

# **Bond Case Briefs**

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## **IRS' TEB Office: Village Center CDD Ruling Should Be Retroactive.**

The Internal Revenue Service's tax-exempt bond office is arguing there should be retroactive application of the chief counsel office's technical advice memorandum that concluded the Village Center Community Development District in Florida is not qualified to issue tax-exempt bonds.

The ruling, if it stands and is retroactive, "would render taxable the interest on some \$426 million of bonds" issued from 1993 to 2004, the Village Center CDD has told TEB.

The TAM, issued in May 2013, found that the CDD is not a political subdivision for purposes of issuing tax-exempt bonds because its board is, and always will be, controlled by the developer rather than publicly-elected officials.

The CDD opposes the conclusion, but said that even if the TAM is upheld, it should be applied prospectively. The CDD claims TEB mischaracterized the basis upon which it is seeking prospective application.

The IRS chief counsel's office has to decide whether it will grant the district's request for relief from the TAM being applied retroactively. Ordinarily, TAMs are applied retroactively, but the IRS has discretionary authority to prescribe they only be applied in the future.

If the chief counsel's office denies the district's request, a years-long audit of the CDD's bonds will continue. If the IRS concludes the audit and determines the bonds are taxable, the district can appeal the ruling to the agency's Office of Appeals. If the appeals office also finds the bonds to be taxable, the CDD will want to pursue litigation in court, said Richard Chirls, a partner at Orrick, Herrington & Sutcliffe in New York. Chirls is working with Perry Israel, a lawyer with his own practice in Sacramento, Calif., on the Village Center case. Israel represents the Village Center CDD and Chirls represents a related CDD.

The Village Center CDD's request for relief is not only significant for it, but is also important for other districts and the broader municipal finance community, Chirls said. If the chief counsel's office decides that the TAM only will be applied prospectively, the market would have comfort that future guidance from the Treasury Department on the definition of a political subdivision would be forward looking, he said.

The IRS and Treasury has put the definition of a political subdivision on its priority guidance plan.

Last summer, the CDD asked the IRS to reconsider the TAM, but the IRS denied this request. Additionally, in August 2013, the district requested relief under Internal Revenue Code section 7805(b) that the TAM not be applied retroactively, and it provided supplements to this request in October and November.

TEB said last month that it disagreed that the TAM should be applied prospectively. TEB said the CDD has to show why its situation is so unique that it deserves to be granted relief from being

applied retroactively, but it has not met its burden of proving that there are rare or unusual circumstances. Instead, TEB believes the district was arguing that the TAM was wrong, essentially re-raising the request to reconsider the TAM that was already denied.

In a reply to TEB sent to that office and the chief counsel's office on May 20, the CDD said that TEB incorrectly characterized its basis for requesting relief.

For the purpose of the request for relief only, the CDD will accept that the TAM was correct. However, the district said it relied on existing IRS practice and published positions at the time it issued its bonds, and the TAM applies a new theory. Moreover, applying this theory retroactively would be a rare and unusual circumstance that "would work inequitable results," the CDD said.

The TAM concludes that the CDD is not a political subdivision because it's not a division of the state. But when authorities have discussed whether an entity is a division of a state, they haven't required it to be answerable to a general public electorate. Instead, they have discussed other factors such as the public purpose of the entity and the treatment of it as a "public body corporate" by state law, which the district satisfies, the CDD said.

The CDD noted that a National Association of Bond Lawyers review of more than 250 private-letter rulings found that only one even suggests that control by an electorate was relevant to determining whether an issuer is a political subdivision. However, in that ruling, accountability to an electorate was not identified as a necessary factor.

The CDD acknowledges that it is not enough to show it relied on previous IRS rulings to get relief, and that it also must show that applying the TAM retroactively would be inequitable. But that is the case in this circumstance, the CDD said.

The district noted that the IRS had previously audited some of its bonds and upheld their tax-exemption. Also, audits of other "landowner-controlled" districts have closed with no change to the bonds' tax-exempt status. "To apply a new interpretation of the requirement of control that requires that the entity be answerable to a general electorate would, in light of the past practice, work an inequitable result upon not only the [CDD], but also its nearly 100,000 residents and the hundreds, if not thousands, of holders of its bonds," the district said.

BY NAOMI JAGODA  
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