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<u>Tax-Exempt Debt Payment Deferrals For Municipal</u> Securities: Dinsmore

The COVID-19 pandemic has delayed and lowered revenues, creating an unprecedented period of fiscal uncertainty for borrowers of tax-exempt debt. Borrowers forced to navigate these conditions may request lenders defer scheduled debt payments to help weather the storm.

Borrowers and lenders of tax-exempt debt must be mindful that a deferral of scheduled payments may endanger the debt's tax-exempt status. A deferral could be considered a modification causing the debt's "reissuance," which is treated as a new issuance for tax purposes and a refinancing of the original bond issue. When a reissuance occurs, the debt will lose its tax-exempt status unless appropriate legal steps are taken.

Not all deferred payments will adversely impact the tax exemption. First, a failure of a borrower to pay is not a modification, because there is no alteration of the rights or obligations of the lender or borrower. Furthermore, a forbearance by the lender will not be treated as a modification until the forbearance remains in effect for more than two years following the borrower's initial nonpayment, plus any additional period during which the parties conduct good-faith negotiations (or during which the borrower is in bankruptcy proceedings or a similar case, e.g., receivership, foreclosure).

A modification altering an instrument's payment schedule will be deemed significant if it materially defers payment. Whether a deferral is material depends on the facts and circumstances of each case. There is a safe harbor allowing a payment to be deferred up to five years (or 50 percent of the original term of the instrument, if shorter) but only from the original due date of the first scheduled payment that is deferred. Yet a finding that a deferred payment satisfies the safe harbor is not the end of the analysis, because a deferral resulting in a change of yield in excess of the greater of 0.25 percent or five percent of the pre-modification yield would still result in a significant modification under the regulations, which would trigger a reissuance of the bonds.

Deferrals of scheduled payments may be undertaken under the right circumstances. Borrowers and lenders of tax-exempt debt who are considering such a delay must be mindful of the reissuance rules to avoid adverse tax consequences.

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