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NABL Issues Guidance for Certain Conduit Bond Deals.

WASHINGTON – Lawyers involved in a conduit bond financing for a charitable nonprofit organization should decide as soon as possible which of them is responsible for ensuring the tax-exempt status of the borrower, the National Association of Bond Lawyers concludes in a just-released paper.

The 24-page paper, called "The 501(c)(3) Opinion In Qualified 501(c)(3) Bond Transactions," follows a few recent cases in which the Internal Revenue Service questioned the tax-exempt status of bonds after the nonprofit borrower lost its tax-exempt status because it failed to file Form 990s, which are annual financial reports.

However, NABL president Allen Robertson, a lawyer with Robinson, Bradshaw & Hinson in Charlotte, N.C., said that while the paper talks about the loss of tax-exempt status, it wasn't prompted by anything other than a need to provide guidance where none existed.

"We've noted from our members that the predominant practice now is to rely on borrower's counsel and that's something that's been developed over the last 20 or 30 years," Robertson said.

But a lot of lawyers representing a charitable nonprofit are not used to giving opinions other than for conduit bond financings and there is no guidance for them to turn to in writing such opinions.

""There wasn't any sort of paper or treatise that borrower's counsel or bond counsel could go to to sort of learn about the opinion, how you might phrase it, what it might mean, and the diligence that you need to do to support it," Robertson said. "We felt we were really trying to fill a gap."

NABL plans to send the paper to groups that might benefit from it, such as the National Association of Health and Educational Facilities Finance Authorities and the American Hospital Association. The majority of 501(c)(3) organizations are educational and health care entities, but others exist, he said.

The paper is divided into four parts. The first summarizes how a charitable nonprofit becomes and maintains its status as a 501(c)(3) organization. The second covers the 501(c)(3) opinion and interpretations of its core phrases and related provisions, as well as information of ancillary opinions that are sometimes needed. The third part addresses the due diligence needed to support the opinion, as well as federal tax matters that are important. The fourth part deals with additional due diligence that may be needed by either the borrower's counsel or bond counsel.

In Part I, NABL says that to qualify as a 501(c)(3) organization, an entity: must be organized and operated for certain specified exempt purposes; is prohibited from using any of its net earnings for the benefit of a private shareholder or individual; cannot engage in activities that are related to a political campaign or that attempt to influence legislation; and must file annual Form 990s, which provide information on its finances.

The paper notes that there are additional requirements for organizations operating one or more hospital facilities as well as for those organizations that must comply with provisions of the Patient

Protection and Affordable Care Act.

Most charitable organizations must apply to the IRS for 501(c)(3) status, but churches and certain religiously-affiliated entities such as schools and hospitals are exempted.

In Part II, NABL says the 501(c)(3) opinion should address two points. First, it should say whether the borrower is still a 501(c)(3) organization as of the date of the opinion, meaning its tax-exempt status has not been revoked. Second, it should say whether the borrower has continued to meet all of the requirements for a 501(c)(3) organization, meaning its tax-exempt status could not be revoked.

This section describes other opinions the borrower's counsel might be asked to render. For example, the borrower's counsel might be asked to provide a Section 513 opinion that states the bond-financed project is, or will not be, used in an unrelated trade or business.

In Part III, NABL lists the issues that the borrower's counsel should investigate, such as whether the organization's documents set forth its charitable purpose and provide for distribution of assets in the event of dissolution. Counsel should find out if the organization has been recognized and is currently recognized as having 501(c)(3) status as well as whether it has operated to further its exempt purpose.

Other key questions that must be probed are whether the organization has served private interests, engaged in political campaigning or excessive lobbying, or unrelated business activity. Finally, the borrower's counsel should determine if the organization has met its Form 990 filing requirements.

NABL describes the documents that must be examined to make these determinations. It also details additional information that must be obtained for certain hospitals and health care borrowers as well requirements that must be met under the Affordable Care Act.

Part IV addresses the issue of whether bond counsel can exclusively rely on the 501(c)(3) opinion of borrower's counsel. NABL said most bond counsel relying on such opinions typically state they are doing so.

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