



Topic: POLICY FOR POST ISSUANCE TAX-EXEMPT BOND COMPLIANCE		
Policy # FAR-2	Version: 1	Effective Date: 05/01/2012

Purpose:

The purpose of these post-issuance compliance policies for tax-exempt bonds and federal tax credit bonds issued by The Board of Trustees of The University of Alabama (“University”) is to insure that the University will be in compliance with requirements of the Internal Revenue Code of 1986, as amended (the “Code”), that must be satisfied with respect to tax-exempt bonds and federal tax credit bonds and other obligations (“bonds”) after the bonds are issued so that interest on the bonds will be and remain tax-exempt or eligible for the federal tax credit, as applicable.

Policy Statement:

The University has financed the acquisition and construction of, and improvements to, many of its facilities and other capital projects with the proceeds of tax-exempt bonds, Direct Pay Build America Bonds, and Recovery Zone Economic Development Bonds. Because bondholders do not pay federal income tax on the interest received on tax-exempt bonds, they are generally willing to accept a lower interest rate than if the bonds were issued on a taxable basis. Build America Bonds (BABs) and Recovery Zone Economic Development Bonds (RZED) are taxable governmental bonds eligible for certain tax credits under the Internal Revenue Code. Those tax credits have been furnished in the form of direct payment subsidies made by the U.S. government. Tax-exempt bonds and federal tax credit bonds provide the University with the ability to finance many of its capital projects at a greatly reduced cost. University bonds are considered governmental bonds and not 501(c)(3) bonds.

For bonds to qualify for tax-exempt status, many detailed rules set forth in the Code and Treasury Regulations must be satisfied. When bonds are issued, outside bond counsel is engaged to review and confirm compliance with these rules as of the issue date. Many rules, however, continue to apply throughout the entire term of the bond issue. The University has accepted the responsibility of maintaining compliance with these rules following the issue date, in order to meet its obligations under federal tax law and to preserve the important benefits associated with tax-exempt financing. The University has assigned to the Vice President for Financial Affairs and Treasurer of the University the primary responsibility of monitoring the University’s compliance with federal tax requirements for the University’s tax-exempt bonds and federal tax credit bonds for the benefit of the University (but not with respect to the University’s other divisions – University of Alabama at Birmingham and University of Alabama in Huntsville).

Policy:

I. Investment of Bond Proceeds

A. Investments must be purchased at Fair Market Value

Prior to being spent, bond proceeds must be invested in a manner that will establish fair market value for federal tax purposes, in order to maintain compliance with the rebate

and arbitrage yield restriction rules per Code Section 148 (See Exhibit A). The rebate regulations require that investments made with Bond proceeds be purchased at fair market value. The purpose of this requirement is to prevent the avoidance of rebate that would otherwise be payable to the US Treasury by purchasing investments at an artificially low price. Unless an investment fits one of the established safe harbors in the regulations, it is rebuttably presumed that an investment is not purchased at fair market value.

The following safe harbors are provided under the fair market value rule (Reg. 1.148-5):

1. Securities traded on an established market.
2. SLGs (State and Local Government Series) – A Treasury obligation purchased directly from the US Treasury Department under its program for SLGs.
3. Certificates of Deposit – Issued by a bank if the CD has a fixed interest rate, fixed payment schedule, substantial penalty for early withdrawal, a yield not less than the yield on a reasonably comparable direct obligation of the US, or a yield that is published or posted by the bank to be currently available from the bank on reasonably comparable CDs offered to the public.
4. Guaranteed Investment Contracts – an investment contract with negotiated withdrawal and reinvestment provisions and a specifically negotiated interest rate. Must meet bidding requirements of the regulations.
5. Securities purchased on the open market for a yield restricted defeasance escrow.

The Associate Vice President (AVP) for Finance provides direction for investing the proceeds in accordance with the University investment guidelines. Unless safe harbor provisions are met, all investments of bond proceeds are purchased at fair market value.

B. Arbitrage Yield Restriction and Rebate Requirements

Tax-exempt bonds lose their tax-exempt status if they are arbitrage bonds under section 148 of the Code (See Exhibit A). In general, arbitrage is earned when the gross proceeds of an issue are used to acquire investments that earn a yield materially higher than the yield on the bonds of the issue. The earning of arbitrage does not, however, necessarily mean that the bonds are arbitrage bonds.

Federal tax law requires the University to “rebate” to the federal government any amounts earned from the investment of bond proceeds at a yield in excess of the bond yield, unless an exception applies. Arbitrage rebate is due on the fifth anniversary of bond issuance plus 60 days and succeeding installments every five years. The final installment is due 60 days after retirement of last bonds of issue. The University retains an outside rebate computation firm to calculate its liability, if any, for rebate for each of its bond issues. The AVP for Finance, along with Financial Accounting & Reporting, are responsible for maintaining the engagement with the firm, providing the firm with the documentation it requires, making sure the firm prepares calculations at the required intervals (including upon the retirement of a given bond issue), reviewing the firm’s calculations for obvious errors, coordinating with the issuer to remit any required rebate to the federal government (Form 8038-T), and retaining appropriate records. The AVP for Finance and Financial Accounting & Reporting are also responsible for monitoring

the spending of bond proceeds and taking appropriate steps to qualify for a “spending exception” (see appendix A) to rebate, to the extent practicable.

II. Expenditure of Bond Proceeds

Federal tax law places restrictions on the types of expenditures that may be financed with tax-exempt or federal tax credit bond proceeds.

- A.** The University’s expectations as to the expenditure of bond proceeds are set forth in the tax certificate executed on the date of issuance of each bond issue, which bond counsel uses to evaluate compliance with these rules as of such date. Expenditures should not deviate materially from the expectations and limitations stated in the tax certificate for the issue without consulting beforehand with bond counsel.
- B.** Costs of issuance financed by the issue are treated as common costs and generally have a private business use percentage equal to the weighted average private business use percentage of the projects financed by the issue. This includes issuance costs withheld from proceeds and any costs incurred separately by the University.
- C.** With respect to the proceeds of Build America Bonds (Direct Pay), 100 percent of the excess of “available proceeds” must be used only for capital expenditures. Available proceeds are the sale proceeds the issuer receives from the bonds minus proceeds it is allowed to spend on costs of issuance (up to 2%) plus proceeds from investment earnings. Thus, investment earnings on BABs (Direct Pay) must also be spent on capital expenditures. The authorizing legislation for BABs expired on December 31, 2010, so no new BABs can be issued.
- D.** Issuers of RZED Bonds must spend 100% of the “available proceeds” for one or more qualified economic development purposes. A qualified economic development purpose means expenditures for promoting development or other economic activity in a recovery zone, including capital expenditures and working capital expenditures paid or incurred in such zone, expenditures for public infrastructure and construction of public facilities, and expenditures for job training and education programs. Available proceeds are the sale proceeds the issuer receives from the bonds minus proceeds it is allowed to spend on costs of issuance (up to 2%) plus proceeds from investment earnings. Thus, investment earnings on RZED bonds must also be spent on a qualified economic development purpose. The authorizing legislation for RZED Bonds expired on December 31, 2010, so no new RZED Bonds can now be issued.
- E.** Projects financed with RZED bond proceeds are subject to Davis-Bacon labor standards. The Davis-Bacon contract clauses stated in 29 CFR 5.5(a)(1) through (10) must be incorporated into covered contracts for construction, alteration, or repair work.
- F.** For each bond financed project, bond proceeds are allocated to expenditures for the project within the period ending on the earliest of the following (the “Permitted Allocation Period”): (i) 18 months after the placed-in-service date of the project (or the payment of the expenditure in question, if later), (ii) five years (plus 60 days) after the issue date of the bonds, or (iii) 60 days after the retirement of the bonds.
- G.** Projects may be approved by the Board of Trustees with a funding source of future bonds and projects may be started prior to the issuance of bonds. In those instances, the board resolution must declare the University’s official intent to use bond proceeds to reimburse the University for expenditures made with University funds and the resolution

must be adopted not longer than 60 days after the first expenditure expected to be reimbursed. The following language must be included in the resolution for the project:

WHEREAS, officials at The University of Alabama have determined that the Board will incur certain costs in connection with the acquisition, construction, and installation of the Project prior to the issuance of the Bonds, and the Board intends to allocate a portion of the proceeds of the Bonds to reimburse the Board for certain costs incurred in connection with the acquisition, construction and installation of the Project paid prior to the issuance of the Bonds; and

The University of Alabama does hereby declare that it intends to allocate a portion of the proceeds of the Bonds to reimburse the Board for expenses incurred after the date that is no more than sixty days prior to the date of the adoption of this resolution, but prior to the issuance of the Bonds in connection with the acquisition, construction, and installment of the Project. This portion of this resolution is being adopted pursuant to the requirements of Treasury Regulations Section 1.150-2(e).

- H.** Preliminary expenditures (often referred to as soft costs) can be reimbursed even if incurred more than 60 days before the adoption of an official intent resolution. Preliminary expenditures include architectural costs, engineering costs, surveying costs, testing costs, advertising, and other similar costs before commencement of construction. Expenditures may not be reimbursed once a construction contract is let and “dirt is turned”.

III. Restrictions on Private Business Use and Private Loans

Restrictions on private business use exist for property financed with proceeds of tax-exempt bonds or federal tax credit bonds and apply to that property after the bonds have been issued. There is also a restriction on the use of the proceeds of tax-exempt bonds or federal tax credit bonds to make or finance any loan to any person other than a state or local government unit. Bonds classified as Private Activity Bonds (IRC sec 141 – see Exhibit A) can lose tax-exempt status. A private activity bond is one that meets the private business use test and the private security/payment test or the private loan financing test.

- Private Business Use means use directly or indirectly in a trade or business carried on by any person other than a governmental unit (use as a member of the general public shall not be taken into account). A bond is a private activity bond when more than the lesser of \$15 million or 10% of the proceeds of a tax exempt issue are used for any private business use. The pro-rata private use portion of costs of issuance is considered private business use and must be deducted in this determination. (5% limit applies to use that is considered unrelated to any government use of bond proceeds, as described more specifically in IRC section 141(b)(3)).
- Private Security or Payment test is met when more than 10% of the proceeds of a tax-exempt issue are directly or indirectly (a) secured by any interest in property used or to be used for private business use or payments in respect of such property or (b) to be derived from payments in respect of property, or borrowed money, used or to be used for private business use.
- Private Loan Financing test is met if the amount of the proceeds of the issue is to be used (directly or indirectly) to make or finance loans to persons other than governmental units exceeds the lesser of 5% of the proceeds of the issue or \$5,000,000.

When a portion of a building is expected to be used by a private business or as a private loan, UA generally funds the private business use portion with taxable bonds or University funds and the remainder with tax-exempt bonds in order to remain in compliance.

Private Business Use can arise from the following:

- A. Management Contracts – A management contract is defined by the IRS as a management, service or incentive payment contract with a service provider under which the service provider provides services involving all or a portion of any function of a facility. Examples would include food service and bookstore, where the outside company has an ongoing presence in or control of the facility. IRS Revenue Procedure 97-13 provides safe harbors for management or service contract arrangements to avoid private business use. See Appendix B.
- B. Sponsored Research Agreements – Research performed in bond-financed facilities may constitute private business use if a commercial business funds the research and receives particular benefits from the results of the research. IRS Revenue Procedure 2007-47 provides three safe harbors for research agreements. See Appendix C.
- C. Unrelated Trade or Business – The general unrelated business use principles under Section 513 of the Internal Revenue Code are applied to analyze the use of tax-exempt bond financed facilities for this purpose.
- D. Naming Rights of Facilities – Private use is generally not created when a building, or a room or an area within a building, is named for an individual or individuals when the name is not that of a company or a commercial name, e.g., the John and Mary Doe Building. Private use could result when a naming situation involves a company or commercial name such as the XYZ Bank Building. A naming rights situation involving a company or a commercial name may require outside bond tax counsel review and/or a ruling request from the Internal Revenue Service.

IV. Record Retention Requirements

The basic purpose of record retention for the University's tax-exempt bonds and federal tax credit bonds is to enable the University to readily demonstrate to the IRS upon an audit of any tax-exempt or federal tax credit bond issue that the University has fully complied with all federal tax requirements that must be satisfied after the issue date of the bonds so that interest on those bonds continues to be tax-exempt under section 103 of the Code (see Exhibit A) or qualifies for the applicable tax credit. Documentation should be maintained for the entire term of the bond issue plus three years after the bonds have matured. If the bonds are refunded in later issues, the combined term of the issues plus three years will be the required retention period. The records may be in paper or electronic form. However, most of the documentation should be saved on the Sharepoint Bond Compliance website <https://finance-estus.fu.ua.edu/bondcomp/default.aspx>.

The records to be maintained include:

- A. The official Transcript of Proceedings for the original issuance of the bonds;
- B. Records showing how the bond proceeds were invested, as described in I above;
- C. Arbitrage calculations and if applicable, information, records and calculations showing that, with respect to each bond issue, the University was eligible for the "small issuer" exception or one of the spending exceptions to the arbitrage rebate requirement or if

not, that the rebate amount, if any, that was payable to the United States of America in respect of investments made with gross proceeds of that bond issue was calculated and timely paid with Form 8038-T and then timely filed with the IRS, and;

- D. Records showing how the bond proceeds were spent, as described in II above;
- E. Records showing that special use arrangements, if any, affecting bond-financed property made by the University with nongovernmental persons, if any are consistent with applicable restrictions on private business use of property financed with proceeds of tax-exempt bonds and restrictions on the use of proceeds of tax-exempt bonds or federal tax credit bonds to make or finance loans to any other person other than a state or local government unit.

V. Other General Requirements

For federal tax credit bonds, Form 8038-CP must be filed from 45-90 days in advance of the bond interest payment. The Form 8038-CP requests a refundable credit for interest on BABS and RZED bonds.

Annually, the Director of Budget provides an email and a hard copy of the Board of Trustees approved budget for the University to the Bond Trustee per Section 6.2 of the Master Trust Indenture. The Master Trust Indenture states that the annual budget should be filed with the Bond Trustee not less than five days prior to the beginning of each Fiscal Year. If for any reason the Board shall not have adopted the annual budget for a Fiscal Year before the first day of such Fiscal Year, the annual budget for the preceding year shall be deemed to have been adopted and be in effect for such Fiscal Year until the annual budget for such Fiscal Year is adopted and a copy thereof filed with the Bond Trustee.

VI. Remediation and the Voluntary Closing Agreement Program

If the potential to fail to comply with post issuance compliance activities is identified, the Bond Compliance Accountant will notify the Director of Financial Accounting and Reporting and seek the advice of qualified bond counsel in order to assess the need to take remedial actions described under section 1.141-12 of the Income Tax Regulations or enter into a closing agreement under the Tax-Exempt Bonds Voluntary Closing Agreement Program described in Notice 2008-31.

Office of the Vice President of Financial Affairs:

Approved by: _____

Date: _____

Appendix A - Spending Exceptions

The Investments of Bond Proceeds are subject to the rebate requirement unless one of the three spending exceptions is met. The general requirements for the three spending exceptions are as follows:

1. **Six-Month Spending Exception.** Money deposited in the bond proceeds account and the related investment income will be exempt from the rebate requirement if all gross proceeds of the bonds are spent within 6 months from the date of issue, although relatively small amounts can be carried beyond the 6-month period under certain circumstances.
2. **Eighteen-Month Exception.** Money deposited in the bond proceeds account and the related investment income will be exempt from the rebate requirement if all gross proceeds are spent in accordance with the following schedule (measured from the date of issue): (i) at least 15% within 6 months, (ii) at least 60% within 12 months, and (iii) 100% within 18 months, although relatively small amounts can be carried beyond the third period under certain circumstances. The 18-month exception cannot be used for any portion of the issue if the 2-year exception, discussed below, is claimed for the issue.
3. **Two-Year Spending Exception.** If any portion of the proceeds in the bond proceeds account qualifies as a “construction issue,” that portion of the proceeds and the related income will be exempt from the rebate requirement if all available proceeds are spent in accordance with the following schedule (measured from the date of issue): (i) at least 10% within 6 months, (ii) at least 45% within 1 year, (iii) at least 75% within 18 months, and (iv) 100% within 2 years, although relatively small amounts can be carried beyond the fourth period under certain circumstances. The following additional rules apply for purposes of the 2-year spending exception:
 - a. Definition of construction issue. In order to qualify as a “construction issue,” at least 75% of the available proceeds of the construction issue must be spent for construction purposes (as defined in the regulations).
 - b. Amount of available proceeds. The amount of available construction proceeds includes the combined investment earnings on the bond proceeds account. It does not include expenditures for issuance costs, and those expenditures do not count toward the spending requirement.

Appendix B – Management Contracts

Safe Harbors for Management or Service Contract Arrangements to avoid private business use:

- A. At least 95% of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee (defined as a stated dollar amount for services rendered for a specified period of time). The term of the contract, including all renewal options, must not exceed the lesser of 80% of the reasonably expected useful life of the financed property and 15 years. A one-time incentive award during the term of the contract under which compensation automatically increases when gross revenue or expense target (but not both) is reached if that award is equal to a single, stated dollar amount.
- B. At least 80% of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80% of the reasonably expected useful life of the financed property and 10 years. A one-time incentive award as described in (A) is permitted.
- C. Either at least 50% of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee, or all of the compensation for services is based on a capitation fee (defined as a fixed periodic amount for each person for whom the service provider assumes the responsibility to provide all needed services for a specified period) or a combination of a capitation fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 5 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the third year of the contract.
- D. All of the compensation for services is based on a per-unit fee (defined as a fee based on a unit of service provided) for a combination of a per-unit fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 3 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the second year of the contract term.
- E. All compensation for services is based on a percentage of fees charged or a combination of a per-unit fee and a percentage of revenue or expense fee. The term of the contract including all renewal options, must not exceed 2 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the first year of the contract term.

Appendix C – Research Agreements

Research performed in bond-financed facilities may constitute private business use if a commercial business funds the research and receives particular benefits from the results of the research. Revenue Procedure 2007-47 provides three safe harbors for research agreements. If a research agreement meets the requirements of the applicable safe harbor, use of the research facility or equipment subject to the research agreement is considered not to result in private business use.

Research agreements with a corporate sponsor:

- A. The qualified user permits any license or other use of resulting technology by the sponsor on the same terms as such use by any unrelated, non-sponsoring part (that is, the sponsor must pay a competitive price for its use), and
- B. The price paid for use of any license or other use of resulting technology is determined at the time the license or other resulting technology is available for use. (NOTE: the qualified user need not permit persons other than the sponsor to use any license or other resulting technology, but the price paid by the sponsor must be no less than the price that would be paid by any non-sponsoring party for those same rights.)

Research agreements with industry sponsors:

- A. One or more sponsors agree to fund basic research performed by a qualified user;
- B. The qualified user determines the research to be performed and the manner in which it is to be performed (for example, selection of the personnel to perform the research);
- C. The qualified user retains exclusive title to any patent or other product incidentally resulting from the basic research; and
- D. The sponsor or sponsors receive no more than a nonexclusive, royalty-free license to use the product of any of that research.

Research agreements with federal government sponsors:

- A. The qualified user determines the research to be performed and the manner in which it is to be performed (for example, selection of the personnel to perform the research);
- B. The qualified user retains exclusive title to any patent or other product incidentally resulting from the basic research; and
- C. Any party other than the qualified user is entitled to no more than a nonexclusive, royalty-free license to use the product of any of that research.

Exhibit A – Tax Rules

IRC Section 103

(a) Exclusion

Except as provided in subsection (b), gross income does not include interest on any State or local bond.

(b) Exceptions

Subsection (a) shall not apply to—

(1) Private activity bond which is not a qualified bond

Any private activity bond which is not a qualified bond (within the meaning of section 141).

(2) Arbitrage bond

Any arbitrage bond (within the meaning of section 148).

(3) Bond not in registered form, etc.

Any bond unless such bond meets the applicable requirements of section 149.

(c) Definitions

For purposes of this section and part IV—

(1) State or local bond

The term “State or local bond” means an obligation of a State or political subdivision thereof.

(2) State

The term “State” includes the District of Columbia and any possession of the United States.

IRC Section 141

(a) Private activity bond For purposes of this title, the term "private activity bond" means any bond issued as part of an issue - (1) which meets - (A) the private business use test of paragraph (1) of subsection (b), and (B) the private security or payment test of paragraph (2) of subsection (b), or (2) which meets the private loan financing test of subsection (c). (b) Private business tests (1) Private business use test Except as otherwise provided in this subsection, an issue meets the test of this paragraph if more than 10 percent of the proceeds of the issue are to be used for any private business use. (2) Private security or payment test Except as otherwise provided in this subsection, an issue meets the test of this paragraph if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly - (A) secured by any interest in - (i) property used or to be used for a private business use, or (ii) payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use. (3) 5 percent test for private business use not related or disproportionate to government use financed by the issue (A) In general An issue shall be treated as meeting the tests of paragraphs (1) and (2) if such tests would be met if such paragraphs were applied - (i) by substituting "5 percent" for "10 percent" each place it appears, and (ii) by taking into account only - (I) the proceeds of the issue which are to be used for any private business use which is not related to any government use of such proceeds, (II) the disproportionate related business use proceeds of the issue, and (III) payments, property, and borrowed money with respect to any use of proceeds described in subclause (I) or (II). (B) Disproportionate related business use proceeds For purposes of subparagraph (A), the disproportionate related business use proceeds of an issue is an amount equal to the aggregate of the excesses (determined under the following sentence) for each private business use of the proceeds of an issue which is related to a government use of such proceeds.

The excess determined under this sentence is the excess of - (i) the proceeds of the issue which are to be used for the private business use, over (ii) the proceeds of the issue which are to be used for the government use to which such private business use relates. (4) Lower limitation for certain output facilities An issue 5 percent or more of the proceeds of which are to be used with respect to any output facility (other than a facility for the furnishing of water) shall be treated as meeting the tests of paragraphs (1) and (2) if the nonqualified amount with respect to such issue exceeds the excess of - (A) \$15,000,000, over (B) the aggregate nonqualified

amounts with respect to all prior tax-exempt issues 5 percent or more of the proceeds of which are or will be used with respect to such facility (or any other facility which is part of the same project). There shall not be taken into account under subparagraph (B) any bond which is not outstanding at the time of the later issue or which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue. (5) Coordination with volume cap where nonqualified amount exceeds \$15,000,000 If the nonqualified amount with respect to an issue - (A) exceeds \$15,000,000, but (B) does not exceed the amount which would cause a bond which is part of such issue to be treated as a private activity bond without regard to this paragraph, such bond shall nonetheless be treated as a private activity bond unless the issuer allocates a portion of its volume cap under section 146 to such issue in an amount equal to the excess of such nonqualified amount over \$15,000,000. (6) Private business use defined (A) In general For purposes of this subsection, the term "private business use" means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For purposes of the preceding sentence, use as a member of the general public shall not be taken into account. (B) Clarification of trade or business For purposes of the 1st sentence of subparagraph (A), any activity carried on by a person other than a natural person shall be treated as a trade or business. (7) Government use The term "government use" means any use other than a private business use. (8) Nonqualified amount For purposes of this subsection, the term "nonqualified amount" means, with respect to an issue, the lesser of - (A) the proceeds of such issue which are to be used for any private business use, or (B) the proceeds of such issue with respect to which there are payments (or property or borrowed money) described in paragraph (2). (9) Exception for qualified 501(c)(3) bonds There shall not be taken into account under this subsection or subsection (c) the portion of the proceeds of an issue which (if issued as a separate issue) would be treated as a qualified 501(c)(3) bond if the issuer elects to treat such portion as a qualified 501(c)(3) bond. (c) Private loan financing test (1) In general An issue meets the test of this subsection if the amount of the proceeds of the issue which are to be used (directly or indirectly) to make or finance loans (other than loans described in paragraph (2)) to persons other than governmental units exceeds the lesser of - (A) 5 percent of such proceeds, or (B) \$5,000,000. (2) Exception for tax assessment, etc., loans For purposes of paragraph (1), a loan is described in this paragraph if such loan - (A) enables the borrower to finance any governmental tax or assessment of general application for a specific essential governmental function, or (B) is a nonpurpose investment (within the meaning of section 148(f)(6)(A)). (d) Certain issues used to acquire nongovernmental output property treated as private activity bonds (1) In general For purposes of this title, the term "private activity bond" includes any bond issued as part of an issue if the amount of the proceeds of the issue which are to be used (directly or indirectly) for the acquisition by a governmental unit of nongovernmental output property exceeds the lesser of - (A) 5 percent of such proceeds, or (B) \$5,000,000. (2) Nongovernmental output property Except as otherwise provided in this subsection, for purposes of paragraph (1), the term "nongovernmental output property" means any property (or interest therein) which before such acquisition was used (or held for use) by a person other than a governmental unit in connection with an output facility (within the meaning of subsection (b)(4)) (other than a facility for the furnishing of water). For purposes of the preceding sentence, use (or the holding for use) before October 14, 1987, shall not be taken into account. (3) Exception for property acquired to provide output to certain areas For purposes of paragraph (1) - (A) In general The term "nongovernmental output property" shall not include any property which is to be used in connection with an output facility 95 percent or more of the output of which will be consumed in - (i) a qualified service area of the governmental unit acquiring the property, or (ii) a qualified annexed area of such unit. (B) Definitions For purposes of subparagraph (A) - (i) Qualified service area The term "qualified service area" means, with respect to the governmental unit acquiring the property, any area throughout which such unit provided (at all times during the 10-year period ending on the date such property is acquired by such unit) output of the same type as the output to be provided by such property.

For purposes of the preceding sentence, the period before October 14, 1987, shall not be taken into account. (ii) Qualified annexed area The term "qualified annexed area" means, with respect to the governmental unit acquiring the property, any area if - (I) such area is contiguous to, and annexed for general governmental purposes into, a qualified service area of such unit, (II) output from such property is made available to all members of the general public in the annexed area, and (III) the annexed area is not greater than 10 percent of such qualified service area. (C) Limitation on size of annexed area not to apply where output capacity does

not increase by more than 10 percent Subclause (III) of subparagraph (B)(ii) shall not apply to an annexation of an area by a governmental unit if the output capacity of the property acquired in connection with the annexation, when added to the output capacity of all other property which is not treated as nongovernmental output property by reason of subparagraph (A)(ii) with respect to such annexed area, does not exceed 10 percent of the output capacity of the property providing output of the same type to the qualified service area into which it is annexed. (D) Rules for determining relative size, etc. For purposes of subparagraphs (B)(ii) and (C) - (i) The size of any qualified service area and the output capacity of property serving such area shall be determined as the close of the calendar year preceding the calendar year in which the acquisition of nongovernmental output property or the annexation occurs. (ii) A qualified annexed area shall be treated as part of the qualified service area into which it is annexed for purposes of determining whether any other area annexed in a later year is a qualified annexed area. (4) Exception for property converted to nonoutput use For purposes of paragraph (1) - (A) In general The term "nongovernmental output property" shall not include any property which is to be converted to a use not in connection with an output facility. (B) Exception Subparagraph (A) shall not apply to any property which is part of the output function of a nuclear power facility. (5) Special rules In the case of a bond which is a private activity bond solely by reason of this subsection - (A) subsections (c) and (d) of section 147 (relating to limitations on acquisition of land and existing property) shall not apply, and (B) paragraph (8) of section 142(a) shall be applied as if it did not contain "local". (6) Treatment of joint action agencies With respect to nongovernmental output property acquired by a joint action agency the members of which are governmental units, this subsection shall be applied at the member level by treating each member as acquiring its proportionate share of such property. (e) Qualified bond For purposes of this part, the term "qualified bond" means any private activity bond if - (1) In general Such bond is - (A) an exempt facility bond, (B) a qualified mortgage bond, (C) a qualified veterans' mortgage bond, (D) a qualified small issue bond, (E) a qualified student loan bond, (F) a qualified redevelopment bond, or (G) a qualified 501(c)(3) bond. (2) Volume cap Such bond is issued as part of an issue which meets the applicable requirements of section 146, and (FOOTNOTE 1) (FOOTNOTE 1) So in original.

Probably should end with a period after "146". (3) Other requirements Such bond meets the applicable requirements of each subsection of section 147.

Section 148

(a) Arbitrage bond defined

For purposes of section 103, the term "arbitrage bond" means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly—

- (1) to acquire higher yielding investments, or
- (2) to replace funds which were used directly or indirectly to acquire higher yielding investments.

For purposes of this subsection, a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described in paragraph (1) or (2).

(b) Higher yielding investments

For purposes of this section—

(1) In general

The term "higher yielding investments" means any investment property which produces a yield over the term of the issue which is materially higher than the yield on the issue.

(2) Investment property

The term "investment property" means—

- (A) any security (within the meaning of section 165 (g)(2)(A) or (B)),
- (B) any obligation,
- (C) any annuity contract,

(D) any investment-type property, or

(E) in the case of a bond other than a private activity bond, any residential rental property for family units which is not located within the jurisdiction of the issuer and which is not acquired to implement a court ordered or approved housing desegregation plan.

(3) Alternative minimum tax bonds treated as investment property in certain cases

(A) In general

Except as provided in subparagraph (B), the term “investment property” does not include any tax-exempt bond.

(B) Exception

With respect to an issue other than an issue a part of which is a specified private activity bond (as defined in section 57 (a)(5)(C)), the term “investment property” includes a specified private activity bond (as so defined).

(4) Safe harbor for prepaid natural gas

(A) In general

The term “investment-type property” does not include a prepayment under a qualified natural gas supply contract.

(B) Qualified natural gas supply contract

For purposes of this paragraph, the term “qualified natural gas supply contract” means any contract to acquire natural gas for resale by a utility owned by a governmental unit if the amount of gas permitted to be acquired under the contract by the utility during any year does not exceed the sum of—

(i) the annual average amount during the testing period of natural gas purchased (other than for resale) by customers of such utility who are located within the service area of such utility, and

(ii) the amount of natural gas to be used to transport the prepaid natural gas to the utility during such year.

(C) Natural gas used to generate electricity

Natural gas used to generate electricity shall be taken into account in determining the average under subparagraph (B)(i)—

(i) only if the electricity is generated by a utility owned by a governmental unit, and

(ii) only to the extent that the electricity is sold (other than for resale) to customers of such utility who are located within the service area of such utility.

(D) Adjustments for changes in customer base

(i) New business customers If—

(I) after the close of the testing period and before the date of issuance of the issue, the utility owned by a governmental unit enters into a contract to supply natural gas (other than for resale) for a business use at a property within the service area of such utility, and

(II) the utility did not supply natural gas to such property during the testing period or the ratable amount of natural gas to be supplied under the contract is significantly greater than the ratable amount of gas supplied to such property during the testing period, then a contract shall not fail to be treated as a qualified natural gas supply contract by reason of supplying the additional natural gas under the contract referred to in subclause (I).

(ii) Lost customers The average under subparagraph (B)(i) shall not exceed the annual amount of natural gas reasonably expected to be purchased (other than for resale) by persons who are located within the service area of such utility and who, as of the date of issuance of the issue, are customers of such utility.

(E) Ruling requests

The Secretary may increase the average under subparagraph (B)(i) for any period if the utility owned by the governmental unit establishes to the satisfaction of the Secretary that, based on objective evidence of growth in natural gas consumption or population, such average would otherwise be insufficient for such period.

(F) Adjustment for natural gas otherwise on hand

(i) In general The amount otherwise permitted to be acquired under the contract for any period shall be reduced by—

(I) the applicable share of natural gas held by the utility on the date of issuance of the issue, and

(II) the natural gas (not taken into account under subclause (I)) which the utility has a right to acquire during such period (determined as of the date of issuance of the issue).

(ii) Applicable share For purposes of the clause (i), the term “applicable share” means, with respect to any period, the natural gas allocable to such period if the gas were allocated ratably over the period to which the prepayment relates.

(G) Intentional acts

Subparagraph (A) shall cease to apply to any issue if the utility owned by the governmental unit engages in any intentional act to render the volume of natural gas acquired by such prepayment to be in excess of the sum of—

(i) the amount of natural gas needed (other than for resale) by customers of such utility who are located within the service area of such utility, and

(ii) the amount of natural gas used to transport such natural gas to the utility.

(H) Testing period

For purposes of this paragraph, the term “testing period” means, with respect to an issue, the most recent 5 calendar years ending before the date of issuance of the issue.

(I) Service area

For purposes of this paragraph, the service area of a utility owned by a governmental unit shall be comprised of—

(i) any area throughout which such utility provided at all times during the testing period—

(I) in the case of a natural gas utility, natural gas transmission or distribution services, and

(II) in the case of an electric utility, electricity distribution services,

(ii) any area within a county contiguous to the area described in clause (i) in which retail customers of such utility are located if such area is not also served by another utility providing natural gas or electricity services, as the case may be, and

(iii) any area recognized as the service area of such utility under State or Federal law.

(c) Temporary period exception

(1) In general

For purposes of subsection (a), a bond shall not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which such bond is a part may be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which such issue was issued.

(2) Limitation on temporary period for pooled financings

(A) In general

The temporary period referred to in paragraph (1) shall not exceed 6 months with respect to the proceeds of an issue which are to be used to make or finance loans (other than nonpurpose investments) to 2 or more persons.

(B) Shorter temporary period for loan repayments, etc.

Subparagraph (A) shall be applied by substituting “3 months” for “6 months” with respect to the proceeds from the sale or repayment of any loan which are to be used to make or finance any loan. For purposes of the preceding sentence, a nonpurpose investment shall not be treated as a loan.

(C) Bonds used to provide construction financing

In the case of an issue described in subparagraph (A) any portion of which is used to make or finance loans for construction expenditures (within the meaning of subsection (f)(4)(C)(iv))—

(i) rules similar to the rules of subsection (f)(4)(C)(v) shall apply, and

(ii) subparagraph (A) shall be applied with respect to such portion by substituting “2 years” for “6 months”.

(D) Exception for mortgage revenue bonds

This paragraph shall not apply to any qualified mortgage bond or qualified veterans’ mortgage bond.

(d) Special rules for reasonably required reserve or replacement fund

(1) In general

For purposes of subsection (a), a bond shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of the issue of which such bond is a part may be invested in higher yielding investments which are part of a reasonably required reserve or replacement fund. The amount referred to in the preceding sentence shall not exceed 10 percent of the proceeds of such issue unless the issuer establishes to the satisfaction of the Secretary that a higher amount is necessary.

(2) Limitation on amount in reserve or replacement fund which may be financed by issue

A bond issued as part of an issue shall be treated as an arbitrage bond if the amount of the proceeds from the sale of such issue which is part of any reserve or replacement fund exceeds 10 percent of the proceeds of the issue (or such higher amount which the issuer establishes is necessary to the satisfaction of the Secretary).

(e) Minor portion may be invested in higher yielding investments

Notwithstanding subsections (a), (c), and (d), a bond issued as part of an issue shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of such issue (in addition to the amounts under subsections (c) and (d)) is invested in higher yielding investments if such amount does not exceed the lesser of—

(1) 5 percent of the proceeds of the issue, or

(2) \$100,000.

(f) Required rebate to the United States

(1) In general

A bond which is part of an issue shall be treated as an arbitrage bond if the requirements of paragraphs (2) and (3) are not met with respect to such issue. The preceding sentence shall not apply to any qualified veterans' mortgage bond.

(2) Rebate to United States

An issue shall be treated as meeting the requirements of this paragraph only if an amount equal to the sum of—

(A) the excess of—

(i) the amount earned on all nonpurpose investments (other than investments attributable to an excess described in this subparagraph), over

(ii) the amount which would have been earned if such nonpurpose investments were invested at a rate equal to the yield on the issue, plus

(B) any income attributable to the excess described in subparagraph (A),

is paid to the United States by the issuer in accordance with the requirements of paragraph (3).

(3) Due date of payments under paragraph (2)

Except to the extent provided by the Secretary, the amount which is required to be paid to the United States by the issuer shall be paid in installments which are made at least once every 5 years. Each installment shall be in an amount which ensures that 90 percent of the amount described in paragraph (2) with respect to the issue at the time payment of such installment is required will have been paid to the United States. The last installment shall be made no later than 60 days after the day on which the last bond of the issue is redeemed and shall be in an amount sufficient to pay the remaining balance of the amount described in paragraph (2) with respect to such issue. A series of issues which are redeemed during a 6-month period (or such longer period as the Secretary may prescribe) shall be treated (at the election of the issuer) as 1 issue for purposes of the preceding sentence if no bond which is part of any issue in such series has a maturity of more than 270 days or is a private activity bond. In the case of a tax and revenue anticipation bond, the last installment shall not be required to be made before the date 8 months after the date of issuance of the issue of which the bond is a part.

(4) Special rules for applying paragraph (2)

(A) In general

In determining the aggregate amount earned on nonpurpose investments for purposes of paragraph (2)—

(i) any gain or loss on the disposition of a nonpurpose investment shall be taken into account, and

(ii) any amount earned on a bona fide debt service fund shall not be taken into account if the gross earnings on such fund for the bond year is less than \$100,000.

In the case of an issue no bond of which is a private activity bond, clause (ii) shall be applied without regard to the dollar limitation therein if the average maturity of the issue (determined in accordance with section 147(b)(2)(A)) is at least 5 years and the rates of interest on bonds which are part of the issue do not vary during the term of the issue.

(B) Temporary investments

Under regulations prescribed by the Secretary—

(i) In general An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraph (2) if—

(I) the gross proceeds of such issue are expended for the governmental purposes for which the issue was issued no later than the day which is 6 months after the date of issuance of the issue, and

(II) the requirements of paragraph (2) are met with respect to amounts not required to be spent as provided in subclause (I) (other than earnings on amounts in any bona fide debt service fund). Gross proceeds which are held in a bona fide debt service fund or a reasonably required reserve or replacement fund, and gross proceeds which arise after such 6 months and which were not reasonably anticipated as of the date of issuance, shall not be considered gross proceeds for purposes of subclause (I) only.

(ii) Additional period for certain bonds

(I) In general In the case of an issue described in subclause (II), clause (i) shall be applied by substituting “1 year” for “6 months” each place it appears with respect to the portion of the proceeds of the issue which are not expended in accordance with clause (i) if such portion does not exceed 5 percent of the proceeds of the issue.

(II) Issues to which subclause (I) applies An issue is described in this subclause if no bond which is part of such issue is a private activity bond (other than a qualified 501(c)(3) bond) or a tax or revenue anticipation bond.

(iii) Safe harbor for determining when proceeds of tax and revenue anticipation bonds are expended

(I) In general For purposes of clause (i), in the case of an issue of tax or revenue anticipation bonds, the net proceeds of such issue (including earnings thereon) shall be treated as expended for the governmental purpose of the issue on the 1st day after the date of issuance that the cumulative cash flow deficit to be financed by such issue exceeds 90 percent of the proceeds of such issue.

(II) Cumulative cash flow deficit For purposes of subclause (I), the term “cumulative cash flow deficit” means, as of the date of computation, the excess of the expenses paid during the period described in subclause (III) which would ordinarily be paid out of or financed by anticipated tax or other revenues over the aggregate amount available (other than from the proceeds of the issue) during such period for the payment of such expenses.

(III) Period involved For purposes of subclause (II), the period described in this subclause is the period beginning on the date of issuance of the issue and ending on the earlier of the date 6 months after such date of issuance or the date of the computation of cumulative cash flow deficit.

(iv) Payments of principal not to affect requirements For purposes of this subparagraph, payments of principal on the bonds which are part of an issue shall not be treated as expended for the governmental purposes of the issue.

(C) Exception from rebate for certain proceeds to be used to finance construction expenditures

(i) In general In the case of a construction issue, paragraph (2) shall not apply to the available construction proceeds of such issue if the spending requirements of clause (ii) are met.

(ii) Spending requirements The spending requirements of this clause are met if at least—

(I) 10 percent of the available construction proceeds of the construction issue are spent for the governmental purposes of the issue within the 6-month period beginning on the date the bonds are issued,

(II) 45 percent of such proceeds are spent for such purposes within the 1-year period beginning on such date,

(III) 75 percent of such proceeds are spent for such purposes within the 18-month period beginning on such date, and

(IV) 100 percent of such proceeds are spent for such purposes within the 2-year period beginning on such date.

(iii) Exception for reasonable retainage The spending requirement of clause (ii)(IV) shall be treated as met if—

(I) such requirement would be met at the close of such 2-year period but for a reasonable retainage (not exceeding 5 percent of the available construction proceeds of the construction issue), and

(II) 100 percent of the available construction proceeds of the construction issue are spent for the governmental purposes of the issue within the 3-year period beginning on the date the bonds are issued.

(iv) Construction issue For purposes of this subparagraph, the term “construction issue” means any issue if—

(I) at least 75 percent of the available construction proceeds of such issue are to be used for construction expenditures with respect to property which is to be owned by a governmental unit or a 501(c)(3) organization, and

(II) all of the bonds which are part of such issue are qualified 501(c)(3) bonds, bonds which are not private activity bonds, or private activity bonds issued to finance property to be owned by a governmental unit or a 501(c)(3) organization. For purposes of this subparagraph, the term “construction” includes reconstruction and rehabilitation, and rules similar to the rules of section 142 (b)(1)(B) shall apply.

(v) Portions of issues used for construction If—

(I) all of the construction expenditures to be financed by an issue are to be financed from a portion thereof, and

(II) the issuer elects to treat such portion as a construction issue for purposes of this subparagraph, then, for purposes of this subparagraph and subparagraph (B), such portion shall be treated as a separate issue.

(vi) Available construction proceeds For purposes of this subparagraph—

(I) In general The term “available construction proceeds” means the amount equal to the issue price (within the meaning of sections 1273 and 1274) of the construction issue, increased by earnings on the issue price, earnings on amounts in any reasonably required reserve or replacement fund not funded from the issue, and earnings on all of the foregoing earnings, and reduced by the amount of the issue price in any reasonably required reserve or replacement fund and the issuance costs financed by the issue.

(II) Earnings on reserve included only for certain periods The term “available construction proceeds” shall not include amounts earned on any reasonably required reserve or replacement fund after the earlier of the close of the 2-year period described in clause (ii) or the date the construction is substantially completed.

(III) Payments on acquired purpose obligations excluded The term “available construction proceeds” shall not include payments on any obligation acquired to carry out the governmental purposes of the issue and shall not include earnings on such payments.

(IV) Election to rebate on earnings on reserve At the election of the issuer, the term “available construction proceeds” shall not include earnings on any reasonably required reserve or replacement fund.

(vii) Election to pay penalty in lieu of rebate

(I) In general At the election of the issuer, paragraph (2) shall not apply to available construction proceeds which do not meet the spending requirements of clause (ii) if the issuer pays a penalty, with respect to each 6-month period after the date the bonds were issued, equal to 11/2 percent of the amount of the available construction proceeds of the issue which, as of the close of such 6-month period, is not spent as required by clause (ii).

(II) Termination The penalty imposed by this clause shall cease to apply only as provided in clause (viii) or after the latest maturity date of any bond in the issue (including any refunding bond with respect thereto).

(viii) Election to terminate 11/2 percent penalty At the election of the issuer (made not later than 90 days after the earlier of the end of the initial temporary period or the date the construction is substantially completed), the penalty under clause (vii) shall not apply to any 6-month period after the initial temporary period under subsection (c) if the requirements of subclauses (I), (II), and (III) are met.

(I) 3 percent penalty The requirement of this subclause is met if the issuer pays a penalty equal to 3 percent of the amount of available construction proceeds of the issue which is not spent for the governmental purposes of the issue as of the close of such initial temporary period multiplied by the number of years (including fractions thereof) in the initial temporary period.

(II) Yield restriction at close of temporary period The requirement of this subclause is met if the amount of the available construction proceeds of the issue which is not spent for the governmental purposes of the issue as of the close of such initial temporary period is invested at a yield not exceeding the yield on the issue or which is invested in any tax-exempt bond which is not investment property.

(III) Redemption of bonds at earliest call date The requirement of this subclause is met if the amount of the available construction proceeds of the issue which is not spent for the governmental purposes of the issue as of the earliest date on which bonds may be redeemed is used to redeem bonds on such date.

(ix) Election to terminate 11/2 percent penalty before end of temporary period If—

- (I) the construction to be financed by a construction issue is substantially completed before the end of the initial temporary period,
- (II) the issuer identifies an amount of available construction proceeds which will not be spent for the governmental purposes of the issue,
- (III) the issuer has made the election under clause (viii), and
- (IV) the issuer makes an election under this clause before the close of the initial temporary period and not later than 90 days after the date the construction is substantially completed, then clauses (vii) and (viii) shall be applied to the available construction proceeds so identified as if the initial temporary period ended as of the date the election is made.
- (x) Failure to pay penalties In the case of a failure (which is not due to willful neglect) to pay any penalty required to be paid under clause (vii) or (viii) in the amount or at the time prescribed therefor, the Secretary may treat such failure as not occurring if, in addition to paying such penalty, the issuer pays a penalty equal to the sum of—
 - (I) 50 percent of the amount which was not paid in accordance with clauses (vii) and (viii), plus
 - (II) interest (at the underpayment rate established under section 6621) on the portion of the amount which was not paid on the date required for the period beginning on such date. The Secretary may waive all or any portion of the penalty under this clause. Bonds which are part of an issue with respect to which there is a failure to pay the amount required under this clause (and any refunding bond with respect thereto) shall be treated as not being, and as never having been, tax-exempt bonds.
- (xi) Election for pooled financing bonds At the election of the issuer of an issue the proceeds of which are to be used to make or finance loans (other than nonpurpose investments) to 2 or more persons, the periods described in clauses (ii) and (iii) shall begin on—
 - (I) the date the loan is made, in the case of loans made within the 1-year period after the date the bonds are issued, and
 - (II) the date following such 1-year period, in the case of loans made after such 1-year period. If such an election applies to an issue, the requirements of paragraph (2) shall apply to amounts earned before the beginning of the periods determined under the preceding sentence.
- (xii) Payments of principal not to affect requirements For purposes of this subparagraph, payments of principal on the bonds which are part of the construction issue shall not be treated as an expenditure of the available construction proceeds of the issue.
- (xiii) Refunding bonds
 - (I) In general Except as provided in this clause, clause (vii)(II), and the last sentence of clause (x), this subparagraph shall not apply to any refunding bond and no proceeds of a refunded bond shall be treated for purposes of this subparagraph as proceeds of a refunding bond.
 - (II) Determination of construction portion of issue For purposes of clause (v), any portion of an issue which is used to refund any issue (or portion thereof) shall be treated as a separate issue.
 - (III) Coordination with rebate requirement on refunding bonds The requirements of paragraph (2) shall be treated as met with respect to earnings for any period if a penalty is paid under clause (vii) or (viii) with respect to such earnings for such period.
 - (xiv) Determination of initial temporary period For purposes of this subparagraph, ^[1] the end of the initial temporary period shall be determined without regard to section 149 (d)(3)(A)(iv).
 - (xv) Elections Any election under this subparagraph (other than clauses (viii) and (ix)) shall be made on or before the date the bonds are issued; and, once made, shall be irrevocable.
 - (xvi) Time for payment of penalties Any penalty under this subparagraph shall be paid to the United States not later than 90 days after the period to which the penalty relates.
 - (xvii) Treatment of bona fide debt service funds If the spending requirements of clause (ii) are met with respect to the available construction proceeds of a construction issue, then paragraph (2) shall not apply to earnings on a bona fide debt service fund for such issue.
- (D) Exception for governmental units issuing \$5,000,000 or less of bonds**
 - (i) In general An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraphs (2) and (3) if—
 - (I) the issue is issued by a governmental unit with general taxing powers,

(II) no bond which is part of such issue is a private activity bond,

(III) 95 percent or more of the net proceeds of such issue are to be used for local governmental activities of the issuer (or of a governmental unit the jurisdiction of which is entirely within the jurisdiction of the issuer), and

(IV) the aggregate face amount of all tax-exempt bonds (other than private activity bonds) issued by such unit during the calendar year in which such issue is issued is not reasonably expected to exceed \$5,000,000.

(ii) Aggregation of issuers For purposes of subclause (IV) of clause (i)—

(I) an issuer and all entities which issue bonds on behalf of such issuer shall be treated as 1 issuer,

(II) all bonds issued by a subordinate entity shall, for purposes of applying such subclause to each other entity to which such entity is subordinate, be treated as issued by such other entity, and

(III) an entity formed (or, to the extent provided by the Secretary, availed of) to avoid the purposes of such subclause (IV) and all other entities benefiting thereby shall be treated as 1 issuer.

(iii) Certain refunding bonds not taken into account in determining small issuer status There shall not be taken into account under subclause (IV) of clause (i) any bond issued to refund (other than to advance refund) any bond to the extent the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

(iv) Certain issues issued by subordinate governmental units, etc., exempt from rebate requirement An issue issued by a subordinate entity of a governmental unit with general taxing powers shall be treated as described in clause (i)(I) if the aggregate face amount of such issue does not exceed the lesser of—

(I) \$5,000,000, or

(II) the amount which, when added to the aggregate face amount of other issues issued by such entity, does not exceed the portion of the \$5,000,000 limitation under clause (i)(IV) which such governmental unit allocates to such entity. For purposes of the preceding sentence, an entity which issues bonds on behalf of a governmental unit with general taxing powers shall be treated as a subordinate entity of such unit. An allocation shall be taken into account under subclause (II) only if it is irrevocable and made before the issuance date of such issue and only to the extent that the limitation so allocated bears a reasonable relationship to the benefits received by such governmental unit from issues issued by such entity.

(v) Determination of whether refunding bonds eligible for exception from rebate requirement If any portion of an issue is issued to refund other bonds, such portion shall be treated as a separate issue which does not meet the requirements of paragraphs (2) and (3) by reason of this subparagraph unless—

(I) the aggregate face amount of such issue does not exceed \$5,000,000,

(II) each refunded bond was issued as part of an issue which was treated as meeting the requirements of paragraphs (2) and (3) by reason of this subparagraph,

(III) the average maturity date of the refunding bonds issued as part of such issue is not later than the average maturity date of the bonds to be refunded by such issue, and

(IV) no refunding bond has a maturity date which is later than the date which is 30 years after the date the original bond was issued. Subclause (III) shall not apply if the average maturity of the issue of which the original bond was a part (and of the issue of which the bonds to be refunded are a part) is 3 years or less. For purposes of this clause, average maturity shall be determined in accordance with section 147 (b)(2)(A).

(vi) Refundings of bonds issued under law prior to Tax Reform Act of 1986 If section 141 (a) did not apply to any refunded bond, the issue of which such refunded bond was a part shall be treated as meeting the requirements of subclause (II) of clause (v) if—

(I) such issue was issued by a governmental unit with general taxing powers,

(II) no bond issued as part of such issue was an industrial development bond (as defined in section 103 (b)(2), but without regard to subparagraph (B) of section 103 (b)(3)) or a private loan bond (as defined in section 103 (o)(2)(A), but without regard to any exception from such definition other than section 103 (o)(2)(C)), and

(III) the aggregate face amount of all tax-exempt bonds (other than bonds described in subclause (II)) issued by such unit during the calendar year in which such issue was issued did not exceed \$5,000,000. References in subclause (II) to section 103 shall be to such section as in effect on the day before the date of the enactment of the Tax Reform Act of 1986. Rules similar to the rules of clauses (ii) and (iii) shall apply for

purposes of subclause (III). For purposes of subclause (II) of clause (i), bonds described in subclause (II) of this clause to which section 141 (a) does not apply shall not be treated as private activity bonds.

(vii) Increase in exception for bonds financing public school capital expenditures Each of the \$5,000,000 amounts in the preceding provisions of this subparagraph shall be increased by the lesser of \$10,000,000 or so much of the aggregate face amount of the bonds as are attributable to financing the construction (within the meaning of subparagraph (C)(iv)) of public school facilities.

(5) Exemption from gross income of sum rebated

Gross income shall not include the sum described in paragraph (2). Notwithstanding any other provision of this title, no deduction shall be allowed for any amount paid to the United States under paragraph (2).

(6) Definitions

For purposes of this subsection and subsections (c) and (d)—

(A) Nonpurpose investment

The term “nonpurpose investment” means any investment property which—

- (i)** is acquired with the gross proceeds of an issue, and
- (ii)** is not acquired in order to carry out the governmental purpose of the issue.

(B) Gross proceeds

Except as otherwise provided by the Secretary, the gross proceeds of an issue include—

- (i)** amounts received (including repayments of principal) as a result of investing the original proceeds of the issue, and
- (ii)** amounts to be used to pay debt service on the issue.

(7) Penalty in lieu of loss of tax exemption

In the case of an issue which would (but for this paragraph) fail to meet the requirements of paragraph (2) or (3), the Secretary may treat such issue as not failing to meet such requirements if—

- (A)** no bond which is part of such issue is a private activity bond (other than a qualified 501(c)(3) bond),
- (B)** the failure to meet such requirements is not due to willful neglect, and
- (C)** the issuer pays to the United States a penalty in an amount equal to the sum of—
 - (i)** 50 percent of the amount which was not paid in accordance with paragraphs (2) and (3), plus
 - (ii)** interest (at the underpayment rate established under section 6621) on the portion of the amount which was not paid on the date required under paragraph (3) for the period beginning on such date.

The Secretary may waive all or any portion of the penalty under this paragraph.

(g) Student loan incentive payments

Except to the extent otherwise provided in regulations, payments made by the Secretary of Education pursuant to section 438 of the Higher Education Act of 1965 are not to be taken into account, for purposes of subsection (a)(1), in determining yields on student loan notes.

(h) Determinations of yield

For purposes of this section, the yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274).

(i) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

Sec. 1.141-12 Remedial actions

(a) Conditions to taking remedial action. 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 described in paragraph (d), (e), or (f) of this section with respect to the nonqualified bonds and if all of the requirements in paragraphs (a) (1) through (5) of this section are met.

(1) *Reasonable expectations test met.* The issuer reasonably expected on the issue date that the issue would meet neither the private business tests nor the private loan financing test for the entire term of the bonds. For this purpose, if the issuer reasonably expected on the issue date to take a deliberate action prior to the final maturity date of the issue that would cause either the private business tests or the private loan financing test to be met, the term of the bonds for this purpose may be determined by taking into account a redemption provision if the provisions of §1.141-2(d)(2)(ii) (A) through (C) are met.

(2) *Maturity not unreasonably long.* The term of the issue must not be longer than is reasonably necessary for the governmental purposes of the issue (within the meaning of §1.148-1(c)(4)). Thus, this requirement is met if the weighted average maturity of the bonds of the issue is not greater than 120 percent of the average reasonably expected economic life of the property financed with the proceeds of the issue as of the issue date.

(3) *Fair market value consideration.* Except as provided in paragraph (f) of this section, the terms of any arrangement that results in satisfaction of either the private business tests or the private loan financing test are bona fide and arm's-length, and the new user pays fair market value for the use of the financed property. Thus, for example, fair market value may be determined in a manner that takes into account restrictions on the use of the financed property that serve a bona fide governmental purpose.

(4) *Disposition proceeds treated as gross proceeds for arbitrage purposes.* The issuer must treat any disposition proceeds as gross proceeds for purposes of section 148. For purposes of eligibility for temporary periods under section 148(c) and exemptions from the requirement of section 148(f) the issuer may treat the date of receipt of the disposition proceeds as the issue date of the bonds and disregard the receipt of disposition proceeds for exemptions based on expenditure of proceeds under §1.148-7 that were met before the receipt of the disposition proceeds.

(5) *Proceeds expended on a governmental purpose.* Except for a remedial action under paragraph (d) of this section, the proceeds of the issue that are affected by the deliberate action must have been expended on a governmental purpose before the date of the deliberate action.

(b) *Effect of a remedial action—(1) In general.* The effect of a remedial action is to cure use of proceeds that causes the private business use test or the private loan financing test to be met. A remedial action does not affect application of the private security or payment test.

(2) *Effect on bonds that have been advance refunded.* If proceeds of an issue were used to advance refund another bond, a remedial action taken with respect to the refunding bond proportionately reduces the amount of proceeds of the advance refunded bond that is taken into account under the private business use test or the private loan financing test.

(c) *Disposition proceeds—(1) Definition.* *Disposition proceeds* are any amounts (including property, such as an agreement to provide services) derived from the sale, exchange, or other disposition (disposition) of property (other than investments) financed with the proceeds of an issue.

(2) *Allocating disposition proceeds to an issue.* In general, if the requirements of paragraph (a) of this section are met, after the date of the disposition, the proceeds of the issue allocable to the transferred property are treated as financing the disposition proceeds rather than the transferred property. If a disposition is made pursuant to an installment sale, the proceeds of the issue continue to be allocated to the transferred property. If an issue does not meet the requirements for remedial action in paragraph (a) of this section or the issuer does not take an appropriate remedial action, the proceeds of the issue are allocable to either the transferred property or the disposition proceeds, whichever allocation produces the greater amount of private business use and private security or payments.

(3) *Allocating disposition proceeds to different sources of funding.* If property has been financed by different sources of funding, for purposes of this section, the disposition proceeds from that property are first allocated to the outstanding bonds that financed that property in proportion to the principal amounts of those outstanding bonds. In no event may disposition proceeds be allocated to bonds that are no longer outstanding or to a source of funding not derived from a borrowing (such as revenues of the issuer) if the disposition proceeds are not greater than the total principal amounts of the outstanding bonds that are allocable to that property. For purposes of this paragraph (c)(3), principal amount has the same meaning as in §1.148-9(b)(2) and outstanding bonds do not include advance refunded bonds.

(d) *Redemption or defeasance of nonqualified bonds—(1) In general.* The requirements of this paragraph (d) are met if all of the nonqualified bonds of the issue are redeemed. Proceeds of tax-exempt bonds must not be used for this purpose, unless the tax-exempt bonds are qualified bonds, taking into account the purchaser's use of the facility. If the bonds are not redeemed within 90 days of the date of the deliberate action, a defeasance escrow must be established for those bonds within 90 days of the deliberate action.

(2) *Special rule for dispositions for cash.* If the consideration for the disposition of financed property is exclusively cash, the requirements of this paragraph (d) are met if the disposition proceeds are used to redeem a pro rata portion of the nonqualified bonds at the earliest call date after the deliberate action. If the bonds are not redeemed within 90 days of the date of the deliberate action, the disposition proceeds must be used to establish a defeasance escrow for those bonds within 90 days of the deliberate action.

(3) *Notice of defeasance.* The issuer must provide written notice to the Commissioner of the establishment of the defeasance escrow within 90 days of the date the defeasance escrow is established.

(4) *Special limitation.* The establishment of a defeasance escrow does not satisfy the requirements of this paragraph (d) if the period between the issue date and the first call date of the bonds is more than 10 1/2 years.

(5) *Defeasance escrow defined.* A defeasance escrow is an irrevocable escrow established to redeem bonds on their earliest call date in an amount that, together with investment earnings, is sufficient to pay all the principal of, and interest and call premium on, bonds from the date the escrow is established to the earliest call date. The escrow may not be invested in higher yielding investments or in any investment under which the obligor is a user of the proceeds of the bonds.

(e) *Alternative use of disposition proceeds—(1) In general.* The requirements of this paragraph (e) are met if—

(i) The deliberate action is a disposition for which the consideration is exclusively cash;

(ii) The issuer reasonably expects to expend the disposition proceeds within two years of the date of the deliberate action;

(iii) The disposition proceeds are treated as proceeds for purposes of section 141 and are used in a manner that does not cause the issue to meet either the private business tests or the private loan financing test, and the issuer does not take any action subsequent to the date of the deliberate action to cause either of these tests to be met; and

(iv) If the issuer does not use all of the disposition proceeds for an alternative use described in paragraph (e)(1)(iii) of this section, the issuer uses those remaining disposition proceeds for a remedial action that meets paragraph (d) of this section.

(2) *Special rule for use by 501(c)(3) organizations.* If the disposition proceeds are to be used by a 501(c)(3) organization, the nonqualified bonds must in addition be treated as reissued for purposes of sections 141, 145, 147, 149, and 150 and, under this treatment, satisfy all of the applicable requirements for qualified 501(c)(3) bonds. Thus, beginning on the date of the deliberate action, nonqualified bonds that satisfy these requirements must be treated as qualified 501(c)(3) bonds for all purposes, including sections 145(b) and 150(b).

(f) *Alternative use of facility.* The requirements of this paragraph (f) are met if—

(1) The facility with respect to which the deliberate action occurs is used in an alternative manner (for example, used for a qualifying purpose by a nongovernmental person or used by a 501(c)(3) organization rather than a governmental person);

(2) The nonqualified bonds are treated as reissued, as of the date of the deliberate action, for purposes of sections 55 through 59 and 141, 142, 144, 145, 146, 147, 149 and 150, and under this treatment, the nonqualified bonds satisfy all the applicable requirements for qualified bonds throughout the remaining term of the nonqualified bonds;

(3) The deliberate action does not involve a disposition to a purchaser that finances the acquisition with proceeds of another issue of tax-exempt bonds; and

(4) Any disposition proceeds other than those arising from an agreement to provide services (including disposition proceeds from an installment sale) resulting from the deliberate action are used to pay the debt service on the bonds on the next available payment date or, within 90 days of receipt, are deposited into an escrow that is restricted to the yield on the bonds to pay the debt service on the bonds on the next available payment date.

(g) *Rules for deemed reissuance.* For purposes of determining whether bonds that are treated as reissued under paragraphs (e) and (f) of this section are qualified bonds—

(1) The provisions of the Code and regulations thereunder in effect as of the date of the deliberate action apply; and

(2) For purposes of paragraph (f) of this section, section 147(d) (relating to the acquisition of existing property) does not apply.

(h) *Authority of Commissioner to provide for additional remedial actions.* The Commissioner may, by publication in the Federal Register or the Internal Revenue Bulletin, provide additional remedial actions, including making a remedial payment to the United States, under which a subsequent action will not be treated as a deliberate action for purposes of §1.141-2.

(i) *Effect of remedial action on continuing compliance.* Solely for purposes of determining whether deliberate actions that are taken after a remedial action cause an issue to meet the private business tests or the private loan financing test—

(1) If a remedial action is taken under paragraph (d), (e), or (f) of this section, the private business use or private loans resulting from the deliberate action are not taken into account for purposes of determining whether the bonds are private activity bonds; and

(2) After a remedial action is taken, the amount of disposition proceeds is treated as equal to the proceeds of the issue that had been allocable to the transferred property immediately prior to the disposition. See paragraph (k) of this section, *Example 5*.

(j) *Nonqualified bonds*—(1) *Amount of nonqualified bonds*. The percentage of outstanding bonds that are nonqualified bonds equals the highest percentage of private business use in any 1-year period commencing with the deliberate action.

(2) *Allocation of nonqualified bonds*. Allocations to nonqualified bonds must be made on a pro rata basis, except that, for purposes of paragraph (d) of this section (relating to redemption or defeasance), an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds.

(k) *Examples*. The following examples illustrate the application of this section:

Example 1. Disposition proceeds less than outstanding bonds used to retire bonds. On June 1, 1997, City C issues 30-year bonds with an issue price of \$10 million to finance the construction of a hospital building. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the building. On the issue date, C reasonably expects that it will be the only user of the building for the entire term of the bonds. Six years after the issue date, C sells the building to Corporation P for \$5 million. The sale price is the fair market value of the building, as verified by an independent appraiser. C uses all of the \$5 million disposition proceeds to immediately retire a pro rata portion of the bonds. The sale does not cause the bonds to be private activity bonds because C has taken a remedial action described in paragraph (d) of this section so that P is not treated as a private business user of bond proceeds.

Example 2. Lease to nongovernmental person. The facts are the same as in *Example 1*, except that instead of selling the building, C, 6 years after the issue date, leases the building to P for 7 years and uses other funds to redeem all of the \$10 million outstanding bonds within 90 days of the deliberate act. The bonds are not treated as private activity bonds because C has taken the remedial action described in paragraph (d) of this section.

Example 3. Sale for less than fair market value. The facts are the same as in *Example 1*, except that the fair market value of the building at the time of the sale to P is \$6 million. Because the transfer was for less than fair market value, the bonds are ineligible for the remedial actions under this section. The bonds are private activity bonds because P is treated as a user of all of the proceeds and P makes a payment (\$6 million) for this use that is greater than 10 percent of the debt service on the bonds, on a present value basis.

Example 4. Fair market value determined taking into account governmental restrictions. The facts are the same as in *Example 1*, except that the building was used by C only for hospital purposes and C determines to sell the building subject to a restriction that it be used only for hospital purposes. After conducting a public bidding procedure as required by state law, the best price that C is able to obtain for the building subject to this restriction is \$4.5 million from P. C uses all of the \$4.5 million disposition proceeds to immediately retire a pro rata portion of the bonds. The sale does not cause the bonds to be private activity bonds because C has taken a remedial action described in paragraph (d) of this section so that P is not treated as a private business user of bond proceeds.

Example 5. Alternative use of disposition proceeds. The facts are the same as in *Example 1*, except that C reasonably expects on the date of the deliberate action to use the \$5 million disposition proceeds for another governmental purpose (construction of governmentally owned roads) within two years of receipt, rather than using the \$5 million to redeem outstanding bonds. C treats these disposition proceeds as gross proceeds for purposes of section 148. The bonds are not private activity bonds because C has taken a remedial action described in paragraph (e) of this section. After the date of the deliberate action, the proceeds of all of the

outstanding bonds are treated as used for the construction of the roads, even though only \$5 million of disposition proceeds was actually used for the roads.

Example 6. Alternative use of financed property. The facts are the same as in *Example 1*, except that C determines to lease the hospital building to Q, an organization described in section 501(c)(3), for a term of 10 years rather than to sell the building to P. In order to induce Q to provide hospital services, C agrees to lease payments that are less than fair market value. Before entering into the lease, an applicable elected representative of C approves the lease after a noticed public hearing. As of the date of the deliberate action, the issue meets all the requirements for qualified 501(c)(3) bonds, treating the bonds as reissued on that date. For example, the issue meets the two percent restriction on use of proceeds of finance issuance costs of section 147(g) because the issue pays no costs of issuance from disposition proceeds in connection with the deemed reissuance. C and Q treat the bonds as qualified 501(c)(3) bonds for all purposes commencing with the date of the deliberate action. The bonds are treated as qualified 501(c)(3) bonds commencing with the date of the deliberate action.

Example 7. Deliberate action before proceeds are expended on a governmental purpose. County J issues bonds with proceeds of \$10 million that can be used only to finance a correctional facility. On the issue date of the bonds, J reasonably expects that it will be the sole user of the bonds for the useful life of the facility. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the facility. After the issue date of the bonds, but before the facility is placed in service, J enters into a contract with the federal government pursuant to which the federal government will make a fair market value, lump sum payment equal to 25 percent of the cost of the facility. In exchange for this payment, J provides the federal government with priority rights to use of 25 percent of the facility. J uses the payment received from the federal government to defease the nonqualified bonds. The agreement does not cause the bonds to be private activity bonds because J has taken a remedial action described in paragraph (d) of this section. See paragraph (a)(5) of this section.

Example 8. Compliance after remedial action. In 1997, City G issues bonds with proceeds of \$10 million to finance a courthouse. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the courthouse. G uses \$1 million of the proceeds for a private business use and more than 10 percent of the debt service on the issue is secured by private security or payments. G later sells one-half of the courthouse property to a nongovernmental person for cash. G immediately redeems 60 percent of the outstanding bonds. This percentage of outstanding bonds is based on the highest private business use of the courthouse in any 1-year period commencing with the deliberate action. For purposes of subsequently applying section 141 to the issue, G may continue to use all of the proceeds of the outstanding bonds in the same manner (that is, for both the courthouse and the existing private business use) without causing the issue to meet the private business use test. The issue, however, continues to meet the private security or payment test. The result would be the same if D, instead of redeeming the bonds, established a defeasance escrow for those bonds, provided that the requirement of paragraph (d)(4) of this section was met.

Notice 2008-31

SECTION 1. PURPOSE

This notice provides information about the voluntary closing agreement program for tax-exempt bonds and tax credit bonds (“TEB VCAP”). In particular, the notice updates procedures whereby issuers of tax-exempt bonds and tax credit bonds can resolve violations of the Internal Revenue Code (the “Code”) through closing agreements with the Internal Revenue Service (the “Service”). The Tax Exempt Bonds Compliance & Program Management (“TEB CPM”) function of Tax Exempt and Government Entities (TE/GE) is

continuing to develop voluntary compliance initiatives to insure compliance by issuers of tax-exempt bonds and tax credit bonds with applicable provisions of the Code. TEB VCAP is part of the TEB CPM voluntary compliance initiatives and provides appropriate remedies when issuers voluntarily come forward and express a desire to resolve violations of the Code. TEB VCAP is intended to encourage issuers and conduit borrowers to exercise due diligence in complying with the Code and to provide a vehicle to correct violations of the Code. It is the continuing policy of the Service to attempt to resolve violations of the Code without taxing bondholders. TEB VCAP reflects this policy.

The Service is continuing to work on more detailed procedures about the program, and intends to provide those procedures in forthcoming guidance. For example, the Service anticipates specifying standardized closing agreement terms and amounts for particular violations.

SECTION 2. CHANGES

This notice modifies and supersedes Notice 2001-60, 2001-2 C.B. 304. In general, Notice 2001-60 is amended by: (1) changing references to Outreach Planning and Review (OPR) to Compliance & Program Management (CPM); (2) incorporating tax credit bonds into the TEB VCAP program; (3) simplifying section 5(a) by referring to Internal Revenue Manual (“IRM”) 7.2.3 for the specific information required for a VCAP submission; (4) clarifying that under section 5(b) CPM staff will obtain additional information as needed; (5) clarifying that all information for a VCAP submission must be provided in electronic format; and (6) providing email and regular mail addresses for submissions.

SECTION 3. BACKGROUND

Gross income does not include interest on any state or local bond that meets the requirements of section 103 and related provisions of the Code. A credit against tax is provided to a holder of a qualified tax credit bond issued under sections 54, 1397E or 1400N that meets the requirements of those sections and related provisions of the Code. Under certain circumstances, an issuer may take remedial action under provisions such as sections 1.141-12, 1.142-2, 1.144-2, 1.145-2, and 1.147-2 of the Income Tax Regulations and similar provisions that are applicable to tax credit bonds in order to cure a violation of the Code.

The Service has previously provided formal tax-exempt bond closing agreement programs such as the program described in Rev. Proc. 97-15, 1997-1 C.B. 635. Violations of section 103 and related provisions of the Code that cannot be remediated under existing remedial action provisions or other tax-exempt bond closing agreement programs contained in regulations or other published guidance may be resolved by entering into a closing agreement under TEB VCAP.

Section 7121 of the Code and the regulations thereunder authorize the Commissioner to enter into written closing agreements with any person in connection with the tax liability of such person (or of the person or estate for which he acts). Section 301.7121-1 of the Income Tax Regulations provides, in part, that a closing agreement may be entered into in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or if good and sufficient reasons are shown by the taxpayer for desiring a closing agreement and it is determined by the Commissioner that the United States will sustain no disadvantage through consummation of such an agreement.

SECTION 4. SCOPE OF TEB VCAP

Under TEB VCAP, an issuer may request a closing agreement with respect to its bonds to resolve violations of sections 103, 54, 1397E, 1400N and related provisions of the Code. TEB VCAP is not available when:

- (a) Absent extraordinary circumstances, the violation can be remediated under existing remedial action provisions or tax-exempt bond closing agreement programs contained in regulations or other published guidance.
- (b) The bond issue is under examination. A bond issue is generally treated as under examination on the date a letter opening an examination on the bond issue is sent.
- (c) The tax-exempt status of the bonds or qualified status of tax credit bonds is at issue in any court proceeding or is being considered by the IRS Office of Appeals.
- (d) The Service determines that the violation was due to willful neglect.

SECTION 5. PROCEDURES FOR REQUESTING A CLOSING AGREEMENT UNDER TEB VCAP

- (a) *Information Required in Requests.* An issuer or its authorized representative requesting a closing agreement must submit the information specified in IRM 7.2.3 and the information reporting return for the applicable bonds on IRS Form 8038 or other comparable form that was filed with respect to the issue. (For convenience of reference, the relevant portions of the Internal Revenue Manual (IRM) are available on the IRS website, at www.irs.gov, in the section on the Tax-Exempt Bond Community, under the subheading of Published Guidance.) All information concerning the closing agreement must be submitted under penalty of perjury signed by an official of the issuer with knowledge of the issue and authorized to make the submissions on behalf of the issuer. The request may also contain a Form 2848 with the name, address, phone number, and fax number of an authorized contact person.
- (b) *Additional Information for Requests.* CPM staff may require additional information depending on the facts and circumstances. All additional information must be submitted under penalty of perjury signed by the person who initially signed the submission or who would have been authorized to make the original submission.
- (c) *Electronic Format.* All information submitted in support of a closing agreement request must be provided in an electronic format that is either emailed in PDF format or provided on a compact disc (“CD”) sent via regular mail to the address provided by this notice. Hard copies of the submissions can be provided but are not required.
- (d) *Anonymous Closing Agreement Requests.* An issuer or its authorized representative may initiate discussions regarding the appropriate terms of a closing agreement on an anonymous basis. An anonymous request may be made on behalf of a group of similarly situated issuers. However, the execution of a closing agreement must be between the Service and a disclosed issuer, and all terms of a closing agreement must be consistent with section 7121 of the Code. Until the name of the bond issue is disclosed to the Service, a request for a closing agreement under TEB VCAP will not prevent the Service from beginning an examination of the bond issue. An issue for which a request has been submitted under this paragraph (d) that has been placed under examination prior to the date the issue is identified to the Service will no longer be eligible for TEB VCAP.
- (e) *TEB VCAP Mailing Address.* TEB VCAP submissions should be mailed to:

Internal Revenue Service
Attn: TEB VCAP
1122 Town & Country Commons
St. Louis, MO 63017

(f) *TEB VCAP E-Mail Address*. In the alternative, VCAP information may be submitted in PDF format to *TEBVCAP@irs.gov*. TEB CPM will provide an acknowledgement of receipt of an email request.

SECTION 6. CLOSING AGREEMENT TERMS

Closing agreements under TEB VCAP will generally follow the model closing agreement in IRM 4.81.1, Exhibit 9, as the same may be modified or changed. Specific closing agreement terms will depend on the facts and circumstances of the case, including the degree of diligence exercised by the issuer and any conduit borrower. Any standardized closing agreement terms that are developed for TEB VCAP will be set forth in the Internal Revenue Manual and/or other published guidance.

SECTION 7. EFFECT OF CLOSING AGREEMENT EXECUTED UNDER TEB VCAP

A closing agreement properly executed by the issuer and the Service will protect bondholders from including in their gross income any interest on the bonds or from recapturing tax credits during the period specified in the agreement for any violation described in the agreement. A closing agreement executed under section 7121 of the Code shall be final and conclusive except that: (1) the matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of a material fact; (2) it is subject to the sections of the Code that expressly provide that effect be given to their provisions (including any stated exception for section 7122 of the Code) notwithstanding any other law or rule of law; and (3) it is subject to any law, enacted after the date of the agreement, that applies to a tax period ending after the date of the agreement covered by the agreement.

SECTION 8. REQUESTS FOR COMMENTS

We anticipated that TEB VCAP will continue to be expanded and refined over time based on experience and public comment. The Service welcomes comments regarding the format and operation of TEB VCAP, and suggestions with regard to the general framework of closing agreement terms including standardized closing agreement terms and amounts that may be specified for particular violations. Comments should be submitted in writing and should be emailed to *Steven.A.Chamberlin@irs.gov* or mailed to the following address:

Steven A. Chamberlin
Manager, Tax Exempt Bonds
Compliance & Program
Management
SE:T:GE:TEB:CPM
1122 Town & Country Commons
St. Louis, MO 63017

SECTION 9. EFFECT ON OTHER DOCUMENTS

Notice 2001-60, 2001-2 C.B. 304, is modified and superseded.

SECTION 10. EFFECTIVE DATE

TEB VCAP is effective February 27, 2008.

SECTION 11. DRAFTING INFORMATION

The principal authors of this notice are Steven A. Chamberlin of Tax Exempt Bonds Compliance & Program Management, Tax Exempt & Government Entities, and Carla Young of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Steven Chamberlin at (636) 255-1290 or Carla Young at (202) 622-3980 (not toll-free calls).