

OMNIBUS BUDGET RECONCILIATION ACT OF
1987

R E P O R T

OF THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

TO ACCOMPANY

H.R. 3545

A BILL TO PROVIDE FOR RECONCILIATION PURSUANT TO SECTION 4 OF THE FIRST CONCURRENT RESOLUTION ON THE BUDGET FOR FISCAL YEAR 1988

together with

SUPPLEMENTAL, ADDITIONAL, AND MINORITY
VIEWS

Part 2 of 2



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E. Tax-Exempt Bond Provisions

1. Limitation on issuance of tax-exempt bonds to acquire existing output facilities (sec. 10173 of the bill and sec. 142 of the Code)

Present Law

Interest on State and local government bonds generally is tax-exempt if the proceeds of the bonds are used to finance actual activities of the government or for certain specified private activities (secs. 103 and 141). Among the activities for which State and local governments may issue tax-exempt bonds is the financing and operation of governmentally owned and operated output facilities such as electric generating and transmission systems and gas distribution systems.

Reason for Change

The committee is aware of recent actions taken by several State and local governments to acquire assets of or interests in existing electric and gas generating and transmission systems. Financing the purchase of such investor-owned facilities with tax-exempt bonds effectively substitutes tax-exempt securities for taxable securities. As such, any benefit that consumers may gain from using tax-exempt financing rather than taxable financing comes at the expense of reduced Federal Government revenues. Since such use of tax-exempt financing is undertaken at the discretion of the State or local government, it effectively removes control of Federal Government revenues from Congress. The cost to the Federal Government in terms of revenue foregone could be substantial if this activity were allowed to continue and grow. Therefore, consistent with its actions in recent years to limit the Federal revenue loss from tax-exempt bonds, the committee believes it is important to restrict the use of tax-exempt bonds for the purchase of privately owned output facilities.

Explanation of the Provision

The bill provides that tax-exempt bonds used to finance nongovernmental output property are private activity bonds for which tax-exemption is specifically authorized. These bonds generally are subject to the applicable State private activity bond volume limitation and to all other provisions of the Code governing issuance of tax-exempt private activity bonds (other than the restriction on financing existing property in sec. 147(d)).

A bond is treated as used for acquisition of nongovernmental output property if an amount exceeding the lesser of (a) 5 percent or (b) \$5 million of proceeds is used directly or indirectly to acquire

such property. Output property includes any property used in the generation, transmission, or distribution of electric energy, gas, district heating or cooling, and any other output facility that would be subject to the special limits on private use in section 142(b)(4), if the property were being financed before originally being placed in service.

Nongovernmental output property includes the physical assets comprising output property as well as any interest therein, if the assets have been placed in service (or held while in service) after October 13, 1987, by any person other than a State or local governmental unit before the acquisition to be financed with the tax-exempt bonds. The term also includes property which was constructed by or for an investor-owned utility with the expectation that it would be placed in service by an investor owned utility but that is not actually placed in service before its acquisition by a governmental unit. For purposes of this rule, the committee intends that the acquisition of power or other output pursuant to an output, capacity, or similar arrangement that is different from the basis on which the output is made available to the public generally is treated as acquisition of an interest in the underlying property unless the contract is of short duration and for wheeling of excess capacity.

This provision is not intended to apply where property is acquired for uses other than in connection with output facilities. The provision would not apply, for example, to the acquisition by a governmental unit of land, easement, office buildings, or used vehicles from an investor-owned utility.

Effective Date

This provision applies to bonds issued after October 13, 1987, subject to two transitional exceptions.

Under the first exception, property that is acquired after October 13, 1987, pursuant to a binding contract entered into before that date is not subject to the new restriction. The rules governing binding contracts contained in Title XIII of the Tax Reform Act of 1986 are to be used to determine whether such a contract exists. (This rule principally applies to outright acquisition of assets since under the provision, a contract other than a short-term wheeling contract for excess capacity generally is treated as acquisition of an interest; thus power, etc. acquired pursuant to output contracts entered into before October 13, 1987, generally would be treated as interests acquired before that date provided that the contracts are not modified so as to result in a new contract (determined as under the Title XIII rules cited above) on or after that date.

The second exception provides targeted relief for a project to be acquired under a certain State law.

2. **Limitation on issuance of tax-exempt bonds by indian tribes**
(sec. 10174 of the bill and sec. 7871 of the Code)

Present Law

Interest on State and local government bonds generally is tax-exempt if the proceeds of the bonds are used to finance actual ac-

tivities of the governments or if the bonds are used for certain specified private activities (secs. 103 and 141). Indian tribal governments in general are treated like State governments under the Internal Revenue Code; however, tribal governments may issue tax-exempt bonds only for "essential governmental purposes" (sec. 7871). Tribal governments may not issue private activity bonds.

Treasury Department regulations have incorrectly defined "essential governmental purposes" to include projects for which Federal assistance could be provided under the terms of non-tax statutes governing Federal assistance to Indian tribes. These regulations have permitted issuance of tax-exempt bonds for the acquisition of off-reservation enterprises. (Such issuance may, however, violate the arbitrage provisions of the 1986 Act preventing the issuance of tax-exempt bonds for investment-type property.)

Reasons for Change

The committee is extremely concerned about recent reports of Indian tribal governments issuing tax-exempt bonds for what are substantively interests in commercial and industrial enterprises. The committee is aware that some or all of these bond issues may in fact be taxable arbitrage bonds because of restrictions presently in the Code restricting investment of bond proceeds in higher yielding investment-type property. In enacting, and subsequently making permanent, the Indian Tribal Government Tax Status Act, Congress specifically provided that Indian tribal governments were limited to issuing bonds for essential governmental functions. The committee believes, that notwithstanding the arbitrage restrictions described above, it is appropriate to reiterate the scope of bond authority granted to Indian tribal governments.

Explanation of Provision

The bill clarifies that, with respect to bonds issued by Indian tribal governments, the term essential governmental function does not include any governmental function that is not customarily performed (and financed with governmental tax-exempt bonds) by States and local governments with general taxing powers. For example, issuance of bonds to finance commercial or industrial facilities (e.g., private rental housing, cement factories, or mirror factories) which bonds technically may not be private activity bonds is not included within the scope of the essential governmental function exception.

Additionally, the committee wishes to stress that only those activities that are *customarily* financed with governmental bonds (e.g., schools, roads, government buildings, etc.) are intended to be within the scope of this exception, notwithstanding that isolated instances of a State or local government issuing bonds for another activity may occur. Further, the fact that the Bureau of Indian Affairs may provide Federal assistance for Indian tribal governments to engage in commercial and industrial ventures as tribal government activities is not intended to be determinative for purposes of the Internal Revenue Code. (Any existing Treasury Department regulations that may infer a contrary result are to be treated as invalid.)

Effective Date

This provision applies to bonds (including refunding bonds) issued after October 13, 1987.