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WHAT IS THE MEANING OF TAX-EXEMPT?

The following should clarify what is consistently upheld in 48 of the 50 states. Arkansas and New Mexico are the two exceptions.

Reciprocal Immunity Doctrine

Reciprocal immunity is the principal that neither the states nor federal government may tax income received from securities issued by the other. The doctrine provides the original, constitutional basis for the federal tax exemption on interest paid on municipal securities. **<u>Reference</u>**: Pollock v. Farmers' Loan & Trust Co., 157 U.S 429 (1895); National Life Insurance Co. v United States, 277 U.S. 508 (1928).

"Tax-exempt" in this context means that the interest portion of each lease payment is <u>excludable from Federal & State (where applicable) income tax of the Lessor</u>, or owner of the lease. The issue has nothing to do with sales, use, property taxes or status as in a not-for-profit corporation.

Why are lease payments not considered debt?

Tax-exempt leases are structured as a series of one-year renewable obligations, subject to the agency's ability to appropriate funds to make the lease payments in subsequent years. As a result, payments constitute a **current expense** of the lessee. In the sole event that sufficient funds are not available for payment, the agreement is terminated and the equipment is delivered to the lessor.

Since payments are a "current expense" (meaning: due during the current fiscal year and renewable annually), they are not considered debt. This means two things:
The lease **does not require voter approval** and,
The amount financed **does not count against a lessee's debt ceiling**.

What mechanism permits the lessee to terminate the lease early without penalty?

The lease contains a **<u>non-appropriation clause</u>** that enables the lessee to terminate the lease agreement at the end of the current fiscal year without further obligation or penalty and can be implemented only in cases where the lessee was unable to obtain funding for subsequent payments. The non-appropriation clause enables the lessee to show the lease obligation as a current expense instead of debt.