Post Issuance Tax Compliance Services For Tax-Exempt Bonds

BondLogistiX LLC

INSIGHT. INNOVATION. INTEGRATION.

Post Issuance Services to Assist With Tax Compliance Matters Relating to Tax-Exempt Bonds

Post Issuance Tax Compliance—A Long Term Responsibility

State and local government entities and conduit borrowers are responsible for monitoring post issuance compliance with federal tax rules for property and programs financed with tax-exempt bonds. As further described herein, issuers and borrowers of tax-exempt bonds have the burden of establishing compliance with a wide range of federal tax law requirements over the life of the obligations (including any refunding bonds). This burden includes the retention of material bond documents and records.

The Ever-Changing Regulatory Environment

The tax regulatory requirements regarding the monitoring of tax-exempt bond financed property and recordkeeping continue to evolve. Issuers and conduit borrowers that do not keep abreast of current developments in this area may unknowingly jeopardize the tax-exempt status of their bonds given increased regulatory complexity and an active enforcement environment. For example, the Internal Revenue Service (the "IRS") recently issued proposed allocation and accounting regulations. If these regulations are later finalized in their present from, issuers and borrowers are almost certain to need post issuance advice for their bond issues regarding the proper and timely election of certain allocation methods for bond proceeds.

Benefits of Monitoring Post Issuance Activities For Refunding Bonds

Sooner or later, just about every tax-exempt bond issue is refunded. Prior to the issuance of any refunding bonds, the issuer or borrower working with their bond counsel, must undertake a due diligence process (similar to that undertaken when the original bonds were issued) to determine the scope and extent of private use and related tax compliance matters. Current Treasury Regulations mandate an integration of private use analysis of the refunded and refunding bonds. In many bond refundings, the due diligence phase can be expensive and time consuming, especially if there has been little or no post issuance monitoring and/or a lack of adequate recordkeeping. Also, in the absence of any post issuance monitoring, there can even be an unfortunate discovery during this phase regarding a lack of tax compliance which may slow down or derail a planned refunding. Monitoring tax compliance on an annual basis will make refunding transactions less onerous, more efficient and less costly given that tax compliance has been actively monitored and good and adequate records exist for bond counsels' review.

Bond Logistix LLC—Post Issuance Tax Compliance Services

To assist State and local government entities and conduit borrowers in meeting their ongoing monitoring responsibilities, Bond Logistix LLC ("BLX") is pleased to offer a range of post issuance services, including periodic private use review and tabulation, private activity bond monitoring and analysis, internal audits, review of post issuance tax compliance procedures and review of tax record and documentation policies.

BLX is a consulting and investment advisory firm that offers strategic financial and consulting services to State and local governments and conduit borrowers. BLX was founded in 2000, having previously been the Financial Services Group of Orrick, Herrington & Sutcliffe LLP. With over 50 finance professionals dedicated to public finance and 14 support staff in seven offices nationwide, BLX is well qualified to assist and guide issuers and conduit borrowers with all elements of post issuance tax monitoring. BLX's services, including the tax compliance services described herein, are closely coordinated with the national leading public finance practice of Orrick, Herrington & Sutcliffe LLP.

Arbitrage rebate analysis and arbitrage restriction compliance are key elements of post issuance tax compliance. These requirements represent a core business service provided by BLX since the beginning of its predecessor firm in 1989. BLX's arbitrage service, which is the largest of any firm in the nation, is not the focus of the services described in this brochure. Additional information regarding BLX's arbitrage services is available at www.bondlogistix.com or upon request.

IRS Audits of Tax-Exempt Bonds Are Now Commonplace

For many years, the IRS did not actively audit or review tax-exempt bond transactions. Over the last decade, however, the tax enforcement environment with respect to the review and audit of tax-exempt bonds transactions has changed dramatically. The IRS now has a division of revenue agents (expert in municipal finance) that audits in excess of 300 State and local government tax-exempt bond issues each year. The IRS bond audit program will continue to expand, as evidenced by the planned expansion to audit over 500 qualified 501(c)(3) bonds.

During the course of an IRS audit examination, the IRS will request all material records and information necessary to support the bond issue's compliance with applicable tax law requirements. Typically, the audit process is very expensive and requires significant time and effort by staff and professionals. If an issuer has strong internal controls to measure compliance and safeguards in place to produce and retain proper tax records, it is significantly more likely that the issuer will be able to respond to an audit on a successful and cost-effective basis.

The Challenge of Monitoring Post Issuance Tax Compliance

Tax-exempt bonds can be issued for a wide variety of governmental and private purposes. Although a broad spectrum of federal tax law requirements apply to all tax-exempt bond issues (such as arbitrage rebate), each category of bonds generally has its own specific subset of requirements that must be satisfied.

Governmental and Qualified 501(c)(3) Bonds

For governmental and qualified 501(c)(3) bonds (i.e., bonds issued for the benefit of non-profit entities such as hospitals, universities and cultural institutions), the specific subset of requirements pertain to monitoring private activity and unrelated trade or business activity ("private use"). Under existing tax law, only a de minimis amount of the proceeds of such bond issues may be used for a private use.

How Can Private Use Arise?

The following types of arrangements can give rise to private use.

- management or service contracts
- leases
- research contracts
- parking contracts
- mixed-use of bond financed property (e.g., use of a portion of the facility by other than a governmental entity or a Section 501(c)(3) organization)
- professional service contracts
- food service contracts
- contracts with independent contractors
- naming rights involving a bond financed facility
- privatization/change in use—sales or dispositions of bond financed property

How is Private Use Measured?

Generally, private use is measured over the duration of the new money bonds and any refunding bonds. Accordingly, an issuer or conduit borrower has a continuous obligation to monitor private use over a time period that often exceeds 30 years given the typical term of a long term bond issue.

Qualified Private Activity Bonds

For qualified private activity bonds, the specific subset of tax requirements generally pertain to the qualified use of the facility (as in a multi-family housing) or specific program requirements (as in the case of single family mortgage and student loan financings).

What Tax Document Records Should be Retained?

Although the required records to be retained by an issuer and borrower will depend on the specific transaction and applicable requirements, the IRS recommends that issuers and borrowers maintain the following records—

- Documentation evidencing the expenditure of bond proceeds (e.g., how were the proceeds spent and when).
- Documentation relating to any investment of bond proceeds (e.g., purchase and investment of securities, guaranteed investment contracts and rebate calculations).
- For governmental and qualified 501(c)(3) bonds, documentation regarding any private use and all sources of payment and security with respect to the bonds.
- For single family mortgage bonds, documents evidencing that at least 20% of the proceeds were available for owner financing of targeted area residences and satisfaction of other program requirements.
- For multi-family housing bonds, documents evidencing that the facility is not used on a transient basis, satisfaction of the low-income set aside requirements and satisfaction of other program requirements.
- For student loan bonds, documentation evidencing that the student-borrower is a resident of the State entity issuing the bonds or that the student-borrower is attending an educational institution enrolled in such State and other program requirements.

For other categories of qualified private activity bonds, similar documentation requirements will apply. Generally, each transaction is unique and may, accordingly, require other records that are material to establishing tax compliance.

How Long Should Tax Documents Be Retained?

The IRS recommends that material tax records should generally be retained for as long as the bonds are outstanding, plus three years. In the case of a refunding bond issue, material tax records relating to both the original new money bonds and any refunding bonds should generally be retained for as long as the refunding bonds are outstanding, plus three years.

The current IRS view regarding record retention raises a number of challenges for State and local government entities and borrowers to properly catalogue tax compliance and construct a record storage system that indexes, preserves and reproduces all transferred information.

Menu of Post Issuance Tax Compliance Services

Annual Private Use Monitoring— Governmental and Qualified 501(c)(3) Bonds

This service involves the periodic review of all management contracts, service contracts, research contacts and similar arrangements with private parties relating to the use of the bond financed property. Issuers or conduit borrowers will be provided a comprehensive and detailed summary regarding the level of existing private use and private payments at bond financed facilities allocable to outstanding bond issues. The comprehensive summary will serve as a tax compliance document for retention with other permanent bond records.

Annual Program Monitoring— Qualified Private Activity Bonds

This service involves the periodic review of the use and operation of the bond financed property (where applicable, such as multi-family housing) and the review of bond program operations and documents (where applicable, such as single family housing). For example, in the case of a multi-family housing bond issue, this service includes a review of rental application forms, lease agreements and low or moderate income unit "set-aside" rental requirements. Issuers or conduit borrowers will be provided a comprehensive and detailed summary regarding tax compliance for retention with other permanent bond records.

Review of Post Issuance Tax Compliance for Outstanding Bonds and Internal Controls

This service involves a comprehensive review of all outstanding bond issues (or a select portion), tracing the use of bond proceeds to expenditures and review of those expenditures for tax compliance. As part of the review process, our consultants will assist with formulating approaches to any historical deficiencies in tax records and record retention. Our consultants will review internal controls regarding tax compliance matters and make recommendations regarding best practices, including the use of checklists and other procedures to improve compliance and document retention.

Full Day or Half Day Educational Seminars

BLX consultants, working together with Orrick public finance tax lawyers, will prepare a full day or half day seminar specifically tailored to your specific needs and requirements regarding post issuance tax law compliance, recordkeeping, record retention and best practices.

IRS Settlements and Closing Agreements

To the extent that a tax law violation is discovered in connection with a post issuance review, the IRS has established a voluntary compliance agreement program for issuers to voluntarily report tax law violations and pursue a monetary or other settlement. Generally, issuers who voluntarily report a violation to the IRS fare better than those whose violations are brought to light through a post issuance audit. BLX consultants, working with Orrick public finance tax lawyers, can assist and advise issuers in pursuing a voluntary settlement in appropriate circumstances.

Sale or Disposition of Bond Financed Property

Under existing tax rules, issuers may be required to take one or more "remedial actions" with respect to outstanding tax-exempt bonds (e.g., defeasance of some or all of the bonds), if bond financed property is sold or no longer used for its tax-exempt purpose. BLX consultants, working with Orrick public finance tax lawyers, can assist and advise issuers in formulating one or more appropriate remedial actions taking into account legal, budget and other factors for the best overall result.

Review of Tax Document Recordkeeping and Retention Policies

The IRS recommends that issuers retain material tax records for up to three years after the bonds are retired (including any refunding bonds). BLX and its consultants can assist issuers and conduit borrowers in formulating and implementing record retention policies, safeguards and record retention systems to enhance and improve post issuance tax compliance.

Attorney advertising. As required by New York law, we hereby advise you that prior results do not guarantee a similar outcome.

About Bond Logistix

Bond Logistix LLC, is a consulting and SEC registered investment advisory firm. Focused on the needs of state and local governments, Bond Logistix offers a comprehensive range of financial and consultative services to the public finance community. Since 1989, our team has provided pre and post issuance financial consulting services for over 15,000 transactions issued by approximately 1,500 state and local governmental entities. These services include:

- arbitrage rebate, yield restriction, and other federal tax compliance services
- rebate refund requests and IRS audit representation
- investment advisory and placement services
- swap advisory and monitoring services
- evaluation of proposed financing strategies
- troubled transaction workouts
- complex cash flow modeling
- continuing disclosure services
- economic life and private use calculation services

With more than 50 finance professionals dedicated to public finance in seven offices nationwide, Bond Logistix can assemble a team of consultants with the appropriate skills and experience to formulate solutions to even the most demanding projects.

For More Information

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