

Recently, post issuance compliance for tax-exempt financing has become a central focus in the bond and note issuance process.

This is not a new issue; it has been around as long as tax certificates have been executed with tax-exempt securities. And it shouldn't be new to most certified treasurers; it has been discussed in the opening session of the annual MCTA School in Amherst for the past three years. However, now it is an issue that has made its mark – a box to be checked on the IRS form 8038-G; and for those of you who have done recent bond or note issues with full disclosure and legal opinion, it is an issue receiving considerably more attention from Bond Counsel than in previous years.

This article is the first of two on post issuance compliance that we will present on this website – two articles because there is plenty to discuss, and because we don't want to overload you with too much information creating one more concern that might keep you awake at night. This month, we review the basic issues associated with post issuance compliance; and next month we will present what we suggest as an outline of objectives and topics that should be included in a policy.

First, “post issuance compliance” refers to the oversight and, as needed, actions that must be taken by a treasurer and/or a finance director to ensure that the tax-exempt status of any outstanding security is not jeopardized by some other action – or perhaps inaction – after the security is issued. Post issuance compliance responsibilities have always been addressed as part of the bond closing process, primarily presented in the tax certificate, but also referenced in general terms in other closing documents. However, that being said, we likely suspect that all too often these documents are all but forgotten within, say, a year or two of the issuance of the bonds in question. Then, even worse, we also likely assume that many, if not most, of non-finance local officials are totally unaware of or unconcerned by post issuance compliance responsibilities – or of the potential consequences that actions they might take could have on the tax-exempt status of outstanding bonds.

There are three general types of post issuance compliance violations:

- A change in ownership of a bond-funded project or acquisition – for example, after the purchase of property with tax-exempt bonds, the sale of a substantial portion of that property to a private developer.

- A change in operation of the project or acquisition – for example, the hiring of a private contractor to operate a school cafeteria that was just upgraded with the use of tax-exempt bonds.
- A failure to abide by laws and rules governing arbitrage on the investment of tax-exempt proceeds – for example, the failure to make a rebate payment when due to the federal government.

There are many other examples that could be cited; but these three are good general representations of the activities a treasurer should be focusing on to prevent any post issuance compliance violations.

As previously mentioned, the issue is not new. However, three events in recent years began the re-energized focus on it. First, about four or so years ago, the IRS began to perform random audits of tax-exempt financings, to determine whether the proceeds were used properly and completely, and to determine whether the projects were still being used as originally contemplated. The most frequent violations discovered were associated with violations of expenditure tests and the failure to make rebate payments when due.

Then, about three years ago, the IRS sent questionnaires to a randomly selected group of bond issuers inquiring specifically – very specifically – about their post issuance compliance policies and procedures. Apparently, many responded by simply citing the presence of the tax certificate associated with their issue of bonds, notwithstanding whether anyone had actually referred to it after the bonds were issued. In the case of towns we work with at UniBank, one of the communities we serve received the questionnaire. It responded by using the questionnaire as an opportunity and very convenient guideline in preparing and adopting its own post issuance compliance policy.

Finally, this past year, a revised IRS form 8038-G was released; and it included a box to be checked if the issuer had adopted a post issuance compliance policy. And we can only guess whether that box being left unchecked might be interpreted by the IRS as a lack of attention to post issuance compliance.

Thus, there has been a rejuvenated effort to encourage communities to focus on post issuance compliance and, in turn, to adopt a post issuance compliance policy. Over the past several months, Bond Counsel has presented a comprehensive draft policy to bond issuers, particularly focusing on the rules of the Internal Revenue Code – and we at UniBank have prepared our own draft policy, particularly focusing on the allocation of responsibility among municipal officials –

to be considered and, hopefully, adopted with new issues of notes and bonds. Yes, progress is being made.

But, of course, the ability to check the box on the 8038-G isn't only associated with large bond or note issues. Forms 8038-G are submitted with every tax-exempt note issued through the State House Loan Note program in Massachusetts – and with every tax-exempt lease purchase that a treasurer may, or may not, hear about. Until you adopt a policy, it is reasonable to think that every new issue, regardless of the size, should be followed by a discussion among local officials as to whether and how a policy should be implemented.

Post issuance violations can present interesting challenges for treasurers. In many cases, they can be remedied relatively easily. However, in some cases, the development of a remedy may require written communications back and forth with the enforcement branch of the IRS. Fortunately, it can be reasonably assumed that the IRS wants to remedy problems as easily as possible – it is not looking to meet some prescribed quota of new federal penitentiary occupants. However, most important, it should be recognized that the penalty for violations will be considerably more extreme if it appears the violation was known of and ignored or if there appears to be other forms of “willful neglect”. If you know you have a problem, address it!

For this month, we think this is a sufficient introduction of the post issuance compliance issue. Next month, we will present our thoughts on the objectives and content of a post issuance compliance policy. However, we leave you with one final thought – if you have any questions, concerns, suspicions, etc., please contact your financial advisor and/or your Bond Counsel. Please exercise all appropriate due diligence in addressing issues you think you might have inadvertently walked into.

And please note, we offer this as a general introduction to post issuance compliance. Please don't rely on articles like this as sufficient guidance to compliance issues you might be concerned about. Pick up that telephone and call us and/or Bond Counsel for guidance relating to a particular problem you are facing.

And have a pleasant night's sleep tonight; your financial advisor and your Bond Counsel are there to help you.