

Office of Chief Counsel
Internal Revenue Service
Memorandum

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date: November 04, 2016

to: Carmen B. Zucker
Group Manager
(TEB, Field Operations)

from: Patricia P. Wang
Area Counsel (Pacific Coast Area)
(Tax Exempt & Government Entities Division Counsel)

subject:

This memorandum responds to your request for advice concerning whether changes, as described below, cause the Bonds to be reissued. This advice may not be used or cited as precedent in other cases. This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

ISSUE

Will changes to the Bonds, as described below, cause the Bonds to be reissued as other than Qualified Zone Academy Bonds (QZABs).

CONCLUSION

Changes to the Bonds will not cause the Bonds to be reissued. 


FACTS

("Issuer") is a small school district. The Issuer issued the Bonds on

pursuant to a ground lease agreement, for purposes enumerated in I.R.C. § 54E(d)(3). The Bonds met all other requirements to be QZABs within the meaning of I.R.C. § 54E.

The Issuer timely filed Form 8038-TC, *Information Return for Tax Credit Bonds and Specified Tax Credit Bonds*. The Issuer checked "Yes" in Part II, line 3, to indicate that it had made an irrevocable election to apply I.R.C. § 6431(f). On line 5 of Schedule C, *Schedule for Qualified Zone Academy Bonds (QZABs)*, the Issuer provided that a carryover of unused limitation, which arose in _____, was being used. The Issuer then filed Form 8038-CP, *Return for Credit Payments to Issuers of Qualified Bonds*, to claim the refundable credit. Upon receipt of the initial Form 8038-CP the IRS put a hold on the claim and referred the Form 8038-TC to TEB for examination.

During the examination TEB determined that the Bonds meet all requirements for compliance, including under I.R.C. §§ 54A, 54E and 103, except that the Bonds were issued at a time when issuers could no longer elect to receive the refundable credit under I.R.C. § 6431(f). The Issuer told TEB they were unaware the provision had expired but agreed with TEB's position that they were not entitled to the refundable credit.

Subsequently, the Issuer's counsel amended the Bond documents to eliminate references to an election under I.R.C. § 6431(f), recalculated the Bond yield and payments to the Bondholder, and filed an amended Form 8038-TC.

LAW AND ANALYSIS

The rules for determining whether a modification of the terms of a debt instrument results in an exchange of the original debt instrument for a modified instrument are provided in Treas. Reg. § 1.1001-3. Generally, a "significant modification" results in an exchange, while a modification that is not a significant modification will not be considered to be an exchange. Treas. Reg. § 1.1001-3(b). A modification is defined broadly to include any alteration of a legal right or obligation of the issuer or holder of a debt instrument. Treas. Reg. § 1.1001-3(c)(1)(i). In the current case, the Bonds were modified when the Issuer altered the bond documents to reflect that they were not entitled to the refundable credit under I.R.C. § 6431(f) and adjusted the yield of the Bonds and payments to the Bondholder pursuant to this change.

The rules for determining whether a modification of a debt instrument is a significant modification are provided in Treas. Reg. § 1.1001-3(e). Generally, under Treas. Reg. § 1.1001-3(e)(1) a modification is a significant modification "only if, based on the facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant." The rules in Treas. Reg. §§ 1.1001-3(e)(2) through 1.1001-3(e)(6) apply this general rule in specific situations. Thus, in order to determine whether there has been a significant modification, it must first be determined if one of the specific rules apply. Treas. Reg. § 1.1001-3(f)(1)(i).

Under Treas. Reg. § 1.1001-3(e)(2), a change in the yield of a debt instrument is a significant modification if the yield of the modified instrument varies by more than the greater of (i) $\frac{1}{4}$ of one percent, or (ii) 5 percent of the annual yield of the unmodified instrument. Treas. Reg. § 1.1001-3(e)(2)(iii) provides that, the yield of the modified debt instrument is computed with certain adjustments to the issue price not at issue here, and with payments on the modified debt instrument from the date of the modification.

For purposes of qualified bonds, including QZABs, I.R.C. § 54A(f) provides that the credit received by bondholders is treated as interest. Thus, in determining the yield of the modified instrument under Treas. Reg. § 1.1001-3(e)(2), the credit to the Bondholder must be taken into account in addition to any other interest.

In the current case, the original Form 8038-TC filed by the Issuer in _____ states that the stated interest rate on the Bonds was _____. The amended Form 8038-TC filed in _____ by the Issuer following the modification of the Bonds states that the stated interest rate on the Bonds is _____.

Accordingly, there was no significant modification within the meaning of Treas. Reg. § 1.1001-3(e)(2).

The facts in this case do not appear to support a finding that there was a significant modification pursuant any of the other rules in Treas. Reg. §§ 1.1001-3(e)(3) through 1.1001-3(e)(6). Thus, the determination of whether there was a significant modification is made under the general rule of Treas. Reg. § 1.1001-3(e)(1).

As such, under the facts and circumstances of this case the modification that occurred was not economically significant, and there was no "significant modification" within the meaning of Treas. Reg. § 1.1001-3(e). Accordingly, the modification of the terms of the Bonds did not result in an exchange of the original debt instrument for a modified instrument under Treas. Reg. § 1.1001-3, and there was no deemed reissuance of the Bonds.

Because the alterations made to the Bond documents and adjustment to the yield on the Bonds did not cause a reissuance, the Bonds would continue to be QZABs for which the Bondholder is entitled to receive a credit pursuant to I.R.C. § 54A as of the _____ issue date. Although the Issuer drafted bond documents and filed a Form 8038-TC electing the irrevocable election under I.R.C. § 6431(f), it is undisputed that at the time it did so the election was no longer available. As a general matter, where a taxpayer intends to make an election provided for under the Code, but the election is untimely, said election is invalid and the taxpayer will not be treated as having made that election for any purpose. Here, because the Issuer's election was invalid, it is treated as though it did not make the election under I.R.C. § 6431(f). As such, when the Bonds were issued on _____, meeting all the other

requirements to be QZABs, they continued to be QZABs within the meaning of I.R.C. §§ 54A and 54E.

CONCLUSION



If you have any further questions or concerns, please contact Michelle Weigelt at (206) 946-3584.

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