



TEB Post-Issuance Compliance: Some Basic Concepts

Tax Exempt Bonds (TEB) focuses on providing participants in the municipal bond industry with quality service to assist issuers and conduit borrowers in understanding their tax responsibilities. As part of that service, TEB is providing the following basic information for issuers of tax-advantaged bonds with respect to their post-issuance compliance requirements. Issuers may use this basic information to establish due diligence practices to monitor tax compliance throughout the period that their bonds are outstanding. However, issuers may not cite this basic information as an authoritative source. TEB recommends that issuers review this basic information in consultation with their counsel.

Generally

Tax-advantaged bonds (tax-exempt, tax credit, and direct pay) are bonds that receive preferential tax treatment. 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 for so long as the bonds remain outstanding. An issuer or other party's failure to comply with any applicable federal tax requirement with respect to tax-advantaged bonds jeopardizes the preferential tax status of those bonds.

Compliance with certain applicable federal tax requirements normally occurs at the closing of the bond transaction, while other federal tax requirements require on-going monitoring after the issuance of the bonds. Issuance related requirements include filing a Form 8038 series information return ([8038](#), [8038-G](#), [8038-GC](#), [8038-B](#), or [8038-TC](#)) and the issuer having reasonable expectations of on-going post-issuance compliance. Additional issuance related requirements might include volume cap allocation limits and public approval of the bond issue.

Post-issuance federal tax requirements generally fall into two categories: (1) qualified use of proceeds and financed property; and (2) arbitrage yield restriction and rebate. Qualified use requirements require monitoring of the various direct and indirect uses of bond-financed property over the life of the bonds and calculations of the percentage of nonqualified uses. Arbitrage requirements also require monitoring over the life of the bonds to determine whether both the yield on investments acquired with bond proceeds are properly restricted and whether the issuer must file [Form 8038-T](#) to pay a yield reduction payment and/or rebate payment.

Some federal tax requirements that are generally issuance related might require some level of post-issuance due diligence monitoring. For example, adjustments to the determination of issue price for federal tax purposes can affect compliance with volume cap allocation, arbitrage yield restriction, and other federal tax requirements. Similarly, some level of post-issuance monitoring may be required to determine compliance with the issuance costs limitations applicable to qualified private activity bonds.

Importance of Post-Issuance Compliance

The on-going nature of post-issuance compliance requirements applicable to tax-advantaged bonds requires issuers to actively monitor compliance throughout the entire period their bonds remain outstanding. This due diligence will significantly improve the issuer's ability to identify noncompliance and prevent violations from occurring, or timely correct identified violations (when prevention is not possible), to ensure the continued tax-advantaged status of the bonds.

Written Procedures for Monitoring Compliance

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 provision 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 relating 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 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.

How Does the IRS Promote Post-Issuance Compliance?

TEB administers a [Voluntary Closing Agreement Program \(TEB VCAP\)](#) to assist issuers in resolving federal tax violations related to their bonds as described in [Notice 2008-31](#) and [IRM section 7.2.3](#).

Generally, an issuer will receive more favorable resolution terms under TEB VCAP than for the same tax violation discovered during an examination of the bonds. In addition, an issuer that identifies a violation in accordance with the implementation of its written post-issuance compliance procedures can generally expect to receive more favorable treatment in resolving its tax violation under TEB VCAP than if the issuer has not implemented such procedures.

TEB uses compliance check questionnaires to evaluate compliance trends and practices issuers use to monitor compliance with federal tax requirements. For example, in May 2011 TEB initiated a [questionnaire project on advance refundings](#). Generally, the design of the questionnaires is to gather information from a segment of the municipal bond market. While these questionnaires are not examinations of specific bond issues, the data collected allows TEB to develop new voluntary compliance and education programs as well as to identify future compliance projects.

Issuers of tax-advantaged bonds are required to file a Form 8038 series information return. All Form 8038 series returns include questions regarding whether the issuer has established written procedures to timely identify and correct violations and to ensure compliance with the arbitrage yield restriction and rebate requirements.

[The Advisory Committee on Tax Exempt and Government Entities \(ACT\)](#) issued several reports related to post-issuance compliance. Specific ACT recommendations on post-issuance compliance procedures are included in an [exhibit to its June 2007 report](#).

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