July 21, 2020

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on relief relating to tax-exempt financing in response to COVID-19

Dear Commissioner Rettig:

Enclosed please find comments on relief relating to tax-exempt financing in response to the COVID-19 emergency. These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Tom Callahan
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Hon. Michael Desmond, Chief Counsel, Internal Revenue Service
William M. Paul, Deputy Chief Counsel (Technical), Internal Revenue Service
Helen M. Hubbard, Associate Chief Counsel (Financial Institutions & Products), Internal Revenue Service
Johanna Som de Cerff, Office of the Associate Chief Counsel (Financial Institutions & Products), Internal Revenue Service
Timothy L. Jones, Office of the Associate Chief Counsel (Financial Institutions and Products), Internal Revenue Service
AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on Relief Relating to Tax-Exempt Financing in Response to the COVID-19 Emergency

These comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation (the "Section") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Mark O. Norell, Chair of the Committee on Tax-Exempt Financing. Substantial contributions were made by Matthias M. Edrich, Charles C. Cardall, Larry L. Carlile, Todd L. Cooper, Todd Greenwalt, Adam C. Harden, William Henn, Darren McHugh, Andrew P. Rubin, Jeremy A. Spector, and Stefano Taverna. These Comments were reviewed by Kurt Lawson on behalf of the Section’s Committee on Government Submissions and by Eric Sloan, the Section’s Vice Chair of Government Relations.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by the Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of, one or more specific issues addressed by the Comments or has participated in the preparation of the portion (or portions) of the Comments addressing those issues. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting or review of the Comments.

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Date: July 21, 2020
Executive Summary

These Comments respond to the request by the Department of Treasury ("Treasury") and the Internal Revenue Service (the "Service") for input regarding tax-related issues arising as a result of the coronavirus disease 2019 ("COVID-19") emergency. These comments address tax-exempt financings permitted under sections 103 and 141-150 and recommend that relief be granted from the certain requirements under applicable sections of the Code and Treasury Regulations on account of the financial and economic crisis facing state and local governments and borrowers of the proceeds of tax-exempt bonds as a result of the COVID-19 emergency.

- **Relief for Working Capital Financings.** The COVID-19 emergency is resulting in unprecedented needs for working capital by state and local governments and section 501(c)(3) entities eligible to benefit from tax-exempt financings under section 145. Working capital financings are permitted under the Code and Treasury Regulations, although only in limited circumstances and subject to complex rules. These Comments recommend a simplified and streamlined approach for working capital financings related to costs resulting from the COVID-19 emergency. We believe that the proposed approach is consistent with relief previously provided by the Service in private letter rulings (cited below) and would provide both administrative relief and greater certainty with regard to structuring working capital financings for state and local governments and section 501(c)(3) entities.

- **Relief from Potential Reissuance.** To address reissuance considerations under section 1001, we recommend that relief be granted that is similar to the relief that was provided in connection with the 2008 financial crisis during a “relief period” (explained in more detail below) with respect to the COVID-19 emergency. We also recommend certain additional relief solely for purposes of sections 103 and 141-150.

- **Relief from Deadlines.** Rules addressing tax-exempt financings set forth a number of deadlines with respect to the use of proceeds of tax-exempt bonds and projects financed by such bonds. These Comments recommend relief with respect to deadlines that were not addressed in Notice 2020-18, Notice 2020-20, or Notice 2020-23.

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1 Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the "Code") and all "Treas. Reg. §" references are to the Treasury regulations promulgated under the Code, all as in effect (or, in the case of proposed regulations, as proposed) as of the date of these Comments. References in these Comments to “tax-exempt” obligations refer to tax-advantaged bonds within the meaning of Treas. Reg. § 1.150-1(b).


3 2020-16 I.R.B. 660.

4 2020-18 I.R.B. 742.
Comments

Specific items where we recommend the Service consider administrative relief are set forth below. We believe that a published notice or similar guidance would be the most efficient and effective way to provide the relief and therefore refer to such guidance below as the “Proposed Notice.”

I. Working Capital Financings for COVID-19 Emergency-Related Costs

A. Background

The COVID-19 emergency is resulting in unprecedented needs for working capital by state and local governments and section 501(c)(3) entities eligible to benefit from tax-exempt financings under section 145 (together the “Issuers,” and individually, an “Issuer”). Simple upfront guidelines with regard to working capital financings would help meet those needs, but such guidance is not available under the existing Treasury Regulations. In particular, Treas. Reg. § 1.148-6(d)(3) states that “proceeds of an issue may only be allocated to working capital expenditures as of any date to the extent that those working capital expenditures exceed available amounts . . . as of that date (i.e., a ‘proceeds-spent-last’ method).” Compliance with the regulatory requirements applicable to the proceeds-spent-last method and the need to monitor available amounts often impose significant administrative burdens on Issuers and borrowers of tax-exempt obligations. Additionally, difficult issues arise when determining the duration of financings for working capital expenditures given the very general standards set forth in Treas. Reg. § 1.148-1(c)(4), which requires that the bonds be outstanding “[no] longer than is reasonably necessary for the governmental purposes of the issue.”

The Service addressed the working capital financing needs of a local government faced with a similar situation following the terrorist attack on September 11, 2001 (the “Occurrence”), in PLR 200210006 and PLR 200306004 (the “PLRs”). We believe the PLRs provide a model for useful guidelines Treasury and the Service could issue in response to the COVID-19 emergency.

The PLRs addressed “Recovery Costs,” which the PLRs defined to include costs that, in the judgment of the Mayor of the Issuer, were related to or arose from the Occurrence and included capital expenditures, operating expenditures and the Issuer’s loss of revenues related to the Occurrence, some of which were to be reimbursed through federal grants. In PLR 200210006, the Issuer represented that the proceeds to be used for Recovery Costs would satisfy the three requirements of Treas. Reg. § 1.148-2(e)(2)

5 Some of the recommendations contained in these Comments suggest changes in the way that the existing Treasury Regulations are applied that might require amendments to those regulations. To that extent, the Proposed Notice might need to be followed up with amendments to the regulations.

6 March 8, 2002.

required for expenditures to be allocated to capital projects to qualify for a temporary period of three years.

In PLR 200210006, the Service concluded that (i) the operating expenses portion of the Recovery Costs would be treated as extraordinary working capital costs under Treas. Reg. § 1.148-6(d)(3)(ii)(B), as an exception to the proceeds-spent-last accounting method generally required for tax-exempt-bond-financed working capital expenditures, and (ii) citing its authority under Treas. Reg. § 1.148-10(g), the proceeds of the tax-exempt financings to be used for capital expenditures, as well as the working capital expenditures, would qualify for the three-year temporary period under Treas. Reg. § 1.148-2(e)(2)(i).

In PLR 200306004, the Service concluded that bonds issued to directly finance Recovery Costs and refinance notes issued to finance Recovery Costs, with a term of E years and a weighted average maturity of Y years, would not be outstanding longer than necessary to accomplish the governmental purpose of the bonds under Treas. Reg. § 1.148-1(c), particularly given the sudden and extraordinary nature of the Occurrence, the size of the expenditures relative to the Issuer’s operating budget, and the financial distress that the Issuer experienced and expected to continue as a direct result of the Occurrence.

B. Recommendations

We recommend that, with respect to financings for a category of “COVID-19 Emergency-Related Costs” (as defined below), a Proposed Notice be issued and provide relief similar to that set forth in the PLRs, as follows:

a. Definition of COVID-19 Emergency-Related Costs. Provide that Treas. Reg. § 1.148-1(b) will be applied as if it included the following definition: “COVID-19 Emergency-Related Costs mean costs and expenses that, in the reasonable judgment of the Issuer, are related to or arising from the COVID-19 emergency and include capital expenditures and working capital expenditures and loss of revenues related to the COVID-19 emergency, and paid prior to December 31, 2025.”

b. First Testing Period for Issues Financing COVID-19 Emergency-Related Costs. Provide that, for purposes of Treas. Reg. § 1.148-1(c)(4)(ii)(A), in the case of any portion of an issue that is for COVID-19 Emergency-Related Costs, the first testing year need not occur before the date that is 10.5 years after the issue date.

c. Duration of Issues Financing COVID-19 Emergency-Related Costs. Provide that Treas. Reg. § 1.148-1(c)(4)(ii) will be applied as if it included the following new paragraph (F):

(F) Additional safe harbor for COVID-19 Emergency-Related Costs. Notwithstanding anything to the contrary in this paragraph (c)(4), replacement proceeds will not arise with regard to the portion of bonds issued to finance COVID-19 Emergency-Related Costs provided that either (1) the weighted average maturity of such bonds does not exceed
10.5 years, or (2) for bonds with a final maturity not exceeding 30 years, the period between the issue date and the first call date of the bonds is not more than 10.5 years. In the case of any refunding of bonds issued to finance COVID-19 Emergency-Related Costs, the unused portion of the 10.5-year period shall be applicable to the refunding.

d. **Three-Year Temporary Period for COVID-19 Emergency-Related Costs.** Provide that the second sentence of Treas. Reg. § 1.148-2(e)(2)(i) will be applied as if it had been revised to read as follows:

The 3-year temporary period also applies to the proceeds of qualified mortgage bonds and qualified veterans’ mortgage bonds, and any portion of an issue used to finance COVID-19 Emergency-Related Costs by substituting qualified mortgage loans, and COVID-19 Emergency-Related Costs, as applicable, in each place that capital projects appears in this paragraph (e)(2).

e. **Treatment of COVID-19 Emergency-Related Costs as Extraordinary, Nonrecurring Items.** Provide that, for purposes of Treas. Reg. § 1.148-6(d)(3)(ii)(B), all COVID-19 Emergency-Related Costs will be deemed to be extraordinary, nonrecurring items without regard to whether such costs may be recovered from legal judgments, grants, cost-sharing arrangements, insurance recoveries, or other sources.

f. **Potential Concerns Regarding Volume of Working Capital Financings.** If and to the extent that Treasury and Service have concerns regarding the volume of bonds issued for COVID-19 Emergency-Related Costs, the Proposed Notice can include a requirement similar to the provisions in former section 54A(d)(2)(B)(i), relating to qualified tax credit bonds, that unexpended funds on hand three years after the issue date must be used to redeem bonds issued for COVID-19 Emergency-Related Costs.

**II. Potential Reissuances**

A. **Background**

The COVID-19 emergency has resulted in the loss of revenues available to Issuers and conduit borrowers to make current or pending debt service payments directly or indirectly on their outstanding tax-exempt bonds. For example, numerous governmental units have acted to defer tax, assessment, and enterprise revenue collections during the COVID-19 emergency. Similarly, governmental and non-profit hospitals exempt under section 501(c)(3) are facing severe revenue shortfalls and increased expenses. It has been reported that, with nearly 10 million Americans newly unemployed, more than 30% of the renters in the United States were unable to make rental payments in April 2020, which makes for an unprecedented loss of revenues for

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8 As in effect before December 22, 2017. Section 54A was repealed by section 13404(d) of Pub. L. No. 115–97, 131 Stat. 2054, 2138 (2017).

9 E.g., electric systems and housing projects.
governmental and conduit multifamily housing projects financed with tax-exempt bonds.  

In response to the disruption of the bond markets during the 2008 financial crisis, Notices 2008-41\(^{11}\) and 2008-88\(^{12}\) (the “2008 Notices”) modified reissuance standards and rules under Treas. Reg. § 1.1001-3 with respect to tax-exempt qualified tender bonds and auction rate bonds. In addition, the 2008 Notices addressed several rules under section 148 relating to qualified hedges, temporary purchases of their own tax-exempt bonds by Issuers and conduit borrowers, and sales of remarketed bonds at a market premium. Finally, the 2008 Notices addressed temporary waivers of interest rate caps and the tax treatment of tax-exempt nonrecourse debt under Treas. Reg. § 1.1001-3.

In addressing reissuance in the 2008 Notices, Treasury and the Service noted that:

A reissuance of a tax-exempt bond for purposes of the tax-exempt bond rules may result in various negative consequences to a bond issuer, including among other things, changes in yield for purposes of the arbitrage investment restrictions, acceleration of arbitrage rebate payment obligations, deemed terminations of integrated interest rate swaps under the qualified hedge rules for arbitrage purposes, new public approval requirements for qualified private activity bonds, and change in law risk.

The negative consequences also apply to bond Issuers or conduit borrowers of tax-exempt bonds who deal with the economic fallout of the COVID-19 emergency by significant modification of loan and bond documents through alteration of payment amounts and schedules, among other changes.

On May 4, 2020, Treasury and the Service released Notice 2020-25, which extends the period in which state or local government units can purchase and hold their own qualified tender bonds and commercial paper from 90 days to 180 days. In addition, Notice 2020-25 provides that qualified hedges will not be deemed terminated by such purchases. This expansion applies to purchases of such bonds through the end of the year. The Section appreciates Treasury and the Service’s prompt release of the guidance and relief set forth in Notice 2020-25. Notice 2020-25 does not address, however, the reissuance consequences of modifications to loan or bond documents resulting from financial distress caused by the pandemic.

B. Recommendations

We recommend that the Proposed Notice (i) reinstate all of the expired relief provisions in the 2008 Notices and (ii) provide additional debt modification relief from the application of certain aspects of Treas. Reg. § 1.1001-3 solely for purposes of


\(^{11}\) 2008-15 I.R.B. 742.

sections 103 and 141-150, in each case during the Relief Period (as defined in the last paragraph below).

The first recommendation above would be limited to relief provisions in the 2008 Notices that were time-limited and thus have expired. The second recommendation above (the “Deferral Modification Recommendation”) would have two parts:

a. The first part would allow Issuers, conduit borrowers, bondholders, and lenders to negotiate a deferral of principal and interest payments, and interest on such interest amounts (collectively, the “Deferred Amounts”), without triggering a “significant modification” within the meaning of Treas. Reg. § 1.1001-3 for purposes of sections 103 and 141-150. Specifically, it would allow the parties to (i) alter the terms of a debt instrument to determine the amount and timing of the Deferred Amounts, provided that the Deferred Amounts are payable on a date in a period that begins on the original due date of the first scheduled payment that is deferred and extends for a period equal to the lesser of six years or 60% of the original term of the instrument (the “Additional Payment Period”), and (ii) alter the terms of their bonds solely to the extent necessary to accommodate such deferral.

b. The second part would allow Issuers, conduit borrowers, bondholders, and lenders to negotiate a permanent reduction of principal or interest on outstanding bonds or conduit loans without triggering a “significant modification” within the meaning of Treas. Reg. § 1.1001-3 for purposes of sections 103 and 141-150, provided that such alterations occur during the Relief Period. Frequently, bonds and loans issued to finance projects like low-income housing are repaid only to the extent there is cash available. Permitting reductions through direct negotiations will avoid the need to force the project into an expensive bankruptcy proceeding.

We recommend that the relief described above apply to all Deferred Amounts and/or principal and interest reductions occurring on or after March 1, 2020, and until at least December 31, 2020 (the “Relief Period”). Although our intent is to accommodate modifications necessitated by the COVID-19 emergency, we recommend not limiting the relief to such modifications because that will impose additional fact-specific proof requirements that could hinder use of the relief, and because modifications during the relief period are likely to be tied to the COVID-19 emergency in any event.

III. Certain Deadlines Applicable to Tax-Exempt Bonds

A. Background

Notice 2020-23 postpones certain time-sensitive actions by cross-reference to Rev. Proc. 2018-58. Several of these actions relate to tax-exempt bonds. However,  

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13 By contrast, Treas. Reg. § 1.1001-3(e)(3)(ii) allows deferrals until the earlier of five years or 50% of the original term without triggering a "material modification."

Notice 2020-23, and previous Notices delaying deadlines based on the COVID-19 emergency, did not address a number of other deadlines.

B. Recommendations

We recommend that the Proposed Notice provide relief from certain deadlines described below that were not addressed in Notice 2020-23.\(^{15}\) The deadlines are “post-issuance” requirements relating to maintaining the tax-exempt status of bonds. The deadlines relate directly or indirectly to the expenditure of bond proceeds and/or the construction of projects. Failing to meet them could jeopardize the tax-exempt status of the bonds. The COVID-19 emergency has resulted in delays in project schedules, the completion of construction projects, and the attraction of tenants to projects, and we expect those delays to continue well beyond the period of the pandemic. The extent of the delay and the related expenditure of bond proceeds will depend on the supply of services and products (supply chain delays) that are beyond the control of state and local governments and borrowers of tax-exempt bond proceeds. Certainty with regard to deadlines well in advance of the deadlines will facilitate compliance with the requirements applicable to tax-exempt bonds and will further sound tax administration. Therefore, we recommend the following:

a. Treas. Reg. § 1.141-12(e)(1)(ii) allows an Issuer to remediate nonqualified bonds if the required portion of the disposition proceeds of the bonds are spent on permitted alternative uses within two years of the date of the “deliberate action” (as defined in Treas. Reg. § 1.141-2(d)(3)). We recommend that the Proposed Notice extend this two-year deadline to December 31, 2023, for any bonds for which the deliberate action occurred after March 1, 2018, and before December 31, 2021.

b. Section 142(d) and Rev. Proc. 2004-39\(^ {16}\) require a borrower of bond proceeds incurred to fund residential rental housing facilities to rent a certain portion of the financed facilities to tenants of low and moderate incomes within certain time frames (defined in Rev. Proc. 2004-39 as the “set-aside requirements”). Many owners of multi-family housing facilities are having difficulty obtaining new tenants on account of the COVID-19 emergency. Strict compliance with the existing time frames could discourage construction of such facilities at a time when they are desperately needed. To avoid this, we recommend that the Proposed Notice extend compliance with the set-aside requirements to two years after the placed-in-service date of the financed facility for bonds issued between March 1, 2019, and December 31, 2020.

c. Section 142(d) permits the issuance of bonds to finance the acquisition and rehabilitation of residential rental facilities so long as the rehabilitation requirement of section 147(d)(3) is met within the two-year time frame set forth in section

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\(^{15}\) Terms used but not defined in this section have the meanings given them in the applicable sections of the Code or Treasury Regulations.

147(d)(3)(C). We recommend that the Proposed Notice extend that two-year time frame to three years for bonds issued between March 1, 2019, and December 31, 2021.

d. Treas. Reg. § 1.148-3(g) requires an Issuer to pay an arbitrage rebate owed to the Service on each “installment computation date” and the “final computation date” (each as defined in that section). We recommend that the Proposed Notice provide that any arbitrage rebate payment due under that section after January 1, 2020, and before December 31, 2020, will be due on or before December 31, 2021, and that any interest, penalties or additions to the amount of such payment will accrue only after December 31, 2021.

e. Subsections (d) and (e) of Treas. Reg. § 1.148-7 permit an Issuer to avoid the payment of any arbitrage rebate owed to the Service if the proceeds of the bonds are spent within certain enumerated time frames. Similar to our recommendation in the previous paragraph, we recommend that the Proposed Notice provide that each applicable exception will be met if all of the proceeds are spent before December 31, 2024, for any bonds issued after March 1, 2017.

f. Treas. Reg. § 1.148-2(e)(2) provides for a three-year temporary period (as defined in that section) for proceeds of bonds to be used for capital projects and qualified mortgage bonds. We recommend that, for any bonds issued after March 1, 2017, and before the last expiration date of any federal or state disaster declaration as a result of the COVID-19 emergency, the Proposed Notice extend this three-year temporary period so that it ends no earlier than the later of (i) March 1, 2022, and (ii) the date that is three years after the last expiration date of any such federal or state disaster declaration.

g. Treas. Reg. § 1.148-6(d)(1)(iii) allows an Issuer to make an allocation of its bond proceeds not later than the earlier of (i) 18 months after the placed-in-service date of the project that is financed, and (ii) five years and 60 days after the issuance date of the bonds. We recommend that the Proposed Notice extend this allocation expiration date to earlier of (i) five years after the placed-in-service date of the last project funded with a portion of the proceeds of the bonds, and (ii) March 1, 2025, for any bonds issued primarily to fund capital projects after March 1, 2015.

h. We recommend that the Proposed Notice state that Treasury and the Service intend to revise Treas. Reg. § 1.150-2(d)(1) to provide that any reimbursement resolution for COVID-19 Emergency-Related Costs may be adopted no later than 180 days after payment of an original expenditure, and to revise Treas. Reg. § 1.150-2(d)(2) to provide that expenses paid or incurred before April 1, 2020, will be deemed to satisfy the reimbursement period provisions under that section. The 180-day period is requested given the new and unique nature of financings COVID-19 Emergency-Related Costs and since some of the expenditures may be incurred while state and local governments are not fully operational.

i. With respect to the requirement relating to the timely filing of information reporting forms set forth in section 149 and Treas. Reg. § 1.149(e)-1, we recommend that the Proposed Notice allow the use of a digital signature affixed to a reporting form or a
PDF signed version submitted to the Service by an Issuer representative or paid preparer to satisfy the signature requirement for the applicable form provided that evidence of approval for affixing such signature (e.g., retention of emails relating to affixing the signature) are retained by the Issuer representative or paid preparer, as applicable. The use of digital signatures is similar to the use of facsimile signatures, which is expressly allowed by paid preparers in the Instructions for Form 8038-G (Rev. Sept. 2018) and will facilitate meeting the filing deadline.

**Conclusion**

We thank Treasury and the Service for their consideration of the requested relief suggested by this letter and would be pleased to discuss with representatives of Treasury and the Service the recommendations set forth herein and assist with drafting all or portions of the Proposed Notice.