

HAWKINS ADVISORY

WRITTEN PROCEDURES FOR POST-ISSUANCE TAX COMPLIANCE

Hawkins Delafield & Wood LLP would like to invite issuers to consider the benefits of adopting adequate written post-issuance tax compliance procedures to supplement the undertakings set forth in the tax certificate accompanying each tax-exempt or tax-advantaged bond issue.

The issuance of a tax-exempt or tax-advantaged bond opinion is predicated upon future compliance with the requirements and restrictions relative to both arbitrage and the use of the facilities financed with the proceeds of the tax-exempt or tax-advantaged bond issue.

It is the issuer's obligation to continue to monitor the actual investment and expenditure of the proceeds of the bonds and the use of the facilities financed with such proceeds. The information gathered during this process must be maintained as long as tax-exempt or tax advantaged bonds, including refunding bonds, are outstanding in connection with such facilities, plus three years after the last bond is retired. To that end, issuers are encouraged to adopt written procedures that will assist them in addressing this obligation.

I. BACKGROUND

In 2003, the Internal Revenue Service (the "IRS" or the "Service") posted "Tax Exempt FAQs regarding Record Retention Requirements" (the "FAQs") on its website. The FAQs, most recently updated in August 2012, noted, in relevant part, that during the course of an examination, the IRS agent will request all material records and information to support an issue's compliance with section 103 of the Internal Revenue Code of 1986, as amended (the "Code"). The FAQs state that the recordkeeping requirements of the Code, established under section 6001, apply to issuers, conduit borrowers, and bondholders, and may apply to other parties to a tax-exempt bond transaction. Material records should be retained for as long as the bonds are outstanding (including refunding bonds), plus three years after the final redemption date of all bond issues. While the state and local governmental persons and organizations designated under section 501(c)(3) of the Code that are the beneficiaries of tax-exempt bond issues may not be taxpayers per se, section 1.6001-1(a) of the Treasury Regulations ("Regulations") generally provides that books and records must be maintained that are sufficient to establish the amounts required to be shown in any return required to be filed, e.g., the Internal Revenue Service Form 8038 series.

II. IRS DOCUMENTS INQUIRING AS TO THE EXISTENCE OF WRITTEN PROCEDURES TO ENSURE POST-ISSUANCE COMPLIANCE

Most, if not all filings with the Service in connection with the issuance of tax-exempt or tax advantaged bonds instruct the issuer to indicate whether it has established (i) written proce-

dures to ensure that all nonqualified bonds of this issue are remediated in accordance with the requirements under the Code and Regulations, and (ii) written procedures to monitor the requirements of Section 148 of the Code (the arbitrage requirements).

For example, see Part VII, Lines 43 and 44, of the IRS Form 8038, Information Return for Tax-Exempt Private Activity Bond Issues and Part VI, Lines 43 and 44, of the IRS Form 8038-G, Information Return for Tax-Exempt Governmental Obligations.

The instructions accompanying Form 8038, Line 43, explain that "if there are applicable provisions under either the Code or the Regulations to ensure that all nonqualified bonds of this issue are remediated and the issuer has established written procedures to comply with such remedial provisions, check the box. For example, remedial provisions under Regulations section 1.142-2 apply to exempt facility bonds; Regulations section 1.144-2 applies to qualified small issue bonds; Regulations section 145-2 applies section 1.141-12 to qualified 501(c)(3) bonds; and section 142(f)(2)(B) applies to bonds issued to financed facilities for the local furnishing of electric energy or gas." The instructions also indicate that the box on Line 44 should be checked "if the issuer has established written procedures to monitor compliance with the arbitrage, yield restriction, and rebate requirements of Section 148."

The instructions accompanying Form 8038-G explain that if "the issuer takes a 'deliberate action' after the issue date that causes the conditions of the private business test or the private loan financing test to be met, then such issue is also an issue of private activity bonds. Regulations section 1.141-2(d)(3) defines a deliberate action as any action taken by the issuer that is within its control regardless of whether there is an intent to violate such tests. Regulations section 1.141-12 explains the conditions to taking remedial action that prevent an action that causes an issue to meet the private business tests or private loan financing test from being treated as a deliberate action. Check the box if the issuer has established timely remedial action for all nonqualified bonds according to Regulations section 1.141-12 or other remedial actions authorized by the Commissioner under Regulations section 1.141-12(h)." The instructions also indicate that the box on Line 44 should be checked "if the issuer has established written procedures to monitor compliance with the arbitrage, yield restriction, and rebate requirements of Section 148."

The Service has also used its Information Document Request, Form 4564, in connection with examinations of tax-exempt bond issues to ask whether such written procedures have been adopted. For example, the following has been included in the context of some recent IRS initiatives:

Internal Revenue Code section 6001 requires that every person liable for any tax imposed by title 26 of the U.S. Code shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Have adequate records necessary to substantiate compliance and support the continued exclusion from gross income of the interest paid on the Bonds been retained? If “No”, please describe any deficiencies in the records retained.

Are there written procedures, other than bond documents provided at closing, which contain the following key characteristics to ensure that violations are timely identified and corrected so that the Bonds remain in compliance with federal tax requirements from the time they are issued until they are no longer outstanding?

- a. Due diligence review at regular intervals?
- b. Identification and training of the officer or employee responsible for review and record retention?
- c. Retention of adequate records to substantiate compliance (e.g. records relating to the allocation of proceeds, etc.)?
- d. Procedures reasonably expected to timely identify noncompliance?
- e. Procedures to ensure that steps will be taken to timely correct noncompliance?

Finally, applicable provisions of the Internal Revenue Manual governing the Service’s Voluntary Closing Agreement Program, which is available to issuers of tax-exempt tax credit and direct pay bonds who independently and voluntarily identify Code violations in connection with their bond issues, establish that **more favorable settlement terms will be available** to those issuers who have implemented appropriate written post-issuance tax compliance procedures. See IRM 4.81.6.5, and 7.2.3.4.4.

The documents and records may consist of paper and/or electronic medium.

III. ADVICE FROM THE IRS WEBSITE

The IRS has provided the following advice to issuers on its website: “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 actual operations. Written procedures should contain certain key characteristics, including making provision for:

- a. Due diligence review at regular intervals;
- b. Identifying the official or employee responsible for review;
- c. Training of the responsible official/employee;
- d. Retention of adequate records to substantiate compliance (e.g., records relating to expenditure of proceeds and the use of bond-financed facilities);
- e. Procedures reasonably expected to timely identify noncompliance; and
- f. Procedures ensuring that the issuer will take steps to timely correct noncompliance.

The goal of establishing and following written procedures is to identify and resolve noncompliance, on a timely basis, to preserve the preferential status of tax-advantaged bonds. Generally, an issuer that has established and followed comprehensive written procedures to promote post-issuance compliance is less likely, than an issuer that does not have such procedures, to violate the federal tax requirements related to its bonds.”

Please contact a member of Hawkins Delafield & Wood LLP if you would like to discuss any matter regarding written post-issuance tax compliance procedures.

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New York
One Chase Manhattan Plaza
New York, NY 10005
Tel: (212) 820-9300

Washington, D.C.
601 Thirteenth Street, N.W.
Washington, D.C. 20005
Tel: (202) 682-1480

Newark
One Gateway Center
Newark, NJ 07102
Tel: (973) 642-8584

Hartford
20 Church Street
Hartford, CT 06103
Tel: (860) 275-6260



Sacramento
1415 L Street
Sacramento, CA 95814
Tel: (916) 326-5200

Los Angeles
333 South Grand Avenue
Los Angeles, CA 90071
(213) 236-9050

San Francisco
One Embarcadero Center
San Francisco, CA 94111
Tel: (415) 486-4200

Portland
200 SW Market Street
Portland, OR 97201
Tel: (503) 402-1320