

In the last edition of this newsletter, we reviewed the general issues associated with post issuance compliance. We also reviewed the specific new requirement associated with the issue of tax-exempt debt – that a new box be checked on the IRS form 8038 indicating, if applicable, that the issuer has a post issuance compliance policy in place. Over this calendar year, this new requirement has become the catalyst that has resulted in the adoption of many such policies by issuers of notes and bonds, primarily at the prompting of bond counsel – and we should all assume that this practice will continue.

In this edition, we will present what we believe should be incorporated into an effective post issuance compliance policy.

By way of brief review, post issuance compliance is comprised of all those activities that should or, as the case may be, shouldn't be done to ensure compliance with federal tax law after the issuance of tax exempt notes and bonds. In our last article we cited three general situations that may create post-issuance violations of the tax code: an excessive private use after the original funding of an acquisition, property, etc., funded with tax-exempt note and bond proceeds; a change in use of a tax-exempt funded project, where the new use would not be eligible for tax-exempt funding; and a tax code violation, such as exceeding the allowed investment yield or the failure to pay a required rebate when due.

As we mentioned in the last article, these issues are not new. They have always been incorporated into the tax certificates associated with any tax-exempt bond or note issue. In addition, the issuer – and particularly, the finance director or treasurer – has always had the responsibility to ensure no post issuance violation occurs.

However, with that new extra box on the 8038-G which asks whether “the issuer has established written procedures to ensure that all nonqualified bonds ... are remediated according to ... the Code”, it now appears necessary that a post issuance compliance policy be developed, approved and put in place. Thus, with recent bond issues, bond counsels have been providing forms of such policies that should be implemented; and bond counsels have incorporated into the votes approving the issuance of bonds and notes the direction to the treasurer that a post issue compliance policy be implemented. Then, that important box on the 8038-G can be checked accordingly.

Unfortunately, the draft policies provided by bond counsels have not been as complete as we believe they should be. With all proper respect to the many bond counsels' good efforts, these draft policies have been mostly a reiteration of the particular points in the tax certificates, although in more accessible terms than the typically dense tax certificate. However, the draft policies have provided virtually no direction as to how post issuance compliance should be accomplished.

Our goal here is to lay out what we believe a comprehensive policy should include to ensure effective implementation. We believe it must prescribe how compliance will be accomplished – how the municipal issuer is to become aware of and continually monitor post issuance compliance, and how the municipal issuer is to address and, if necessary, remedy potential compliance violations. The “what” of

post issuance compliance is necessary but not sufficient – the “how it will be done” is the key piece that must be in every policy.

Here are some ideas of what we suggest should be in the policy:

First, the logical starting point of a good policy is to assign the responsibility for compliance to the treasurer or finance director of the community (and hereafter, the two will be collectively referred to as the treasurer). We apologize in advance to all you treasurers who may be offering, presumably tongue-in-cheek, “thanks” for being given one more task to do – or who may be feeling an uncomfortable new anxiety, since this likely appears as an assignment of responsibility without the necessary authority to accomplish it. And this latter point is justified – treasurers do not have the authority to ensure violations are not committed.

Thus, the second and next logical point is to include in the policy the process by which other appropriate municipal officials are informed of the scope of post issuance compliance and, in turn, of their responsibility to ensure violations are avoided or are reported to the treasurer when discovered. We believe the policy should include the requirement that the treasurer periodically remind other officials in the city, town or district of what constitutes a violation and of what should or should not proceed without the consideration of the treasurer, the municipality’s financial advisor, and perhaps even bond counsel.

This second point does not solve the “lack of authority” issue, but it does allow the treasurer to say, if a violation occurs, that he or she had done everything within his or her power and everything required by the policy to avoid such a violation. Since the structure of municipal governance cannot provide the requisite authority to a treasurer – the authority, for example, for the treasurer to simply state to a board of selectmen that “no, you can’t do that – period”, the policy must then prescribe the process by which those other municipal officials are to be made aware of the pitfalls of post issuance compliance. Then, if one of those parties causes a violation, the treasurer can at least say “I warned you”. This may not prevent or solve a violation; but when the treasurer’s name appears in that dreaded letter from the IRS, he or she ought to be able to represent to the IRS that the treasurer’s responsibilities were fulfilled to the best of his or her ability.

How should this be done?

- In advance of any borrowing, the treasurer should review with other appropriate municipal officials the scope, activities, goals, etc., of the borrowing as related to applicable tax code issues – and the treasurer should document this review. At this point in the process of issuing notes or bonds, the treasurer should have the best understanding of anyone in the community of tax law issues; thus, the treasurer is best able to assess whether and how violations might occur. The important responsibility here is for the treasurer to confer with the right municipal officials, ask the right questions, etc., and comfortably make the assessment as to whether possible compliance issues might occur.

- Annually, the treasurer should review post issuance compliance expectations with the board of selectmen or city council or school committee, as the case may be. This should include a general review of post issuance compliance issues and then a specific review of particular projects, acquisitions, etc., that may have piqued the treasurer's interest – and this should include the request as to whether the board is considering or may know of any potential private use or change in use proposals.
- Annually, the treasurer should distribute a memorandum reviewing post issuance compliance expectations to appropriate department heads and school department officials. This should be sufficiently detailed to ensure department heads have enough of an appreciation for likely post issuance compliance problems to know when to advise the treasurer of a potential problem.

Third, the policy should explicitly reference the actions the treasurer must be responsible for. For example –

- The treasurer should be required to project by date and par amount the possible note and bonds issues each year, primarily to appropriately document expectations relating to the \$5 million and \$10 million tests in the tax code. Thus, for example, at the beginning of each calendar year, the treasurer should prepare a list of reasonably anticipated tax-exempt financings for the calendar year. This schedule should be prepared with the assistance of other municipal officials, and it presumably should be consistent with the municipality's annual capital plan.
- With each tax-exempt borrowing, the treasurer and town accountant should implement the process by which expenditures can be most effectively tracked and documented. In particular, in anticipation of what would be required to have a rebate calculation performed, the treasurer should deposit the funds in an account where expenditures and earnings can be precisely identified; and the town accountant should confirm that he or she is also able to produce necessary data, particularly when the project is complete and all funds are assumed to be expended.
- At the end of each fiscal year and at other appropriate times during the fiscal year, the treasurer should review the expenditures for each project funded with tax-exempt note or bond proceeds and assess compliance with expenditure expectations associated with that project. As necessary, the treasurer should consider the likelihood of rebate exposure, the need for a rebate calculation, the need to reserve funds for a rebate payment, and the schedule by which a potential payment is to be made to the federal treasury.
- At the completion of each project, the treasurer should review the expenditure of funds – to ensure all the funds have been expended, or to prompt the appropriate local officials to

finishing using the funds as allowed, or to re-appropriate the funds to some other capital purpose for expenditure in accordance with the General Laws of the Commonwealth.

- The treasurer should establish a repository for required documentation.
- When potential or actual violations occur, the treasurer should assume the responsibility to effect resolution of the violation. This is important – if a violation is believed to have occurred, it is necessary to take prompt appropriate action to remedy the situation. The consequences of ignoring a recognized problem can be severe.

Fourth, the policy should provide specific direction relating to certain activities –

- The treasurer should be identified as the only person authorized to sign an 8038-G or GC.
- All lease purchase agreements should be provided to the treasurer for review before execution, particularly to ensure compliance with annual issuance expectations relating to the \$5 million and \$10 million issuance limits and, of course, to ensure the proper execution of 8038's.
- All management service contracts should be provided to the treasurer for review prior to execution.
- All proposed changes in use of tax-exempt note or bond funded property or projects should be presented to the treasurer for review prior to execution.

And, fifth, the policy should require the prompt reporting of any potential violation to the treasurer; and, as previously mentioned, the treasurer should be responsible for conferring with the municipality's financial advisor and/or Bond Counsel to review the potential violation and respond accordingly.

In closing, the overarching goal of an effective post issuance compliance policy is to ensure all appropriate parties in a municipality have an appreciation of tax code issues and potential post issuance compliance violations – or at least enough of an appreciation to know how to recognize or when to be concerned with a potential problem and to act accordingly rather than to ignore or assume the problem will go away. Local officials cannot be expected to have a comprehensive understanding of the tax code's constraints on tax exempt financings; they can, however, have enough knowledge of such issues, provided in a periodically administered manner, to be able to recognize a potential problem before it becomes a real problem.