

Client Alert

Current Issues Relevant to Our Clients

July 9, 2015

California Issuer Pays \$1,013,000 in VCAP Settlement with IRS

On June 8, 2015, Long Beach Community College District in California (the “District”) paid the Internal Revenue Service (the “IRS”) \$1,013,000 as a result of the private activity use of certain real property acquired by the District with proceeds of tax-exempt certificates of participation (“COPs”) issued in 2001. The COPs were later refinanced with proceeds of the District’s General Obligation Bonds, 2008 Election, 2008 Series A (the “Bonds”). The District requested a settlement under the IRS’ voluntary closing agreement program (the “VCAP”) in May 2014.

In 2004, the proceeds of the COPs were used to purchase property that contained two buildings occupied by doctors and other tenants. The District initially intended to demolish and renovate the buildings for certain of the District’s educational programs. However, the District ultimately decided that the property was not needed for such educational purposes. The District continued to lease the buildings to private users and received monthly lease payments from such tenants.

Under the Internal Revenue Code of 1986 (the “Code”), governmental use bonds will be taxable private activity bonds if the bonds satisfy both the “private business use test”¹ and the “private payment or security test”² under the Code. Rather than risk the determination that its bonds were taxable private activity bonds due to the use and payments related to the lease of the bond-financed property, the District chose instead to avail itself of the VCAP. The District thereby was able to preserve the tax-exempt status of the interest on its Bonds.

The IRS administers the VCAP to assist governmental issuers in resolving violations of federal tax laws applicable to tax-exempt bonds, tax credit bonds and direct pay bonds. Under the VCAP, issuers can resolve violations through the execution of closing agreements with the IRS. The primary goal of the VCAP is to encourage issuers, and any other parties to a bond transaction, to exercise due diligence in complying with applicable federal tax laws. The VCAP achieves this goal by providing a vehicle to correct tax violations expeditiously.

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- 1 Bonds satisfy the business use test if more than five percent of the bond proceeds are used in a private business use. Private business use generally means use, directly or indirectly, in a trade or business carried on by any person other than a state or local governmental unit. Such five percent limit is raised to ten percent if the use is not unrelated or disproportionate to the governmental use of the property.
 - 2 Bonds generally satisfy the private payment test if more than five percent (ten percent in circumstances discussed in footnote 1) of the proceeds of tax-exempt bonds are directly or indirectly (i) secured by any interest in property used or to be used for a private business use, (ii) secured by any interest in payments in respect of property used or to be used for a private business use, or (iii) derived from payments, whether or not to the issuer, in respect of property, or borrowed money, used or to be used for private business use.
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For More Information

If you have questions regarding private use or private payments or the use of the VCAP to resolve federal tax law violations related to tax-exempt bonds, tax credit bonds or direct pay bonds, please contact a member of the firm’s Public Finance Group.

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To the extent that any part of this summary is interpreted to provide tax advice, (i) no taxpayer may rely upon this summary for the purposes of avoiding penalties, (ii) this summary may be interpreted for tax purposes as being prepared in connection with the promotion of the transactions described, and (iii) taxpayers should consult independent tax advisors.

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