Tax Exempt Bonds Questionnaire Project: Final Report on Governmental and Charitable Financings

July 1, 2011

Executive Summary

In 2007, the Tax Exempt Bonds (TEB) function of the IRS Tax Exempt and Government Entities Division (TE/GE) initiated a soft-contact compliance check program to evaluate the post-issuance compliance and record retention practices within the tax-exempt bonds industry. This final report summarizes the data, analysis and conclusions regarding the Tax-Exempt Bond Financings Compliance Check Questionnaire (Form 13907) and the Governmental Bond Financings Compliance Check Questionnaire (Form 14002).

Objective

In general, governmental issuers of tax-exempt bonds are responsible for ensuring that their financings satisfy all applicable federal tax requirements both at the time of issuance and for so long as such bonds remain outstanding. When such bonds are issued to finance a loan to another entity as part of a conduit financing, including the issuance of qualified 501(c)(3) bonds, the responsibility of monitoring post-issuance compliance and maintaining adequate records to substantiate compliance is often shared between the governmental issuer and the entity borrowing the bond proceeds. A failure to fulfill the responsibility for monitoring and maintaining adequate records of compliance may result in post-issuance noncompliance causing the bonds to lose their tax-exempt status.

The projects' primary objective was to identify the overall knowledge of § 501(c)(3) organizations and governmental issuers of tax-exempt bonds relating to applicable post-issuance compliance and record retention requirements. To accomplish this objective, TEB sent Form 13907 to 207 exempt organizations described under § 501(c)(3) of the Internal Revenue Code that had reported outstanding tax-exempt liabilities at the end of the 2005 calendar year. TEB also sent Form 14002 to 200 governmental bond issuers that issued tax-exempt governmental bonds in the 2005 calendar year.

The summaries in this final report are based on the responses from 192 § 501(c)(3) organizations and 175 governmental bond issuers. Eleven exempt organization respondents indicated they did not have tax-exempt bond liabilities that were the subject of the charitable financing questionnaire. Three of the governmental bond issuers reported that they did not issue bonds. Four of the exempt organizations did not respond and have been referred for follow-up. Twenty-five governmental bond issuers failed to respond to the governmental bond financing questionnaire and have been referred for follow-up.

Key Findings from Data

The compliance questionnaires addressed policies, practices, and recordkeeping of § 501(c)(3) organizations and governmental issuers benefitting from tax-exempt financing in such key areas as use of proceeds, use of property, arbitrage, expenditures, and other requirements.

This final report summarizes the reported data. A review was performed for each response, including narratives and all supplemental information. We have not tested or attempted to verify the accuracy or completeness of the responses.

Exempt Organizations:

Almost all (95%) of the responding § 501(c)(3) organizations reported that they had implemented written post-issuance compliance procedures or guidelines to ensure continued compliance with applicable federal tax requirements. However, a closer analysis of the narrative responses suggested that only 49% either implemented written specific procedures (16%) or an ad hoc process (33%) to ensure effective monitoring of post-issuance compliance. Although exempt organizations who did not establish such procedures may not necessarily be less compliant with tax-exempt bond rules, our examination experience suggests that the adoption and consistent utilization of formal procedures and practices generally improves the likelihood of post-issuance compliance.

Almost all (89%) of the responding § 501(c)(3) organizations reported that they assigned a management official the primary responsibility of monitoring post-issuance compliance. Moreover, most of those exempt organizations reported that they provided some level of related training to these management officials; whereas, others provided some level of related training to non-management personnel.

Almost all (97%) of the responding § 501(c)(3) organizations indicated that they maintained books and records necessary to substantiate compliance. However, some of the respondents indicated that they are not retaining certain types of required records on a consistent basis.

Governmental Bond Issuers:

Only a slight majority of the governmental bond issuers indicated they had written procedures to ensure continued compliance with applicable federal tax law requirements (use of proceeds – 58.9%; timely expenditure of proceeds – 58.3%; use of financed property – 57.1%; yield restriction and rebate – 62.3%; timely return filing – 60.6%; documenting compliance with other general requirements – 55.4%). However, a closer analysis of the narrative responses suggested that only 20% either had implemented written specific procedures (8%) or an ad hoc process (12%) to ensure effective monitoring of post-issuance compliance.

Most (65%) of the responding governmental issuers responded they assigned an official the primary responsibility of monitoring post-issuance compliance. Another 38% indicated a staff person has responsibility for monitoring compliance. Approximately 65% of the respondents reported that they provide some level of related training to these officials.

Almost all (94.29%) of the responding governmental issuers indicated they maintained books and records necessary to substantiate compliance. Additionally, up to two-thirds (15% to 66%, depending on the category) stated that the following types of records were not applicable to them: formal tax elections, appraisals, demand surveys and feasibility studies, government grants, publications related to the bond financing, trustee's statements, correspondence related to the bonds, and reports of IRS examinations.

Summary of Conclusions

While the responding § 501(c)(3) organizations and governmental bond issuers largely recognized the importance of effective post-issuance compliance procedures, there may be significant gaps or divergent practices in the implementation of such procedures throughout the charitable financings and governmental bonds market segments. Although nearly all respondents reported that they maintained written policies and practices in three key areas of compliance, about half of the respondents failed to describe their written procedures and guidelines, despite being asked to do so. Gaps in record maintenance and written procedures and practices is consistent with our past examination experience of bond issues.

In evaluating overall industry compliance, stakeholder associations have demonstrated strong support for the importance of implementing effective post-issuance compliance processes and for TEB's emerging use of soft-contact compliance check projects. In particular, TEB has received informative comments from various associations with respect to record retention, tax-exempt bond related information returns, and the questionnaires used in this project.

Through increasing use of soft-contact compliance check projects, combined with an on-going partnership with Chief Counsel, Treasury, and the TE/GE Advisory Committee on record retention guidance and streamlined voluntary compliance programs, TEB will actively continue to promote post-issuance compliance while exploring opportunities to reduce overall taxpayer burden in the tax-exempt bond industry. The growth in use of tax credit bonds and direct pay tax credit bonds is also expected to promote post-issuance compliance. For direct pay tax credit bonds each Form 8038-CP, *Return for Credit Payments to Issuers of Qualified Bonds*, submitted by the issuer to claim the refundable credit relating to each interest payment date must be signed under penalty of perjury by an authorized representative with the authority to bind the issuer and constitutes a certification by the issuer that the obligation meets all applicable requirements as of the date that it files Form 8038-CP.