma	2,325	(19)
Oregon	922	(42)
Pennsylvania	777	(10)
Rhode Island	0	(0)
South Carolina	8,703	(47)
South Dakota	55	(13)
Tennessee	8,646	(73)
Texas	13,921	(91)
Utah	2,688	(31)
Vermont	91	(9)
Virginia	465	(8)
Washington	14,646	(188)
West Virginia	11	(1)
Wisconsin	1,384	(64)
Wyoming	403	(7)
Guam	207	(3)
Puerto Rico	8,511	(15)
Virgin Islands	227	(6)
U.S. TOTAL	**$177,401**	**2,149**

Sources: The Bond Buyer/Thomson Reuters 2009, 2014 Yearbooks.



Appendix B:

Summary Tables of BLX Tax Reform Proposal Analysis

Bond Financing Models (Assumes "A" Rated) Large Borrower ($250 Million Project)			
Type of Issue	**All-Inclusive Cost** (annual rate)	**Current Law Municipal Bond vs. Alternative**	
		Percentage Point Difference in All-Inclusive Cost	Percent Increase in All-Inclusive Cost
Current Law Municipal Bond	3.19%	Not Applicable	Not Applicable
Alternatives			
Municipal Bond with Surtax/28% "Cap"	3.95%	+0.77	+24%
Taxable Direct Payment Bond (25%)	3.69%	+0.51	+16%
Taxable Bond	4.69%	+1.50	+47%

Bond Financing Models (Assumes "A" Rated) Small Borrower ($25 Million Project)			
Type of Issue	**All-Inclusive Cost** (annual rate)	**Current Law Municipal Bond vs. Alternative**	
		Percentage Point Difference in All-Inclusive Cost	Percent Increase in All-Inclusive Cost
Current Law Municipal Bond	3.39%	Not Applicable	Not Applicable
Alternatives			
Municipal Bond with Surtax/28% "Cap"	4.31%	+0.92	+27%
Taxable Direct Payment Bond (25%)	3.97%	+0.58	+17%
Taxable Bond	5.05%	+1.66	+49%

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