



# Voluntary Compliance for Tax-Exempt and Tax-Credit Bonds

Part one of this publication is a summary of highlighted considerations to help issuers of tax-advantaged bonds comply with related federal tax law requirements. Part two is a summary of Tax-Exempt Bonds Voluntary Closing Agreement Program (TEB VCAP) provisions.

## Tax-Advantaged Bonds Compliance

### The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

The office of Tax Exempt Bonds ("TEB"), of the Internal Revenue Service ("IRS"), Tax Exempt and Government Entities division, offers specialized information and services to the municipal finance community. Municipal bonds provide tax-exempt financing for the furtherance of governmental and qualified purposes. Detailed educational resources on post-issuance compliance and voluntary compliance (including TEB VCAP requirements) are available on TEB's website: [www.irs.gov/Tax-Exempt-Bonds](http://www.irs.gov/Tax-Exempt-Bonds)

### Useful IRS Publications

- [1](#) Your Rights as a Taxpayer
- [4077](#) Tax-Exempt Bonds for 501(c)(3) Charitable Organizations
- [4078](#) Tax-Exempt Private Activity Bonds
- [4079](#) Tax-Exempt Governmental Bonds
- [5005](#) Your Responsibilities as a Conduit Issuer of Tax-Exempt Bonds

### PART ONE: Introduction to Tax-Advantaged Bond Compliance

Tax-advantaged bonds (tax-exempt, tax credit and direct pay) are obligations that receive preferential tax treatment under the Internal Revenue Code (the "Code"). These bonds, issued by or on behalf of state and local governments, are subject to applicable federal tax requirements both at the time of issuance and as long as the bonds remain outstanding. An issuer, conduit borrower, or other party's failure to comply with any applicable federal tax requirements with respect to tax-advantaged bonds jeopardizes the preferential tax status of those bonds.

#### Compliance at Time of Issuance

Compliance with certain applicable federal tax requirements at the time the bonds are issued include filing a Form 8038 series information return (e.g., 8038, 8038-G, 8038-GC, or 8038-TC) and reasonable expectations by the issuer that there will be ongoing post-issuance compliance. Additional issuance requirements might include a proper volume cap allocation and public approval of the bond issue.

#### Compliance Following Issuance

Post-issuance federal tax requirements generally fall into two categories: (1) qualified use, including use of the bond proceeds and the property financed by bond proceeds; and (2) arbitrage, including appropriate restrictions of investment yields and rebate of arbitrage from the investment of bond proceeds. Qualified use requirements require monitoring of the various direct and indirect uses of bond-financed property over the life of the bonds, determination of the sources of debt service payments and security for the debt, and calculations of the percentage of nonqualified uses within the project to be financed with the bond proceeds. Arbitrage requirements involve calculating and monitoring the yields on investments, determining appropriate restrictions on the investment yields, determining the amount of arbitrage on the investments, and calculating the amount and timing of arbitrage rebate payments that must be paid to the US Treasury.

There may be other post-issuance due diligence requirements. For example, some level of post-issuance monitoring may be required to determine compliance with issuance cost limitations applicable to qualified private activity bonds.

#### Importance of Post-Issuance Compliance

The ongoing nature of post-issuance federal tax requirements applicable to tax-advantaged bonds requires issuers to actively monitor compliance throughout the entire life of their bonds. This due diligence will significantly improve the issuer's ability to ensure the continued tax-advantaged status of its bonds by: (1) identifying noncompliance; (2) preventing violations from occurring; and (3) timely correcting identified violations (when prevention is not possible).

#### Role of Written Procedures in Post-Issuance Compliance

Issuers should adopt appropriate written procedures for their tax-advantaged bond issues that go beyond reliance on tax certificates provided at closing and bond documents. Sole reliance on tax certificates and bond documents may result in insufficiently detailed procedures or procedures not adequately incorporated into an issuer's operations. Appropriate written procedures may contain certain key characteristics including:

- (1) Due diligence review at regular intervals;
- (2) Identifying the official or employee responsible for review;
- (3) Training of responsible officials/employees;
- (4) Retention of adequate records to substantiate compliance (e.g., records relating to expenditure/investment of proceeds, use of debt financed property and related contracts);
- (5) Procedures reasonably expected to timely identify noncompliance; and
- (6) Procedures ensuring that the issuer will take steps to timely correct identified noncompliance.

Establishing and following written monitoring procedures helps issuers to preserve the preferential tax status of their tax-advantaged bonds. Generally, an issuer that has established and followed comprehensive written monitoring procedures to promote post-issuance compliance will be significantly less likely to violate the federal tax requirements related to its bonds than an issuer without such procedures.

#### Remedial Actions

An action that causes an issue to meet the private business tests or the private loan financing test is not treated as a deliberate action if the issuer takes a remedial action under the Treasury regulations. Application of an appropriate remedial action prevents the bonds from losing their tax-advantaged status. Some of the more common deliberate actions for which remedial action may be available include:

- (1) A management contract that causes private business use;
- (2) The sale of bond-financed property;
- (3) The lease of bond-financed property to a nongovernmental person; and
- (4) The failure to use 95% of net proceeds to provide an exempt facility.

An issuer that discovers it has taken a deliberate action that may result in a violation of any of the federal tax requirements applicable to its bonds should immediately ascertain if there are available remedial actions under the Income Tax Regulations (the "Treasury regulations") or other published guidance.

#### Record Retention Requirements

Various sections of the Code and Treasury regulations, including, but not limited to, sections 103, 141-150, and 6001 require

the retention of the records necessary to substantiate compliance with federal tax requirements applicable to tax-advantaged bonds. Generally, any person subject to income tax, or any person required to file a return of information with respect to income, must keep such books and records as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by that person in any return. This includes Form 8038 series and other returns filed by the issuer with respect to a tax-advantaged bond issue.

## **PART TWO: TEB Voluntary Closing Agreement Program**

### **Introduction**

The Tax Exempt Bonds Voluntary Closing Agreement Program (TEB VCAP) is described in Notice 2008-31, 2008-11 I.R.B. 592, which provides information about TEB VCAP for tax-advantaged bonds. This program provides remedies for issuers who voluntarily come forward to resolve a violation which cannot be rectified under self-correction programs described in the Treasury regulations or other published guidance. Closing agreement terms and amounts may vary according to the degree of violation as well as the facts and circumstances surrounding the violation. TEB VCAP operating procedures are in section 7.2.3 of the Internal Revenue Manual ("IRM").

### **Objective of TEB VCAP**

TEB VCAP encourages issuers and other parties involved in tax-advantaged bond transactions to exercise due diligence in complying with the applicable federal tax requirements, and to provide a vehicle to correct violations as expeditiously as possible before they are discovered during an examination. An issuer submitting a TEB VCAP request can expect to settle the case on terms that are no less favorable, and generally on terms that are more favorable than the settlement terms that would be expected had the violation been discovered as a result of an examination.

### **Availability of TEB VCAP**

TEB VCAP is available to issuers of tax-advantaged bonds who have discovered a violation of the federal tax requirements applicable to their bonds. TEB VCAP is not available for bonds under examination, or if the tax-advantaged status is at issue in a federal court or before the IRS Office of Appeals. TEB VCAP is generally not available, absent extraordinary circumstances, if the violation can be resolved under existing remedial action provisions or closing agreement programs contained in the Treasury regulations or other published guidance.

### **Submitting a TEB VCAP Request**

A TEB VCAP request must include Form 14429 Tax-Exempt Bonds Voluntary Closing Agreement Program Request, available on TEB's website at [www.irs.gov/Tax-Exempt-Bonds](http://www.irs.gov/Tax-Exempt-Bonds). Form 14429 must be signed under penalty of perjury and included at the beginning of the request. This form assists issuers in organizing their TEB VCAP requests and ensuring that their submissions are complete in accordance with the requirements under Notice 2008-31 and IRM section 7.2.3. Email requests with this required information to: [TEBVCAP@irs.gov](mailto:TEBVCAP@irs.gov). Requests may also be mailed to: Internal Revenue Service, Attn. TEB VCAP, 1122 Town & Country Commons, Chesterfield, MO 63017.

### **TEB VCAP Resolution Standards**

In order to standardize closing agreement terms (including settlement amounts) and to provide transparency to issuers and other parties to tax-advantaged bond transactions, TEB has described in IRM section 7.2.3 resolution standards that may be used to conclusively resolve certain violations. Methodologies relating to calculation of settlement amounts under these resolution standards are fully described in IRM section 4.81.6. If a violation does not fall within a specific resolution standard, TEB VCAP general resolution standards may be applied on such terms as are determined appropriate under the facts and circumstances. TEB frequently expands the resolution standards available under its IRM procedures in order to address additional violations.

### **Resolution Standards for Tax-Exempt Bonds**

IRM section 7.2.3.4.2 describes resolution standards for specific violations of federal tax laws applicable to tax-exempt bonds. Examples of violations that these standards address include:

- (1) A final allocation of tax-exempt bond proceeds to nonqualified purposes that exceeds the defined percentage limits;
- (2) Property financed with proceeds of a qualified 501(c)(3) bond issue is owned by a person other than a 501(c)(3) organization or governmental unit;
- (3) A failure to successfully remediate nonqualified bonds through establishment of a defeasance escrow because some or all of the bonds are not callable within 10.5 years of the issue date;
- (4) On an allocation of proceeds to property, the average maturity of the bonds exceeds 120% of the average reasonably expected economic life of such property; and
- (5) A party to the escrow agreement fails to meet their obligations to timely reinvest proceeds of a refunding issue, upon maturity of the investments, as directed by the escrow instructions.

### **Resolution Standards for Direct-Pay Bonds**

IRM section 7.2.3.4.3 describes resolution standards for specific violations of federal tax laws applicable to certain direct pay bonds. Examples of violations that these standards address include:

- (1) A deliberate action that causes build America bonds to be private activity bonds;
- (2) A final allocation of proceeds to an impermissible use; and
- (3) The acquisition by an issuer of its own debt instrument resulting in extinguishment.

### **Anonymous Request**

A TEB VCAP request may be submitted on an anonymous basis to find the appropriate resolution method for a violation. This option is intended to assist issuers in evaluating appropriate resolution methods in instances where the violations are novel or in instances where there is significant uncertainty regarding the appropriate settlement terms. The anonymous request may only pertain to a general matter, question, or factual scenario. It may not be used to inquire as to appropriate resolution methods for violations involving detailed facts and circumstances.

### **Resolution Benefit for Issuers with Post-Issuance Compliance Procedures**

The TEB VCAP program provides an incentive for issuers and conduit borrowers to implement written post-issuance compliance monitoring procedures. Under this program, issuers that adopt written procedures to ensure their tax-advantaged bonds remain in compliance with all post-issuance related federal tax requirements that are conditions to the tax-advantaged status of the bonds may be eligible to resolve violations on terms that are more favorable than issuers that have not adopted such post-issuance compliance monitoring procedures. Please see section 7.2.3 of the IRM for additional information.