Tax Issues in the Tax-Exempt Bond Market During COVID-19 Crisis

During this uncertain time of the COVID-19 pandemic, not only is there an impact to the health of many around the world, but there has been major disruption to our daily lives and businesses. The tax-exempt bond market has seen an unprecedented reaction by investors. The current environment has also created potential federal tax issues in the tax-exempt bond market. The requested modifications to regulations governing the tax-exempt bond market are of interest to state government, municipalities, conduit borrowers and other entities planning to issue new bonds or refund existing bonds.

The National Association of Bond Lawyers has recently submitted letters to Congress, the Internal Revenue Service and the U.S. Department of Treasury requesting implementation of certain tools and suggested actions to provide support and access to the tax-exempt market for state and local governments. Some of these requests include making changes to the Internal Revenue Code of 1986, as amended (the "Code") and related regulations governing tax-exempt bonds. The following is a summary of some of these requests:

- ability to issue tax-exempt debt for expenses related to the handling of the pandemic under the extraordinary working capital exception under Treasury Regulation Section 1.148-6(d)(3)(ii)(B)
- provide a federal guaranty program of tax-exempt and taxable debt or for a federal government liquidity facility for qualified tender bonds and commercial paper by enacting a regulation, notice or amendment to Section 149(b) of the Code
- permit advance refunding by amending Section 149(d) of the Code
- remove Section 265 bank deductibility limitations for tax-exempt bonds or increase the cap of small issuer exception substantially so as to encourage banks to purchase bonds
- suspend or relax private business tests and private loan restrictions under Section 141 of the Code to facilitate public-private partnerships to provide needed responses to the pandemic
- reinstate previously removed types of private activity bonds
- permit access to TEFRA hearings by telephone call instead of in-person hearings as is required under Treasury Regulation Section 1.147(f)-1

- temporary rule to permit governmental issuers to purchase their own tax-exempt bonds without resulting in an extinguishment of such bonds
- extending the final date for purchase of bonds under a qualified tender right
- suspend “best efforts” requirement to remarket bonds pursuant to tender rights
- no swap termination under Treasury Regulation Section 1.148-4(h) as a result of the governmental issuer holding hedged bonds
- permit a conduit borrower to purchase a tax-exempt bond that financed its loan without it being treated as “related” under arbitrage rules
- waivers of interest rate caps as constituting a significant modification under reissuance rules

Other concerns related to the reissuance rules involve issuers and conduit borrowers who may be looking to modify the terms of payment on their tax-exempt bonds to avoid default. A reissuance of bonds occurs when there are significant modifications to the terms of a bond so that the bond ceases to be the same bond for tax purposes. Generally, Treasury Regulation Section 1.1001-3 uses a significant modification standard to determine whether the bonds are to be treated as reissued. One has to look at all the facts and circumstances of the proposed modification, the legal rights or obligations that are altered and whether the degree to which they are altered is economically significant. There are also special rules for specific types of modifications, including change in annual yield, change in timing of payments, substitution of new obligor or the addition or deletion of a co-obligor, change in security or credit enhancement, change in priority of an obligation, change in the nature of the debt instrument and change in the payment expectations.

Anyone considering modifying the terms of a tax-exempt bond issue should contact their bond counsel to determine if there is a possibility of a reissuance and the consequences of such. It is also a hope of the bond counsel community that the reissuance rules could be modified in a way to carve out the modifications related to the COVID-19 pandemic.

If you have any questions or need assistance with your tax-exempt bond issues, please contact Jennifer M. Egan at (860) 548-2628 or jegan@uks.com or Michael P. Botelho at (860) 548-2637 or mbotelho@uks.com. If you would like to read the letters issued by the National Association of Bond Lawyers to Congress, please follow these links:

https://nabl.informz.net/nabl/data/images/Congress_FINAL_NABL%20Letter_Economic%20Stimulus%20March%202020_%20Bond%20Proposals.pdf

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