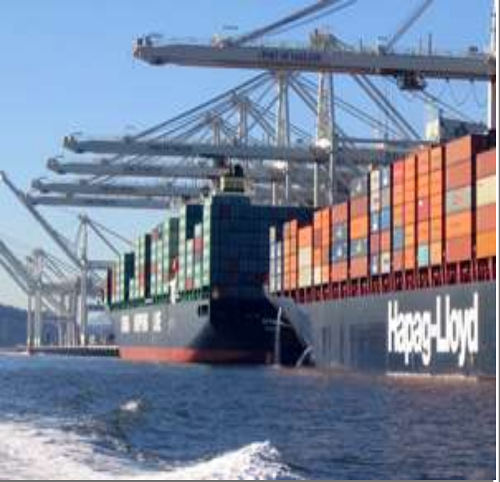

Port Administration & Legal Issues Seminar

Federal Tax Law Considerations

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Financing Port Facilities: Tax Exempt Bonds Policy Considerations

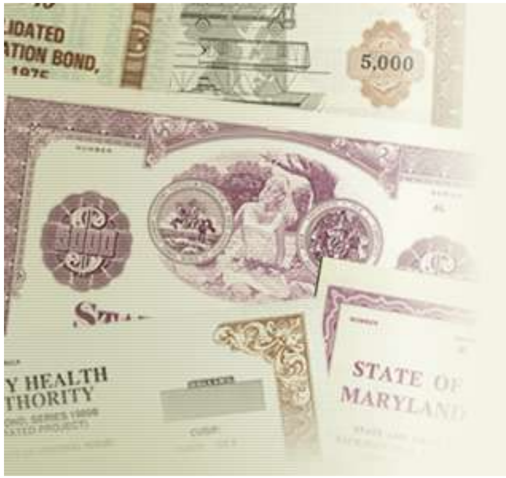
- Perceived as a direct federal subsidy
- Rules are designed to ensure that subsidy is targeted appropriately
- Benefits
  - › Lower cost of funds
  - › Bridge financing not needed
- Disadvantages
  - › Complex rules
  - › On-going compliance obligations

Port Financing Menu

- Bonds issued for Public Ports are either:
  - › Tax Exempt Governmental Bonds
    - – generally only govt/public projects
  - › Tax Exempt Qualified Bonds qualify for tax-exempt financing despite private interests in the facilities
    - – Dock and wharf facilities
    - – Interest on Qualified Bonds are subject to AMT – rates slightly higher
  - › Taxable Bonds
    - – certain port costs may be required to be financed with Taxable Bonds.

Governmental Bonds

- Financing Port Facilities with Governmental Bonds:
  - **General Public Use** – Dock and wharf facilities which are available for use by and are used by the general public.
  - **Public Parking Facilities**
  - **Roads**
  - **Utility Mains**
  - **Dredging of Public Waterways**



Private Activity Bonds

(Qualified Bonds)

Qualified Dock and Wharf Facilities

- **Docks and Wharves**
  - **Facilities generally must have insubstantial activities with no maritime connection**
- **Functionally Related and Subordinate**
  - **Structure alongside docks**
  - **Equipment needed to receive and discharge cargo and passengers from vessels**
    - **Cranes and conveyors**
    - **Storage, handling, office and passenger areas**
- **Storage and training facilities directly related to a dock and wharf and located <u>at or adjacent to</u> the port are also included in the definition of Qualified Facilities.**
- **95% Test – 95% of the proceeds of Qualified Bonds for Ports must be spent on "Qualified Dock and Wharf Facilities"**

Private Activity Bonds
(Qualified Bonds)

- **Public Use** – must be available for use by:
  - Members of the general public; or
  - Common carriers or charter carriers which serve members of the general public.
  - Public dock or wharf is deemed to be used by general public.
- **Governmental Ownership**
  - Qualified Dock and Wharf Facilities must be governmentally owned
  - Safe Harbor for Leases
    - The lessee makes an irrevocable election not to claim depreciation or an investment credit;
    - The lease term is not more than 80% of the reasonably expected economic life of the property; and
    - The lessee has no option to purchase the property other than at FMV

Private Activity Bonds
(Qualified Facilities)

- Proceeds used for issuance costs (2% max) are not treated as spent on Qualified Facilities
- Working Capital
  - Generally may not be financed with Qualified Bonds
  - Capitalized interest through in-service date is **not** working capital
- Excess proceeds, *i.e.***,** unexpended proceeds at project completion
  - Generally, must be used to redeem bonds
- Relief available in certain cases where there is a "change in use" – an unexpected event -- causes the 95% test to be failed
- Special considerations
  - Equity
  - Common areas or costs (***e.g.*****,** project management for mixed governmental and private facility)

Private Activity Bonds
(Qualified Bonds – Other Requirements)

- **Land** — Limited to 25% of the proceeds of the bonds
- **120% Test** — Average maturity may not exceed 120% of the expected economic life of the facility financed
- **Cost of Issuance Limit** — Limited to 2% of the proceeds of the bonds
- **Prohibited Facilities** — May not be used for "sin" businesses
- **Advance Refunding** — Qualified Bonds cannot be advance refunded using tax-exempt bonds.
- **TEFRA** — A PUBLIC HEARING and PUBLIC APPROVAL PROCESS is required for all Qualified Bonds, except certain refundings.

Arbitrage

- **"Arbitrage" is the ability to buy and sell the same commodity in different markets.**

- **Statutory Framework**
  - **General Rule: Arbitrage is prohibited!**
  - **Exceptions for Temporary Periods and Reserve Fund**
  - **Permissible arbitrage must be rebated**
  - **Exceptions to rebate**

- **Interest on "Arbitrage Bonds" is not tax-exempt.**

Arbitrage Bonds

- **Rebate**
  - Notwithstanding the exceptions to arbitrage discussed above, in general, all earnings in excess of the bond yield must be returned or "rebated" to the federal government.
    - Requires continuing compliance and tax opinion based upon the issuer's covenant to calculate and pay rebate.
    - Frequency of calculations: excess earnings must generally be paid every 5 years.
- **Exceptions to Rebate** — The issuer may keep arbitrage earnings that qualify for an exception to rebate.
  - Each exception is independent.
  - Exceptions are not mandatory.

Section 149 Requirements

- Tax-exempt bonds must be registered.
- Tax-exemption must be derived from the Internal Revenue Code (Title 26 of the United States Code).
- Payment on the bonds cannot be federally guaranteed.
- The Issuer must file an IRS Form 8038, 8038-G, or 8038-GC.
- Hedge bonds are generally not tax-exempt.

Post Issuance Compliance

- Loss of Tax-Exemption can be Retroactive to Date of Issue
- Qualified Use Limitations Apply for Life of Bonds
- "Nonqualified Use" is cumulative
- Can be impacted by
  - › Sale of Bond Financed Assets
  - › Leases of Bond Financed Assets
  - › Management Contracts
    - – Parking
  - › For Qualified Bonds, Excess Capitalized Interest and Excess Proceeds
- Arbitrage Requirements also apply for life of Bond
  - › Rebate
  - › Yield Restriction

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Thank you!

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