PROCEDURES APPLICABLE TO FILING FORMS AND RECOVERING OR PAYING REBATE

by
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1. Introduction

"May you live in interesting times," is a phrase with a double edge. As a blessing it conveys excitement of the new, as a curse it conveys the uncertainty and turmoil of change. The world of tax-exempt bonds has seen some interesting times since the 1980s. Uncertainty lurks around every corner. Change can be quick, while responses to change may be more deliberate. Guidance that is helpful one day may have limited application the next. In this respect, this article will review changes in procedural requirements that cause some revenue procedures to have limited applicability which may create some uncertainty and make the field of tax-exempt bonds more interesting than it needs to be.

Specifically, this article will review regulations applicable to filing information returns, making late rebate payments, and requesting recovery of overpayments of rebate. Rev. Proc. 88-10, 1988-1 C.B. 635, Rev. Proc. 90-11, 1990-1 C.B. 469, and Rev. Proc. 92-83, 1983-2 C.B. 487, provide additional procedural guidance on these filing issues. It is expected that these revenue procedures will be replaced by updated revenue procedures in the near future.

2. Discussion of Procedures

A. Filing Information Returns

The Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248, added a filing requirement for private activity bonds issued after December 31,1982. Prior to this time there had been no reporting requirements for tax-exempt bonds. Under the provision, any industrial development bond, bond used to finance student loans or used by an organization described in 501(c)(3) would not be tax-exempt if the information reporting requirement was not satisfied.

On December 14, 1983, the Service published IR-83-152, a news release providing guidance to issuers that failed to timely file Form 8038. The purpose of the news release was to provide issuers relief from the consequences of late filing. The standard set forth in the news release was a showing of reasonable cause for the delay. The new release was reprinted as Announcement 84-51, 1984-20 I.R.B. 14.

The Deficit Reduction Act of 1984, P.L. 98-369, extended the reporting requirements to qualified mortgage bonds. The Tax Reform Act of 1986, P.L. 99-514, extended the reporting requirement to any state or local bond. Section 1.149(e)-1T, of the Temporary Income Tax Regulations, T.D. 8129, 52 Fed. Reg. 7410 (1987)(the "1987 regulation"), clarified that private activity bonds file Form 8038, governmental bond issuances of $100,000 or more file Form 8038-G and governmental bond issuances under $100,000 file a consolidated return, 8038-GC. The preamble to the regulation states,

Forms 8038 and 8038-G are to be filed on or before the 15th day of the second calendar month after the close of the calendar quarter in which the issue is issued. Form 8038-GC is to be filed on or before February 15th of the following calendar year. All forms are to filed with the Internal Revenue Service Center, Philadelphia, PA 19255.

Section 149(e) provides that interest on a bond will be taxable unless the reporting requirements of the regulation with respect to a bond are satisfied. The statute allows the Secretary to grant an extension of time for filing the form if the failure to file is not due to willful neglect. Section 1.149(e)-1T lessens the effect of non-filing. For example, following provisions afford issuers some protection from taxability of the bonds: 1) a form will be regarded as completed if the issuer makes a good faith effort to complete the form; 2) an inadvertent failure to file the correct form will be disregarded; 3) forms will be completed on the basis of available information; and the Commissioner may grant an extension of time to file any form required under the regulation if the failure to file in a timely manner was not due to willful neglect. This final provision, which allows extensions for late filing is the subject of Rev. Proc. 88-10.

For the most part, Rev. Proc. 88-10 simply provides that an issuer that fails to timely file its information return, should mail the form along with a letter of explanation soon after the discovery of the failure to file. This provision applies irrespective of which form the issuer is required to file. Thus, extensions are available for filing Form 8038, 8038-G or 8038-GC.

Under this revenue procedure, the form and explanation was filed with the SOI Unit in the Philadelphia Service Center. The SOI Unit was responsible for acknowledging receipt of the form and letter of explanation. It would also make the determination of whether the failure to timely file was due to willful neglect. If it could not make that determination, then it would request technical advice from the Associate Chief Counsel (Technical and International).

If the failure to file in a timely manner was not due to willful neglect, then the information reporting requirements of section 149(e) of the Code were deemed satisfied. If, however, failure to file was determined to be the result of willful neglect, then the form was not accepted and the filing requirements were not satisfied.

Although these regulations have been amended from time to time, they have changed very little substantively. In fact, section 1.149(e)-1T(2)(ii), which contained the provision regarding extension of time to file is virtually identical to the current extension provision found in section 1.149(e)-1(d)(2)(ii)of the regulations ("current regulations").

However, regulation and form changes require issuers to follow slightly different procedures. Returns and late filed returns are now filed with the Submission Processing Center in Ogden, Utah. The Submission Processing Center makes the determination of whether the failure is the result of willful neglect, if it is able. If it is unable to make the determination, it will notify the filer and refer the matter to the Manager, Tax Exempt Bonds, Outreach, Planning and Review ("OPR") for consideration.

The key to making a determination is understanding the application of willful neglect. Since this determination also applies to late payment of rebate under section 1.148-3(h) of the regulations and Rev. Proc. 90-11, it will be discussed separately.

B. Late Payment of Rebate

The Deficit Reduction act of 1984 added section 103(c)(6) of the Internal Revenue Code of 1954 (the "Code of 1954"). Generally, this section provided that industrial development bonds were required to rebate to the United States the amount that their nonpurpose investments exceeded the yield on the bonds. This requirement was generally extended to all tax-exempt bonds by the Tax Reform Act of 1986. Under section 103 of the Code, bonds are not tax-exempt if they are arbitrage bonds. With a few exceptions, failure to pay the required rebate on bonds when due causes bonds to be taxable arbitrage bonds. Generally, the Code requires that rebate installments must be paid at least once every five years. If an installment is not paid when required, a bond may be a taxable. However, the Code provides an escape clause. An issuer may pay a penalty in lieu of loss of tax exemption under section 148(f)(7). Pursuant to this section, an issue will be treated as having made the correct rebate payment when required if the issuer pays a penalty and the failure is not due to willful neglect.

The rebate provisions of the Code were implemented in section 1.148-1T of the 1989 Temporary Regulations. Specifically, the regulation relevant to the avoidance of loss of exemption for a late payment of rebate is section 1.148-1T(c). The 1989 Temporary Regulations were due by their own terms to expire by June 30, 1992. The 1989 regulations were adopted as final regulations in the T.D. 8418, 57 Fed. Reg. 20971 (the "1992 Regulations"). Procedures to carry out the provisions of 148(f)(7) and 1.148-1T(c) and later 1.148-1(c) are set forth in Rev. Proc. 90-11.

By design the 1992 Regulations expired on June 30, 1993. Since June 1993 section 1.148-3(h) of the Regulations (the "1993 Regulations") has governed the late payment of rebate. Issues outstanding on June 30, 1993, may elect to apply the 1993 regulations or continue under the 1992 regulations.

The 1989/1992 regulations and Rev. Proc. 90-11 provide a two-tier approach. Both tiers try to address the intent of the issuer with respect to the failure to pay the correct rebate when due. The first tier involves a determination of "innocent failure." Although "innocent failure" is not defined in either the regulations or the revenue procedure, the regulations provide factors to be considered when determining whether or not a failure is innocent. The factors to be considered "include the size of the correction amount, the size of the issue, the sophistication of the issuer, (or ultimate obligor), the steps taken to comply, the nature of the failure, and the length of the delay." In addition to these factors, if the correction amount owed is $50,000 or more, the payment must be accompanied by a brief explanation of the failure and a basis for concluding it is innocent. It is not usual for a determination of innocent failure to be made on the basis of such factors. However, innocent failure may be determined very mechanically by using the regulation's safe harbor.

Under the safe harbor, a failure is innocent if an issuer can show the following:

- (1)(a) If the amount of the rebate owed plus interest is $50,000 or more, the amount owed is paid within 60 days after discovery of the failure; or (b) if the amount of rebate owed plus interest is under $50,000, the amount owed is paid within 180 days after discovery of the failure;

- (2) If the amount owed plus interest is $50,000 or more, the brief explanation is reasonably accurate; and

- (3) The Commissioner does not notify the issuer within 90 days after receipt of the payment that the safe harbor does not apply.

The most significant of the three factors is the first because it provides a bright line standard. It may be clearly demonstrated whether the issuer did, in fact, pay within 60 or 180 days after discovery. This determination is made by the issuer, so, it may be expected that under the 1989 and 1992 regulations, issuers that failed to rebate earned arbitrage to the United States when due, could still be treated as having made a timely payment by satisfying the safe harbor.

The second tier involves a determination of willful neglect. Even if an issue is unable to demonstrate innocent failure, the failure will not result in loss of tax exemption unless it is due to willful neglect. Under the 1989/1992 regulations, willful neglect operates as a safety net for failures that were not considered innocent. For example, in PLR 9842002 the Service ruled that failure to properly account for proceeds was not an innocent failure. With no discussion, the ruling concludes that the failure to use a reasonable, consistently applied accounting method was not due to willful neglect.

The 1993 Regulations abandoned innocent failure. Rather, section 1.148-3(h) provides that a failure to pay the correct rebate when required will cause the bonds to be arbitrage bonds unless the Commissioner determines that the failure was not due to willful neglect and the issuer promptly pays the rebate owed plus interest and penalty specified in the regulations to the United States. This requirement applies to every failure to pay the correct rebate when required.

To make a determination of willful neglect, the Commissioner must be able to review the factors relevant to the failure. Accordingly, every late payment of rebate must include an explanation of why the payment is late and is not a result of willful neglect. A failure or refusal to provide the explanation could result in the bonds being taxable arbitrage bonds because without an explanation, the Commissioner would be unable to make the determination. Mere acceptance and processing of the late payment by the Service Center should not be misconstrued as an acceptance of the explanation regarding the failure.

While the Service Center will continue to collect and process late payments, it will not make determinations of willful neglect. This function will be performed by OPR, which will also develop the files and request information, if necessary. It will request the written explanation, if not provided.

Determination of willful neglect applicable to late payments of rebate will be the same as willful neglect as applied to late filed information returns. A discussion of willful neglect applicable to both will be discussed in a separate section.

C. Recovery of Overpayments of Rebate

No section of either the 1954 Code or the 1986 Code provide for the recovery of overpayments of rebate. The first mention of recovery of rebate overpayments appeared in 1985 in section 1.103-15AT(e)(3) of the regulations (the "1985 regulations"). These regulations provide that:

> If during any computation period the aggregate amount earned on nonpurpose obligations in which the proceeds of the issue are invested is less than the amount that would have been earned if the yield on such obligations had been equal to the yield on the issue, the issuer may not recover such deficit from an excess previously paid to the United States.

Although the regulation was silent with respect to a recovery of an overpayment resulting from a mistake (such as an arithmetic mistake), it was quite clear that earning of negative arbitrage did not provide a basis for recovering rebate payments. Examples provided in section 1.103-15AT(e)(4) demonstrate that prior installments of rebate would be taken into consideration when aggregating the rebate owed from more than one computation period. The examples show that the issuer would not have to make any rebate payment for the second computation period since the rebate paid for the first period was sufficient to cover the aggregate rebate due as of the close of the second period. However, none of the second period's negative amount was subtracted from the first period's payment.

The 1989 Regulations reserved recovery of overpayment at section 1.148-1T(d). However, section III (F) of the preamble to the regulations states:

> Rebate payments are not refundable. However, it is anticipated that the regulations will provide that issuers generally may recover overpayments if the issuer establishes to the satisfaction of the Commissioner that: (1) The issuer paid an amount in excess of the rebatable arbitrage determined as of the day before the date of payment (and in certain cases as of the computation date immediately preceding such date); (2) the excess was paid as the result of a mistake (*e.g.*, a mathematical error); and (3) recovery of the overpayment on the date the recovery was first requested would result in no rebatable arbitrage as of such date.

When the 1989 Regulations were republished as the permanent 1992 Regulations, section 1.148-1(d) remained as reserved. The 1992 Regulations included a new temporary regulation in section 1.148-13T that provided for recovery of rebate. The preamble to the 1992 Regulations restates the position announced in the 1989 Regulations. An issuer could recover amounts paid by mistake but could not recover rebate paid because of a decrease in the yield of nonpurpose investments. The regulation, itself, makes clear that an overpayment may be recovered only if it is paid as a result of a mistake.

The 1993 Regulations changed the focus of recovery of an overpayment. Prior to these regulations, mistake was a key element for any recovery. Under the 1993 Regulations, payment by mistake may effect the timing of the refund of the overpayment of rebate. The fact that an overpayment was not made by mistake would not preclude recovery under the 1993 Regulations. Thus, under these regulations, an issuer can recover overpayments of rebate merely because the yield on its nonpurpose investments decreased to a yield lower than the bond yield.

Originally, this provision applied only to issues issued after June 30, 1993, and to issues outstanding on June 30, 1993, electing to apply the 1993 Regulations in total. Thus, issues electing to apply the 1992 Regulations could recover overpayments of rebate only if the overpayment was based on a mistake. This was considered unfair to issues applying the 1992 Regulations and was corrected by temporary regulations issued in 1994 in TD 8538, 59 Fed. Reg. 24039 (1994). Section 1.148-11T(c)(4) provides that an issue may apply the rebate recovery provisions of the 1993 Regulations to any bonds subject to the rebate provisions of the Code. This provision was finalized as a permanent regulation in 1.148-11(c)(1) and 1.148-11A(c)(4) in T.D. 8718, 62 Fed. Reg. 25502 (1997).

Since 1997, nothing of note regarding Rev. Proc. 92-83 had been published until the publication of Form 8038-R, issued November, 2001. Line 11 of this Form provides a box to be checked if the issuer elects to apply the current regulations, although the line instruction is worded as an election not to apply the 1992 regulation. The general instructions explains line 11 as follows:

Current Regulation sections 1.148-1 through 1.148-11 apply to issues outstanding after June 30, 1993. If the issue was outstanding prior to July 1, 1993, the 1992 regulations apply (i.e., Regulations section 1.148-1 through 1.148-12 effective May 18, 1992 (T.D. 8418, 1992-1 C.B. 29)). However, check the box if the issue was outstanding prior to July 1, 1993, and the issuer has elected **not** to apply the 1992 regulations; the current Regulations sections 1.148-1 through 1.148-11 apply.

These instructions are correct, however, they may cause confusion for issuers unfamiliar with recovery of rebate provisions or effective date provisions in the regulations. The instructions suggest that an election is an all or nothing proposition. That is, if an issuer does not elect to apply the 1993 Regulations, then the 1992 Regulations would apply, in their entirety, to the bonds, including the 1992 provisions applicable to recovery of rebate. Actually, an issuer may elect to apply the 1992 Regulations to its rebate calculations or rebate payment generally, but nonetheless, apply the current regulations to the recovery of rebate overpayments pursuant to section 1.148-11(c)(1) or 1.148-11A(c)(4) of the current regulations. As a matter of course, this is the provision applied to requests for recovery of overpayments of rebate.

The instructions state that Form 8038-R replaces Rev. Proc. 92-83. Announcement 2001-115, 2001-48 I.R.B. 539, also states that the Form replaces the revenue procedure. As a practical matter these statements are true. Form 8038-R requests information relevant only to the current regulations and has eliminated information relevant only to the 1992 Regulations. Rev. Proc. 92-83 will most likely not be used, however, because the rebate recovery provisions of the 1992 Regulations severely limit an issuer's recovery of its overpayment. Rev. Proc. 92-83, however, has not yet been formally superceded or obsoleted.

3. Willful Neglect

Under the 1986 Act, the failure to file a substantially completed information return or a failure to pay the correct rebate when required may cause an otherwise tax-exempt bond issue to become taxable. See sections 148(f)(1) and 149(e)(1) of the Code. Loss of tax-exemption is the ultimate penalty imposed on a tax-exempt bond issue. The Code does not impose such a penalty lightly. Accordingly, both sections allow for correction by the issuer, provided the failure is not due to willful neglect.

The Code requires the IRS to make a determination regarding willful neglect before treating the bonds as taxable. As discussed in prior sections, OPR will make this determination. Thus, processing of late rebate payments and late filings of information returns requires an understanding of willful neglect.

"Willful neglect" is not defined in the Code or the regulations. The term is, however, construed in the case law interpreting many of the Code sections using the term. Unfortunately, to date, no cases have construed "willful neglect" as it is used in section 148 or 149 of the Code. However, the term is used many similar sections in the Code which impose penalties for a failure to file a return or pay taxes when due. By analogy, this discussion will apply Court constructions of "willful neglect" as the term is applied in other sections and will focus primarily on section 6651. It will also compare I.R.S. interpretations of "willful neglect" as that term is applied to section 148 and 149.

A. Interpretation of Willful Neglect in Other Code Sections

Section 6651 of the Code may be the most significant section applying "willful neglect" because it is generally applicable to a failure to file a return or pay tax under a variety of provisions in the Code. It is also the section most recently reviewed by the Supreme Court of the United States in United States v. Boyle, 469 U.S. 241 (1985). Because of the latter distinction, many courts, although not all, have been inclined to import an interpretation of the use of the terms "willful neglect" and "reasonable cause" for section 6651 purposes into discussions of the use of such terms in other sections. Several courts noted that "willful neglect" and "reasonable cause" should be interpreted consistently in various Code sections. See Dogwood Forest Rest Home v. United States, 181 F. Supp. 2d 554 (M.D.N.C. 2001), Del Commercial Properties, Inc. v. Commissioner, 251 F.3d 210 (DC Cir. 2001), and Erickson v. Commissioner, 172 B.R. 900 (1994).

For the present, it may be appropriate for OPR to use the Boyle case and discussions of section 6651 generally when making determination of willful neglect under sections 148 and 149 of the Code. However, section 6651 uses the term "due to reasonable cause and not due to willful neglect,"whereas sections 148 and 149 refer only to "willful neglect."

These are not treated as separate and distinct terms. Many courts address only "reasonable cause" treating the terms "due to reasonable cause" and "not due to willful neglect" as alternatives. The same facts prove both elements. Although many cases discuss only reasonable cause, they also impose a penalty which requires a finding of willful neglect. Some courts even state that "reasonable cause" is an implied alternative to "willful neglect" even when not present.

1) Mistake

In Marrin v. Commissioner, 147 F.3d 147 (2d Cir. 1998), the Court held

that taxpayer's belief that it did not have to file a return was not due to reasonable cause and imposed a penalty. The Court found that the belief was based on a mistaken belief rather than competent advice. Generally, an unsupported belief, no matter how sincere, will not protect a taxpayer from imposition of the penalty. Similarly, the Court in Sabatini v. Commissioner, 98 F.2d 753 (2d Cir. 1938) concluded that taxpayer's innocent belief that he did not have to file returns was not reasonable cause.

However, a mistaken belief supported by some corroborating or mitigating factor may preclude imposition of a penalty. For example, uncertain or ambiguous requirements may provide sufficient reason to support taxpayer's belief. See United States v. Brennan, 488 F.2d 858 (5th Cir. 1974). Mistaken belief of the taxpayer will generally result in no penalty when the basis for that belief is the erroneous advice of a tax professional. But note, the tax professional must have all the necessary facts. See Haywood Lumber Co. v. Commissioner, 178 F.2d 769 (2d Cir. 1950) and Hatfried, Inc. v. Commissioner, 162 F.2d 628 (3d Cir. 1947). In Given v. Commissioner, 238 F.2d 579 (8th Cir. 1956), the Court held that the failure to file was due to willful neglect where it concluded that the taxpayer kept information from the tax professional.

2) Inadvertence

In cases where the taxpayer is aware of the requirement, but nevertheless, fails to file or pay tax due to inadvertence, courts generally uphold imposition of a penalty. In Logan Lumber Company v. Commissioner, 365 F.2d 846 (5th Cir. 1966), the new president of the taxpayer took office one month before the return was due. In upholding the penalty, the Court stated, "[i]f every taxpayer who forgot to file a return or was too busy to file a return escaped the penalty for failure to file, our tax system would soon collapse." Inadvertence will not provide reasonable cause for a failure to pay tax. See In re Priest, 204 B.R. 53 (1996).

3) Incomplete Information

In some cases, a taxpayer failed to file a timely return because he did not have all information required on the form. In other cases taxpayers were unable to acquire the necessary information in spite of their best efforts. If accessing information was clearly beyond the control of the taxpayer, courts are reluctant to uphold a penalty. In re Sims, 92-1 U.S.T.C. ¶50,034, held that taxpayer was not subject to penalties under sections 6651 and 6654 of the Code since the taxpayer and his accountant found it impossible to acquire the necessary information. It noted that a showing that compliance was beyond taxpayer's control provides a basis for concluding that the failure occurred as a result of a reasonable cause. In

re Molnick's, Inc., 95-1 U.S.T.C. ¶ 50,209 reaches a similar outcome where the necessary information is indeterminable at the time the returns were due.

However, courts generally look for some effort on taxpayer's part to acquire the necessary information in a timely manner. In Randall v. Commissioner, T.C.M. 1997-351, the Court upheld imposition of a penalty for a failure to file. The U.S. Court of Appeals for the District of Columbia (in an unreported opinion, see 1998 U.S. App. Lexis 28499 for a full opinion) noted that the taxpayer in this case offered no explanation for his failure to obtain the necessary information. Similarly, in Blum v. Commissioner, 5 T.C. 702 (1945), the Tax Court upheld Commissioner's imposition of a penalty for failure to file. Taxpayer had claimed that he lacked the necessary information to file in a timely manner. However, the Tax Court noted that "[t]here is no showing in the record as to what efforts petitioner made to obtain the necessary figures or as to why he was unable to obtain them." A taxpayer's lack of efforts to acquire such information may demonstrate willful neglect and uphold imposition of a penalty.

While most of the cases have discussed, "reasonable cause" and "willful neglect" when applied to a failure to file, the terms seem to have the same meaning when applied to a failure to pay tax when due, although circumstances surrounding the failure may differ. Taxpayer's position that it had a reasonable cause for a failure to pay must be supported by more than a bare statement without corroboration. For example, in Kennedy v. United States, 542 F. Supp. 1046 (D.N.H. 1982) a claim that payment of tax would cause hardship did not provide a reasonable cause when the taxpayer made no effort to demonstrate the amount of its assets and liabilities. The Court held that taxpayer did not show that the failure was not the result of willful neglect.

The Boyle opinion noted that after 70 years of case law "willful neglect" has come to be defined as a conscious, intentional failure or a reckless indifference. The cases that have been discussed demonstrate some of the factors that may demonstrate willful neglect even when there is no clear conscious or intentional failure.

B. Application of Willful Neglect in Sections 148 and 149

Although no court cases have interpreted the meaning of "willful neglect" as the term is used in section 148 and 149 of the Code, the Service has issued several private letter rulings to issuers in which the Service made a specific determination as to whether a failure was due to willful neglect. The following letter rulings are discussed solely to demonstrate the Service's analysis of "willful

neglect," however, under section 6110(k) of the Code, a written determination (such as a private letter ruling) may not be used or cited as precedent.

The rulings interpreting section 148 or 149 of the Code do not seem as likely to determine that a failure to file or pay rebate is the result of willful neglect as in other sections of the Code. Of the rulings that have considered whether a failure was the result of willful neglect, none has concluded that a failure actually resulted from willful neglect. Several rulings conclude that willful neglect is not present without any discussion. Others in applying the 1992 Regulation conclude that if an issuer satisfies the safe harbor for innocent failure, that failure would not result from willful neglect. Again, very little light is shed on the meaning of the term. See PLRs 8819064, 9044057, 9204024, 9405018, 9814002, and 200023002.

1) PLR 200037018

Two of the rulings demonstrate that a finding of willful neglect may be a very limited under section 148 of the Code. In PLR 200037018 the issuer elected to pay a penalty-in-lieu of rebate. This election is made pursuant to section 148(f)(4)(C)(vii) and applies to expenditure of construction proceeds. Under the provision, the spending of construction proceeds must satisfy the spending requirements of section 148(f)(4)(C)(ii). This section requires 10 percent of the available construction proceeds to be spent within 6 month of issue; 45 percent within one year of issue; 75 percent within 18 months of issue; and 100 percent within 2 years of issue. If the spending requirement is not satisfied, issuer must pay the penalty within 90 days of the close of the spending period. In this case, the trustee had the responsibility to make certain that the issue complied with its rebate requirements. Although this arrangement might be unusual, the ruling noted that the trustee did not contact issuer and the issuer did not contact the trustee over an 8½-year period. Neither issuer nor trustee monitored tax compliance of the bonds.

The ruling notes that the discovery of the failure to pay was made late in 1998, (although not specified, the date would have been in late October or early November). However, issuer was under the incorrect impression that no penalty-in-lieu of rebate was owed unless rebate was actually earned. The trustee and the issuer reviewed the bond documents and transactions from February 1999 to August 1999. Also during this time legal counsel advised issuer that the failure to pay penalty and the penalty-in-lieu-of rebate was owed. In January 2000 issuer requested a private letter ruling waiving the failure to pay penalty. At the request of the Service, issuer made its penalty-in-lieu-of rebate payment in April 2000. The ruling letter concluded that the failure to monitor the penalty-in-lieu-of rebate for about 8½ years and the failure to pay for another 1½ year was at a minimum negligent. However, without further discussion the ruling concluded that it was not willful neglect.

2) PLR 9842002

PLR 9842002 involves another fact pattern where an issuer elected to pay a penalty-in-lieu-of rebate on its construction proceeds. The entity paid the penalty when required, however, it consistently underpaid the amount of penalty. This occurred because of the method by which the entity determined its available construction proceeds. The ruling states that the "[e]ntiy attempted to increase the amount of proceeds allocated to expenditures in prior spending periods by reallocating bond proceeds from investments to expenditures." The entity also attempted to change project line items to which proceeds were allocated. In this manner, "[e]ntity allocated more to expenditures than it actually withdrew from its Construction Account. Yet, Entity determined its earnings for the spending period based upon the actual balance in the Construction Account." These accounting procedures allowed the Entity to demonstrate satisfaction of its spending requirements. The Service concluded that:

> The number and nature of the adjustments to each allocation, the inconsistent allocations within each spending period, and the substantial period of time over which these adjustments were made lead us to conclude that the failure to properly account for proceeds was not innocent and, thus, if the penalty was underpaid, that underpayment was not an innocent failure.

The ruling recognizes the intentional nature of the accounting methodology to avoid paying penalty-in-lieu-of rebate. Notwithstanding, such conclusions the ruling states, "we also conclude that this failure was not due to willful neglect."

Both of these rulings discuss fact patterns in which the issuer or conduit borrower elected to pay the penalty-in-lieu-of rebate under section 148 of the Code. However, as noted in Erickson, *supra*, use of the same term in the same statute would presumptively have the same meaning. Therefore, discussion of "willful neglect" under section 148(f)(4)(C)(x) would be equally applicable to "willful neglect" used in section 148(f)(7). Even so, as nonprecedential documents, private letter rulings provide only limited assistance in efforts to interpret the phrase "not due to willful neglect" in the context of provisions related to failure to pay or file tax-exempt returns.

C. Making a Determination of Willful Neglect

The aforementioned court cases and private letter rulings do provide, however, some indication of the facts and circumstances that the Service should consider when making a determination regarding willful neglect in the context of a failure to timely file a completed information return or make a rebate payment.

The questions below attempt to draw from the cases and rulings a list of inquiries that should be made to insure that the Service has considered all the relevant facts of a matter before making such a determination.

1. Did the failure result from inadvertence?
2. Did the failure result from a lack of knowledge of the law?
3 Did the failure result from a mistaken belief of the requirements?
4. Were there any circumstances causing the mistake or misunderstanding?
5. Did the failure occur as a result of advice of a tax professional?
6. If the failure resulted from mistake or reliance, do facts support that the belief or reliance was reasonable?
7. Did the failure result from a reasonable cause and therefore not constitute willful neglect?

A) Were there unavoidable postal delays?
B) Did issuer file with the wrong office?
C) Did the I.R.S. provide misleading or incorrect advice?
D) Did a death or serious illness cause the failure?
E) Were the responsible parties unavoidably absent?
F) Were issuer's records destroyed?

8. Were corroborating factors reasonably relied upon?
9. Had there been a very recent change in the law?
10. If failure was based on a good faith belief, what factors caused this good faith belief?
11. If issuer believed that no rebate was owed, was that belief reasonable?
12. Did the issuer contact the Service as soon as it discovered the failure to pay rebate?

4. Conclusion

In certain instances, such as when an issuer fails to correct for significant period of time after discovery or when an issuer consistently applies an accounting method which underreports proceeds, a finding of willful neglect may be appropriate. In making such a determination, the Service will weigh all of the relevant facts and circumstances in each case prior to making a determination regarding whether a failure was due to willful neglect. If the Service determines that the failure is due to willful neglect, the Service will provide the issuer an opportunity to enter into a closing agreement, including, but not limited to, payment of a closing agreement amount, to preserve the tax-exempt status of the bonds.