

# **Bond Case Briefs**

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## **TEB Says Muni Audits Can Be Closed After Full Redemption.**

CHICAGO — The Internal Revenue Service's Office of Tax-Exempt Bonds has told its auditors that, if an issuer redeems 100% of the outstanding principal amount of its tax-exempt or tax-credit bonds, the audit can be closed without further TEB action.

But the interim guidance, which was released this week in a memo from Rebecca Harrigal, TEB's director to amend the Internal Revenue Manual (IRM) to include a new resolution method for audits, has drawn criticism from a former TEB director who says it could lead to more tax law violations.

The guidance gives four factors auditors must consider when closing an audit with no further action: the reasons for noncompliance and whether it falls under an anti-abuse rule; whether the underwriter, conduit borrower or other user of proceeds with a financial interest in the transaction were involved in aspects of the deal that led to noncompliance; and whether the issuer or borrower took reasonable steps to ensure the bonds complied with law or attempted to self-correct the problem before the audit.

Speaking at the National Association of Bond Lawyers' Bond Attorneys' Workshop here on Wednesday, Harrigal said that the guidance "generally won't affect bond issues."

"If the guidance is going to resolve a problem you see then it is worth putting effort into the audits," Harrigal said. "Certain times - yes it makes sense to close audits and other times that doesn't make sense and we should continue audits."

"The rules for re-opening a TEB exam are not as clear as I hope they would be," she added. "There are very strict rules of re-opening a case that has already been reviewed."

Should an auditor determine the bonds don't comply with law, it can issue a closing Letter 5859, Full Bond Redemption - Compliance Issue Identified.

The new guidance does not apply if the bonds are redeemed with other tax-advantaged bonds or if they are direct-pay bonds. It also does not apply if the issuer did not make appropriate rebate payments on the bonds or if the issuer asks for a closing agreement. The guidance is applicable for two years.

Mark Scott, the former head of TEB who is now in private practice representing whistleblowers, said that IRS officials are "clearly walking away from doing their job" and are trying to prevent the payment of what is owed. This could lead to bond counsel opinions that do not meet the NABL standard, he warned.

Because IRM provisions are not law and can be changed at will, Scott said the "unthinkable" provision should be revoked.

"This sounds like a pass for a bad bond counsel opinion," Scott said. "This could lead to significantly aggressive tax opinions given by bond counsel in an industry that is already out of control."

"If the only penalty that applies is redeeming and refunding bonds, then it is essentially encouraging tax counsel to not comply with tax laws," he added.

Although redemption of bonds is important, he said, this guidance will lead to inappropriate actions and does not clearly state whether the issuer took reasonable steps if bond counsel gives an incorrect tax opinion.

The interim guidance comes as TEB continues to work with a diminished staff and limited resources. At BAW, Harrigal said that TEB lost eight employees in the past year for various reasons, including transfers and retirements. The office is now down to roughly 65 employees, she said, including 14 tax law specialists.

For this fiscal year, TEB will work on selecting audits with a higher risk of noncompliance, including specific returns as well as classes of returns.

She said the office is using market segments where there is information that there may be a high level of noncompliance for targeted audits, including sports facilities, advance refundings and government facilities with private activity. None of those market segment audits are closed, she said, though some are more than 80% complete, Harrigal said.

"We identify issues and fact patterns we hypothesize have a higher risk of noncompliance," she said. "What we do with those is create a sample. We will pick out a statistical sample of returns and examine them. Some in there will be perfectly fine."

In March, TEB released model closing agreements for both the general examination program and the Voluntary Closing Agreement Program (VCAP) to expedite and increase consistency. Harrigal said that VCAP "continues to be a priority and we will devote resources based on that," but added that the office has gotten significantly fewer VCAPs since then.

TEB also said in its two-page work plan for fiscal 2017, which began this month, that the highest priority would be given to claims and referrals warranting audit resources.

Because of revisions made to the direct-pay bond refund process, TEB said it expects fewer direct-pay referrals in fiscal 2017, but that they will likely have a higher risk of noncompliance than under the prior process.

Mike Bailey, a partner with Foley & Lardner in Chicago and chair of Wednesday's panel, noted TEB typically audits bonds five-to-six years after their issuance to give it time to see how the proceeds were spent and other determining factors. He also noted that it marks six years since the issuance peak of direct-pay bonds and Build America Bonds (BABs), and asked Harrigal if a wave of audits can be expected.

Harrigal said it is "happening under the radar," adding that BABs are included in the market segment audits.

## **The Bond Buyer**

By Evan Fallor

October 20, 2016

