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IRS Use of Section 6700 Penalties for Muni Wrongdoers to be Audited.

WASHINGTON - The Treasury Department Inspector General for Tax Administration plans to audit the Internal Revenue Service's use of a much-feared enforcement tool under which it can impose penalties for the misconduct of municipal bond transaction participants such as underwriters, lawyers, municipal advisors or their firms.

The audit, listed in TIGTA's annual audit plan for fiscal 2019, could spell trouble for the IRS' tax-exempt bond folks, who seem to have virtually stopped using these penalties under Section 6700 of the Internal Revenue Tax Code.

"Taking 6700 action against law firms or banks does not make you popular when you're trying to leave the IRS," said Mark Scott, former director of the IRS Tax-Exempt Bond Office who now has a private practice representing whistleblowers. "It decreases your opportunities for post-government employment."

Section 6700 was originally intended to allow the IRS to impose penalties against promoters of abusive tax shelters.

But in 1989 Congress approved legislation allowing the agency to apply Section 6700 in municipal bond enforcement cases so it could go after the bad actors in muni bond transactions and not be restricted to declaring bonds taxable or entering into settlement agreements with issuers. This tax enforcement tool, unlike others, has no statute of limitations.

The revised Section 6700 allowed the IRS to impose penalties on municipal bond transaction participants who make or provide statements related to the tax exemption or other tax benefits in transactions that they know or have reason to know are false or fraudulent.

The penalties can apply to individuals or firms, including underwriters, bond counsel or other lawyers, issuers, conduit borrowers, financial advisors, or feasibility consultants.

The penalties used to equal the lesser of \$1,000 per activity or 100% of the gross income from the activity, with the IRS taking the stance that "activity" could mean a single bond, typically \$5000, so the penalties would soar in large transactions.

But since Oct. 23, 2004, penalty amounts have been required to be 50% of the gross income derived, or to be derived, from the activity of the person or firm targeted with enforcement action.

IRS tax-exempt bond officials ramped up the use of this section in 2000, with Scott, who was then the IRS' national bond director, telling The Bond Buyer at that time that the agency was using this anti-abuse tool in more than 40 bond audits, representing about 10% of its pending bond audits.

A TIGTA audit of the IRS Tax-Exempt Bond Office's enforcement activities from fiscal year 2002 through fiscal year 2004 that was released in September 2005 found the office closed 16 Section

6700 cases with more than \$34 million in penalties in 2002, 44 with more than \$4 million in penalties in 2003 and 19 with \$6.61 million in penalties in 2004.

Scott left the IRS at the end of 2005 to join the law firm of Vinson & Elkins, which no longer exists. He was replaced by Cliff Gannett, who retired from the IRS in June 2013. Gannett was in turn replaced by Rebecca Harrigal in October 2013. Harrigal left in December 2016 to join Greenberg Traurig as a shareholder in its public finance practice.

A TIGTA audit on TEB enforcement activities from fiscal year 2005 through fiscal year 2010, released in August 2012, found the number of Section 6700 misconduct investigations had dropped to two in fiscal 2010 from 21 in fiscal 2005.

“TEB office management stated they believe the reason for the decrease in cases can be attributed to the suspension of eight investigations in fiscal 2006 and 2007 that they plan to reactivate in the future, and that highly public criminal prosecutions have created a deterrent effect,” TIGTA said in the audit, the second and last one done on TEB’s enforcement program.

Robert Henn, former acting director of the TEB Office, had high hopes for the use of this tool when he told The Bond Buyer in a November 2012 interview as he was set to retire at the end of the year that he was disappointed he would not see completion of the IRS’ efforts to pursue Section 6700 probes of firms and individuals that violated the tax laws by participating in schemes to rig the bids for guaranteed investment contracts and other products for the investment of muni bond proceeds.

The IRS had initially investigated bid-rigging but referred the cases to the Department of Justice’s division for criminal prosecution in 2005. The DOJ launched a massive antitrust probe in the municipal market in 2006 that led to the indictments and convictions of numerous firms and individuals, as well as some settlements.

Later Scott obtained information from the TEB Office under a Freedom of Information Act request showing its examination plans for fiscal 2015 included only one Section 6700 case pending at that time.

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