

Maintaining Tax-Exempt Status in a Debt Restructuring Necessitated by the COVID-19 Financial Crisis

In response to the COVID-19 pandemic, recent actions by government agencies regulating financial institutions and Section 4013 of the CARES Act (HR 748) signed by President Donald J. Trump on March 27, 2020, facilitate loan restructurings for legal or economic reasons related to financial distress caused by the pandemic. Relief granted by financial institutions to borrowers to lessen their financial strain during severe revenue shortfalls may include reductions in stated interest rates, redemption or maturity date extensions, principal reductions, liquidity covenant modifications, interest payment deferrals, collateral reductions, and default waivers, among other changes to loan documents. In this context, prior to finalizing such modifications, borrowers and financial institutions are encouraged to discuss any contemplated modifications with experienced bond counsel to avoid loss of tax exempt status of the debt resulting from “reissuance” treatment under the Internal Revenue Code of 1986, as amended (Code), or other adverse consequences.

Generally, certain “significant” loan modifications such as changes in scheduled interest rates, security, nature of instrument, timing of payments, or other changes of economic significance may cause the debt to be deemed exchanged and reissued on a taxable basis absent certain remedial actions taken by the governmental issuer involved with the financing. Adverse effects may include loss of tax exempt status, acceleration of rebate payments to the US Department of the Treasury (Treasury), application of new tax law requirements and recalculation of bond yield in certain cases. However, certain modifications, if carefully structured, should not cause a reissuance under Treasury Regulation Section 1.1001-3, as modified by Notices 2008-41 and 2008-88 (Notices) issued by Treasury and the IRS during the 2008 financial crisis. Much of the relief from the adverse effects of reissuance in those Notices remains intact. However, with respect to those sections of the Notices that have expired, the National Association of Bond Lawyers (NABL) has submitted a comment letter to Treasury and the IRS essentially requesting reinstatement of such provisions.

For assistance or further guidance on the impact of your contemplated debt modifications on your tax-exempt debt, you are invited to call your regular contact in the Public and Project Finance Practice Group at Cozen O'Connor or Jerry Spector at 215.665.2039.



Jeremy A. Spector

Member

jspector@cozen.com
Phone: (215) 665-2039
Fax: (215) 253-6788

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