

Post-Issuance Tax Compliance Policies – Recent IRS Guidance[©]

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You've been a municipal finance officer for years, and you have just closed another tax-exempt bond issue. No problems with this issue – they are routine for you now. The next tax-exempt financed project is already in the wings, ready for you to get it started. You'd like to set the closed project aside and focus solely on the new project but as you know, the municipality's obligations do not end at closing. You've just entered the "Post-Issuance Tax Compliance Zone."

Post-issuance tax compliance is not a new topic of discussion for municipal finance officers and has been a **HOT TOPIC** of the Internal Revenue Service (the "Service") over the last year or so. Governmental issuers of tax-exempt bonds are responsible for ensuring that their financings satisfy applicable federal tax requirements, both at the time of issuance and *for so long as the bonds remain outstanding*. Prudent governmental issuers have carefully monitored their actions to assure continued compliance with the federal tax law, since a failure to satisfy federal tax requirements could cause the interest income from the bonds to become taxable to the bondholders. So why has this topic become one of new interest?

For some time now, the Internal Revenue Service has been urging issuers of tax-exempt obligations to adopt "written procedures" to help ensure their post-issuance compliance with the requirements of the Internal Revenue Code of 1986, as amended. Although the current Tax Code does not require a governmental issuer to adopt these written procedures, the Service has stepped up its inquiries whether such procedures have been adopted. Inquiries that were limited to Build America Bonds or selected advanced refundings have now been added to the informational return that must be filed in connection with all tax-exempt borrowings, the 8038-G.

On its website, the Service has posted recent guidance which makes it clear that detailed post-issuance compliance procedures should be an integral component of any issuer's bond program:

“Issuers should adopt written procedures, applicable to all bond issues, which go beyond reliance on tax certificates included in bond documents provided at closing. Sole reliance on the closing bond documents may result in procedures insufficiently detailed or not

incorporated into an issuer's operations. Written procedures should contain certain key characteristics, including making provisions for:

- Due diligence review at regular intervals;
- Identifying the official or employee responsible for review;
- Training of the responsible official/employee;
- Retention of adequate records to substantiate compliance (e.g., records related to expenditure of proceeds);
- Procedures reasonably expected to timely identify noncompliance; and
- Procedures ensuring that the issuer will take steps to timely correct noncompliance.”

The Service has amended Form 8038-G to include additional questions as to whether the issuer has established written procedures related to post-issuance compliance for private business use and arbitrage rebate. Furthermore, if reimbursement expenditures are made from bond proceeds, the amended Form requires the issuer to state the amount of the reimbursement, and the date that the official intent to make reimbursement was adopted. These questions must be answered under penalty of perjury. The questions on the amended Form, and a short explanation of each question, are below.

43 If the issuer has established written procedures to ensure that all nonqualified bonds of this issue are remediated according to the requirements under the Code and Regulations (see Instructions), check box

Private activity bonds do not qualify for tax-exempt status. Bonds can become private activity bonds by meeting the private business use tests and the private financing tests. As these tests are complex and can arise well after closing (such as through a lease of the financed premises to another party, or sale of the property to a private entity while bonds remain outstanding), governmental issuers need to carefully monitor whether subsequent actions create private activity issues. This question asks whether the issuer has established written procedures to ensure that timely remedial action is taken should the bonds become non-qualified private activity bonds.

44 If the issuer has established written procedures to monitor the requirements of section 148, check box

Section 148 of the Tax Code addresses arbitrage. This question asks whether the issuer has established written procedures to monitor compliance with the arbitrage, yield restriction, and rebate requirements of the Tax Code.

45a If some portion of the proceeds was used to reimburse expenditures, check here and enter the amount of reimbursement
b Enter the date the official intent was adopted

Under the Tax Code, an issuer may use bond proceeds to reimburse itself for pre-issuance expenditures if within 60 days of the original expenditure the issuer adopts an "official intent" that the reimbursement occur. While the previous Form 8038-G inquired whether reimbursement would occur, it did not ask for the amount of the reimbursement or the date that the official intent was adopted.

While it is not clear how the Service will use the new information that it is gathering through the Form 8038-G, from a practical standpoint issuers will want to indicate to the Service that they have adopted written procedures relating to private business use and arbitrage, and that they have adopted the official intent necessary to support reimbursement expenditures. Written procedures that follow the guidance from the Service provide the issuer not only with a guide to exercising diligence in complying with the Tax Code, but also with the records necessary to show that such compliance occurred. Post-issuance compliance policies indicate to the Service that the issuer is well aware of its post-issuance obligations under the Tax Code, and intends to meet those obligations.

As another means of promoting post-issuance compliance, the Service also provides that issuers who participate in its VCAP program, (which allows issuers to identify a post-issuance violation to enter into a settlement with the Service to cure the violation) will receive more favorable treatment for violations which are identified through the issuer's post-issuance compliance procedures.

What follows is an example of a Post-Issuance Compliance Policy, and a form resolution to adopt the policy. ***The attached policy is provided as an example only and may not be appropriate for all issuers, given the unique circumstances of each issuer. We encourage each issuer to consult with their counsel before adopting any post-issuance compliance policy.*** The sample policy enclosed names a "Coordinator" who will monitor and retain proof of compliance with the policy. This sample is just one way to structure a policy that meets the Service guidelines, and you may already have policies in place that meet the guidelines. But given the issuer's strong interest in ensuring ongoing compliance with the rules and regulations governing tax-exempt bonds and the Service's increased interest in post-issuance compliance, issuers should get this type of policy in place so that the next Form 80308-G it files can reflect the adoption of such a policy.

The purpose of this column is to identify issues. It does not purport to be exhaustive or to render legal advice. You should consult with qualified counsel or other professionals in developing responses to specific situations.

EXHIBIT "A"

POST-ISSUANCE COMPLIANCE POLICY FOR TAX-EXEMPT OBLIGATIONS

1. Compliance Coordinator:
 - a) The _____ ("Coordinator") shall be responsible for monitoring post-issuance compliance.
 - b) The Coordinator will maintain a copy of the transcript of proceedings in connection with the issuance of any tax-exempt obligations. Coordinator will obtain such records as are necessary to meet the requirements of this policy.
 - c) The Coordinator shall consult with bond counsel, a rebate consultant, financial advisor, IRS publications and such other resources as are necessary to understand and meet the requirements of this policy.
 - d) Training and education of Coordinator will be sought and implemented upon the occurrence of new developments and upon the hiring of new personnel to implement this policy.

2. Financing Transcripts. The Coordinator shall confirm the proper filing of an 8038 Series return, and maintain a transcript of proceedings for all tax-exempt obligations issued by the _____, including but not limited to all tax-exempt bonds, notes and lease-purchase contracts. Each transcript shall be maintained until eleven (11) years after the tax-exempt obligation it documents has been retired. Said transcript shall include, at a minimum:

- a) Form 8038s;
- b) minutes, resolutions, and certificates;
- c) certifications of issue price from the underwriter;
- d) formal elections required by the IRS;
- e) trustee statements;
- f) records of refunded bonds, if applicable;
- g) correspondence relating to bond financings; and
- h) reports of any IRS examinations for bond financings.

3. Proper Use of Proceeds. The Coordinator shall review the resolution authorizing issuance for each tax-exempt obligation issued by the _____, and that the _____ shall:

- a) obtain a computation of the yield on such issue from the _____'s financial advisor;
- b) create a separate Project Fund (with as many sub-funds as shall be necessary to allocate proceeds among the projects being funded by the issue) into which the proceeds of issue shall be deposited;
- c) review all requisitions, draw schedules, draw requests, invoices and bills requesting payment from the Project Fund;
- d) determine whether payment from the Project Fund is appropriate, and if so, make payment from the Project Fund (and appropriate sub-fund if applicable);
- e) maintain records of the payment requests and corresponding records showing payment;
- f) maintain records showing the earnings on, and investment of, the Project Fund;
- g) ensure that all investments acquired with proceeds are purchased at fair market value;
- h) identify bond proceeds or applicable debt service allocations that must be invested with a yield-restriction and monitor the investments of any yield-restricted funds to ensure that the yield on such investments does not exceed the yield to which such investments are restricted;
- i) maintain records related to any investment contracts, credit enhancement transactions, and the bidding of financial products related to the proceeds;

4. Timely Expenditure and Arbitrage/Rebate Compliance. The Coordinator shall review the Tax-Exemption Certificate (or equivalent) for each tax-exempt obligation issued by the _____ and the expenditure records provided in Section 2 of this policy, above, and shall:

- a) monitor and ensure that proceeds of each such issue are spent within the temporary period set forth in such certificate;

- b) if the _____ does not meet the “small issuer” exception for said obligation, monitor and ensure that the proceeds are spent in accordance with one or more of the applicable exceptions to rebate as set forth in such certificate;
- c) not less than 60 days prior to a required expenditure date confer with bond counsel and a rebate consultant if the _____ will fail to meet the applicable temporary period or rebate exception expenditure requirements of the Tax-Exemption Certificate; and
- d) in the event the _____ fails to meet a temporary period or rebate exception:
 - i. procure a timely computation of any rebate liability and, if rebate is due, file a Form 8038-T and arrange for payment of such rebate liability;
 - ii. arrange for timely computation and payment of “yield reduction payments” (as such term is defined in the Code and Treasury Regulations), if applicable.

5. Proper Use of Bond Financed Assets. The Coordinator shall:

- a) maintain appropriate records and a list of all bond financed assets. Such records shall include the actual amount of proceeds (including investment earnings) spent on each of the bond financed assets;
- b) with respect to each bond financed asset, the Coordinator will monitor and confer with bond counsel with respect to all proposed:
 - i. management contracts,
 - ii. service agreements,
 - iii. research contracts,
 - iv. naming rights contracts,
 - v. leases or sub-leases,
 - vi. joint venture, limited liability or partnership arrangements,
 - vii. sale of property; or
 - viii. any other change in use of such asset;
- c) maintain a copy of the proposed agreement, contract, lease or arrangement, together with the response by bond counsel with respect to said proposal for at least three (3) years after retirement of all tax-exempt obligations issued to fund all or any portion of bond financed assets; and

- d) In the event the _____ takes an action with respect to a bond financed asset, which causes the private business tests or private loan financing test to be met, the Coordinator shall contact bond counsel and ensure timely remedial action under IRS Regulation Sections 1.141-12.

6. General Project Records. For each project financed with tax-exempt obligations, the Coordinator shall maintain, until three (3) years after retirement of the tax-exempt obligations or obligations issued to refund those obligations, the following:

- a) appraisals, demand surveys or feasibility studies,
- b) applications, approvals and other documentation of grants,
- c) depreciation schedules,
- d) contracts respecting the project.

7. Advance Refundings. The Coordinator, shall be responsible for the following current, post issuance and record retention procedures with respect to advance refunding bonds:

- a) Identify and select bonds to be advance refunded with advice from internal financial personnel, and a financial advisor;
- b) The Coordinator shall identify, with advice from the financial advisor and bond counsel, any possible federal tax compliance issues prior to structuring any advance refunding;
- c) The Coordinator shall review the structure with the input of the financial advisor and bond counsel, of advance refunding issues prior to the issuance to ensure (i) that the proposed refunding is permitted pursuant to applicable federal tax requirements if there has been a prior refunding of the original bond issue; (ii) that the proposed issuance complies with federal income tax requirements which might impose restrictions on the redemption date of the refunded bonds; (iii) that the proposed issuance complies with federal income tax requirements which allow for the proceeds and replacement proceeds of an issue to be invested temporarily in higher yielding investments without causing the advance refunding bonds to become “arbitrage bonds”; and (iv) that the proposed issuance will not result in the issuer’s exploitation of the difference between tax exempt and taxable interest rates to obtain a financial advantage nor overburden the tax exempt market in a way that might be considered an abusive transaction for federal tax purposes.
- d) The Coordinator shall collect and review data related to arbitrage yield restriction and rebate requirements for advance refunding bonds. To ensure

such compliance, the Coordinator shall engage a rebate consultant to prepare a verification report in connection with the advance refunding issuance. Said report shall ensure said requirements are satisfied.

- e) The Coordinator shall, whenever possible, purchase SLGS to size each advance refunding escrow. The financial advisor shall be included in the process of subscribing SLGS. To the extent SLGS are not available for purchase, the Coordinator shall, in consultation with bond counsel and the financial advisor, comply with IRS regulations.
- f) To the extent as issuer elects to the purchase a guaranteed investment contract, the Coordinator shall ensure, after input from bond counsel, compliance with any bidding requirements set forth by the IRS regulations.
- g) In determining the issue price for any advance refunding issuance, the Coordinator shall obtain and retain issue price certification by the purchasing underwriter at closing.
- h) After the issuance of an advance refunding issue, the Coordinator shall ensure timely identification of violations of any federal tax requirements and engage bond counsel in attempt to remediate same in accordance with IRS regulations.

8. Continuing Disclosure. The Coordinator shall assure compliance with each continuing disclosure certificate and annually, per continuing disclosure agreements, file audited annual financial statements and other information required by each continuing disclosure agreement. The Coordinator will monitor material events as described in each continuing disclosure agreement and assure compliance with material event disclosure. Events to be reported shall be reported promptly, but in no event not later than ten (10) Business Days after the day of the occurrence of the event. Currently, such notice shall be given in the event of:

- a) Principal and interest payment delinquencies;
- b) Non-payment related defaults, if material;
- c) Unscheduled draws on debt service reserves reflecting financial difficulties;
- d) Unscheduled draws on credit enhancements relating to the bonds reflecting financial difficulties;
- e) Substitution of credit or liquidity providers, or their failure to perform;

- f) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of the bonds, or material events affecting the tax-exempt status of the bonds;
- g) Modifications to rights of Holders of the Bonds, if material;
- h) Bond calls (excluding sinking fund mandatory redemptions), if material, and tender offers;
- i) Defeasances of the bonds;
- j) Release, substitution, or sale of property securing repayment of the bonds, if material;
- k) Rating changes on the bonds;
- l) Bankruptcy, insolvency, receivership or similar event of the Issuer;
- m) The consummation of a merger, consolidation, or acquisition involving the Issuer or the sale of all or substantially all of the assets of the Issuer, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and
- n) Appointment of a successor or additional trustee or the change of name of a trustee, if material.

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