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IRS Expands Ability of Issuers to Purchase Their Own Tax-Exempt Bonds: Holland & Knight

The COVID-19 crisis has caused many disruptions in the municipal bond market. Over the course of the crisis, many issuers of tender bonds or tax-exempt commercial paper have been unable to remarket their tender bonds or roll-over their commercial paper either at all or at commercially advantageous interest rates. There have been instances where even issuers with strong credits have been forced to remarket their short-term bonds at rates in excess of 10 percent.

In such circumstances, some issuers have considered holding their bonds during the crisis period rather than remarket or roll them over at high interest rates. However, the problem is that under federal tax rules, there are situations where the debt is treated as either exchanged for new debt (reissued) or retired when it is purchased by the issuer. While the municipal bond market has stabilized lately, there is still concern regarding this.

In light of this situation, the IRS has released guidance in Notice 2020-25 (the Guidance), a temporary rule that provides:

1. Issuers of tax-exempt qualified tender bonds can purchase and hold their own bonds during calendar year 2020 without the bonds being treated as reissued or retired. During this period, the issuer also may refund the purchased bond with a refunding bond, tender the purchased bond for purchase in a qualified tender right as a bondholder or otherwise resell the purchased bonds.
2. Tax-exempt bonds purchased during calendar year 2020 pursuant to a qualified tender right can be held for up to 180 days by the issuer or on behalf of the issuer without the bonds treated as being retired (the prior law's period was 90 days). For example, bonds purchased on Dec. 31, 2020, pursuant to a tender right can be held by the issuer until June 2021 without the bonds being treated as retired. However, a tender bond purchased by an issuer on Jan. 1, 2021, would revert to the prior 90-day holding period.
3. Issuers of tax-exempt commercial paper may purchase and hold this debt during calendar year 2020 without the debt being treated as reissued or retired. During this period, the issuer also may refinance the purchased commercial paper (even if purchased at maturity) with more commercial paper that will be treated as part of the same issue as the purchased commercial paper.
4. Qualified hedges of tax-exempt bonds will not be treated as terminated as a result of the governmental issuer holding the hedged bonds during the periods described in Nos. 1, 2 and 3 above.

Prior Law Issues

Under prior law, issuers were allowed to hold their own tender bonds when they were unable to remarket them for up to 90 days without the bonds being treated as retired. However, those provisions applied only when issuers were unable to remarket their bonds at par following reasonable best efforts, and it was unclear whether it would apply in cases where remarketing was possible but at unfavorable interest rates. Also, many considered the 90-day period to be too short under the COVID-19 crisis and it did not cover commercial paper. The Guidance provides comfort to

issuers in these areas.

The Guidance took effect on May 4, 2020, and may be applied retroactively to purchases on and after Jan. 1, 2020.

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Holland & Knight LLP

Holland & Knight attorneys are assisting a number of issuers in analyzing the impact of COVID-19 legislation and proposals on future tax-exempt bond financings. For questions about a specific situation and its impact on your organization, contact the author or another member of Holland & Knight's Public Finance Team.

Information contained in this alert is for the general education and knowledge of our readers. It is not designed to be, and should not be used as, the sole source of information when analyzing and resolving a legal problem. Moreover, the laws of each jurisdiction are different and are constantly changing. If you have specific questions regarding a particular fact situation, we urge you to consult competent legal counsel.

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