

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.
(Also Part I, §§ 148; 1.148-3)

Revenue Procedure 2005-40, 2005-28 I.R.B. (July 11, 2005)

SECTION 1. PURPOSE

This revenue procedure provides issuers of State or local bonds described in § 103(a) of the Internal Revenue Code and subject to § 148(f)(3) and § 1.148-3(g) of the Income Tax Regulations with procedures for correcting a failure to timely pay the proper amount of arbitrage rebate as required by the regulations. This revenue procedure also modifies Rev. Proc. 90-11, 1990-1 C.B. 469, which provides similar procedures for State or local bonds subject to § 1.148-1T of the temporary Income Tax Regulations initially published on May 12, 1989 as part of T.D. 8252. The modification provides a new address for filing late rebate payments and related requests.

SECTION 2. BACKGROUND

.01 Section 103(a) generally provides that gross income does not include interest on any State or local bond. Under § 103(b)(2), however, interest on an arbitrage bond (within the meaning of §148) is includable in gross income.

.02 Section 148(f)(1) generally provides that a bond that is part of an issue shall be treated as an arbitrage bond unless the issuer pays to the United States the amounts

described in § 148(f)(2) for the issue (rebate amounts) in accordance with § 148(f)(3).

.03 Section 148(f)(3) provides that, except to the extent provided by the Secretary, rebate amounts must be paid in installments that are made at least once every five years. The last installment must be made no later than 60 days after the day on which the last bond of the issue is redeemed.

.04 Section 1.148-3(f) provides in part that the first rebate installment payment must be made for a computation date (as determined under § 1.148-3(f)) that is not later than five years after the issue date. Subsequent rebate installment payments must be made for a computation date that is not later than five years after the previous computation date for which an installment payment was made.

.05 Section 1.148-3(g) provides that each rebate payment must be paid no later than 60 days after the computation date to which the payment relates. Any rebate payment paid within this 60-day period may be treated as paid on the computation date to which it relates. A rebate payment is paid when it is filed with the Internal Revenue Service at the place or places designated by the Commissioner. See § 7502(a) for the treatment of certain payments made by U.S. mail.

.06 Section 148(f)(7) provides that if an issue would, but for § 148(f)(7), fail to meet the requirements of § 148(f)(2) or (3), the Secretary may treat the issue as not failing to meet those requirements if: (1) no bond of the issue is a private activity bond, as defined in § 141 (other than a qualified 501(c)(3) bond within the meaning of § 145); (2) the failure to meet those requirements is not due to willful neglect; and (3) the issuer pays to the United States a penalty in an amount equal to the sum of (i) 50 percent of the amount that was not paid in accordance with § 148(f)(2) and (3), plus (ii) interest (at the underpayment rate established under section 6621) on the portion of the amount that was not paid on the date required under § 148(f)(3) for the period beginning on that date. Section 148(f)(7) further provides that the Secretary may waive all or any portion of the penalty under § 148(f)(7).

.07 Section 1.148-3(h)(1) provides that the failure to pay the correct rebate amount when required will cause the bonds of an issue to be arbitrage bonds unless the Commissioner determines that the failure was not caused by willful neglect and the issuer promptly pays a penalty to the United States. If no bond of the issue is a private activity bond (other than a qualified 501(c)(3) bond), the penalty equals 50 percent of the rebate amount not paid when required to be paid, plus interest on the rebate amount not paid when required to be paid. Otherwise, the penalty equals 100 percent of the rebate amount

not paid when required to be paid, plus interest on the rebate amount not paid when required to be paid.

.08 Section 1.148-3(h)(2) provides that interest accrues at the underpayment rate under § 6621 beginning on the date the correct rebate amount is due and ending on the date ten days before it is paid.

.09 Section 1.148-3(h)(3) provides that the penalty is automatically waived if the rebate amount that the issuer failed to pay is paid with interest within 180 days after discovery of the failure, unless the Commissioner determines that the failure was due to willful neglect, or the issue is under examination by the Commissioner at any time during the period beginning on the date the failure first occurred and ending on the date 90 days after the receipt of the rebate amount. Generally, extensions of this 180-day period and waivers of the penalty in other cases will be granted by the Commissioner only in unusual circumstances.

.10 Rev. Proc. 90-11 provides issuers of State or local bonds subject to § 1.148-1T, initially published on May 12, 1989 as part of T.D. 8252, with guidance for filing (1) a request for an extension of time to pay a correction amount of arbitrage rebate, (2) an explanation of an innocent failure to meet a requirement for payment of arbitrage rebate, or (3) a request for a ruling regarding a failure (other than an innocent failure or one that is so treated) to meet a requirement for payment of arbitrage rebate.

SECTION 3. PROCEDURES FOR CORRECTING A FAILURE TO PAY REBATE

.01 *In general.* A failure to pay the correct rebate amount when required by § 148(f)(3) and § 1.148-3(g) will not cause the bonds of an issue to be arbitrage bonds if the requirements of section 3.01(1) or 3.01(2) are met.

(1) *Payment within 180-day period.* The requirements of this section 3.01(1) are met if, within 180 days after the issuer discovers the failure to pay the correct rebate amount when required (the 180-day period), the rebate amount that the issuer failed to pay, plus interest, is paid to the United States in accordance with section 3.04, unless--

(a) The Commissioner determines that the failure was due to willful neglect, or

(b) The issue is under examination by the Service at any time during the period beginning on the date the failure first occurred and ending on the date 90 days after the Service receives the rebate amount.

(2) *Payment after 180-day period.* The requirements of this section 3.01(2) are met if, after the expiration of the 180-day period--

(a) The rebate amount that the issuer failed to pay, plus interest, plus the penalty determined under section 3.02, is paid to the United States in accordance with section 3.04, and

(b) The Commissioner determines that the failure was not caused by willful neglect.

.02 Penalty.

(1) *Governmental and qualified 501(c)(3) bonds.* If no bond of the issue is a private activity bond (other than a qualified 501(c)(3) bond), the penalty equals 50 percent of the rebate amount not paid when required to be paid.

(2) *Private activity bonds (other than qualified 501(c)(3) bonds).* If the issue consists of private activity bonds (other than qualified 501(c)(3) bonds), the penalty equals 100 percent of the rebate amount not paid when required to be paid.

.03 Extensions of 180-day period and waivers of penalty. An issuer may apply for an extension of the 180-day period for purposes of section 3.01(1), or a waiver of the penalty for purposes of section 3.01(2), in accordance with the procedures set forth in section 5. Under § 1.148-3(h)(3), extensions of the 180-day period and waivers of the penalty generally will be granted only in unusual circumstances.

.04 Payment and explanation of why the late payment was not due to willful neglect. The amount described in section 3.01(1) or (2) must be mailed to the Internal Revenue Service, Ogden Submission Processing Center, Ogden, Utah 84201, together with Form 8038-T (Arbitrage Rebate and Penalty in Lieu of Arbitrage Rebate) and a detailed explanation addressing why the failure to timely pay the correct rebate amount was not due to willful neglect. The explanation must include the following declaration signed by an individual who has personal knowledge of the relevant facts and circumstances: "Under penalties of perjury, I declare that I have examined this explanation, including accompanying documents, and, to the best of my knowledge and belief, the explanation contains all the relevant facts relating to the explanation, and such facts are true, correct, and complete." The explanation must include all relevant information, including when the rebate amount was required to be paid, why the rebate amount was not timely paid and a description of the events that led up to both the failure to timely pay and discovery of the

failure. The explanation should also discuss the factors set forth in section 4.01 and should indicate whether the bond issue in question is under examination by the Service. Acceptance and processing of the payment by the Ogden Submission Processing Center does not constitute a determination by the Commissioner that the failure was not caused by willful neglect. The determination of whether a failure was due to willful neglect is made in accordance with the procedures set forth in section 4.

.05 Interest. For purposes of section 3.01, interest accrues at the underpayment rate under § 6621 beginning on the date the correct rebate amount is due and ending on the date ten days before it is paid. For this purpose, a rebate amount is due on the date that is 60 days after the computation date to which the rebate amount relates.

.06 Issue under examination. For purposes of this revenue procedure, an issue is under examination by the Service on the date a letter opening an examination of the issue is sent.

SECTION 4. PROCEDURES FOR ESTABLISHING LACK OF WILLFUL NEGLIGENCE

.01 In determining whether a failure to timely pay the correct rebate amount was due to willful neglect, the Service will consider the following factors:

- (1) The unpaid rebate amount;
- (2) The sophistication of the issuer;
- (3) The length of the delay;
- (4) The steps taken to comply, including the steps taken after the discovery of the failure to pay;
- (5) The steps taken to prevent recurrence of a failure to pay;
- (6) The nature of the failure;
- (7) Any history of timely or late payments by the issuer; and
- (8) Any other relevant information.

.02 If the Service does not notify the issuer in writing within 90 days after receiving the explanation submitted in accordance with section 3.04, the explanation is accepted, and the issuer's failure to timely pay the rebate amount will be treated as not due to willful neglect.

.03 If, based on the explanation submitted by the issuer, the Service is unable to make a determination that the failure to timely pay the rebate amount was not due to willful neglect, the Service will notify the issuer in writing within 90 days after the Service's receipt

of the explanation and late payment. The written notice will describe any additional information needed, identify a contact person who is handling the matter, and provide the issuer with a reasonable period of not less than 21 days to provide additional information.

.04 Generally, within 90 days of receiving the additional information requested, the Service will notify the issuer in writing that either (1) the Service has determined that the failure to timely pay the rebate amount was not due to willful neglect or (2) the Service is unable to make a determination that the failure to timely pay the rebate amount was not due to willful neglect.

.05 If the Service notifies the issuer under section 4.04 that the Service is unable to make a determination that the failure to timely pay the rebate amount was not due to willful neglect, the issuer will be entitled, upon request, to a conference with the Service.

.06 After conducting the conference and reviewing any additional submissions by the issuer, the Service will notify the issuer in writing that either (1) the Service has determined that the failure to timely pay the rebate amount was not due to willful neglect or (2) the information available to the Service is insufficient for the Service to find a lack of willful neglect. If the Service is unable to find a lack of willful neglect, an examination of the bond issue may be opened. If, however, an examination of the bond issue is not opened within 180 days after the date the Service's notification described in this section 4.06 is sent, then the issuer's failure to timely pay the rebate amount will be treated as not due to willful neglect.

.07 For purposes of this section 4, a notification in writing is made on the date the written notification is sent.

SECTION 5. PROCEDURES CONCERNING REQUESTS FOR AN EXTENSION OF TIME OR A WAIVER OF PENALTY

.01 *Extension of time to pay the late payment amount.* Prior to the expiration of the 180-day period described in section 3.01(1), an issuer may request that the Service grant it an extension of 180 days to pay the late payment amount determined under section 3.01(1). The request should be submitted to Internal Revenue Service, ATTENTION: SE:T:GE:TEB:O, 1111 Constitution Avenue N.W., PE-5T2, Washington, D.C. 20224. The request should include the explanation required by section 3.04 and should address the unusual circumstances upon which the extension should be granted. Within 90 days after receiving a request for extension, the Service will notify the issuer in writing whether the extension is approved. If the Service does not notify the issuer in writing within that 90-day

period, the issuer's request for extension is approved. If a request for extension is approved, and payment is made within 180 days after the expiration of the 180-day period, then the late payment amount is the rebate amount that the issuer failed to pay, plus interest, as determined under section 3.01(1). If a request for extension is not approved, the issuer must pay either: (1) if within the 180-day period, the amount determined under section 3.01(1); or (2) if after the 180-day period, the amount determined under section 3.01(2).

.02 Waiver of penalty. Within 180 days after the expiration of the 180-day period described in section 3.01(1), an issuer may request that the Service grant it a waiver of the penalty described in section 3.02. The request for a waiver of penalty must be submitted to the Internal Revenue Service, Ogden Submission Processing Center, Ogden, Utah 84201, and must be accompanied by payment of the amount determined under section 3.01(2), together with Form 8038-T (Arbitrage Rebate and Penalty in Lieu of Arbitrage Rebate). The request for a waiver of penalty should include the explanation required by section 3.04 and should address the unusual circumstances that justify waiver of the penalty. The Ogden Submission Processing Center will process the payment and immediately forward the request to SE:T:GE:TEB:O. Within 90 days after receiving a request for a waiver of penalty, the Service will notify the issuer in writing whether any portion of the penalty is waived and, if applicable, will promptly thereafter refund to the issuer any amount so waived. If the Service does not approve a waiver request with respect to any portion of the penalty, the issuer will be entitled, upon request, to a conference with the Service. If a conference is held, then, within 30 days after the conference, the Service will notify the issuer in writing whether any portion of the penalty is waived and, if applicable, will promptly thereafter refund to the issuer any amount so waived.

.03 Date of notification or refund. For purposes of this section 5, a notification in writing (or a refund) is made on the date the written notification (or refund) is sent.

SECTION 6. EFFECT OF CORRECTING A FAILURE TO PAY REBATE

If an issuer satisfies the requirements of this revenue procedure for correcting a failure to timely pay a rebate amount under § 148(f)(3) and § 1.148-3(g), the rebate amount will be treated as paid on the computation date to which it relates. Any interest or penalty amounts paid under this revenue procedure are not treated as payments under § 1.148-3(d) for purposes of computing the rebate amount. Acceptance by the Service of a late payment amount under this revenue procedure does not constitute a determination by the Service that the issuer paid a correct rebate amount as required by § 148(f) and § 1.148-3.

SECTION 7. MODIFICATION OF REV. PROC. 90-11

Rev. Proc. 90-11 is modified by changing all references to the Internal Revenue Service Center, Philadelphia, Pennsylvania in sections 3.02(5), 4.02(1)(c), 4.02(3), and 5.02 of the revenue procedure to:

Internal Revenue Service
Ogden Submission Processing Center
Ogden, Utah 84201

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 90-11, 1990-1 C.B. 469, is modified in part.

SECTION 9. EFFECTIVE DATE

This revenue procedure applies to discoveries after July 11, 2005, of a failure to timely pay the correct rebate amount under § 148(f)(3) and §1.148-3(g) (or, with respect to the modification of Rev. Proc. 90-11 made by section 7 of this revenue procedure, § 1.148-1T initially published on May 12, 1989 as part of T.D. 8252).

SECTION 10. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1880.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

This revenue procedure contains a collection of information requirement in sections 5.01 and 5.02. The purpose of the collection of information is to enable the Service to evaluate an issuer's request for a waiver of a penalty, or an extension of time to make a late payment, in the case of a failure by the issuer to timely pay the correct rebate amount:

The likely respondents are state and local governments.

The estimated total annual reporting burden is: 3 hours.

The estimated annual burden per respondent: 30 minutes.

The estimated number of respondents: 6.

The estimated annual frequency of responses: on occasion.

The collection of information contained in section 3.04 of this revenue procedure has been previously reviewed and approved by OMB under control number 1545-1219.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Lynn Kawecki of the Tax Exempt Bond office of the Tax Exempt and Government Entities (TE/GE) Division and David White of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue procedure contact Mr. Kawecki on (202) 283-9782 (not a toll-free call).