

## *Lender Alert*



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### **Lender Alert: Bank Loan Payment Accommodations on Tax-Exempt Bank Loans during COVID-19**

Coronavirus and COVID-19 continue to wreak havoc on the economy as governments around the world attempt to mitigate the effects of the global health pandemic. Federal, state and local governments continue to issue new restrictions and guidelines as new data becomes available. President Trump declared a national emergency on March 13, 2020.<sup>i</sup> On the same day, Minnesota's Governor Tim Walz declared a peacetime emergency under Emergency Executive Order 20-02.<sup>ii</sup> Several state governments including, California, Wisconsin, Indiana, Michigan, Minnesota, Ohio, Washington, Oregon and several others have issued "shelter in place" orders.<sup>iii</sup> Many businesses and organizations have been instructed to close their doors indefinitely while others face a shortage of business due to concerns stemming from the unprecedented nature of the health pandemic.

Unsurprisingly, many organizations are or will soon be forced to confront cash flow shortages stemming from the unforeseen and extensive challenges presented by a COVID-19 economy. As a result, many organizations with outstanding bank loans may need to address debt service repayment options, including modifications to underlying loan documents.

This Lender Alert is intended to be a resource for borrowers and lenders considering modifications to tax-exempt borrowing terms on outstanding bank notes.

## **Background**

Federal tax laws and regulations allow state and local governments and some private organizations (including 501(c)(3) nonprofits) to borrow money through the issuance of tax-exempt bonds. Such bonds are subject to various limitations and requirements under federal tax laws in order for interest to remain exempt during the term of the obligations.

One such limitation is provided under the “Reissuance Regulations” contained in § 1.1001-3 of the Treasury Regulations.<sup>iv</sup> At a high level, the Reissuance Regulations provide guidance for “determining whether a modification of the terms of a debt instrument results in an exchange.”<sup>v</sup> Whether an “exchange” has occurred can impact whether a tax-exempt instrument remains tax-exempt and thus may have material consequences for lenders and borrowers alike. If an exchange has occurred, a tax-exempt obligation is considered “reissued” and is treated as a new debt obligation under the Reissuance Regulations.

## **Changes to Repayment of Tax-Exempt Debt**

As lenders and borrowers begin conversations of whether to pursue and how to modify or postpone compliance with terms of certain loan documents related to tax-exempt debt, it is important to be aware of the federal tax law restrictions on tax-exempt debt. Modifications to the terms of such instruments, including but not limited to changes in the timing of payments, extension of maturity, change in yield of 25 basis points or more (up or down) or change in security or credit enhancement could result in a tax-exempt bond being reissued for purposes of the Reissuance Regulations. Changes that are not specifically addressed under the Reissuance Regulations may nonetheless result in a reissuance where “based on all facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant.”<sup>vi</sup> Modifications are considered together for purposes of making a determination of whether such modifications rise to the level of economic significance.<sup>vii</sup>

If a tax-exempt obligation is reissued for purposes of the Reissuance Regulations, it is no longer tax-exempt, unless certain procedures are followed. These procedures can include: (i) the requirement to file a new information return (IRS Form 8038 or 8038-G) with the Internal Revenue Service; (ii) approval by the issuer; (iii) a public hearing, and (iv) certification of arbitrage expectations (federal regulations regarding the use and investment of proceeds of a tax-exempt obligation). Failure to file an information return or to otherwise meet certain federal tax requirements in existence at the time of reissuance could result in a bond ceasing to be tax-exempt.

## **Conclusion**

Coronavirus and COVID-19 have placed many businesses and organizations in difficult positions. Many have been asked to close indefinitely pursuant to emergency orders while others struggle to remain open due to general economic uncertainty surrounding the health pandemic. As these organizations begin to experience cash flow issues, they may seek to temporarily modify debt service requirements related to outstanding tax-exempt debt obligations.

If you are a lender or borrower considering options to modify or delay application of the terms of outstanding tax-exempt debt, it is important that you reach out to your bond counsel. Whether a specific change will result in a reissuance depends on the nature of the change in addition to the facts and circumstances surrounding such change. Regardless of whether a change results in a reissuance for purposes of federal tax law, it is important such analysis is undertaken in order to determine what, if anything, is required in order to ensure the bond remains tax-exempt.

## **For More Information**

If you have any questions about this Lender Alert, please contact any of the attorneys in the Public Finance Practice Group identified above or the attorney in the firm with whom you are regularly in contact.

## **Disclaimer**

This Lender Alert has been prepared and published for informational purposes only and is not offered, nor should be construed, as legal advice.

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<sup>i</sup> Charlie Savage, *Trump Declared an Emergency over Coronavirus. Here's What It Can Do.*, New York Times (Mar. 13, 2020), <https://www.nytimes.com/2020/03/13/us/politics/coronavirus-national-emergency.html>.

<sup>ii</sup> State of Minnesota, Executive Department, Governor Tim Walz, Emergency Executive Order 20-02 Authorizing and Directing the Commissioner of Education to Temporarily Close Schools to Plan for a Safe Educational Environment (Mar. 13, 2020) [https://mn.gov/governor/assets/EO%2020-02%20Final\\_tcm1055-423073.pdf](https://mn.gov/governor/assets/EO%2020-02%20Final_tcm1055-423073.pdf).

<sup>iii</sup> Minnesota's Governor Tim Walz issued a stay at home directive on March 25, 2020 through Executive Order 20-20 available here <https://www.leg.state.mn.us/archive/execorders/20-20.pdf>.

<sup>iv</sup> 26 CFR § 1.1001-3.

<sup>v</sup> See *id.*

<sup>vi</sup> 26 CFR § 1.1001-3(e)(1).

<sup>vii</sup> See *id.*