

Deferral of Tax-Exempt Debt Obligations May Result in a Reissuance

PUBLISHED ON
April 2, 2020

In the wake of the COVID-19 public health and fiscal crisis, many lenders are taking a cooperative and sympathetic approach to borrowers whose ability to repay debt has diminished and, in some cases, completely deteriorated, but certain types of debt will not lend itself to that approach.

Holders of tax-exempt debt, including qualified private activity or "conduit" debt, must apply an extra level of caution when considering any type of forbearance or modification because, in some cases, doing so may constitute a reissuance of the tax-exempt debt. Reissuance of tax-exempt obligations generally triggers retesting of all the various federal tax requirements that apply to a new issue. Specific potential consequences include, among other things, a change in yield affecting arbitrage investment restrictions, acceleration of rebate payments, new public approval requirements for qualified private activity debt, deemed terminations of integrated interest rate swaps under the qualified hedge rules for arbitrage purposes, a need for volume cap, and a required filing of a new information return with the IRS. Any of these may result in significant potential cost to the borrower.

Generally speaking, in order for a reissuance to occur, there must be a "significant modification" to a debt instrument, meaning that the modification has altered the rights and obligations of an issuer or bondholder in an "economically significant" manner. One type of modification which can be deemed to be "significant" is a change in the timing of payments due under the tax-exempt-bond such as an extension of the final maturity or a deferral of payments prior to maturity. A holder of tax-exempt debt who defers an issuer's obligation to timely repay may trigger a reissuance under certain circumstances and significant penalties may apply.

Not all payment deferrals will result in a modification, however, as a "safe harbor" period applies under IRS regulations whereby the deferral of one or more scheduled payments within the safe harbor period is not a material deferral (and not a significant modification) if the deferred payments are unconditionally payable by the end of the safe harbor period. The safe harbor begins on the original due date of the first scheduled payment that is deferred and extends for a period equal to the lesser of five years or 50% of the original term of the debt instrument. The term of an instrument is determined without regard to any option to extend the original maturity and deferrals of *de minimis* payments are ignored. If the safe harbor period is not used in full, the unused portion may be carried over to a subsequent deferral.

While lenders and borrowers work their way through this crisis, it is important to consider what type of debt you are considering modifying and what, if any, regulatory or other penalties may attach. Before any modification of tax-exempt debt is made, including deferral of payments, issuers and bondholders should consult with bond counsel.

If you are in need of advice concerning this or any other tax-exempt debt question, please contact [Dan Desmond](#), [Sean Frederick](#) or William McCarty.

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