



Voluntary Compliance for Tax-Exempt and Tax-Credit Bonds

Tax-Advantaged Bonds Compliance

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

The Internal Revenue Service Office of Tax Exempt Bonds (TEB) offers specialized information and services to the municipal finance community. Municipal bonds provide tax-advantaged financing to further governmental and qualified purposes. Detailed educational resources, including resources on post-issuance compliance and voluntary compliance (including TEB VCAP requirements) are available on TEB's website: www.irs.gov/Tax-Exempt-Bonds.

Tax-Advantaged Bond Compliance

Tax-advantaged bonds (tax-exempt, tax-credit and direct pay) are obligations that receive preferential treatment under the Internal Revenue Code (Code). These bonds, issued by or on behalf of state and local governments, are subject to federal tax requirements, both at the time of issuance and as long as the bonds remain outstanding. An issuer, conduit borrower or other party's failure to comply with any federal tax requirements of tax-advantaged bonds could jeopardize the preferential tax status of those bonds.

Compliance at Time of Issuance

Federal tax requirements that apply at the time the bonds are issued include a requirement that the issuer file a Form 8038 Series information return (for example, 8038, 8038-G, 8038-GC or 8038-TC) and that the issuer have reasonable expectations that there will be ongoing post-issuance compliance. Additional issuance requirements might include a proper volume cap allocation and public approval of the bond issue.

Compliance Following Issuance

Post-issuance federal tax requirements generally fall into two categories:

- (1) Qualified use, including use of the bond proceeds and the property financed by bond proceeds; and
- (2) Investment restrictions of bond proceeds under the arbitrage rules.

Qualified use requirements require monitoring of the various direct and indirect uses of bond financed property over the life of the bonds, determining the sources of debt service payments and security for the debt and calculating the percentage of nonqualified uses within the project to be financed with the bond proceeds. Arbitrage requirements involve calculating and monitoring investment yield on investments of bond proceeds, determining appropriate restrictions on the investment yields and the amount of arbitrage on the investments, and calculating the amount and timing of arbitrage rebate payments that must be paid to the U.S. Treasury.

There may be other post-issuance due diligence requirements. For example, post-issuance monitoring may be required to determine whether qualified private activity bonds comply with issuance cost limitations.

Importance of Post-Issuance Compliance

The ongoing nature of post-issuance federal tax requirements that apply to tax-advantaged bonds requires issuers to actively monitor compliance throughout the life of their bonds. An issuer's due diligence should help the issuer retain the tax-advantaged status of its bonds by:

- Identifying noncompliance;
- Preventing violations from occurring; and
- Correcting identified violations timely (when prevention is not possible).

Post-Issuance Compliance Procedures

The IRS encourages issuers to adopt effective monitoring procedures for their tax-advantaged bond issues beyond reliance on tax certificates and bond documents provided at closing. Sole reliance on tax certificates and bond documents may result in an issuer having insufficient procedures to ensure continued compliance. Effective compliance procedures may include:

- Periodic due diligence review;
- Having specific officials or employees responsible for the review;
- Training responsible officials or employees;
- Retaining adequate records to substantiate compliance (for example, records of expenditure/investment of proceeds, use of debt financed property and related contracts);
- Procedures reasonably expected to timely identify noncompliance; and
- Procedures ensuring that the issuer will take steps to timely correct identified noncompliance.

Establishing and following monitoring procedures helps issuers preserve the preferential tax status of their tax-advantaged bonds.

Remedial Actions

An action that causes an issue to meet the private business tests or the private loan financing test is not treated as a deliberate action if the issuer takes a remedial action under the Income Tax Regulations (Treasury Regulations). If the issuer takes an appropriate remedial action, it prevents the bonds from losing their tax-advantaged status. Some common deliberate actions for which remedial action may be available include:

- A management contract that results in private business use;
- Sale of bond-financed property;
- Lease of bond-financed property to a nongovernmental person; or
- Failure to use 95% of net proceeds to provide an exempt facility.

An issuer who discovers a deliberate action that may result in a federal tax requirement violation should determine if there are available remedial actions under the Treasury Regulations or other published guidance.

Record Retention Requirements

The Code and Treasury Regulations require the retention of the records necessary to substantiate compliance with federal tax requirements for tax-advantaged bonds. Generally, any person subject to income tax, or any person required to file a return of information with respect to income, must keep books and records sufficient to establish the amount of gross income, deductions, credits or other matters required to be shown by that person on any return. This includes Form 8038 Series and other returns filed by the issuer with respect to a tax-advantage bond issue.

TEB Voluntary Closing Agreement Program

The Tax Exempt Bonds Voluntary Closing Agreement Program ([TEB VCAP](#)) provides remedies for issuers who voluntarily come forward to resolve a violation that cannot be resolved under self-correction programs described in the Treasury Regulations or other published guidance. Closing agreement terms and amounts may vary according to the degree of violation as well as the facts and circumstances surrounding the violation. TEB VCAP operating procedures are in [section 7.2.3](#) of the Internal Revenue Manual (IRM). TEB, on occasion, will publish a highly streamlined VCAP for specific noncompliance issues. While these programs are part of the VCAP program, special provisions apply to them.

Objectives

The TEB VCAP encourages issuers and other parties involved in tax-advantaged bond transactions to exercise due diligence in complying with the federal tax requirements, and to provide a vehicle to correct violations as quickly as possible before they are discovered during an examination. An issuer submitting a TEB VCAP request under the program can generally expect to resolve the case on terms that are more favorable than terms had the violation been discovered as a result of an examination.

Availability

TEB VCAP is available to issuers of tax-advantaged bonds who have discovered a violation of the federal tax requirements that applies to their bonds. The program is not available for bonds under examination, or if the tax-advantaged status is at issue in a federal court or before the IRS Office of Appeals. The program is generally not available, absent extraordinary circumstances, if the violation can be resolved under existing remedial action provisions or other non-VCAP closing agreement programs in the Treasury Regulations or other published guidance.

Submitting a Request

A TEB VCAP request must include [Form 14429](#), Tax Exempt Bonds Voluntary Closing Agreement Program Request. The form must be signed under penalty of perjury and included at the beginning of the request. This form assists issuers in organizing their TEB VCAP requests and ensuring that their submissions meet all the requirements under Notice 2008-31 and IRM Section 7.2.3. E-mail submissions should be sent to: TEBVCAP@irs.gov. Requests may also be mailed to: Internal Revenue Service, Attn: TEB VCAP, 1122 Town & Country Commons, Chesterfield, MO 63017.

Standard TEB VCAP Resolution Terms and Requirements

Generally, TEB uses [standard closing agreement resolution terms](#) for VCAP closing agreements. For certain violations, TEB also uses [standard methods](#) for computing a closing agreement amount. TEB describes [resolution standards](#) that may be used to conclusively resolve certain violations. Methodologies relating to calculation of settlement amounts under these resolution standards are fully described in IRM section 4.81.6. If a violation does not fall within one of these standards, TEB will determine the appropriate resolution requirements and closing agreement amount under the facts and circumstances of the case. In determining this amount, TEB may expand upon the resolution standards available under its IRM procedures. Examples of resolution standards for specific violations of federal tax laws that apply to tax-exempt bonds include:

- A final allocation of tax-exempt bond proceeds to nonqualified purposes that exceeds the defined percentage limits;
- Property provided with the net proceeds of a qualified 501(c)(3) bond issue is owned by a person other than a 501(c)(3) organization or a governmental unit;
- When the net proceeds allocated to property are from bonds that have an average maturity of more than 120% of the average reasonably expected economic life of the property;
- A party to the escrow agreement violates the agreement by failing to timely reinvest proceeds of a refunding issue, upon maturity of the investments (for example, failure to reinvest proceeds of a matured guaranteed investment contract in 0% U.S. Treasury Securities – State and Local Government Series in an effective escrow); and
- An issuer of otherwise qualified 501(c)(3) advance refunding bonds for which public approval is required issues the bonds without obtaining public approval.

Examples of resolution standards for specific violations of federal tax laws that apply to certain direct pay bonds include:

- A deliberate action that causes Build America Bonds or Recovery Zone Economic Development Bonds to be private activity bonds;
- A final allocation of proceeds to an impermissible use;
- A violation when on the issue date, any maturity of certain Build America Bonds, Recovery Zone Economic Development Bonds or Tax Credit Bonds subject to their applicable requirements are issued at a price in excess of the permissible price; and
- The acquisition by an issuer of its own debt instrument resulting in extinguishment.

Additional Resources

[Notice 2008-31](#), *Procedures for TEB VCAP*

[Announcement 2015-2](#), *Simplified VCAP Process for Issuers of Qualified 501(c)(3) Bonds*

[Publication 1](#), *Your Rights as a Taxpayer*

[Publication 4077](#), *Tax-Exempt Bonds for 501(c)(3) Charitable Organizations*

[Publication 4078](#), *Tax-Exempt Private Activity Bonds*

[Publication 4079](#), *Tax-Exempt Governmental Bonds*

[Publication 5005](#), *Your Responsibilities as a Conduit Issuer of Tax-Exempt Bonds*