Bond Case Briefs

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IRS Model Closing Agreements for VCAP and Examinations.

The IRS office of Tax Exempt Bonds (TEB) developed model closing agreements to resolve compliance issues on an examination and in the Voluntary Closing Agreement Program (VCAP). These model agreements contain language that will generally be used by TEB in closing agreements relating to tax-exempt bonds. Closing agreements for build America bonds and other types of tax credit bonds will use similar agreements modified for tax credits rather than tax exempt interest.

The model agreements are designed to improve consistency in closing agreements for similar violations, whether the case is in VCAP or under examination. In most instances, deviations from the operative terms of the model agreement language will require additional review.

MODEL CLOSING AGREEMENTS

These examples show use of the model closing agreement for an examination and a VCAP case.

All VCAP submission requests must include a draft of the VCAP model closing agreement filled in as appropriate for the TEB VCAP request.

- TEB VCAP Model Closing Agreement – showing use of the model agreement when the violation was discovered by the issuer and brought to TEB under VCAP
- TEB Examinations Model Closing Agreement – showing use of the model agreement when the violation was discovered during an examination

The examples cover the compliance issue of the sale of bond-financed property to an entity that is not a 501(c)(3) organization or governmental unit. Under VCAP, this violation is described in the resolutions standards found in IRM 7.2.3.4.2.2. For simplicity, we kept the settlement amount the same in both examples; however, a violation identified during an examination will generally be resolved less favorably than the same violation identified through VCAP.

PARTS OF THE MODEL CLOSING AGREEMENTS

Generally, the model closing agreement contains the following elements (references are to the paragraph identifiers in the attached closing agreements):

Authorizing paragraph – The closing agreement is executed under the authority of section 7121 of the Code and is between the parties identified in this paragraph: generally the issuer, the conduit borrower for the bond issue (if applicable), and the IRS.

Preamble ("Whereas" Clauses):

Paragraph A – Describes the bond issue to which the closing agreement relates. Only the bonds described in this paragraph will be covered by the closing agreement.

Paragraph B – For VCAP: Issuer's representations reflecting the basis for the IRS having reason to conclude that the bonds do not meet the requirements of tax-advantaged bonds. For examination cases: a statement providing a basis for the IRS to conclude that taxpayers are taking a position that interest on the bonds is tax-exempt or the bonds are otherwise tax-advantaged.

Paragraph C – Provides a description of the matter that is being resolved with the closing agreement. Any matter not described in this paragraph is not resolved with the closing agreement.

Paragraphs D-F – Additional description of the scope of the agreement.

Paragraph G – Provides issuer representations that describe the sources of the monies to be used to fund the settlement payment and a description of any other remedial action to be taken. VCAP Internal Revenue Manual provisions generally require redemption of any nonqualified bonds prior to the execution of the closing agreement by the IRS. For examination closing agreements, in certain situations an irrevocable notice of redemption of bonds to be redeemed may be allowed in lieu of a defeasance escrow, but will generally include a requirement to provide the IRS with evidence the required redemption was made.

OPERATIVE PARAGRAPHS

Paragraph 1 – Provides the settlement amount required to be paid under the closing agreement and the required method of payment.

Paragraphs 2-4 – Procedural and tax treatment of Settlement Amount paid.

Paragraph 5 – Describes the federal tax treatment provided by the closing agreement for the matter described in paragraph C.

Closing agreements resolving the taxability of interest on a bond issue may also address whether the facilities acquired with bond proceeds by a taxable conduit borrower shall be treated as tax-exempt bond financed property under section 168(g) of the Code (relating to accelerated depreciation).

Paragraph 6 – Provides that only matters described in paragraph C are covered by the agreement.

Paragraph 7 – Provides that proceeds of any bond redeemed as a condition of the closing agreement are treated as unspent proceeds for any future refunding of those bonds. The effect of this paragraph is to sever the connection between bond proceeds and the expenditures to which they were originally allocated. Accordingly, should a taxable refunding of the nonqualified portion of the bonds subsequently be refunded with tax advantaged bonds the proceeds would not be considered as “spent,” which could result in violations of tax rules regarding the expectation to use proceeds and certain arbitrage restrictions.

Paragraphs 8-10 – Describe limitations on the scope of the agreement, and finality of agreement.

Signatures – The signatures required include the issuer, the conduit borrower (when a conduit borrower is a party to the agreement), and the IRS. If an issuer and the conduit borrower are not able to sign on the same page due to logistical limits, the IRS may modify the signature page of the agreement to allow for separate execution by issuers and borrowers. The issuer (and borrower, if applicable) sign the agreement before it is signed by the IRS.

Exhibit A –When terms of the closing agreement include a redemption or defeasance of bonds prior to execution of the agreement, this exhibit describes the bonds redeemed or defeased. In cases where redemption of bonds is to be completed after execution of the closing agreement, the agreement will contain instructions for submitting a notification to the IRS of the actual redemption.

Exhibit B – Instructs issuers how to make the settlement payment required under the closing agreement using the Electronic Federal Tax Payment System.

Disclosure Consent – The consent will authorize the IRS to disclose the existence and subject matter of a closing agreement to correct any material misstatement with respect to any public statement by the issuer or borrower (or their agents).

This article is intended to give you an overview of what to expect with the new closing agreement templates. Any questions about how the agreement will be applied to the facts of any specific case should be directed to the TEB employee assigned to that case.

Additional resources

- Tax Exempt Bonds Voluntary Compliance
- TEB VCAP Resolution Standards