Primer On Monitoring Post-Issuance Compliance

Phone Forum Presented by
IRS Office of Tax Exempt Bonds

Speakers

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Disclaimer

- The information contained in this power point is current as of the date it was presented and is for educational purposes only. It should not be considered official IRS guidance or legal advice.
- The information contained in this power point is a summary of key points. Reference should be made to sections 103, 141 through 150 of the Internal Revenue Code and the related regulations, revenue procedures, and the applicable sections of the Internal Revenue Manual.

Monitoring Post-Issuance Compliance

- TEB and Post-Issuance Compliance Integration: Why, Where and How
- Application of Post-Issuance Compliance to Private Business Use Rules
- Application of Post-Issuance Compliance to Arbitrage Rules

Monitoring Post-Issuance Compliance - Why?

- Facilitates the prevention of violations
- Facilitates self-remediation
- Facilitates a more favorable resolution of TEB Voluntary Closing Agreement Program requests

Monitoring Post-Issuance Compliance - Where?

Post-issuance monitoring procedures are incorporated into key aspects of the TEB program.

- VCAP
- Self Remediation
- Examinations
- Forms
- Questionnaires
- Record Retention

Monitoring Post-Issuance Compliance – How?

Voluntary Closing Agreement Program (VCAP) application requirements include:

- Statement whether the issuer has written post-issuance compliance monitoring procedures
- Detailed description of such procedures

The presence and use of written post-issuance compliance monitoring procedures can be a favorable factor in determining the resolution.

VCAP - Streamlined Resolution Standards

- Generally, the resolution standards provide a more favorable settlement if issuers submit their VCAP request within 6 calendar months of the violation (IRM 7.2.3.4.2). Effective compliance monitoring promotes timely identification of violations.

- Generally, resolution standards may be favorably modified if the issuer adopted written monitoring procedures prior to the occurrence of the violation (IRM 7.2.3.4.4).

Self Remediation - Post-Issuance Compliance

The presence of post-issuance compliance monitoring procedures generally facilitates self correction through the use of the remedial action provisions found in the Treasury Regulations:

- § 1.141-12 private business tests and the private loan financing test;
- § 1.142-2 exempt facility bonds;
- § 1.144-2 qualified small issue bonds;
- § 1.145-2 qualified 501(c)(3) bonds; and
- § 1.147-2 requirements under Code section 147 that apply to certain private activity bonds.

Exam & Post-Issuance Compliance

- Generally, examination Information Document Requests ask questions concerning the presence of written post-issuance compliance monitoring procedures.

- Revised IRM 4.82 (to be released later this year) addresses agent evaluation of internal controls, including written post-issuance compliance monitoring procedures.

- Evidence an issuer has written post-issuance compliance monitoring procedures generally indicates a lower risk of noncompliance.

Forms & Post-Issuance Compliance

- Form 8038 information returns generally require a “check the box”

  - if the issuer has established written procedures to ensure all nonqualified bonds of the issue are remediated in accordance with the requirements under the Code & Regulations

  - if the issuer has established written procedures to monitor the requirements of section 148

TEB's Information Returns

- Form 8038 for tax-exempt private activity bonds
- Form 8038-G for governmental purpose tax-exempt bonds
- Form 8038-GC for small tax-exempt governmental bonds
- Form 8038-TC for tax credit and specified tax credit bonds
- Form 8038-B for build America bonds and recovery zone economic development bonds is now used only for amendments as those bonds can no longer be issued.

Form 8038-CP Return to Claim Certain Refundable Credit Payments

Used by issuers of build America bonds, recovery zone economic development bonds & certain specified tax credit bonds.

- Signed under penalty of perjury by authorized representative of the issuer with authority to bind the issuer.

- The instructions state that the return is to be filed only if, as of the date filed, the issuer of the outstanding obligations for which the return is submitted has reasonably concluded that the obligations meet all applicable requirements for the payment of the requested credit

Schedule K to Form 990

Filed annually by certain exempt organization conduit borrowers or issuers of outstanding tax-exempt bonds. Requests whether the organization has written procedures to:

- Ensure that all nonqualified bonds of the issue are remediated;
- Monitor the requirements of Code section 148 relating to arbitrage; and
- Ensure that violations of federal tax requirements are timely identified and corrected through the voluntary closing agreement program if self-remediation is not available.

Questionnaires & Post-Issuance Compliance

- Post-issuance compliance has been emphasized in TEB compliance check questionnaires.

Record Retention - Post-Issuance Compliance

- Section 6001 provides record retention requirements for federal tax purposes.
- To ensure continued tax-favored treatment, it is important that sufficient records are retained to demonstrate the bonds maintain their tax-advantaged status.

More Information on irs.gov

- At www.irs.gov/bonds, click “TEB Voluntary Compliance” to find links to articles on post-issuance compliance and information about the VCAP program.

More information on irs.gov

- At www.irs.gov/bonds, click "TEB Forms & Pubs" to find:
  - Links to TEB's Forms and Instructions
  - Publication 1 TEB - Understanding the Tax-Exempt Bonds Examination Process
  - Publication 4077 - Tax-Exempt Bonds for 501(c)(3) Charitable Organizations / Compliance Guide
  - Publication 4078 - Tax-Exempt Private Activity Bonds / Compliance Guide
  - Publication 4079 – Tax-Exempt Governmental Bonds / Compliance Guide
  - Publication 5005 – Your Responsibilities as a Conduit Issuer of Tax-Exempt Bonds
  - Publication 5091 - Voluntary Compliance for Tax-Exempt & Tax Credit Bonds
  - Report - "Avoiding Troubled Tax-Exempt Bonds"

Prior Teleconferences & Webinars

At www.irs.gov/bonds, click "TEB Archives" to find links to TEB teleconferences and webinars on:

- Arbitrage and Rebate Compliance
- The VCAP Program
- The Examination Process
- Qualified 501(c)(3) Bonds and Schedule K
- Form Filing & Compliance Issues for Direct Pay Bonds
- Planning to Avoid Unintended Consequences

Upcoming Free Teleconference

- Free phone forum on Voluntary Compliance and the Voluntary Closing Agreement Program
  - Scheduled for September, 2013

- Registration information will be posted on our website soon.

Private Business Use & Post- Issuance Compliance

- Only a minimal amount of private use is permitted when more than a minimal amount of the debt service on the bonds is paid from or secured with private payments or security.
- It is important that issuers monitor the use of bond proceeds and bond-financed assets throughout the life of the bonds to prevent or correct excessive private use.

Private Business Use Examples

Actions taken by the owner or user of a bond-financed facility may result in private business use. Examples are:

- **Sale of facilities**
- **Leases**
- **Management contracts**
- **Special legal entitlements**

Private business use may jeopardize the tax-advantaged status of the bonds.

Arbitrage & Post-Issuance Compliance

Tax-advantaged bonds lose their status if they are deemed arbitrage bonds under section 148 of the Code.

- In general, arbitrage is earned when the proceeds of an issue are used to acquire investments that earn a yield materially higher than the yield on the bonds of the issue.

Monitoring the yield on invested proceeds is important to ensure compliance with section 148 requirements.

Arbitrage & Post-Issuance Compliance

Two general sets of requirements under the Code section 148 determine whether bonds are arbitrage bonds:

- **Yield Restriction Rules:** § 148(a) prohibits use of bond proceeds to acquire "higher yielding investments."
  - If the investment property acquired with the proceeds of the bond issue produces a yield which is "materially higher" than the yield on the bond issue, then the proceeds of the bond issue are used to acquire higher yielding investments.

- **Rebate Requirements:** § 148(f) requires that certain earnings on nonpurpose investments allocable to the gross proceeds of an issue be paid to the United States to prevent the bonds in the issue from becoming arbitrage bonds.

Exceptions to Yield Restriction Rules

- The investment of proceeds in materially higher yielding investments does not cause the bonds of an issue to be arbitrage bonds in the following three instances:
  - First, during certain temporary periods (for example, the 3-year temporary period for capital projects and 13 month temporary period for restricted working capital expenditures);
  - Second, as part of a reasonably required reserve or replacement fund; and
  - Third, as part of a minor portion, which is an amount not exceeding the lesser of 5% of the sale proceeds of the issue or $100,000.

Spending Exceptions to Rebate

Treasury Regulations § 1.148-7:

- 1) The 6-month spending exception for certain proceeds allocated to expenditures for governmental or qualified purposes within six months after the date of issuance.

- 2) The 18-month spending exception for certain proceeds allocated to capital expenditures for governmental purposes at a rate of:
  - 15% within six months of the date of issuance;
  - 60% within 12 months of the date of issuance; and
  - 100% within 18 months of the date of issuance.

Spending Exceptions to Rebate, Continued

- 3) The two year exception for construction issues financing property generally to be owned by a governmental entity or a 501(c)(3) organization when certain “available construction proceeds” are allocated to construction expenditures at a rate of:
  - 10% within 6 months of the date of issuance;
  - 45% within 12 months of the date of issuance;
  - 75% within 18 months of the date of issuance; and
  - 100% within 24 months of the date of the date of issuance.

TaxExemptBondQuestions@irs.gov

Contact us with your questions by e-mail

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- tege.teb.questions@irs.gov
- Include contact information so we can reply by phone if necessary

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