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April 9, 2020

VIA Electronic Mail

The Honorable Mitch McConnell
Majority Leader
U.S. Senate

The Honorable Nancy Pelosi
Speaker
U.S. House of Representatives

The Honorable Chuck Schumer
Minority Leader
U.S. Senate

The Honorable Kevin McCarthy
Minority Leader
U.S. House of Representatives

Re: NABL Suggestions to Congress and the Department of the Treasury Relating to Impacts on Tax-Advantaged Bonds of COVID-19

Dear Majority Leader McConnell, Speaker Pelosi, and Minority Leaders Schumer and McCarthy:

The National Association of Bond Lawyers (NABL) is a non-profit corporation and specialty bar association of approximately 2,500 lawyers. NABL exists to promote the integrity of the municipal bond market by advancing the understanding of and compliance with the law affecting public finance. NABL members and their firms are involved every year in a significant portion of the municipal financings by U.S. state and local governments.

As Congress and the Department of the Treasury ("Treasury") continue to develop additional legislation to provide economic stimulus and fiscal relief as a result of the economic impact of the COVID-19 pandemic, NABL is sending this letter as a follow up to our March 22, 2020 letter (enclosed) in which we identify proposals that will allow state and local governments to access much needed capital now, while also mitigating damages affecting our nation in the longer term. This letter builds upon our March 22, 2020 letter and provides a more robust explanation of how certain proposals will assist in getting our nation through these uncertain times.

State and local governments are crucial to the American economy and a successful response to the COVID-19 crisis. The financial well-being of state and local governments is imperative for delivering essential infrastructure and support to American citizens; such financial well-being depends in large part upon on the robustness of the municipal bond market.

As a result of the swift action already undertaken by Congress and the Treasury, state and local governments are in a better position to manage the health and well-being of the country. However, the economic impact (and on-going repercussions) of the pandemic on domestic and global markets is significant and continuing, and there is a dire need for further action by Congress and Treasury to address the needs of state and local governments and the American public.

We urge Congress and the Treasury, as applicable, to implement the recommendations we propose below. Adopting these proposals will enable state and local governments to access much needed capital at a time when support to our communities is of paramount and immediate concern. The relief provisions set forth below will greatly assist state and local governments to more effectively address the financial crisis currently affecting our nation.

This supplemental letter was prepared by an ad hoc task force comprising the individuals listed on Appendix L and was approved by the NABL Board of Directors. We stand ready to discuss the application and implementation of any of our suggested ideas. If NABL can provide further assistance, please do not hesitate to contact Jessica Giroux, Director of Governmental Affairs, in our Washington DC office, at (202) 503-3290 or at jgiroux@nabl.org.

Sincerely,

Richard J Moore
President
National Association of Bond Lawyers

Enclosure: NABL letter dated March 22, 2020 to the U.S. Treasury regarding COVID-19 Economic Stimulus

cc: Members of the U.S. Senate
Members of the U.S. House of Representatives

EXECUTIVE SUMMARY

The COVID-19 pandemic has resulted in unprecedented challenges for state and local governments, including immediate cash flow reductions and future cash flow uncertainty. These challenges, together with difficulties in accessing the existing capital markets for the purpose of borrowing to provide needed facilities, have prompted this request. This letter describes legislative and administrative actions that would greatly assist state and local governments in responding to the financial crisis presented by COVID-19, and supplements our previous letters to Congress and Treasury, dated March 22, 2020, and to Treasury and the Internal Revenue Service, dated March 25, 2020. In conveying these recommendations, for ease of implementation, we have built upon structures previously utilized in response to other calamities, including the credit crisis of 2008.

The recommendations that follow expand mechanisms for state and local governments to efficiently borrow to provide crucial infrastructure, improve demand for obligations to reduce borrowing costs, and assist state and local governments in efficiently responding to the challenges presented by COVID-19. As proposed in detail below, we urge that through legislation and administrative guidance desperately needed measures be provided to state and local governments to facilitate the financing of essential infrastructure; in addition, these measures will bolster demand for tax-advantaged obligations to effectuate such purposes. Among others, we propose "direct-pay" tax credit bonds, federal guarantees, long-term working capital financings, financings for hospital supplies and equipment, the ability for issuers to alter or modify existing bonds, provisions to enhance access to housing and long-term care facilities, and measures to facilitate demand by purchasers, such as financial institutions.

In addition to the suggestions set forth in this letter, we continue to strongly urge adoption of the recommendations made in our above-referenced letters, importantly including those made to Treasury and the Internal Revenue Service with respect to the TEFRA issues of Section 147(f) of the Internal Revenue Code of 1986, as amended (the "Code"), and those relating to facilitating issuer purchases of their own tax-advantaged bonds.

PROBLEM PRESENTED

State and local governments, as well as charitable and other organizations which customarily borrow the proceeds of tax-exempt obligations, are facing unprecedented challenges because of the COVID-19 pandemic while continuing to support public needs. The actions taken by Congress and Treasury to date are helpful; however, state and local governments continue to experience difficulty accessing the tax-exempt and taxable markets to obtain funds for the provision of essential infrastructure and support to the public. The important measures taken by state and local governments to protect the health and well-being of their citizens have resulted in closures of a wide spectrum of businesses, and have had severe, far-ranging, and uncertain economic consequences. Most state and local governments are expending unbudgeted amounts in their efforts to respond to and contain the spread of COVID-19. In addition to the burden of ensuring the continued protection and well-being of their citizens, many local jurisdictions anticipate experiencing delays of property tax and other revenues, essential to fund operations and pay current debt service. Impacts on credit and cash flow, together with difficulty in accessing the bond market, have resulted in a crisis that will severely impact state and local governments for the

next several years, with exponential consequences. State and local governments must be able to borrow in order to provide essential infrastructure to support the public, and assistance to respond to cash flow shortfalls that affect their ability to pay principal and interest on outstanding debt.

LISTING OF RECOMMENDATIONS FOR LEGISLATIVE ACTION

A. Provide for a New Direct-Pay Taxable Bond.

B. Reinstate Advance Refundings.

C. Stimulate Demand by Financial Institutions.

D. Facilitate the Recovery of Housing and Continuing Care Facilities.

E. Facilitate Federal Guarantees.

F. Facilitate Partnerships with Business for Recovery.

G. Facilitate Access to Working Capital.

LISTING OF RECOMMENDATIONS TO BE IMPLEMNTED BY THE TREASURY

A. Clarify Ability to Issue Tax-Advantaged Bonds for Long-Term Working Capital.

B. Election to Treat Pledged Funds As Not Constituting Replacement Proceeds.

C. Facilitate Alterations of Tax-Advantaged Obligations as the Result of the Financial Crisis.

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H. Facilitate Provision of Hospital Supplies for Long-Range Planning.

RECOMMENDATIONS FOR LEGISLATIVE ACTION

A. Provide for a New Direct-Pay Taxable Bond.

Background. The well-developed and sophisticated tax-exempt bond market brings investors together with state and local governments that have capital projects in need of financing. Because state and local governments are responsible for repaying principal and interest, they have a strong interest in providing necessary and well-vetted projects, many requiring approval through public referendums. Similarly, private-sector investors analyze the financing and need for projects before investing their money, providing an additional "reality check" on projects. In addition, state and local governments need to safeguard their reputations in the market, given that borrowing is an important component of how budgets are funded year after year. Because interest on tax-exempt bonds is exempt from federal income tax, investors are willing to accept lower interest payments. That savings makes the infrastructure projects more affordable, keeping taxes, fees and other charges associated with the infrastructure lower and enabling greater infrastructure investment than would be the case if the interest were federally taxable.

Moreover, state and local governments have the ability to issue tax-exempt bonds, under certain circumstances, to finance working capital.

As part of past emergency relief legislation, Congress has from time to time authorized different types of tax-advantaged bonds in an effort to expand the market for such bonds to investors who do not traditionally invest in tax-exempt bonds. One alternative taxed the interest on bonds but also provided the investor with a federal income tax credit. These tax-credit bonds were designed to provide a greater federal interest subsidy than the tax exemption on interest, sometimes being designed to provide a credit worth as much as 100% of the interest expense. Tax-credit bonds, however, were not widely accepted by the financial markets.

An alternative to the tax credit bond, the "direct-pay" taxable bond, was widely accepted by the financial markets. The direct-pay bond provided for a "refundable credit" paid by the federal government equal to a percentage of the taxable interest on such bonds. The refundable credits (also referred to as direct payments) were payable directly to the issuer of the bonds, effectively reducing financing costs. The percentage paid to the issuer varied depending on the category of direct-pay bond issued. The most utilized type of direct-pay bond was the build America bond, under Section 54AA of the Code, with a direct payment equal to 35% of the interest on such bonds. Direct-pay build America bonds could be issued in 2009 and 2010 and were widely accepted in the financial markets; the Code provisions for build America bonds were provided to address the 2008 financial crisis as part of the American Recovery and Reinvestment Act, P.L. 111-5, 111th Cong. (2009) ("ARRA"). From April 2009 to December 2010, more than $185 billion in direct-pay build America bonds were issued. While the purposes for which these bonds could be issued were narrower than for traditional tax-exempt bonds, issuers still found that these bonds provided an effective funding source for the projects that could be financed. Underlying the success of the bonds was that the investor base was expanded to include entities that were not traditionally interested in tax-exempt bonds because they are not subject to federal income tax,

such as pension funds and foreign investors. The competition among these additional investors lowered the costs of the infrastructure financed with the bonds – both to the issuers of the bonds and to the federal government. The costs of financing were commonly further lowered by combining direct-pay bonds with longer maturities and tax-exempt bonds with shorter maturities, as this mix resulted in the lowest overall cost to both state and local governments and the federal government. However, the direct payments to issuers were reduced by sequestration under the Balanced Budget and Emergency Deficit Control Act of 1985, which led some issuers to be skeptical of direct-pay bonds because of the uncertainty introduced into the financing process.

Problem. The scope of potential investors in state and local government obligations needs to be broadened in order to ensure sufficient demand (the $30 trillion taxable bond market in addition to the approximately $4 trillion tax-exempt bond market) for such obligations. In addition, state and local governments that are experiencing revenue shortfalls would generally benefit from additional federal subsidies to access the debt market during this financial crisis. In order to increase infrastructure investment, provide cash flow relief, and broaden the potential investor base, expanded access to federally tax-advantaged bonds is required. One of the most effective ways to provide that support is to increase the federal subsidy to state and local issuers of bonds by reducing the interest cost to the issuers through a direct payment of a percentage of the interest paid on taxable bonds. These bonds should be available for the same purposes as all governmental tax-exempt bonds and certain qualified private activity bonds. To ensure stability in state and local government finances, and to restore confidence in direct-pay bonds, payments to issuers should not be subject to sequestration.

Recommendation. We therefore urge Congress to create a new category of state and local bonds called "American infrastructure bonds" modeled on build America bonds (Code Sections 54AA and 6431) to cover the needs of state and local governments responding to the COVID-19 crisis. Draft legislative text is contained in Appendix A. Although the suggested structure is based on the build America bonds model, our suggestion differs from build America bonds in several notable ways:

- The 40% direct-pay credit recommended is a deeper "subsidy rate," i.e., a rate that exceeds the revenue neutral rate, than was available for build America bonds. Because of the dramatic financial challenges certain to confront state and local governments in the ongoing response to the COVID-19 crisis, we propose that American infrastructure bonds issued on or prior to December 31, 2025 be eligible for a 40% credit. We also propose that the credit for American infrastructure bonds issued after December 31, 2025 be the revenue neutral rate as compared to tax-exempt bonds. We have used 28% as a placeholder for such a rate which we presume will be determined by Congress. The direct-pay bond framework also has the advantage of readily permitting higher "subsidy rates" for bonds that provide for different types of facilities.

- As the COVID-19 crisis is almost certainly going to result in dire cash flow problems for state and local governments, it is important that American infrastructure bonds be available for any purpose for which tax-exempt governmental bonds could otherwise be issued for, including working capital financings and refundings. Accordingly, the requirement to spend 100% of the "available project proceeds" on capital expenditures has been eliminated.

- In order to ensure American infrastructure bonds are available to finance critical infrastructure particularly impacted by the COVID-19 crisis, e.g., airports and hospitals, American infrastructure bonds should include certain private activity bonds, if all of the requirements applicable to private activity bonds are met and if, the bond issue meets the ownership requirement of Section 145(a)(1), i.e., the bond financed facility is owned by a governmental entity or an organization described in Section 501(c)(3). This is expected to primarily facilitate the use of American infrastructure bonds to finance (1) airports, (2) docks and wharves, (3) mass commuting facilities, and (4) facilities owned by 501(c)(3) organizations (e.g. hospitals and educational facilities).

- The direct-pay subsidy provisions for American infrastructure bonds are permanent; there is no sunset provision.

- This proposal protects the direct-pay subsidy to issuers of American infrastructure bonds against the effects of budgetary sequestration pursuant to the Balanced Budget and Emergency Deficit Control Act of 1985 or the Statutory Pay-As-You-Go Act of 2010 (or future legislation having similar effect), by grossing up the statutory credit rate on American infrastructure bonds to a level that, after taking into account the applicable sequestration rate, ensures a net direct-pay subsidy for American infrastructure bonds equal to 40% (or whatever direct pay rate is in effect for a particular obligation).[1]

The proposed legislation does not retain the feature of build America bonds that provided delivery of the subsidy in the form of a tax credit to the holder of the build America bond unless the issuer elected to receive the subsidy in the form of a direct payment and the issue met certain other requirements. Few, if any, build America bonds were issued as tax-credit bonds, and most, if not all, were issued as direct-pay bonds. Rather, we recommend that the direct payment is the only way that the subsidy to issuers of American infrastructure bonds be delivered.

It is important to note that the provisions of this proposal are designed to complement the provisions of Sections 103 and 141 to 150 of the Code applicable to traditional tax-exempt bonds issued by state and local governments, and not to displace those provisions. During 2009 and 2010, many issuers successfully combined offerings of tax-exempt and direct-pay subsidy bonds to achieve the lowest overall cost of funds to finance governmental facilities and projects. This proposal is designed to preserve the ability of issuers to do the same in the future.

B. Reinstate Advance Refundings.

Background. After the January 1, 2018 effective date of the Tax Cuts and Jobs Act of 2017, tax-exempt advance refundings of tax advantaged bonds have not been permitted under Code Section 149(d). An advance refunding bond is defined in Section 149(d)(2) as a bond issued to advance refund another bond more than 90 days before the redemption of the refunded bond.

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[1] There are many ways to attempt to protect the subsidy on qualified new build America bonds from sequestration. All of them are hampered by the general inability of one Congress to bind future Congresses. Another option, for example, would be amending the budget rules governing sequestration to exempt direct payments. We did not follow this approach for several reasons, one of which is that the budget rules are the jurisdiction of Congressional Budget Committees, rather than the tax writing committees. We would be pleased to discuss the potential options with you.

Prior to the amendments to Section 149(d) in 2017, tax-exempt advance refundings of tax-exempt bonds were permitted with certain restrictions. Private activity bonds other than qualified 501(c)(3) bonds could not be advance refunded on a tax-exempt basis. In most cases, a bond issue could only be advance refunded once with tax-exempt bonds. Tax-exempt bonds that were advance refunded with tax-exempt bonds generally were required to be redeemed at the first optional call date permitted under the bond documents. Temporary periods applicable to the investment of proceeds of bonds refunded with tax-exempt advance refunding bonds ended with the issuance of the advance refunding bonds.

The restrictions on advance refunding bonds issued before 2018 were designed to limit the benefits to issuers and conduit borrowers of tax-exempt bonds when multiple bond issues for the same project remained outstanding at the same time.

In addition to the restrictions imposed by Section 149(d), special arbitrage restrictions under Section 148 applied with respect to the investment of the proceeds of issues of advance refunding bonds. The most important of these arbitrage restrictions was that issuers were required to restrict the yield on the investments purchased with proceeds of such bonds to no more than one-thousandth of one percent above the yield on the bonds. These arbitrage restrictions effectively transferred a portion of the benefit of tax-exemption of the advance refunding bonds from the bond issuer to Treasury by requiring issuers to purchase low yielding or 0% United States Treasury Certificates of Indebtedness, Notes and Bonds.

Problem. As a result of the COVID-19 pandemic, many state and local governments and other obligors of tax-exempt bonds are experiencing dire financial situations and are having difficulty paying scheduled principal and interest on their outstanding debt. It would greatly benefit such entities to be able to refinance their debt at today's interest rates that are often lower than the interest rates payable on outstanding debt, which often was issued years ago. Such issuers, including school districts and cities, would also benefit greatly by being able to defer debt service to respond to cash flow issues as a result of the pandemic. Existing debt is often backed by revenue streams that have been interrupted. For example, hospitals have seen revenues drop as elective surgeries and other procedures are cancelled. Taxes levied on hotel and restaurant businesses have dried up as hotels and restaurants have closed. Revenues related to transportation, including highway and bridge tolls and bus and train fares have been drastically reduced. At the same time, state and local taxpayers are facing unprecedented demands on dwindling economic resources and may be unable to timely pay state and local real estate and income taxes.

Most fixed rate state and local governmental debt may not be prepaid (optionally retired or called) for ten years. That means that most debt issued after 2011 cannot be currently refunded before 2022 or later.

Recommendation. To allow state and local governments to recover and efficiently access low interest rates to provide essential facilities, we strongly urge that tax-exempt advance refundings, as generally permitted prior to January 1, 2018, be reinstated permanently. Such refundings benefit the public by allowing state and local governments to save money and restructure debt service.

We note that state and local governments are experiencing extreme cash flow issues as a result of the pandemic. We recommend that tax-exempt refunding bonds would be subject to the requirement, applicable in 2017, that the refunded bonds generally be redeemed on the first

possible redemption date, except that redemption at a "make-whole" redemption premium would not be required. Draft legislative text is provided in Appendix B.

C. <u>Stimulate Demand By Financial Institutions.</u>

<u>Background</u>. Section 265 of the Code generally disallows interest deductions on debt incurred or continued to purchase or carry tax-exempt obligations. Section 265(b) provides for special rules for financial institutions that generally disallow a proportionate share of all of the taxpayer's interest expense based on a ratio of its basis in tax-exempt investments to its basis in all its assets (tax-exempt obligations acquired on or before August 7, 1986 are not taken into account). An exception is provided for certain "qualified tax-exempt obligations," commonly referred to as "bank qualified obligations." "Bank qualified obligations" are generally governmental bonds and qualified 501(c)(3) bonds issued after August 7, 1986 by a "qualified small issuer," one that does not generally issue more than $10 million of such bonds during a calendar year (with certain exceptions).

To respond to the 2008 financial crisis, ARRA increased the limit on the amount of bank-qualified obligations of an issuer from $10 million to $30 million per year; this increase only applied to tax-exempt obligations issued in 2009 and 2010. ARRA also created a temporary 2% safe harbor that allowed financial institutions to purchase certain tax-exempt investments without a 100% interest expense disallowance. To the extent a financial institution's average adjusted basis of tax-exempt obligations was less than 2% of the average adjusted basis of its total assets, the financial institution was permitted to take an 80% deduction for interest on indebtedness related to *all* tax-exempt obligations (both governmental and private activity) issued in 2009 and 2010. This 2% safe harbor only included refunding obligations to the extent the original obligation was issued in 2009 or 2010. Refundings of pre-2009 issues could not take advantage of the 2% safe harbor. Bank-qualified obligations did not count against the 2% limit. This stimulus provision proved to be very effective in stimulating demand for bonds issued by smaller cities and towns and other units of local government.

<u>Problem and Recommendation</u>. Because of the unpredicted financial crisis impacting state and local governments, and the urgent need to stimulate demand for such obligations by financial institutions, we urge that Section 265 of the Code (and any related provisions) be amended to reinstate the rules put in place by ARRA for tax-exempt bonds issued in the aftermath of today's fiscal crisis for the period beginning presently and through December 31, 2025. Suggested language is provided in Appendix C.

We would also support a permanent reinstatement of the rules put in place by ARRA with respect to bank-qualified obligations with the additional comment that the $30,000,000 limit should be indexed to inflation in the context of a permanent reinstatement.

D. <u>Facilitate the Recovery of Housing and Continuing Care Facilities</u>.

<u>Background</u>. Tax-exempt bonds issued for the benefit of a 501(c)(3) organization and used to acquire existing residential rental property for family units must generally satisfy the low-income tenant occupancy requirement of Section 142(d)(1); this requirement does not apply to bonds financing new construction or in connection with substantial rehabilitation of existing residential rental property acquired with the proceeds of tax-exempt bonds, the original use of which commences with the beneficiary of the bonds. The Code provides two circumstances in

which property acquired with the proceeds of qualified 501(c)(3) bonds is treated as new property and not subject to the income targeting requirements of Section 142(d). First, if the housing is financed by sources other than tax-exempt debt and is later refinanced with tax-exempt debt, the facility is not considered "existing" housing for purposes of Section 145(d) if there was a reasonable expectation that the facility would be so refinanced and the facility was in fact so refinanced within a reasonable period. Second, if, for the purpose of a tax-exempt financing to replace a taxable financing, the initial use of the property was pursuant to a taxable financing and, at the time of the taxable financing, state law prohibited tax-exempt financing for the property so financed, then the property will be treated as new property. See Section 145(d) of the Code.

Separately, Section 146 provides for a volume cap that limits the aggregate amount of issuance of certain types of qualified private activity bonds, including bonds issued to finance qualified residential rental property (affordable multifamily housing) under Section 142 and bonds issued to finance qualified mortgage bonds (affordable single family housing) under Section 143.

Problem. The current rules were adopted to ensure that 501(c)(3) organizations are not routinely buying "burnt out" tax shelters. COVID-19 has resulted in unprecedented stress on state and local governments and 501(c)(3) organizations that provide housing, with many obligors in dire financial situations and experiencing difficulty paying scheduled principal and interest on existing projects. The Code should not discourage 501(c)(3) organizations from acquiring residential rental property that would not otherwise be functionally operational, nor should it discourage bona fide continuing care retirement facilities from refinancing existing taxable debt used to acquire independent living units that constitute existing residential rental property.

The volume cap limitation restrains the ability of state and local governments to use tax-exempt bonds to serve as a solution to the nation's affordable housing crisis.

Recommendation. To deal with the dire circumstances facing such facilities as a result of COVID-19, we urge that beginning presently and ending December 31, 2025, tax-exempt bonds may be issued for the benefit of a 501(c)(3) organization and used to acquire any existing property consistent with the organization's purpose, regardless of whether the original project is residential rental property for family units. Further, a refinancing should be permitted of any taxable obligation of the original obligor, regardless of whether there was a reasonable expectation at the time the initial taxable obligation was entered into, that such taxable obligation would be replaced by tax-exempt financing within a reasonable period. Proposed legislative language is in Appendix D.

Through December 31, 2025, each state should be granted an unlimited amount of volume cap for qualified mortgage bonds and bonds issued to finance qualified residential rental projects. It is important that the solution be framed as an unlimited amount of volume cap, particularly as it relates to bonds issued to finance qualified residential rental projects, rather than an elimination of the requirement that such bonds receive volume cap. Bonds that finance qualified residential rental projects are most effective when combined with the 4% low income housing tax credit under Section 42. Section 42(h)(4) has the effect of only allowing that combination to happen if the tax-exempt bonds that finance the project receive volume cap under Section 146.

E. Facilitate Federal Guarantees.

In our March 22nd letter to Congress and Treasury, we suggested that, to address the unprecedented credit and cash flow issues of state and local governments, the federal government should provide guarantees of all or a portion of debt service on tax-advantaged bonds. We continue to strongly believe that federal support of tax-advantaged obligations of state and local governments is essential to facilitate recovery from the impacts of COVID-19. We noted that Section 149(b) of the Code might need to be amended to permit certain federal guarantees. In Section D of our comments to Treasury below, we recommend that Treasury make an exception for certain federal guarantees by administrative guidance. To the extent such guidance is not to be made, we strongly urge that Section 149(b) of the Code be amended to permit federal guarantees of tax-exempt bonds issued (or federal guarantees added to outstanding bonds) in the aftermath of the pandemic.

F. Facilitate Partnerships with Business for Recovery.

Background. The unprecedented crisis presented by COVID-19 makes it essential that state and local governments have the ability to "partner" with local business to promote recovery in their communities. Tax-advantaged bonds are an essential tool to assist in that recovery. The Tax Reform Act of 1986, as amended, restricted "private activity" of bond financed facilities to generally target the tax-exemption subsidy to support projects benefitting the general public. Section 141 of the Code contains more restrictive limitations relating to private involvement with respect to tax-exempt bonds than did Section 103(b) of the Internal Revenue Code of 1954, as amended (the "1954 Code"). Section 103(b) of the 1954 Code contained a "25 percent" de minimis amount test for "private business use" and less restrictive rules for "private security" or "private payments" with respect to the financed facility.

Problem and Recommendation. Because it is essential for state and local governments to work with private businesses in their community to recover and such units of government need additional cash flow and security to access the market to obtain necessary funds to provide essential infrastructure, we strongly urge that Section 141 of the Code be amended to generally reinstate the 1954 Code provisions of Section 103(b), which defined an "industrial development bond," to replace the definition of "private activity bond" in Section 141 at least for obligations issued between the present time and December 31, 2025. We also recommend that during this period state and local governments can issue tax-exempt bonds without regard to the private loan limitation of Section 141(c) of the Code. Proposed legislation is attached in Appendix E. While beyond the scope of this letter, if this proposal is accepted, we believe that providing expanded private use capacity for already outstanding tax-exempt bonds would also be necessary to fully achieve the policy goal of this recommendation.

Alternatively, in lieu of amending Section 141 of the Code, Congress should consider facilitating the recovery of communities by providing for a new type of private activity bond the proceeds of which might be utilized with respect to businesses impacted by COVID-19. Such a structure might be provided similar to Recovery Zone Facility Bonds (Section 1400U-3) under ARRA, or other bond structures provided in the aftermath of calamities.

Another option that would facilitate essential facilities and recovery is to lift the volume cap (required by Section 146 of the Code) available for private activity bonds of Section 146 of the Code for bonds issued from the present until December 31, 2025, at least for essential facilities

such as housing (see other comments relating to housing herein, particularly for methodology to effectuate such recommendation).

G. <u>Facilitate Access to Working Capital</u>.

In our comments to Treasury in A. below, we describe the unprecedented cash flow issues confronting state and local government as a result of the pandemic and the crucial need to access the tax-exempt bond market for working capital. If the suggestions below are not adopted by Treasury, we strongly urge you to enact legislation that would expressly permit, in the absence of guidance from Treasury, certain long-term working capital financings as described in A. below; suggested language is included in Appendix F.

RECOMMENDATIONS TO BE IMPLEMENTED BY THE TREASURY

A. <u>Clarify Ability to Issue Tax-Advantaged Bonds for Long-Term Working Capital</u>.

<u>Background</u>. Under current law, issuers are greatly constrained in issuing tax-exempt bonds to finance working capital expenditures. In general, proceeds of tax-exempt bonds issued by or for state and local governments and 501(c)(3) organizations may be allocated to expenditures for capital projects using any reasonable, consistently applied method of accounting, including specific tracing, gross proceeds spent first, first-in first out accounting, or a ratable allocation between proceeds and amounts other than proceeds. By contrast, these issuers and borrowers can generally only treat expenditures for working capital as spent on a "proceeds-spent-last" basis—i.e., issuers must spend all other available funds before bond proceeds may be allocated to expenditures. There are limited exceptions to the "proceeds-spent-last" rule set forth in Treasury Regulation § 1.148-6(d)(3)(ii). One such exception to the "proceeds-spent-last" rule is for "extraordinary, nonrecurring items that are not customarily payable from current revenues, such as casualty losses or extraordinary legal judgments…" Treas. Reg. § 1.148-6(d)(3)(B).

In addition to the expenditure rules referenced above, there are restrictions with respect to the length of time working capital borrowings can be outstanding. There is no clear guidance as to how long a long-term working capital financing can be outstanding for an issuer responding to a structural cash flow issue as a result of the pandemic. Treasury Regulation Section 1.148-10 imposes serious burdens on issuers if tax-exempt bonds are considered outstanding longer than necessary for the governmental purpose of the issue. The Treasury Regulations do provide a structure for issuing long-term working capital financings on a tax-exempt basis for cash flow deficits that requires monitoring after bond issuance and possible redemptions of bonds utilizing issuer funds or investment in tax-exempt obligations. Treas. Reg. § 1.148-1(c)(4)(ii). The effect of these rules is to force issuers to complete complicated analyses of their projected both before the bonds are issued and periodically thereafter. In many instances, these restrictions serve to limit tax-exempt working capital borrowings to short-term financings.

<u>Problem and Recommendation</u>. State and local governments and 501(c)(3) organizations are facing extreme cash flow difficulties as a result of the pandemic. Complicating matters is that receipt of revenues and amount of expenses are difficult to predict given the rapidly changing environment, making deficit sizing a challenge. Further, the present long-term working capital

guidance is not helpful for issuers and borrowers as it generally requires the addition of a right for the issuer to prepay or redeem the debt which makes such a bond issuance even more difficult to sell in the present volatile market; issuers and borrowers may also find it difficult, given cash constraints, to purchase and hold tax-exempt securities, as required by current guidance, to allow the financing to remain outstanding.

To assist state and local governments and 501(c)(3) organizations in responding to the massive fiscal crisis presented by COVID-19, we recommend that Treasury provide a safe-harbor that during the recovery period beginning immediately and ending December 31, 2025, state and local governments and 501(c)(3) organizations may issue or have issued for their benefit long-term cash flow borrowings on a tax-exempt basis with a weighted average maturity of up to ten years without being subject to the special arbitrage and rebate rules otherwise applicable to restricted working capital borrowings mentioned above. Effectively, this guidance would permit state and local governments and 501(c)(3) organizations to directly trace the expenditure of tax-exempt bond proceeds to working capital costs, without having to apply the "proceeds-spent-last" rule. We believe such guidance is appropriate as the need for working capital outlays by state and local governments and by 501(c)(3) organizations as a result of the pandemic are expected to be "extraordinary" and different in kind and amount from the normal reoccurring cash flow deficits that might result from temporary annual mismatching of revenue and expenses in a stable economic environment. We recommend that the borrowings be permitted to be sized based upon reasonable predictions of potential deficits rather than a clear expected deficit of a certain size as otherwise set forth in the Treasury Regulations. In addition, we recommend that no additional retesting or monitoring be required following the date of issuance to determine if bonds need to be redeemed or funds need to be invested in tax-exempt obligations, given the extent of the fiscal crisis, the uncertainty relating to revenues and expenses, and the difficulty of selling tax-exempt bonds in the present market. We recommend that the average maturity limitation (10 years) mentioned above be applied to an entire issue of tax-exempt bonds or to a portion of those bonds based on an allocation of bonds to the purposes of a multipurpose issue. We also suggest you provide guidance that issuers, during the aftermath of COVID-19, might use unexpended proceeds of outstanding tax-exempt obligations to finance such working capital. Language that might be provided by administrative guidance is attached in Appendix G.

B. Election To Treat Pledged Funds As Not Constituting Replacement Proceeds.

Background. Section 148 of the Code generally provides that investments of gross proceeds of tax-exempt bonds are subject to yield restriction and rebate requirements, subject to certain exceptions. These restrictions apply to proceeds that are used directly or indirectly to acquire higher yielding investments or "to replace" funds which were used directly or indirectly to acquire higher yielding investments. The Code also provides that, for certain of these purposes, "gross proceeds" of an issue include amounts to be used to pay debt service on an issue. Treasury Regulation § 1.148-1(c) sets forth a detailed definition of "replacement proceeds" subject to the yield restriction and rebate requirements, and generally provides that amounts are treated as replacement proceeds "if the amounts have a sufficiently direct nexus to the issue to conclude the amounts would have been used for that governmental purpose if the proceeds of the issue were not used or to be used for that governmental purpose." Treasury Regulation § 1.148-1(c) generally provides that gross proceeds include "pledged funds," which are any amounts that are directly or

indirectly pledged to pay interest on an issue. Section 148 of the Code contains no provision that expressly requires that pledged funds be treated as replacement proceeds.

Problem. As a result of the COVID-19 pandemic, many states and local governments, 501(c)(3) organizations and other borrowers of tax-exempt bond proceeds are experiencing financial distress and are having difficulty accessing capital markets to borrow needed funds. In a time of financial distress, the pledged fund rules restrict the ability of many issuers and borrowers to borrow in a manner that permits them to retain the reserve and endowment funds reasonably necessary to assure long-term financial and operational viability. The pledged fund rules create particular difficulties for many smaller issuers and borrowers, such as 501(c)(3) organizations. The intent of the replacement proceeds rules is to limit the issuance of tax-exempt bonds to indirectly obtain an arbitrage benefit. In a time of extreme financial distress, the pledge of investments to a borrowing does not generally tend to raise such concerns.

Recommendation. We therefore urge that during the recovery period beginning immediately and ending December 31, 2025, states and local governments and other borrowers of tax-exempt bond proceeds may issue tax-advantaged bonds that are secured by pledges of investment property, in a manner that would otherwise cause those proceeds to be treated as replacement proceeds, and elect to treat those investments as not being replacement proceeds. This relief does not apply to any pledged funds that are reasonably expected, as of the date of the pledge, to be used to pay principal or interest on the issue. Suggested language is provided in Appendix H.

C. Facilitate Alterations of Tax-Advantaged Obligations as the Result of the Financial Crisis.

Background. The unprecedented bond market conditions impacting state and local government, together with cash flow issues as a result of the pandemic, are presenting difficult challenges to issuers with respect to outstanding debt. Issuers are (and will continue to) negotiate with bondholders regarding payment deferrals and other changes to bond terms as a result of the financial crisis impacting state and local government.

Under Treasury Regulation § 1.1001-3, significant modifications of a tax-advantaged obligation might result in a deemed sale or exchange of the obligation for a newly issued obligation; such newly issued obligation might not comply with Code restrictions due to timing restrictions, and changes in the law, among other matters. While failure of an issuer to perform its obligations under a debt instrument will not, in and of itself, result in a reissuance, the ability of a holder to stay collection or temporarily waive an acceleration clause or similar default right is limited. The stay or waiver generally cannot exceed two years following the issuer's initial failure to perform and any additional period during which the parties conduct good faith negotiations or during which the issuer is in a title 11 or similar case. Treas. Reg. Section 1.1001-3(c)(4). In addition, material changes to other terms of a bond, such as alterations in interest rates or payments schedules, might result in a reissuance.

Problem. The debt market liquidity disruptions caused by the COVID-19 pandemic have caused many tax-advantaged bonds to trade at abnormally large spreads to U.S. Treasury obligations or bear interest at very high rates. This has caused significant financial distress to political subdivisions who have issued these debt obligations. The economic disruptions caused by the COVID-19 pandemic may also cause projects financed with tax-advantaged bonds to be

delayed or modified resulting in modifications of the terms of these obligations in ways not anticipated when the bonds were first issued, in addition to the need to renegotiate payment terms. If a reissuance of tax-advantaged bonds is considered to have occurred, it might not be considered to meet the requirements of the Code as of the date of issuance because of technical rules with timing limitations or because of changes in the law. Even if such tax-advantaged bonds are considered to comply with Code restrictions, the diligence process necessary to confirm such matters will cost issuers time and money they cannot afford to lose in the aftermath of this pandemic.

Recommendation. From the present and until December 31, 2025, we recommend that issuers should be permitted to make alterations to the terms of their tax-advantaged bond issues to respond to the issues presented by COVID-19, such as extending payment dates, changing the interest rate, altering security, and other changes, without such actions resulting in a "reissuance" of the tax-advantaged bonds, solely for purposes of Sections 103 and 141 through 150 or former Code Sections 54 through 54AA, 1397E, 1400U-2 or 6431. Proposed guidance is attached in Appendix I.

D. Bolster Demand for Tax-Advantaged Obligations by Permitting Certain Federal Guarantees.

Background. Section 149(b) of the Code generally provides that obligations cannot be tax-exempt obligations if "federally guaranteed." This provision contains several exceptions including federal guarantees as a result of investments permitted under regulations promulgated by Treasury. Code § 149(b)(3)(B)(v).

Section 149(b) of the Code was generally enacted to prevent state and local government from benefitting from both increased security from the federal government and tax-exempt rates (a "double-dip").

Problem and Recommendation. Because of the unprecedented freezing of the bond market as a result of COVID-19 and anticipated cash flow shortfalls, the concerns of an improper "double dip" do not exist. Given such conditions, access to a federal guarantee of all or a portion of tax-advantaged obligations would be extremely helpful so that state and local governments can borrow needed cash. We therefore urge Treasury to provide by regulation (or other administrative guidance) an exception to Section 149(b) of the Code, applicable to tax-exempt obligations issued presently and through December 31, 2025, with respect to any guarantees of tax-exempt obligations by the federal government (treating such guarantees as an "investment" solely for this purpose). Permitting such guarantees would provide desperately needed security to bolster the ability of state and local government to access the market to provide essential infrastructure. Draft language relating to Section 149(b) is provided in Appendix J. We note that, alternatively, legislation might be enacted to amend Section 149(b) to address such issues.

E. Filing and Payment Extensions.

Background. To ensure the exclusion of interest on tax-advantaged debt, under Section 148, installment payments of certain excess "arbitrage rebate" earnings must be paid to the United States at least once every 5 years. Section 149 of the Code imposes information reporting requirements on tax-advantaged bond issuances, requiring returns to be filed by the end

of the period that is 15 days after the second calendar month of the close of the quarter in which the bonds were issued. For the first calendar quarter in which bonds are issued, that date is May 15.

Problem. As a result of the disruption of the nation as a result of the COVID-19 pandemic, many issuers are dealing with administrative and operational challenges that make meeting deadlines impractical or, in some cases, physically dangerous. Moreover, some issuers may find themselves in dire financial situations. In order to accommodate the unusual circumstances imposed on the nation by the COVID-19 pandemic, with Notice 2020-18, certain April 15, 2020 filing and payment deadlines have been temporarily and automatically extended to July 15, 2020. A similar extension period should be allowed to issuers and obligors of tax-advantage bonds.

Recommendation. We therefore urge that all federal income tax filings and payments due in accordance with Sections 103, and 141 through 150, and due prior to July 15, 2020, should be postponed to July 15, 2020. We suggest that interest, penalties or additions to tax should be disregarded until then and begin to accrue on July 16, 2020.

F. Permit Temporary Extension of Reimbursement Period for Projects Otherwise Eligible to be Financed on a Tax-Exempt or Tax-Advantaged Basis.

Background. Section 1.150-2 of the Treasury Regulations governs the ability to apply the proceeds of tax-exempt and tax advantaged bonds to reimburse state and local governmental issuers and conduit borrowers for amounts paid in respect of project costs in anticipation of the issuance of such bonds. Among the requirements to be satisfied in order that a reimbursement allocation of bond proceeds be considered an effective expenditure of such proceeds for use of proceeds purposes, the Treasury Regulations apply a timing limitation on when such proceeds are required to be applied to effect the intended reimbursement. The purpose of these rules is to prevent issuers and conduit borrowers from overburdening the markets in situations in which a borrowing may not be needed to provide the requisite funding source for a project, and from creating an opportunity to invest the reimbursed amounts in materially higher yielding investments. Generally, the reimbursement allocation must be made not later than 18 months after the later of (1) the date the original expenditure is paid or (2) the date the project is placed in service or abandoned; however, in no event may the reimbursement allocation be made more than three years after the original expenditure is paid. Exceptions to this general rule apply in connection with preliminary expenditures, de minimis amounts, certain longer term projects, assuming proper documentation of the need for a longer period, and the issues of certain small issuers, as defined in Section 148(f)(4)(D)(i)(I) through (IV) ("small issuers"). The reimbursement period in respect of small issuers provides for the 18 month limit to be changed to three years and the three year maximum reimbursement bond period to be disregarded.

Problem. As a result of the COVID-19 pandemic, many state and local governmental issuers and conduit borrowers of tax-exempt and tax advantaged bonds are experiencing difficulty accessing capital markets to borrow needed funds. These circumstances may prevent issuers and conduit borrowers from issuing bonds and effecting the allocation of the proceeds of such bonds to project costs in compliance with the current timing requirements of the Treasury Regulations, resulting in additional stress on already financially challenged entities that are addressing significant difficulties.

Recommendation. We suggest that during the recovery period beginning immediately and ending December 31, 2025, state and local governmental issuers, as well as conduit borrowers,

may apply the timing requirements generally appropriate to small issuers in respect of reimbursement allocations of proceeds of tax-exempt or tax advantaged bonds to reimbursements of otherwise eligible project costs paid prior to the reimbursement allocation date. Draft language is in Appendix K.

G. Extension of Certain Deadlines Applicable to Qualified Residential Rental Projects.

Background. Section 142(d) requires that a qualified residential rental project set-aside either (i) 20% of its units for tenants with income that does not exceed 50% of area median income, or (ii) 40% of its units for tenants with income that does not exceed 60% of area median income (the “Set-Aside Requirement”).

Section 147(d) requires that proceeds of certain types of qualified private activity bonds, including bonds that finance qualified residential rental projects, may only be spent to acquire an existing building if a minimum amount of money is spent on rehabilitation of the building within two years of the later of (i) the date of bond issuance, or (ii) the date the building was acquired (the “Rehabilitation Requirement”).

Problem. If bond proceeds are used to acquire an existing, occupied housing project, the tenant mix at the time of bond issuance and/or acquisition may not satisfy the Set-Aside Requirement. Unless all or a good portion of existing tenants are evicted immediately, it may take some time until the Set-Aside Requirement is satisfied. Revenue Procedure 2004-39 addresses this problem by providing certain projects up to one year to comply with the Set-Aside Requirement. Leasing activities have stopped around much of the country, however, and it may take longer than one-year for there to be sufficient tenant turnover to comply with the Set-Aside Requirement.

Supply chains have been disrupted across the country. Construction projects are taking longer. Two years may not be sufficient time to satisfy the Rehabilitation Requirement in the context of the COVID-19 crisis.

Recommendation. For any bonds issued to finance qualified residential rental projects between March 1, 2019 and December 31, 2025, extend the period provided under Revenue Procedure 2004-39 to comply with the Set-Aside Requirement from one year to two years.

For any bonds issued to finance qualified residential rental projects between March 1, 2018 and December 31, 2025, extend the period provided to satisfy the Rehabilitation Requirement from two-years to three years.

H. Facilitate Provision of Hospital Supplies for Long-Range Planning.

Background. The COVID-19 pandemic has made the public acutely aware of the need for long-range planning for adequate hospital supplies and shorter-lived equipment. The Treasury Regulations and Section 147 of the Code (applicable to qualified 501(c)(3) bonds) generally limit the weighted average maturity of tax-advantaged bonds to no more than 120 percent of the useful life of the bond financed property.

Problem. Hospital supplies and equipment that should exist for emergencies is rapidly being depleted by the pandemic, may have short useful lives, and are difficult to finance on a long-term basis given the 120 percent limitation referenced above.

Recommendation. We therefore urge that guidance be issued that expressly permits long-term financings (at least ten years) for replenishment of hospital equipment and supplies needed to respond to the COVID-19 pandemic and to provide essential reserves of such equipment and supplies (regardless of the useful life thereof).

APPENDIX A

Draft Language for American Infrastructure Bonds:

The proposal would be effective for bonds issued on or after the date of enactment.

A BILL

To amend the Internal Revenue Code of 1986 to provide for the tax treatment of American infrastructure bonds, and for other purposes relating thereto.

Act Sec. 1 Short title.

This Act may be cited as the "American Infrastructure Bonds Act of 2020."

Act Sec. 2 American Infrastructure Bonds.

(a) IN GENERAL.—Part IV of subchapter A of chapter 1 is amended by adding at the end the following new subpart:

"Subpart H—American Infrastructure Bonds

"SEC. 54 American Infrastructure Bonds.

"(a) IN GENERAL.— Contemporaneous with each interest payment date of an American infrastructure bond, the issuer of such bond shall be allowed a credit in an amount determined under subsection (b) with respect to such dates. The Secretary shall pay (contemporaneously with each interest payment under such bond) to the issuer of such bond (or to any person who makes such interest payments on behalf of the issuer) the amount of the credit with respect to such date as determined under subsection (b).

"(b) AMOUNT OF CREDIT.—

"(1) IN GENERAL.— For any American infrastructure bond issued on or prior to December 31, 2025, the amount of the credit determined under this subsection with respect to any interest payment date for an American infrastructure bond is 40 percent of the amount of interest payable by the issuer with respect to such date.

"(2) Obligations issued after December 31, 2025 — For any American infrastructure bond issued after December 31, 2025, the amount of the credit determined under this subsection with respect to any interest payment date for an American infrastructure bond is [28] percent of the amount of interest payable by the issuer with respect to such date.

"(c) AMERICAN INFRASTRUCTURE BOND.—

"(1) IN GENERAL.—For purposes of this section, the term "American infrastructure bond" means any obligation if—

“(A) the interest on such obligation would (but for this section) be excludable from gross income under section 103,

“(B) either:

(i) the obligation is not a private activity bond, or

(ii) the obligation is a private activity bond, but it is issued as part of an issue 95 percent or more of the net proceeds of which are to be used to finance or refinance property that meets the ownership test in section 145(a)(1) (determined by substituting “95 percent of the property” for “all property” in section 145(a)(1), and

“(C) the issuer makes an irrevocable election to have this section apply.

“(2) APPLICABLE RULES.—For purposes of applying paragraph (1)—

“(A) neither an American infrastructure bond nor any parity obligation or other obligation sharing security with such bond, the interest on which is otherwise excludable from gross income under section 103, shall be treated as federally guaranteed for purposes of section 149(b) by reason of the credit allowed under this section, and

“(B) a bond shall not be treated as an American infrastructure bond if the issue price has more than a de minimis amount (determined under rules similar to the rules of section 1273(a)(3)) of premium over the stated principal amount of the bond.

“(d) INTEREST PAYMENT DATE.—For purposes of this section, the term “interest payment date” means any date on which the holder of record of the American infrastructure bond is entitled to a payment of interest under such bond.

“(e) SPECIAL RULES.— For purposes of this title—

“(1) INTEREST ON AMERICAN INFRASTRUCTURE BONDS INCLUDIBLE IN GROSS INCOME FOR FEDERAL INCOME TAX PURPOSES.—Interest on any American infrastructure bond shall be includible in gross income.

(2) TRANSITIONAL COORDINATION WITH STATE LAW. -- Except as otherwise provided by a State after the date of the enactment of this Act, the interest on any American infrastructure bond shall be treated for purposes of the income tax laws of such State as being exempt from Federal income tax.

(3) APPLICATION OF ARBITRAGE RULES.—For purposes of section 148, the yield on an issue of American infrastructure bonds shall be reduced by the credit allowed under this section, provided that for purposes of section 148 the amount of gross proceeds of an issue that qualifies as a reasonably required reserve or replacement fund

with respect to that issue shall be determined by reference to debt service on the issue under applicable regulations under section 148 without reduction for such credit.

"(f) ADJUSTMENT TO PAYMENT TO ISSUERS IN CASE OF SEQUESTRATION.—In the case of any payment under subsection (a) made after the date of enactment of this Act to which sequestration applies, the amount of such payment shall be increased to an amount equal to—

"(1) such payment (determined before such sequestration), multiplied by

"(2) the quotient obtained by dividing the number 1 by the amount by which the number 1 exceeds the percentage reduction in such payment pursuant to such sequestration.

For purposes of this subsection, the term 'sequestration' means any reduction in direct spending ordered in accordance with a sequestration report prepared by the Director of the Office and Management and Budget pursuant to the Balanced Budget and Emergency Deficit Control Act of 1985 or the Statutory Pay-As-You-Go Act of 2010 or future legislation having similar effect.

"(g) REGULATIONS.—The Secretary may prescribe such regulations and other guidance as may be necessary or appropriate to carry out this section.

"(h) EFFECTIVE DATE.—The amendments made by this section shall apply to obligations issued after the date of enactment of this Act."

APPENDIX B

Proposed Section 149(d):
(the provisions are taken directly from the pre-2017 law)

"Section 149(d) ADVANCE REFUNDINGS. –

(1) **IN GENERAL. –** Nothing in Section 103(a) or any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond issued as part of an issue described in (2), (3), or (4).

(2) **CERTAIN PRIVATE ACTIVITY BONDS. –** An issue is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund a private activity bond (other than a qualified 501(c)(3) bond).

(3) OTHER BONDS. –

(A) **In general**. An issue is described in this paragraph if any bond (issued as part of such issue), hereinafter in this paragraph referred to as the "refunding bond", is issued to advance refund a bond unless--

(i) the refunding bond is only—

(I) the 1st advance refunding of the original bond if the original bond is issued after 1985, or

(II) the 1st or 2nd advance refunding of the original bond if the original bond was issued before 1986,

(ii) in the case of refunded bonds issued before 1986, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed at par or at a premium of 3 percent or less,

(iii) in the case of refunded bonds issued after 1985, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed at par or at a premium of 3 percent or less (provided a redemption right with a market-based redemption premium that is not fixed and determinable on the date of issuance of the refunding bonds is not taken into account for this purpose)

(iv) the initial temporary period under section 148(c) ends—

(I) with respect to the proceeds of the refunding bond not later than 30 days after the date of issue of such bond, and

(II) with respect to the proceeds of the refunded bond on the date of issue of the refunding bond, and

(v) in the case of refunded bonds to which section 148(e) did not apply, on and after the date of issue of the refunding bond, the amount of proceeds of the refunded bond invested in higher yielding investments (as defined in section 148(b)) which are nonpurpose investments (as defined in section 148(f)(6)(A)) does not exceed—

(I) the amount so invested as part of a reasonable required reserve or replacement fund or during an allowable temporary period, and

(II) the amount which is equal to the lesser of 5 percent of the proceeds of the issue of which the refunded bond is a part or $100,000 (to the extent such amount is allocable to the refunded bond).

(B) **Special rules for redemptions**.

(i) **Issuer must redeem only if debt service savings**. Clause (ii) and (iii) of subparagraph (A) shall apply only if the issuer may realize present value debt service savings (determined without regard to administrative expenses) in connection with the issue of which the refunding bond is a part.

(ii) **Redemptions not required before 90th day**. For purposes of clauses (ii) and (iii) of subparagraph (A), the earliest date referred to in such clause shall not be earlier than the 90th day after the date of issuance of the refunding bond.

(4) **Abusive transactions prohibited**. An issues is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund another bond and a device is employed in connection with the issuance of such issue to obtain a material financial advantage (based on arbitrage) apart from savings attributable to lower interest rates.

(5) **Advance refunding**. For purposes of this part, a bond shall be treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

(6) **Special rules for purposes of paragraph (3).** For purposes of paragraph (3), bonds issued before the date of the enactment of the Tax Reform Act of 1986 shall be taken into account under subparagraph (A)(i) thereof except –

(A) a refunding which occurred before 1986 shall be treated as an advance refunding only if the refunding bond was issued more than 180 days before the redemption of the refunded bond, and

(B) a bond issued before 1986, shall be treated as advance refunded no more than once before March 15, 1986.

(7) **Regulations**. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.

APPENDIX C

Proposed amendment to Section 265(b)(3)(G) of the Code:

"Special rules for obligations issued during 2009, 2010, 2020, 2021, 2022, 2023, 2024 or 2025.

(i) Increase in limitation. In the case of obligations issued during 2009, 2010, 2020, 2021, 2022, 2023, 2024 or 2025, subparagraphs (c)(i), (D)(i), and (D)(iii)(II) shall each be applied by substituting "$30,000,000" for "$10,000,000".

(ii) Qualified 501(c)(3) bonds treated as issued by exempt organization. In the case of a qualified 501(c)(3) bond (as defined in section 145) issued during 2009, 2010, 2020, 2021, 2022, 2023, 2024, or 2025, this paragraph shall be applied by treating the 501(c)(3) organization for whose benefit such bond was issued as the issuer.

(iii) Special rule for qualified financings. In the case of a qualified financing issue issued during 2009, 2010, 2020, 2021, 2022, 2023, 2024, or 2025—

(I) Subparagraph (F) shall not apply, and

(II) Any obligation issued as a part of such issue shall be treated as a qualified tax-exempt obligation if the requirements of this paragraph are met with respect to each qualified portion of the issue (determined by treating each qualified portion as a separate issue which is issued by the qualified borrower with respect to which such portion relates)**.**

(iv) Qualified financing issue. For purposes of this subparagraph, the term "qualified financing issue" means any composite, pooled, or other conduit financing issue the proceeds of which are used directly or indirectly to make or finance loans to 1 or more ultimate borrowers each of whom is a qualified borrower.

(v) Qualified portion. For purposes of this subparagraph, the term "qualified portion" means that portion of the proceeds which are used with respect to each qualified borrower under the issue.

(vi) Qualified borrower. For purposes of this subparagraph, the term "qualified borrower" means a borrower which is a State or political subdivision thereof or an organization described in section 501(c)(3) and exempt from taxation under section 501(a)."

Proposed amendment to Section 265(b)(7) of the Code:

"De minimis exception for bonds issued during 2009, 2010, 2020, 2021, 2022, 2023, 2024 or 2025.

(A) In general. In applying paragraph (2)(A), there shall not be taken into account tax-exempt obligations issued during 2009, 2010, 2020, 2021, 2022, 2023, 2024, or 2025.

(B) Limitation. The amount of tax-exempt obligations not taken into account by reason of subparagraph (A) shall not exceed 2 percent of the amount determined under paragraph (2)(B).

(C) Refundings. For purposes of this paragraph, a refunding bond (whether a current or advance refunding) shall be treated as issued on the date of the issuance of the refunded bond (or in the case of a series of refundings, the original bond)."

APPENDIX D

Proposed amendments to Sections 145:

1. Section 145(d)(3) shall be amended as follows:

"(3) Certain property treated as new property. Solely for purposes of determining under paragraph (2)(A) whether the 1st use of property is pursuant to tax-exempt financing—
(A) In general. If the 1st use of property is pursuant to taxable financing, then the 1st use of such property shall be treated as being pursuant to the tax-exempt financing."

2. Section 145(d)(5) shall be added as follows:

"Section 145(d)(5) – Residential Rental Housing for [Recovery Period]

(1) **In General.** Sections 145(d)(1) shall not apply to any bonds issued in 2020, 2021, 2022, 2023, 2024 and 2025.

(2) **Refunding Bonds.** Any bond that refunds a bonds that was originally issued in accordance with this Section shall be treated as being issued on December 31, 2025, to the extent (a) the weighted average maturity of such refunding bonds does not exceed the weighted average maturity of the bonds it refunds, and (b) the amount of the refunding bonds does not exceed the amount of the outstanding bonds."

APPENDIX E

Proposed section 141(f)-

"Section 141(f) – Private Use Allowance for [Recovery Period]

(1) **In General._** For purpose of Sections 141(b)(1) and (2), any reference to "10 percent" for any bonds issued in 2020, 2021, 2022, 2023, 2024 and 2025 shall mean "25 percent". Furthermore, any use that would be unrelated or disproportionate in accordance with Section 141(b)(3) shall be treated as private business use subject to Section 141(b)(1), and any reference to "$5,000,000" shall mean "$10,000,000". Section 141(c) shall not be applicable.

(2) **Output Facilities.** For purpose of Sections 141(b)(4) and (b)(5), any reference to "5 percent" for any bonds issued from [ ] to December 31, 2025 shall mean "15 percent", and any reference to "$5,000,000" or "$15,000,000" shall mean "$25,000,000".

(3) **Coordination with Volume Cap.** For purpose of Sections 141(b)(5), any reference to "$15,000,000" for any bonds issued in 2020, 2021, 2022, 2023, 2024 and 2025, shall mean "$25,000,000."

(4) **Refunding Bonds.** Any bond that refunds a bonds that was originally issued in accordance with this Section shall be treated as being issued on December 31, 2025, to the extent (a) the weighted average maturity of such refunding bonds does not exceed the weight average maturity of the bonds it refunds, and (b) the amount of the refunding bonds does not exceed the amount of the outstanding bonds."

APPENDIX F

Proposed amendment to Section 148:

"(j) Safe-harbor for long-term working capital financings. Proceeds of bonds that are issued between the effective date and December 31, 2025, to finance working capital expenditures of the issuer may be allocated to expenditures on any reasonable basis and other funds of the issuer, unless specifically set aside and pledged to the repayment of the bonds, will not be treated as gross proceeds of the working capital bonds. Bonds issued pursuant to safe-harbor must have a weighted average maturity of not more than 10 years from the date of issuance and issuers must make a good faith reasonable prediction of potential deficits that may be incurred by the issuer."

APPENDIX G

Proposed Treasury Notice:

"Notice 2020-xx

1. Purpose.

This Notice provides a temporary streamlining of the application of the arbitrage regulations to working capital borrowings to be made during the period ending December 31, 2025, and certain related matters. The rules contained in this Notice recognize the extraordinary non-recurring event affecting the entire country as a result of the COVID-19 pandemic.

2. Background.

Regulation §1.148-6(d)(3)(i) provides limitations on the allocation of proceeds of an issue to working capital expenditures. §1.148-6(d)(3)(ii)(B) provides an exception for expenditures for extraordinary non-recurring items. Regulation §1.148-1(c)(4) provides that under certain circumstances, if tax-exempt bonds are permitted to remain outstanding longer than necessary, other amounts will be treated as replacement proceeds of the issue. §1.148-1(c)(4)(ii) provides a safe harbor under which longer term bonds for working capital will not be deemed to give rise to other replacement proceeds. Regulation §1.148-10 provides an anti-abuse rule under which bonds can lose tax-exemption or be subject to harsh restrictions if the bonds are deemed to be outstanding longer than necessary. One factor that is relevant to this determination is whether the bonds give rise to other replacement proceeds under §1.148-1(c)(4).

3. Applicable Rules.

For any bonds issued during the period beginning the present and ending December 31, 2025, as a safe harbor.

(a) Any working capital expenditure of proceeds of the issue of which such bond is a part may be treated by the issuer as an expenditure for an extraordinary non-recurring item meeting the requirements of Regulation §1.148-6(d)(3)(ii)(B).

(b) If the issue of which such bond is a part has a weighted average maturity of not more than 10 years, such bond

(i) will not give rise to other replacement proceeds under Regulation §1.148-1(c)(4) and

(ii) will not be outstanding longer than necessary for purposes of Regulation § 1.148-10(a)(4)

(c) If the issuer of such bond reasonably expects that the amount of proceeds of the issue of which such bond is a part will not exceed anticipated expenditures for which revenues are not expected to be available in a timely manner, such bonds will not be issued in an amount greater than the amount reasonably necessary to accomplish the governmental purpose of the bond issue for purposes of §1.148-10(a)(4).

(d) An issuer may apply the multipurpose issue rules of Regulation §1.148-9(h) in determining compliance with (b) and (c) above.

(e) An issuer may apply the rules above to bonds of an issue outstanding on the effective date with unexpended proceeds with respect to expenditures made during the period from the effective date through December 31, 2025.

4. Interim Guidance and Reliance.

The effective date of this Notice is April_, 2020. This Notice provides interim guidance. Issuers of tax-exempt bonds may apply and rely on this Notice for any actions taken with respect to tax-exempt bonds issued on or after the effective date of the Notice and before January 1, 2026."

APPENDIX H

Treasury Regulation §1.148-1(c)(3) is proposed to be amended by adding the following at the end:

"(iii) With respect to any pledge of investment property (including a deemed pledge pursuant to paragraph (ii)) that is made between the effective date and December 31, 2025, an issuer or other substantial beneficiary may elect to treat the investment property as not being in a pledged fund under this subsection."

APPENDIX I

Proposed Notice to address alterations to obligations as a result of the pandemic:

"Notice 2020-__

<u>Section 1. Purpose</u>

This Notice is intended to provide greater certainty and flexibility to address potential Federal tax issues that have arisen in the tax-exempt bond market as a result of the financial impacts of the COVID-19 pandemic. This Notice permits issuers of tax-advantaged bonds to elect to treat modifications to the terms of these obligations that would otherwise be treated as significant modifications as not being significant modifications for certain limited tax-advantaged bond purposes.

<u>Section 2. Temporary Rule Allowing Issuers to Elect Out of Reissuance Treatment Under Section 1001 for Limited Purposes</u>

Solely for purposes of §103 and §§141 through 150 and former §§54 through 54AA, 1397E, 1400U-2 and 6431 of the Internal Revenue Code of 1986, as amended (the "Code"), during the period beginning on the date of publication of this Notice and ending December 31, 2022, any alteration of the terms of a tax-advantaged bond that would be treated as a significant modification under Section 1001 of the Code at the election of the issuer of such bond may be disregarded resulting in the bond not being treated as being reissued and as remaining the same debt instrument for purposes of the enumerated Code sections and former sections. This election is made on the books and records of the issuer and must be made within 180 days of the significant modification. Any such alteration must be related to or the result of economic conditions caused by the financial or economic disruptions of the COVID-19 pandemic. For example, a delay in construction of a project financed with tax-advantaged bonds caused directly or indirectly by the economic disruptions caused by the COVID-19 pandemic that resulted in a change in yield on the bonds, a deferral of payments on the bonds or an extension of the maturity of the bonds would qualify under this special rule.

<u>Section 3. Applicability Date</u>

The changes made by this Notice shall apply to events and actions taken with respect to tax-advantaged bonds that occur on or after effective date, through December 31, 2025."

APPENDIX J

Proposed guidance relating to Section 149(b):

Treasury Regulation § 1.149(b) –2

"(a) Exception for Tax-Exempt Obligations issued from the effective date through December 31, 2025. Paragraph (1) of Section 149(b) does not apply to any tax-advantaged obligations issued from the effective date through December 31, 2025 (and with respect to the provision of a federal guarantee with respect to bonds outstanding as of the effective if such guarantee is provided on any date beginning the effective date and ending December 31, 2025)."

APPENDIX K

Proposed Amendment to Treasury Regulation § 1.150-2(d)(2) adding subsection (iv):

"(iv) Special Rule for Reimbursements of Eligible Project Costs During the Period Commencing the effective date and ending December 31, 2025. In applying paragraph (d)(2)(i) of this section to an issue of bonds during the period commencing the effective date and ending December 31, 2025, the "18 month" limitation is changed to "3 years" and the "3-year" maximum reimbursement period is disregarded."

APPENDIX L

NABL AD HOC TASKFORCE MEMBERS

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