

# **Tax Exempt Bonds Teleconference on the Voluntary Compliance Program**

**Presented by  
TEB Compliance & Program Management  
on  
Thursday, September 8, 2011**



# Topics & Speakers

- **Post-Issuance Compliance**
  - Mark Westergard
- **VCAP Administrative Process**
  - Debbie Cho
- **VCAP Resolution Standards**
  - George Gurrola
- **Moderator**
  - Steven Chamberlin



# DISCLAIMER

**The information contained in this presentation is current as of the date it was presented. It should not be considered official guidance.**

**The information contained in this presentation is a summary of key points. Reference should be made to Notice 2008-31 and sections 7.2.3 and 4.81.6 of the Internal Revenue Manual in their entirety.**



# **Tax Exempt Bonds Post-Issuance Compliance**

**Presented by:  
Mark Westergard  
Senior Tax Law Specialist**



# Post-Issuance Compliance

- **Federal tax requirements applicable to tax-favored bonds**
- **Tax-exempt bonds**
  - Exclusion of interest income received by bondholders
- **Tax credit bonds**
  - Bondholders allowed a tax credit
- **Direct pay bonds**
  - Issuers receive a direct payment



# What is “Post-Issuance Compliance”?

- On-going compliance requirements after issuance
- Issuer (and possibly others) keeping promises made to maintain qualification for tax-favored treatment
- Tax covenants (promises) in bond documents
  - Tax certificate (or tax agreement), indenture, bond ordinance, or resolution



# Consequences of Failed Compliance (Broken Promises)

- Issuer failure to comply with covenants results in a loss of tax-favored status
  - Assuming covenants satisfy all federal tax requirements
- Bondholders lose exclusion of interest income or availability of tax credits
- Issuer loses refundable credit payments



# Causes of Compliance Failures

- Inadvertent failures
  - Misunderstanding
  - Lack of attention
- Change of facts or expectations



# Self-Correction Actions

## Qualification Requirements

- **Violations of qualification requirements**
  - **Redemption or defeasance of nonqualified bonds within 90 days of the deliberate action**
  - **Alternative use of disposition proceeds within 2 years of the deliberate action**
  - **Alternative use of bond-financed property**
  - **Qualified 501(c)(3) bonds treated as reissued (e.g. public approval and Form 8038 filing requirement)**



# Self-Correction Actions Arbitrage Requirements

- **Violations of arbitrage requirements**
  - **Intentional act**
  - **Cannot be self-corrected but in some cases a yield reduction payment may be allowed**
  - **VCAP available when there are no self-correction options**



# Connection to Written Procedures

- Self-correction actions must be completed within set time periods
- Some self-correction actions have prerequisites (e.g., notices to bondholders)
- Written procedures promote early awareness and due diligence monitoring



# If Self-Correction is Not Available

- Issuer can request relief under VCAP (Voluntary Closing Agreement Program)
  - If no self-correction option is available;
  - If the issuer misses the required time period; or
  - If other prerequisites are not able to be satisfied



# What is VCAP?

- **Alternative dispute resolution program where the issuer voluntarily identifies the problem and negotiates an appropriate resolution**
- **Issuer receives more favorable treatment than resolution of similar matter under examination**
- **Administered by the Compliance & Program Management staff within the Office of Tax Exempt Bonds**



# Effect of Written Procedures in VCAP Resolutions

- Many factors considered in determining appropriate VCAP resolution terms, including the settlement amount
- Whether issuer has effective written procedures to monitor post-issuance compliance is an important consideration
- New IRM section provides for a reduced settlement amount for VCAP requests resolving violations identified as part of an effective post-issuance compliance monitoring process



# Issuers' Use of Written Procedures

- Some issuers have well-crafted tax certificates and use the certificates in their operations to monitor post-issuance compliance for those bonds
- Some issuers have adopted and implemented effective written procedures governing post-issuance compliance monitoring for all of their bonds



# What Should Written Procedures Cover?

- **Written procedures should include:**
  - Performing due diligence review at regular intervals
  - Identifying the official or employee responsible for review
  - Training the responsible reviewer
  - Retaining adequate records to substantiate compliance
  - Taking timely actions to resolve identified noncompliance
- **Goal is to timely identify and resolve violations to maintain tax-favored status**



# Post-Issuance Compliance

## Recap of Key Points

- **Post-issuance compliance is an ongoing responsibility of the issuer**
- **Self-correction options are available**
- **Comprehensive written procedures can help issuers timely identify and prevent or resolve noncompliance**



# **Tax Exempt Bonds Voluntary Closing Agreement Program (VCAP)**

**Presented by:**

**Debbie Cho**

**Tax Law Specialist**



# Tax Exempt Bonds

## Voluntary Compliance Guidance

- Revenue Procedure 97-15
  - Closing agreement program to correct post-issuance changes in use from qualified to nonqualified purposes
- Notice 2001-60
  - Created the TEB Voluntary Closing Agreement Program (VCAP) to correct violations relating to tax-exempt bonds not otherwise correctable through programs described in the Regulations or other published guidance
- Notice 2008-31
  - Expanded jurisdiction of VCAP to include the correction of violations relating to tax credit bonds



# VCAP

## Internal Revenue Manual

- **IRM 7.2.3 provides administrative procedures for the VCAP program**
  - **IRM 7.2.3.2 provides procedures for VCAP submission requests**
  - **IRM 7.2.3.3 provides procedures for the processing of VCAP cases**
  - **IRM 7.2.3.4 provides resolution standards for correcting certain identified violations through a streamlined process**
- **IRM 4.81.6 provides general procedures for entering into TEB closing agreements**



# Objectives of VCAP

- Encourage issuers to timely identify and correct violations as expeditiously as possible
- Resolve violations with issuers at the transaction level as opposed to with bondholders
- Resolution terms (including settlement amounts) generally more favorable than resolution terms in an examination



# Scope of VCAP

## General Eligibility

- When there is an advantage to permanently resolve specific matters and there is no disadvantage to the U.S. government
- VCAP closing agreements conclusively resolve specific matters that have occurred
  - Private letter rulings address matters of law to determine whether a violation will result from future events or actions



# Scope of VCAP

## General Eligibility Exceptions

- If the violation can be remediated
- If the bond issue is under examination
- If the tax-favored status is at issue in any federal court, the IRS Office of Appeals, or other proceeding
- If the violation was due to willful neglect



# Scope of VCAP

## Finality

- VCAP closing agreements are final and conclusive as to matters agreed upon absent fraud, malfeasance, or misrepresentation of a material fact
- Bond issues accepted into VCAP are not selected for examination
  - Anonymous requests may be selected for exam
- Bond issues may be selected for examination after a VCAP case is resolved
  - However, resolution of the specific violation under VCAP remains final and conclusive



# Facts Submitted by Issuer

- VCAP based on factual representation of issuer under penalty of perjury without independent review by CPM
- Facts represented by other parties (e.g., conduit borrower or trustee) submitted under penalty of perjury must also be certified by the issuer under penalty of perjury that to the best of the issuer's knowledge such facts are true and accurate



# Information in Submission

- **IRM 7.2.3.2.1 contains a detailed list of information required in the VCAP submission request**
- **Failure to include all required information may result in case closure without resolution**
- **Information must be submitted under penalty of perjury and with representation that to the best of the issuer's knowledge and belief of the issuer all facts are true, correct and complete**
- **Issuer must include statement as to whether or not it has adopted written post-issuance compliance procedures**
- **Issuer must include detailed description of such procedures relating to the violation**



# VCAP Processing

- Review of file for completeness and request any missing information
- Complete submissions are assigned to a specialist
- Specialist contacts issuer and requests any further information necessary to review the matter
- Failure to respond to the specialist's requests may be considered a lack of good faith by the issuer in proceeding with due diligence toward resolution
  - Issuer may receive demand letter requiring information to be provided within 15 days to avoid case closure



# VCAP Processing Cont'd

- **Specialist prepares memo for Manager**
- **If Manager approves, specialist prepares closing agreement**
  - Resolution of anonymous requests are by correspondence only
- **VCAP proposals generally must be approved by the TEB Closing Agreement Committee**
  - Streamlined resolutions under IRM 7.2.3.4 do not require Committee approval



# Case Resolution and Closure

- Final closing agreement and payment instructions are sent to issuer for signature
- After receipt of payment, issuer executed closing agreements and completion of any remedial action, CPM will execute the closing agreements
- If direct pay bonds involved, a copy of the closing agreement will be sent to TEB's Form 8038-CP prepayment review team
- VCAP cases may be closed by correspondence without resolution when appropriate (e.g., withdrawal, ineligibility)



# Anonymous VCAP Requests

- Purpose is to help issuers identify appropriate resolution methods for complex or unique matters where settlement terms are uncertain
- Request must be limited to a general question or generic factual scenario
  - CPM will only provide a general response with possible settlement approaches and will not discuss specific settlement terms
- Bond issues relating to anonymous requests are subject to examination
  - Issues selected for examination are not eligible for VCAP



# VCAP

## Recap of Key Points

- Notice 2008-31 and IRM 7.2.3 provide administrative procedures for the VCAP program
- Issuers are expected to proceed with due diligence through the VCAP process
- Closing agreements are final and conclusive and are based upon the issuer's factual representations



# **Tax Exempt Bonds**

## **VCAP Resolution Standards**

**Presented by:**  
**George Gurrola**  
**Senior Tax Law Specialist**



# **VCAP Resolution Standards**

## **Topics to be Covered**

- I. Tax-Exempt Bonds (IRM 7.2.3.4.2)**
- II. Certain Direct Pay Bonds (IRM 7.2.3.4.3)**
- III. Certain Modifications to Resolution Standards Based on Timing of Discovery of Violation (IRM 7.2.3.4.4)**
- IV. Customized VCAP Proposals**



# Resolution Standards for Tax-Exempt Bonds

## What's new?

- **2 new resolution standards:**
  - Ownership of 501(c)(3) bond-financed property
  - Extinguishment/merger
- **\$1,000 minimum settlement amount**
- **Establishment of defeasance escrows**



# Resolution Standards for Tax-Exempt Bonds

What isn't new?

- Payment increase of 10% @ 6-12 months
- Technical fixes



# Resolution Standards for Certain Direct Pay Bonds

## Basic resolution framework

- Credit maintenance amount
  - Past subsidy overpayments + interest
  - Present value of future overpayments
- Credit adjustment period
  - First date (date of violation/action or issuance)
  - Final maturity or effective date of modification of debt service schedule for subsidy purposes
- Difference between VCAP and exam
- No defeasance required



# Resolution Standards for Certain Direct Pay Bonds

- 4 new resolution standards:
  - Private activity violation
  - Impermissible use of proceeds
  - De minimis premium violation
  - Extinguishment/merger



# Resolution Standards for Certain Direct Pay Bonds

- **Private activity violation standard – key aspects**
  - Credit adjustment period is from the date of violation or deliberate action to maturity
  - Debt service schedule modification permitted to shorten the credit adjustment period
  - Pro rata principal reductions only



# Resolution Standards for Certain Direct Pay Bonds

- Impermissible use of proceeds standard – key aspects
  - Credit adjustment period is from the date of issuance to maturity
  - Debt service schedule modification permitted to shorten the credit adjustment period
  - Pro rata principal reductions only



# Resolution Standards for Certain Direct Pay Bonds

- **De minimis premium violation standard – key aspects**
  - Credit adjustment period is from the date of issuance to maturity
  - Debt service schedule modification permitted to shorten the credit adjustment period
  - Issuer reliance on issue price certifications



# Resolution Standards for Certain Direct Pay Bonds

- Extinguishment/merger standard – key aspects
  - Required opinion that bonds remain outstanding under State law
  - Credit adjustment period is from the date of initial acquisition to a specified interest payment date
  - Increased payment amount for bonds acquired in the IPO
  - Subsequent sale to unrelated party must have occurred prior to execution of the closing agreement



# Certain Modifications to Resolution Standards

- New provision under section 7.2.3.4.4
- Incentive to adopt and use written procedures to monitor post-issuance compliance as part of on-going operations
- Shortened credit adjustment period
- Favorable treatment in determining settlement amount



# Customized Proposals

- Issuers can propose alternative resolution approaches based upon unique facts and circumstances
  - CPM will evaluate the alternative proposal in light of its benefit to the issuer or bondholders as well as to the U.S. government



# **VCAP Resolution Standards**

## **Recap of Key Points**

- **VCAP resolution standards provide a streamlined settlement approach for quick resolution**
- **Standards are available with respect to certain violations impacting tax-exempt bonds and direct pay bonds**
- **Issuers who timely identify violations pursuant to their written post-issuance compliance procedures and timely submit their VCAP request will be subject to a reduced settlement amount under VCAP**



# For More Information Visit [www.irs.gov/bonds](http://www.irs.gov/bonds)

- **Click “TEB Post-Issuance Compliance”**
  - Article providing basic concepts
- **Click “TEB Voluntary Compliance”**
  - Links to articles on self-correction options and private letter rulings
  - Links to Notice 2008-31 and other guidance
  - Links to a guide for the VCAP IRM providing direct links to specific sections
  - Illustrative examples on how the resolution methodologies apply to generic factual scenarios



# Tax Exempt Bonds

## Compliance Guide Publications

- Pub 4077, *Tax-Exempt Bonds for 501(c)(3) Charitable Organizations*
- Pub 4078, *Tax-Exempt Private Activity Bonds*
- Pub 4079, *Tax-Exempt Governmental Bonds*



# Contact Us With Your Questions

- Send us an email at [TaxExemptBondQuestions@irs.gov](mailto:TaxExemptBondQuestions@irs.gov)
  - Include contact information
- Look for web updates including answers to frequently asked questions later this fall

