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Expect More Tax Guidance in 2015.

WASHINGTON — The Treasury Department and Internal Revenue Service next year will be working on further guidance on issue price, regulations finalizing other proposed arbitrage rules, and additional rulemaking projects.

The agencies came out with their 2014-2015 priority guidance plan in August. “We hope to work very actively and hard to accomplish as much as we possibly can on that guidance plan,” Treasury associate tax legislative counsel John Cross told state and local finance officials earlier this month.

Cross, who rejoined Treasury in November after working at the Securities and Exchange Commission, discussed the items on the plan at the winter meeting of the Government Finance Officers Association’s committee on governmental debt management. Market participants also spoke to The Bond Buyer about what guidance they would like or expect to see in 2015.

Treasury and the IRS plan to release guidance on the determination of issue price separately from rulemaking on other arbitrage-related issues so that one piece focuses “more quickly and discretely on [issue price],” Cross said.

Treasury and the IRS released proposed arbitrage regulations that addressed several topics, including the definition of issue price in September 2013. Market participants have warned the proposed issue price rules are unworkable. Cross said the IRS may propose new rules on issue price.

Leslie Norwood, managing director, associate general counsel, and co-head of municipal securities at the Securities Industry and Financial Markets Association, — said she is hopeful there will be movement on issue price regulations with Cross back at Treasury. SIFMA was among the groups that sent the regulators comments criticizing the rules proposed in 2013.

Treasury and the IRS also hope to work on guidance that encompasses the non-issue price portions of the arbitrage regulations proposed in 2013 as well as a set of arbitrage rules proposed in 2007. The hope is to “wrap those all up with a bow and finalize those in a somewhat more substantial project,” Cross said.

Jack Browning, a senior partner at Squire Patton Boggs, said that some of the non-issue price proposed arbitrage rules are “noncontroversial,” so it would be helpful if they were finalized.

The National Association of Bond Lawyers has recently released comments on part of the non-issue price part of the 2013 proposed arbitrage rules. NABL president Tony Martini, a partner at Edwards Wildman Palmer, said these comments will hopefully be helpful to Treasury and the IRS.

Also on the guidance plan are final allocation and accounting rules, which relate to facilities that are used for both governmental and private use, Cross said. Allocation and accounting rules were proposed in 2006.

Perry Israel, a lawyer with his own firm in Sacramento, Calif., said he would like to see the final regulations take into account comments on the proposed sent to the regulators, such as that when

an issuer contributes both tax-exempt bond proceeds and other funds to a project, they should be able to allocate the private business use first to the other funds, and then to the bond proceeds without having to make a special election to do so. Under the proposed rules, an issuer can only allocate private business use this way if it makes a special election, Israel said.

The IRS is also working on guidance on the definition of a political subdivision, according to its priority list. Cross told state and local finance officers that the IRS chief counsel's office has a "strong interest" in looking into this topic.

In 2013, the IRS issued a technical advice memorandum that concluded the Village Center Community Development District in Florida was not a political subdivision that can issue tax-exempt bonds. NABL and other members of the municipal bond community have expressed concern about the ruling, Cross said.

Matthias Edrich, a shareholder at Greenberg Traurig and chair of the National Association of Bond Lawyers' tax law committee, said, "The tax committee looks forward to getting clarifying guidance from the Treasury Department regarding political subdivisions."

Dave Caprera, an attorney at Kutak Rock in Denver, said he thinks the political subdivision issue is the most important topic on the guidance plan because "it impacts the most transactions." The issue affects outstanding bonds issued by special districts as well as similar deals that haven't been done because bond lawyers are unable to give an opinion.

Israel, who represents the Village Center CDD in the dispute with the IRS, said it could take a while for Treasury and the IRS to develop political subdivision rules. He pointed out that there hasn't been activity on the audit of the district's bonds for many months.

The Treasury and the IRS also are working on a notice to provide a process for allocating unused volume cap of new clean renewable energy bonds. There was a $2.4 billion authorization of the bonds in 2009, and there is about $1.3 billion of unused volume cap, Cross said.

Finalizing proposed rules on public approval requirements for private-activity bonds is also on the list. Israel said he is "hopeful" that these final rules will be released this year. NABL is looking to see if there's something the group can do to speed up the process of finalizing these regulations, since there is "broad consensus" that they have many positive elements, Martini said.

In October, the IRS released interim guidance on accountable care organizations and management contracts to prevent them from causing private-activity bond problems. The notice invited the public to submit comments on the guidance to the agencies by Jan. 22.

Edrich said NABL plans to prepare three comment documents relating to the notice and the management contract issue. They will address the safe harbor in the notice for when ACOs don't result in private business use, the new safe harbor in the guidance for when management contracts don't result in private business use, and other management contract issues.

In addition to the notice on ACOs and management contracts, Treasury and the IRS also released final regulations on arbitrage rebate overpayments and guidance on temporary relief after a disaster in 2014. Martini said that the regulators are making "good, steady progress" on completing items on the guidance list.

Tax controversy lawyer Brad Waterman said he would like to see guidance about procedural questions related to Build America Bonds, such as those relating to the statute of limitations and litigation procedures that have never been addressed.

IRS Enforcement

Rebecca Harrigal, the director of the IRS tax-exempt bond office, said at the GFOA committee meeting that her office in fiscal 2015 will continue to evaluate its programs for "risks, inefficiencies and ineffectiveness." TEB will also target its resources toward the areas where there is the greatest risk of noncompliance with tax rules, she said.

TEB is looking at certain types of bonds early on in the process of using its revised market segment audit program. The bonds include: certain types of advance refunding bonds, bonds for which Form 8038-T's are filed, governmental bonds for environmental and transportation projects, Build America Bonds, private-activity bonds for non-hospital 501(c)(3) organizations, and PABs for solid waste and single-family and multifamily housing, she said.

Under the program, TEB has come up with hypotheses about where there might be the greatest risk of noncompliance that can be identified from data in information returns or readily available public sources. In order for the IRS to test its hypotheses, issuers that are frequently in the market in selected segments may see multiple audits, Harrigal said.

After the IRS has tested its hypotheses, it will look to see if the predictions were proven. If the hypothesis was validated, the IRS may: conduct more audits in that area; set up a special voluntary closing agreement program; or provide more education. The end goal is for market segments where there is a higher level of noncompliance will see a reduction in that level.

Israel said he would like to see the IRS continue to close market segment audits as quickly as reasonably possible.

In fiscal 2014, which ended Oct. 30, TEB spent a lot of time reworking the closing agreement process, for settlements resulting from audits and from the VCAPs. The office created a closing agreement team that looks at the consistency and enforceability of settlements. TEB also put into place "template closing agreements," so that the closing agreement process is more standardized and structured, Harrigal said.

"As you'd expect, with any new thing, there is a learning curve," Harrigal said. But toward the end of fiscal 2014, closing agreements, especially those that had been stuck in the VCAP process for a while, started to clear out faster.

TEB closed about 51 VCAP settlements in fiscal 2014, and from Oct. 1 through the beginning of December, it has closed about 23. "You can see there's a significant uptick in the amount of closing agreements we're actually processing and getting out," she said.

There were 25 closing agreements that stemmed from audits in fiscal 2014, a five-year high, Harrigal said.

TEB plans to continue to place an emphasis on completing settlements quickly. The office is also looking into further standardizing the closing agreement process. For example, TEB will to see if specific VCAP programs could have "fill-in-the-blank" closing agreements, Harrigal said.

TEB staff is monitoring trends in the market, and if they spot an issue, they will reach out to industry groups to figure out if the problem is big. If it is, TEB will try to figure out how to address it, whether through education or a VCAP initiative. Harrigal said she is also examining whether TEB can use industry director directives, a vehicle that other IRS offices use, to address messy issues.

The office is reworking the Internal Revenue Manual, which provides instructions to TEB staff, to

make it clear what the office's process and expectations are, Harrigal said.

Johnny Hutchinson, a senior associate at Squire Patton Boggs, said that people are "eagerly awaiting" the revisions to the IRM.

NABL's tax committee is working on suggestions for additions to the IRM relating to exams and the use of technical advice requests for tax-advantaged bonds such as BABs. The committee is also working on providing comments about the IRM that pertain to VCAPs, Martini said.

TEB hopes to offer three more webcasts in 2015, provided that the office has the budget to do so, Harrigal said. The first, during which Harrigal will speak, will likely take place in January, she said. The IRS has not yet disclosed the topics.

The office also expects to release taxpayer publications on governmental bonds, 501(c)(3) bonds and private-activity bonds soon, Harrigal said she wants to do more of these publications. Additionally, TEB is working on customer satisfaction surveys that will be sent to bond counsel and issuers at the end of VCAPs and audits.

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BY NAOMI JAGODA

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