
IRS LTR: IRS Revokes Exempt Status of Real Estate Trade Group.

Citations: LTR 201329023

The IRS revoked the tax-exempt status of a trade group that supports the real estate industry, saying it primarily engages in nonexempt activities and performs particular services for members.

Person to Contact/ID Number: * * *

Contact Numbers:

Voice: * * *

Fax: * * *

501-06.00

Release Date: 7/19/2013

Date: January 27, 2012

Taxpayer Identification Number: * * *

Form: * * *

Tax Years Ended: * * *

LEGEND:

ORG = Organization name

XX = Date

Address = address

Dear * * *:

In a determination letter dating from October 19XX, you were held to be exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(6) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(6) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On September 23, 20XX, you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(6) of the Code.

You are required to file Federal income tax returns for the tax periods shown above. If you have not yet filed these returns, please file them with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted, or unless an examiner's report for income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

* * *

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing

Director, EO Examinations

* * * * *

Person to Contact/ID Number: * * *

Contact Numbers:

Telephone: * * *

Fax: * * *

501-06.00

Date: November 1, 2011

Employer Identification Number: * * *

LEGEND:

ORG = Organization name

XX = Date

Address = address

Dear * * *:

In a determination letter dated March 28, 19XX, you were held to be exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(6) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(6) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On September 23, 20XX, you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(6) of the Code.

You are therefore required to file Form[s] 1120, U.S. Corporation Tax Return, for the year[s] ended December 31, 20XX, 20XX, and 20XX with the Ogden Service Center. For future periods, you are required to file Form 1120 with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

* * *

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing

Director, EO Examinations

* * * * *

LEGEND:

ORG = Organization name

EIN = ein

XX = Date

State = state

CO-1, CO-2 & CO-3 = 1st, 2nd & 3rd COMPANIES

ISSUES

Whether this exempt organization's (EO) activities permit it to continue to be exempt under § 501(c)(6).

FACTS

ORG (hereinafter, "ORG") was formed with the filing of Articles of Incorporation with the State Corporation Commission on March 28, 19XX.

ORG is a subsidiary of the CO-1 and received its letter of exemption under § 501(c)(6) with an effective date of March 28, 19XX.

The purpose of the organization stated in the original Articles of Incorporation are:

(a) To unite those engaged in the recognized branches of the real estate profession in this community for the purpose of exerting the beneficial influence upon the profession and related interests.

(b) To promote and maintain high standards of conduct in the real estate profession as expressed in the code of Ethics of the CO-2.

(c) To provide a unified medium for real estate owners and those engaged in the real estate profession whereby they may be safe guarded and advanced.

(d) To further the interest of home and other real property ownership.

(e) To unite those engaged in the real estate profession in this community with a CO-1 and the CO-2, thereby furthering their own objectives throughout the state and nation, and obtaining the benefits and privileges of membership therein.

(f) To designate, for the benefit of the public, those individuals within its jurisdiction authorized to use the term Realtor and Realtor Associates as licensed, prescribed, and controlled by the CO-2.

ORG Articles of incorporation also contains the following:

Article XVIII — Multiple Listing

The CO-3® shall maintain for the use of it Members a Multiple Listing Service which shall be a lawful corporation of the state of STATE, all the stock of which shall be owned by the CO-3®.

Section 2. Purpose. A Multiple Listing Service is a means by which authorized Participants make blanket unilateral offers of compensation to other Participants (acting as subagents, buyer agents, or in other agency or nonagency capacities defined by law); by which disseminated to enable authorized Participants to prepare appraisals, analyses, and other valuations of real property for bona fide clients and customers; by which Participants engaging in real estate appraisal contribute to common databases; and is a facility for the orderly correlation and dissemination of listing information so participants may better serve their clients and the public. Entitlement to compensation is determined by the cooperating broker's performance as a procuring cause of the sale (or lease). Amended 11/XX)

The activity pertinent to this discussion is the level of activities devoted to the multiple listing services (hereinafter, MLS) provided to the members of the Association.

There are six classes of members. Only licensed real estate agents, brokers and realtors can list property for sale on the MLS and see sold information within the database.

ORG maintains a committee on its board that is dedicated to the MLS program. The organization generated more income from the MLS than from it membership dues.

A prior examination of the ORG books and records by the Internal Revenue Service Tax Exempt & Government Entities: Exempt Organization Division in calendar year 20XX resulted in the organization being issued an Advisory Letter. The advisory issued cautioned the organization on the impact of its exempt status with regard to the level of non-exempt activities.

The organization prepared and filed Form 990-T for the tax year ending December 31, 20XX to report all unrelated business income.

The 20XX Form 990-EZ states that the organization's primary purpose is "ORG".

Information from the "EO" 20XX Form 990-EZ:

LAW

In Section 501(c)(6) of the Code, it defines business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

In Section 1.501(c)(6)-1 of the regulations, it provides that a business league is an association of persons having some common business interest the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization, whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self sustaining, is not a business league.

Section 1.513-1(b) of the regulations provides that the term "trade or business" for purposes of section 513 of the Code has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or services.

In section 1.513-1(d)(2) of the regulations, in defining unrelated trade or business provides that where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business.

In Rev. Rul. 56-65, it states that a local organization whose principle activity consists of furnishing particular information and specialized individual services to its individual members through publications and other means is performing particular services for individual persons. Such an EO is therefore not entitled to exemption under § 501(c)(6).

Rev. Rul. 68-264 defines a particular service for the purposes of section 501(c)(6) of the Code as an activity that serves as a convenience or economy to the members of the organization in the operation of their own businesses.

In Rev. Rul. 59-234 it states, the purpose of a multiple listing service is:

(a) to assist members of the board in rendering better services to the public by creating a broader and more active market for real estate;

(b) to stimulate and facilitate the transaction of business between members of the board through cooperation and exchange of exclusive listings;

(c) to provide a medium through which real estate may be merchandised more efficiently and expeditiously to the advantage of both buyer and seller and

(d) to encourage realtors to uphold high standards of business practice and to further educate them in adhering to the principles of Realtor's code of Ethics.

Rev Rul. 73-411 states, Trade associations or business leagues under section 501(c)(6) are similar to chambers of commerce, except that they serve only the common business interests of the members of a single line of business or of the members of closely related lines of business within a single industry.

Rev. Rul. 81-175 defines the term "particular services" for the purposes of section 501(c)(6) of the Code, as acting in a manner which provides an economy or a convenience for members in the operation of their own businesses.

In Retailers Credit Ass'n of Alameda County v. Commissioner of Internal Revenue 90 F.2d 47, C.A.9 1937. May 10, 1937, Exemption from petitioner from taxation must be denied on the ground that the purpose to engage in a business of a kind ordinarily carried on for profit is not incidental to a main or principal purpose, but is in fact a principal or main purpose.

In Southern Hardwood Traffic Ass'n v. U.S. 283 F.Supp. 1013 D.C.Tenn. 1968. March 13, 1968, the District Court, Bailey Brown, Chief Judge, held that unincorporated association engaged in regular business of providing, as one of its two main purposes and as substantial part of its total activity, majority of its members with individual services of kind ordinarily carried on for profit was not a 'business league' entitled to tax exempt status.

In Associated Master Barbers and Beauticians of America, Inc., 69 T.C. 53 (1977), the court held that an organization did not qualify as a tax-exempt business league because it both engaged in a regular business of a kind ordinarily carried on for profit and its activities were directed to the performance of particular services for individual members.

In Carolinas Farm & Power Equipment Dealers Ass'n, Inc. v. U.S. 699 F.2d 167, C.A.N.C., 1983. January 24, 1983, we must conclude that the Association's insurance service primarily advances the interests of participating members, and so it is not related to its charitable purpose.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number of exempt purposes. Better Bus. Bureau v. United States, 326 U. S. 279. 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v. Commissioner, 92 T.C. 1056, 1065 (19XX).

TAXPAYER'S POSITION

ORG agrees that it is not entitled to exemption under section 501(c)(6) because its primary purpose is the daily operations of the Multiple Listing Services (MLS) in which * * *% of the organization’s activities are devoted too.

GOVERNMENT’S POSITION

ORG provides professional development, research, and exchange of information among its members.

ORG’s book and records demonstrates the Multiple Listing Services primarily advances the interests of participating members, and so it is not related to its exempt purpose.

In order to qualify for exemption as a business league under Reg. § 1.501(c)(6)-1, an exempt organization must meet all of 6 tests:

(1) Persons having a common business interest

(2) Whose purpose is to promote the common business interest

(3) Not organized for profit

(4) That does not engage in a business ordinarily conducted for profit

(5) Whose activities are directed at improvement of one or more lines of business as distinguished from the performance of particular services

(6) Of the same general class as a chamber of commerce or a board of trade

A review of the ORG books and records indicates the Association fail test 1, 4 and 5 under Reg. § 1.501(c)(6)-1.

ORG fails test (1) — Persons having a common business interest. Rev. Rul. 81-175 defines the term “particular services” for the purposes of section 501(c)(6) of the Code, as acting in a manner which provides an economy or a convenience for members in the operation of their own businesses. A review of the ORG books and record indicates its primary activity is operating a multiple listing service for its members, which is not a common business interest, but rather providing a convenience to members in the operation of their own businesses and thus performing particular services for members.

ORG fails test (4) — Not being engaged in a business ordinarily carried on for profit. The MLS is a database of homes for sale. Real Estate Agents use the MLS to find homes for buyers that they represent. Listing a home on the MLS notifies all local brokers that the home is for sale. If an agent other than the listing agent sees a listing and brings a buyer, the listing agent must pay the buyer’s agent a commission if the buyer accepts the offer. The commission is negotiated on an agent by agent basis. Services to members are an activity ordinarily conducted for profit. These services are of the same character of services provided by Real Estate firms. The membership dues may be construed as being of the same character as that of a professional charging a retainer fee against which future services are applied.

ORG fails test (5) Whose activities are directed at improvement of one or more lines of business as distinguished from the performance of particular services Rev. Rul. 81-175 defines the term “particular services” for the purposes of section 501(c)(6) of the Code, as acting in a manner which provides an economy or a convenience for members in the operation of their own businesses. ORG’s primary activity is providing member with a medium through which real estate may be merchandised more efficiently and expeditiously to the advantage of both buyer and seller. Operation of the MLS provides a convenience to members in the operation of their own businesses and thus is performing particular services for the members.

In Better Bus. Bureau v. United States, 326 U. S. 279. 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945) and Am. Campaign Acad. v. Commissioner, 92 T.C. 1056, 1065 (19XX), it is stated that the presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number of exempt purposes. In Associated Master Barbers and Beauticians of America, Inc., 69 T.C. 53 (1977), the court held that an organization did not qualify as a tax-exempt business league because it both engaged in a regular business of a kind ordinarily carried on for profit and its activities were directed to the performance of particular services for individual members.

The primary activity of providing a multiple listing services to members is an activity ordinarily carried on for profit and therefore is nonexempt. The EO's primary activity is one involving providing particular services to individual members in providing member with a medium through which real estate may be merchandised more efficiently and expeditiously to the advantage of both buyer and seller which conflicts with the EO's tax-exempt status.

Rev. Rul. 56-65 states that a local organization whose principle activity consists of furnishing particular information and specialized individual services to its individual members through publications and other means is performing particular services for individual persons. Such an EO is therefore not entitled to exemption under section 501(c)(6). The subject EO's principle activity consists of furnishing particular and specialized individual services to its individual members through response to individual requests for human resource information specific to the individual member; the EO is therefore performing particular services for individual persons.

This organization fails three of the six tests under section 1.501(c)(6)-1 and as a result, is not entitled to remain exempt. The organization engages in primary nonexempt activities involving activities normally conducted for profit and performs particular services for members.

CONCLUSION

Based on the foregoing reasons, ORG does not qualify for exemption under section 501(c)(6) and its tax exempt status should be revoked effective January 1, 20XX.

IRS LTR: Homeowners Association Loses Exemption.

Citations: LTR 201329022

The IRS revoked the tax-exempt status of a homeowners association because its communal property isn't made available to the general public, but the IRS determined that the organization may make an election to be treated as a taxable homeowners association under section 528.

Person to Contact/ID Number: * * *

Contact Numbers:

Phone: * * *

Fax: * * *

501-04.00

Date: July 7, 2012

Taxpayer Identification Number: * * *

Form: * * *

Tax Period(s) Ended: * * *

LEGEND:

ORG = Organization name

XX = Date

Address = address

Dear * * *,

In a determination letter dated June, 19XX, you were held to be exempt from Federal income tax under section 501(c)(4) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(4) of the Code. Accordingly, your exemption from Federal income tax is revoked effective May 1, 20XX. This is a final letter with regard to your exempt status.

We previously provided you a report of examination explaining why we believe revocation of your exempt status was necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On [date] you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(4) of the Code.

You are required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

* * *

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing

Director, EO Examinations

* * * * *

Person to Contact/ID Number: * * *

Contact Numbers:

Telephone: * * *

Fax: * * *

Date: November 15, 2011

Taxpayer Identification Number: * * *

Form: * * *

Tax Period(s) Ended: * * *

LEGEND:

ORG = * * *

ADDRESS = * * *

Dear * * *,

We have enclosed a copy of the preliminary findings of our examination, explaining why we believe revocation of your exempt status under section 501(a) of the Internal Revenue Code (IRC) is necessary. Your organization may instead make an election to be treated as a taxable homeowner's association under IRC § 528.

If you accept our findings, please sign and return the enclosed Form 6018-A, Consent to Proposed Action, to the individual listed above. We will then send you a final letter revoking your exempt status. Please also file Federal income tax return Form 1120-H for the tax year ending April 30, 20XX, with the individual listed above.

If you disagree with our findings, please provide in writing any additional information you believe may alter the findings. Your reply should include a statement of the facts, the applicable law, and arguments that support your position. Please also include any corrections to the facts that have been stated, if in dispute.

Upon receipt of your response, we will evaluate any additional information you have provided prior to issuing any final report of examination.

Please respond within 30 days from the date of this letter.

Thank you for your cooperation.

Sincerely,

Anne Jewell

Revenue Agent

Enclosure:

Form 886-A, Explanation of Items

Form 6018-A, Consent to Proposed Action

* * * * *

LEGEND:

ORG = Organization name

XX = Date

EIN = ein

State = state

County = county

POA = poa

Treasurer = treasurer

RA-1 = 1st RA

CO-1, CO-2, CO-3, CO-4 & CO-5 = 1ST, 2ND,

3RD, 4TH & 5TH COMPANIES

ISSUES

1. Does ORG (ORG) qualify as a tax exempt homeowners association under § 501(c)(4) of the Internal Revenue Code (IRC)?

2. Does ORG qualify as a for-profit homeowners association under IRC § 528?

3. What are the exempt and non-exempt function income and expenses as defined in IRC § 528?

4. If so, what are the tax implications of the revocation and reclassification of the organization under IRC § 528?

An alternative position based on if the organization continued to qualify as an organization exempt under IRC § 501(c)(4) is included at the end of the primary position.

FACTS

ORG, * * * (ORG) is currently classified as a tax-exempt organization under § 501(c)(4) of the Internal Revenue Code (IRC). Per the Articles of Incorporation ("Articles"), the organization was originally organized in State on October 3, 19XX. These Articles were later amended on October 3, 20XX to expand the stated purpose. The organization was created to "acquire, maintain and conduct building and property and activities for a community life and center at the ORG as above described, to engage in educational and recreational facilities for members; to acquire other property and construct buildings for such proposes; to foster and promote good citizenship among is members; to promote and foster educational, recreational; physical and social activities of its members and their friends; to engage in such activities as shall raise the standards of civic morality and community welfare.” The 19XX Articles were expanded with the following language during the 20XX revision, “ORG’s primary purpose is to own, repair, maintain, and improve the roads within the ORG, and to collect and disperse road maintenance fees related to the private roads within the plats of the Assessor’s Plat of ORG in Volume 16 of Plats, records of County, State, or in Volumes 17, 18, and 19 of said records, or any additions thereto as platted.”

The bylaws were also amended at this time. The current bylaws provide the following definition of a member:

“. . . any Property Owner who chooses to pay an annual membership fee established by the Board of Directors to ORG for the rights to enjoy ORG Member Properties and the secondary purposes of ORG as outlined in the Amended Articles of Incorporation.”

On October 22, 20XX, a Form 2848, Power of Attorney and Declaration of Representative, was received by the Internal Revenue Service allowing POA authority to discuss income tax for the tax periods ending April 30, 20XX through April 30, 20XX.

On September 20, 20XX, a Letter 3611 and Publication 1, Your Rights as a Taxpayer, and a Form 4564, Information Document Request (‘IDR”), were issued to notify the organization of an examination of the Form 990, Return of Organization Exempt from Income Tax, for the year ended April 30, 20XX. The initial appointment was held November 5, 20XX, at POA’s office. Treasurer, the Treasurer, and POA, POA, were present on behalf of the organization. The following is a summary of the relevant points of the initial interview (questions asked in bold and response in italics).

To get a full understanding of your organization, please describe the history of your organization and all of its activities.

The organization was started in 19XX as a group of owners who purchased property from the RA-1. The original plan had 1100 lots which were completely undeveloped and were mostly for tents. The mission is to manage and maintain the roads of ORG. The roads were later deeded to ORG. The organization has changed several times over the years based on who has had power over the board of directors. The organization has been involved in 2 major law suits. The first in 20XX was based around additional assessments made to replace a bridge, the organization won the right to make assessments against the owners based on a formula but the formula was not specified. According to the organization, this suit also stated that the organization was not a homeowners association under state law. The formula determined was based on how many of the main and side roads were used when accessing the properties. The second law suit was a class action suit against the owners of the organization who were not paying assessments. This suit validated the formula used before with minor changes to make it more fair. The new formula was * * *% the old formula and * * *% the assessed value of the property. The suit also allowed the organization to place liens or even foreclose on properties. The organization currently has 95 owners in collections. This case also allowed them to collect for administrative and legal costs.

The organization had a road budget of $$* * * and an Admin budget of $* * * ~ $* * * (used for bookkeeping and lawyers as the organization has no employees). The organization is also in the process of selling some of their properties (some gained through foreclosure and some were road accesses). The properties owned by the organization include two beach access points and a stretch of river beach.

What are the rules for non-owners being on the property?

The road is not open to the public except in limited ways. The CO-1 road to the first arch is public access and the organization has an easement across the land from the first arch to the second arch (~1.5 miles). ORG owns the roads while the CO-1 has an easement. Per the CO-1, the only people who should be on the roads after the first gate are owners or those on official CO-1 business. The remainder of the road is marked as being for property owners and guests only. There are signs on both arches which state that the road is private.

The organization requires stickers to be present on cars that enter the property. If the sticker is not present on the car, the organization will place a note on the car. When asked, the treasurer stated that usually if a person is on the property, they are instructed to carry out their business, leave the premises and that they are not to return.

Does the organization have a gate or security guard shack?

The organization does have a guard shack but it has not been used in years.

How commonly does the organization receive income from logging?

This happens once every 100 years or so and was not for the sale of lumber but instead was compensation for use of the roads. The organization was paid $$.00. The lumber company was required to pay repair costs for any damage done to the roads. Per the treasurer, the money was used to pay for flood damage and the class action lawsuit.

For what reason was the organization property logged?

The logging was occurring on the land on the other side of the property and the logging company had an easement across the organization in order to reach their property.

What access is given to the general public to view the waterfalls and the river?

The public are not given access to view the waterfalls and river. The waterfalls are located beyond the area with the CO-1 easement.

What benefit do you provide to the general public?

No benefit is provided to the public.

What are the requirements for being a property owner?

They must own property within the organization’s serviced area.

What classes of members or property owners are there and are there any differences in voting rights?

There are no classes of property owners and in order to vote you must be in good standing (have paid all assessments).

What are the dues & initiation fees for the various classes of members?

Assessments are between $$* * * and $$* * * a year based on the formula.

Does the organization own, lease or sublease any real property? If so, is the property encumbered by debt?

The organization owns roads and other properties. None are encumbered by debt.

Per the transcript of the class action law suit posted on the organization's website, the organization is not primarily a membership based organization. The determination was made that the organization may solicit voluntary membership and dues for all purposes besides the maintenance of the roads.

The law suit establishes the validity of the agreement between ORG and the CO-1. This agreement establishes a basis for dues assessments to the ORG members to maintain the .6 of a mile that is owned by the CO-1.

The law suit finds that the administrative costs of the organization, including legal fees from this lawsuit, may be assessed against the owners.

The Class Action finds that the correct assessment formula would be * * *% of the implied easement formula (IE) and * * *% the assessed value of the property. The determination of commercial use of the property is also important as commercial activity increases traffic on the roads. The determination was made that a surcharge of $* * * per lot may be assessed for commercial use.

The minutes for the board meeting held March 7, 20XX, state that there was an issue with guests being on the property and being told that they were not allowed to have access to the property. The organization requires that owners display a sticker on their car to show that they are allowed to park on the property. Guests would receive a hanging tag. These plans were finalized January 9, 20XX with each owner receiving two guest tags with the option to purchase more for $* * * a pair. The minutes for June 6, 20XX state that a sign should be posted at CO-2 to notify non-residents that only residents and their guests may park on CO-3. Money was allocated for this activity.

During the tour of the facility, several posted signs were observed. The signs stated that the roads are private roads for owners only. Signs were observed on both the first and second arches.

The following are the income and expenses as reported by the organization.

Income Statement

Per further discussion, it was noted that the logging company owned property within the organization's boundaries. The logging company paid a total of $$* * * as a "special assessment" for the use of the roads by the logging trucks. The logged area was located behind the land owned by the organization. The logging activity was in process from October 20XX through April 20XX, a total of 26 weeks.

Per the ORG response to an IDR dated January 4, 20XX, the organization noted two expenses which could be directly related to the existence of logging trucks on the roads. These expenses as shown below are for lumber and repairs on a bridge within the organization's boundaries. The expenses were incurred in the next fiscal year, ten months after the end of the logging activity.

Per an ORG IDR response, there are a total of 405 property owners in the organization. Of these, 160 are permanent residents who are likely to drive on the roads an average of twice a day, once as they leave and once when they return.

The remaining 245 property owners are non-residents and more likely to use the roads on a more intermittent basis. On average, they may drive the roads twice per time in residence. Per the ORG IDR response, it is likely that the non-residents used the facility an average of 7 times during the six months that the logging company was using the roads.

Per the ORG IDR response, “A large logging truck does much more damage to a road than a passenger car or pickup truck. For purposes of this analysis, it is assumed that a logging truck does twice as much damage as a passenger car or pickup truck.”

ORG spent a total of $$* * * on road maintenance during the year ended April 30, 20XX.

LAW

IRC § 501(c)(4)

IRC § 501(c)(4)(A) holds that civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

It also requires that no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Revenue Ruling 74-99, 1974-1 C.B. 131, modifies Rev. Rul. 72-102, to make clear that a homeowners’ association, oft the kind described in Rev. Rul. 72-102 must, in addition to otherwise qualifying for exemption under section 501(c)(4) of the Code, satisfy the following requirements: (1) It must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof; (2) It must not conduct activities directed to the exterior maintenance of private residences; and (3) It owns and maintains only common areas or facilities such as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public and is not restricted to members of the homeowners’ association.

Flat Top Lake Ass’n, Inc v. US holds that an organization will not qualify for tax exempt status under IRC § 501(c)(4) if it restricts its facility and activities only to members. It sites Rev Rul 74-99 which states that a homeowner’s association must serve a “community” which bears a reasonably, recognizable relationship to an area ordinarily identified as a governmental subdivision or unit. Second it must not conduct activities directed to the exterior maintenance of any private residence, Third common areas or facilities that the homeowners’ association owns and maintains must be for the use and enjoyment of the general public.

IRC § 528

IRC § 528(a) holds that a homeowners association (as defined in subsection (c)) shall be subject to taxation under this subtitle only to the extent provided in this section. A homeowners association shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes. A tax is imposed for each taxable year on the homeowners’ association taxable income of every homeowners association. Such tax shall be equal to 30 percent of the homeowners’ association taxable income.

IRC § 528(c) defines a homeowners association as an organization which is a condominium management association, a residential real estate management association, or a timeshare association if such organization is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property, 60 percent or more of the gross income of such organization for the taxable year consists solely of amounts received as membership dues, fees, or assessment's from owners of residences or residential lots in the case of a residential real estate management association, or 90 percent or more of the expenditures of the organization for the taxable year are expenditures for the acquisition, construction, management, maintenance, and care of association property and, in the case of a timeshare association, for activities provided to or on behalf of members of the association, no part of the net earnings of such organization inures (other than by acquiring, constructing, or providing management, maintenance, and care of association property, and other than by a rebate of excess membership dues, fees, or assessments) to the benefit of any private shareholder or individual, and such organization elects (at such time and in such manner as the Secretary by regulations prescribes) to have this section apply for the taxable year.

IRC § 528(c)(3) defines the term "residential real estate management association" as any organization meeting the requirements of subparagraph (A) of paragraph (1) with respect to a subdivision, development, or similar area substantially all the lots or buildings of which may only be used by individuals for residences.

IRC § 528(c)(5) defines "association property" as property held by the organization, property commonly held by the members of the organization, property within the organization privately held by the members of the organization, and property owned by a governmental unit and used for the benefit of residents of such unit.

IRC § 528(d) For purposes of this section, defines homeowners association taxable income as an amount equal to the excess (if any) of the gross income for the taxable year (excluding any exempt function income), over the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income). The section also allows for the following modifications, there shall be allowed a specific deduction of $100, no net operating loss deduction shall be allowed under Link section 172, and no deduction shall be allowed under part VIII of subchapter B (relating to special deductions for corporations).

IRC § 528(d)(3) defines "exempt function income" as any amount received as membership dues, fees, or assessments from owners of real property in the case of a residential real estate management association.

Federal Tax Regulations (Regulations) § 1.528-1., Homeowners associations

(c) Residential real estate management association. — Residential real estate management associations are normally composed of owners of single-family residential units located in a subdivision, development, or similar area. However, they may also include as members owners of multiple-family dwelling units located in such area. They are commonly formed to administer and enforce covenants relating to the architecture and appearance of the real estate development as well as to perform certain maintenance duties relating to common areas.

TAXPAYER'S POSITION

The taxpayer's position is being solicited at this time.

GOVERNMENT'S POSITION

Issue #1

Does ORG (ORG) qualify as a tax exempt homeowners association under § 501(c)(4) of the IRC?

ORG does not qualify as a tax exempt homeowners association. Per the findings of Revenue Ruling 74-99 and Flat Top Lake Ass'n Inc v. U.S., there are three requirements for a homeowners association to be considered tax exempt under IRC § 501(c)(4). One, the organization must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof. Two, it must not conduct activities directed to the exterior maintenance of private residences. Finally, it must own and maintain only common areas or facilities such as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public and is not restricted to members of the homeowners' association.

The organization satisfies the first and second requirements for exemption but does not satisfy the third requirement The organization, as stated during the initial interview and seen during the tour of the road, does not allow members of the general public access to their road or the common areas maintained by the organization. As noted in the facts above, ORG will ask persons who do not have a parking decal or hanging tag not enter their property again. The organization also posted signs in several locations along the road which state that only members and their guests are allowed access to the road. As such, the communal property of ORG is not made available to the general public and the organization can not qualify under IRC § 501(c)(4).

Issue #2

Does ORG qualify as a for-profit homeowners association under IRC § 528?

Per their bylaws, ORG is organized as a for-profit homeowners association under IRC § 528, as a residential real-estate management association.

IRC § 528 defines a homeowners association as an organization which is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property. A residential real-estate management association is any organization meeting the requirements of a subdivision, development, or similar area substantially all the lots or buildings of which may only be used by individuals for residences.

Given the conclusion reached in Issue #1, ORG is operated to manage and maintain the roads of CO-3. Per the current articles of incorporation, the organizations primary purpose "is to own, repair, maintain, and improve the roads within the ORG, and to collect and disperse road maintenance fees related to the private roads within the plats of the Assessor's Plat of ORG in Volume 16 of Plats, records of County, State, or in Volumes 17, 18, and 19 of said records, or any additions thereto as platted." This furthers the argument that the organization is organized in such a way as to qualify for exemption under IRC § 528.

Issue #3

What are the exempt and non-exempt function income and expenses as defined in IRC § 528?

Per IRC § 528(d), the taxable income of a homeowners association is the gross income for the taxable year less any exempt function income and any deductions that are directly connected with the production of the gross income. IRC § 528(d)(3) further defines "exempt function income" as any amount received as membership dues, fees, or assessments from owners of real property in the case of a residential real estate management association.

As noted in the initial interview and the books and records of the organization, the organization receives the majority of their money from assessments made for road and administrative fees. These amounts would be considered “exempt function income” to an IRC § 528 organization. The organization’s purpose is to conduct activities which support the community as a whole rather than provide a specific benefit. To support this purpose the organization may impose annual or special assessments for road maintenance.

As noted in the initial interview, the organization also received $$* * * from a logging company for use of the road. This income was classified as a “special assessment.” The fundamental difference between a special assessment for road maintenance and the “special assessment” made against the logging company is in the purpose for which it is assessed. A valid special assessment would be assessed against the entire property owner community or a distinct portion of such community in order to pay for an unusual repair, such as the replacement of a culvert or to fix the damage from a flood. In comparison, the “special assessment” made against the logging company was not made in response to the need for an unusual repair, nor was it an assessment that was paid by any distinct portion of the community. The assessment was instead a payment for use of the road by an outside party to alleviate some of the cost of maintaining the road as well as paying for any additional costs associated with increased traffic. As such, this income would not be considered “exempt function income.”

The total exempt function income is $* * * in the year ended April 30, 20XX and $* * * in the year ended April 30, 20XX. The non-exempt function income includes all investment and other income that is not related to the exempt purpose of an IRC § 528 organization. This is income is as follows.

Non-Exempt Function Income

The Non-exempt function expenses are those expenses which are directly connected to the production of the non-exempt income. In this instance, while the organization may not deduct any portion of expenses from the interest income as it has not directly related expenses, it may deduct any expenses which are directly related to the income from the logging company. These expenditures have been allocated using the method below:

Per IRC § 528(d), the organization may deduct only those expenses which are directly related to the production of the non-exempt function income.

The organization identified the following transactions as directly related to damage caused by the logging trucks.

While these transactions are directly related to the unrelated business activity, they may not be deducted in the year ended April 30, 20XX as they were not incurred until the following year. However, these costs are fully deductable in the following year as valid road maintenance expenses.

The organization may deduct an allocated portion of the years total road maintenance expenses to the unrelated business activity. Using a slightly modified version of the allocation method provided by ORG, the road maintenance costs may be allocated using the estimated road use by logging trucks shown below.

Estimated Road use by Logging Trucks

The estimated number of trips made by logging trucks was calculated using the following calculation method provided by ORG.

Estimated number of Trips by Logging Trucks

The explanation for the damage severity factor per ORG is as follows, “A large logging truck does much more damage to a road than a passenger car or pickup truck. For purposes of this analysis, it is assumed that a logging truck does twice as much damage as a passenger car or pickup truck.” The organization used a damage severity factor of 3 to represent this increased damage.

The estimated number of trips by property owners was calculated using the following calculation method provided by ORG.

Estimated number of Trips by Property Owners

In addition to the allocation factor shown above, the agent also allocated the portion of road maintenance expenses that would have been incurred during the logging assuming that the maintenance expense was incurred evenly over the course of the year. This calculation has been shown below.

Allocated Total Maintenance Expenses

This maintenance cost figure is then multiplied by the estimated use by logging trucks to calculation the total maintenance expense allocable to the logging activity as shown below.

Given the above calculation the organization may deduct a total of $* * * from the income received from the logging trucks using the roads.

As such the total net non-exempt function income is shown in the following table.

Net Non-Exempt Function Income

Issue #4

If so, what are the tax implications of the revocation and reclassification of the organization under IRC § 528?

Given the conclusions reached in Issues #1 through 3, the organization can possibly qualify as an organization exempt under IRC § 528. However, this Code section requires that in any given year the organization have either 60% of the total income of the organization consist of membership dues, fees, or assessments from owners of residences or residential lots, or 90% or more of the expenditures of the organization are for the acquisition, construction, management, and care of association property.

ORG, given the income statement shown above, has the following percentages of income from membership dues, fees and assessments.

Percentage of Exempt Function Income

As noted in the figures above, the organization meets the 60% exempt function income test in only the year ended April 30, 20XX. The year ended April 30, 20XX, did not qualify due to the non-exempt function income received from the logging company.

ORG, given the income statement above, has the following percentages of expenditures made for the acquisition, construction, management, maintenance, and care of association property. This figure includes all expenditures made including those made as a result of the logging trucks using the road.

Percentage of Exempt Function Expenditures

The organization also does not qualify for this Code section under the expenditure test as in nether year do they meet the 90% requirement. As such, the organization may not make the election to be treated as a homeowners association under IRC § 528 for the year ended April 30, 20XX but may for the year ended April 30, 20XX.

IRC § 528(d) defines a homeowners association taxable income as the amount equal to the excess (if any) of the gross income, less the exempt function income, for the taxable year, less any deductions which are directly connected with the production of those non-exempt activities. Exempt function income is defined as any membership dues, fees, or assessments from owners of real property.

The calculation of taxable income for the year ended April 31, 20XX has been shown in the first table below and includes investment income and any additional income that is received by the organization in a given year.

Form 1120-H

U.S. Income Tax Return for Homeowners Associations

For Year Ended April 31, 20XX

The second table calculates the taxable income for the year ended April 31, 20XX as that year does not qualify for the IRC § 528 election. This has been calculated using the corporate tax rate.

Form 1120

U.S. Corporation Income Tax Return

For Year Ended April 31, 20XX

CONCLUSION

As noted in the above analysis, the organization does not qualify for exemption under § 501(c)(4) of the IRC but does qualify under IRC § 528 as a taxable homeowners association for the year ended April 30, 20XX. As such, the organization may make an election in the year ended April 30, 20XX and all subsequent years when filing the Form 1120, to instead file the Form 1120-H if they continue to qualify. In the year ended April 30, 20XX, the organization would be assessed $* * * in income tax.

In the year ended April 30, 20XX, the organization does not qualify for exemption under either IRC § 501(c)(4) or § 528. As such, they must file Form 1120 for the year in question. The tax to be assessed in the prior year would be $* * *.

Treatment under IRC § 528 is an election made every year upon the filing of the tax return. An organization may qualify for exemption in one year but not the next due to unusual income. As such, the total tax to be assessed against the organization is $* * *.

ALTERNATIVE POSITION

In the alternative, if the organization continues to qualify for exemption under IRC § 501(c)(4), should the income from logging truck using the road received by the organization in the year ended April 30, 20XX be considered unrelated businesses income under IRC § 511.

ISSUES

1. Is the revenue received from the logging company related to the exempt purpose of the

organization?

2. If not, what expenses may be allocated to the unrelated business income?

3. What is the total unrelated business income tax due?

FACTS

On September 20, 20XX, a Letter 3611 and Publication 1, Your Rights as a Taxpayer; and a Form 4564, Information Document Request (IDR) were issued to notify the organization of an examination of the Form 990, Return of Organization Exempt From Income Tax, for the year ended April 31, 20XX. The initial appointment was held November 5, 20XX at the Power of Attorney's Office. Treasurer, the Treasurer, and POA, POA, were present on behalf of the organization. The following is a summary of the relevant points of the initial interview in relation to the income from the Logging activity.

How commonly does the organization receive income from logging?

This happens once every 100 years or so and was not for the sale of lumber but instead was compensation for use of the roads. The organization was paid $* * * as well as the lumber company fixing any damage done to the roads. Per the treasurer, the money was used to pay for flood damage and the class action lawsuit.

For what reason was the organization property logged?

The logging was happening on the land on the other side of the property and the logging company had an easement across the organization in order to reach their property.

Per further discussion, it was noted that the logging company owned property within the organization and paid a total of $$* * * as a "special assessment" for the use of the roads by the logging trucks. The area being logged is behind the area owned by the organization. The logging activity was in process from October 20XX through April 20XX, a total of 26 weeks.

Per the Information Document Request (IDR) response dated January 4, 20XX, the organization noted two expenses which could be directly related to the existence of logging trucks on the roads. These expenses as shown below are for lumber and repairs on a bridge within the organization. The expenses were incurred in the next fiscal year, ten months after the end of the logging activity.

Per IDR response, there are a total of 405 property owners in the organization. Of these 160 are permanent residents who are likely to drive the roads an average of twice a day, once as they leave and once when they return.

The remaining 245 property owners are non residents and more likely to use the roads on a more intermittent basis. On average, they may drive the roads twice per time in residence. Per the ORG, it is likely that the non-residents used the facility an average of 7 times during the six months that the logging company was using the roads.

Per ORG, "A large logging truck does much more damage to a road than a passenger car or pickup truck. For purposes of this analysis, it is assumed that a logging truck does twice as much damage as a passenger car or pickup truck."

ORG spent a total of $$* * * on road maintenance during the year ended April 30, 20XX. ORG did not file a Form 990-T for the period in question.

LAW

IRC § 512(a)(1) provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the deductions which are directly connected with the carrying on of such trade or business.

Treasury Regulations (Regulations) § 1.512(a)-1(a) defines "unrelated business taxable income" as the gross income derived from any unrelated trade or business regularly carried on, less those deductions allowed by chapter 1 of the Code which are directly connected with the carrying on of such trade or business, subject to certain modifications referred to in § 1.512(b)-1. To be deductible in computing unrelated business taxable income, therefore, expenses, depreciation, and similar items not only must qualify as deductions allowed by chapter 1 of the Code, but also must be directly connected with the carrying on of unrelated trade or business. Except as provided in paragraph (d)(2) of this section, to be "directly connected with" the conduct of unrelated business for purposes of section 512, an item of deduction must have proximate and primary relationship to the carrying on of that business. In the case of an organization which derives gross income from the regular conduct of two or more unrelated business activities, unrelated business taxable income is the aggregate of gross income from all such unrelated business activities less the aggregate of the deductions allowed with respect to all such unrelated business activities. For the treatment of amounts of income or loss of common trust funds, see § 1.584-2(c)(3).

Regulations § 1.512(a)-1(b) defines expenses, depreciation, and other similar items that are attributable solely to the conduct of unrelated business activities as those which are proximately and primarily related to that business activity. Such expenses qualify for deduction to the extent that they meet the requirements of IRC § 162, IRC § 167, or other relevant section of the Internal Revenue Code. Thus, the wages of personnel employed full-time in carrying on unrelated business activates are directly connected with the conduct of said activity and are deductable in computing unrelated business taxable income if they otherwise qualify under the requirements of IRC § 162.

Regulations § 1.512(a)-1(c) provides that when facilities or personnel are used for both exempt activities and the conduct of an unrelated trade or business, expenses, depreciation, and similar items shall be allocated between the two activities on a reasonable basis. The portion of any such item so allocated to the unrelated trade or business is proximately and primarily related to that business activity and shall be allowable as a deduction in computing unrelated business taxable income to the extent provided by IRC § 162, IRC § 167, or other relevant Code section.

TAXPAYER'S POSITION

The taxpayer's position is unknown at this time.

GOVERNMENT'S POSITION

ISSUE # 1

Is the revenue received from the logging company related to the exempt purpose of the organization?

The income received from the logging company is not related to the exempt purpose of the organization.

Per the Bylaws of the organization, the organization is organized "acquire, maintain and conduct building and property and activities for a community life and center at the ORG as above described, to engage in educational and recreational facilities for members; to acquire other property and construct buildings fur such proposes; to foster and promote good citizenship among is members; to promote and foster educational, recreational; physical and social activities of its members and their friends; to engage in such activities as shall fraise the standards of civic morality and community welfare.” As such, the organizations purpose is to conduct activities which support the community as a whole rather than provide a specific benefit. To support this purpose the organization may impose annual or special assessments for road maintenance.

The fundamental difference between a special assessment for road maintenance and the “special assessment” made against the logging company is in the purpose for which it is assessed. A valid special assessment would be assessed against the entire property owner community or a distinct portion of such community in order to pay for an unusual repair, such as the replacement of a culvert or to fix the damage from a flood. In comparison, the “special assessment” made against the logging company was not made in response to the need for an unusual repair, nor was it an assessment that was paid by any distinct portion of the community. The assessment was instead a payment for use of the road by an outside party to alleviate some of the cost of maintaining the road as well as paying for any additional costs associated with increased traffic.

As such, the $$* * * paid by the logging company was a payment for use rather than a valid assessment and is therefore unrelated to the exempt purpose of a IRC § 501(c)(4) homeowner’s organization.

ISSUE #2

If not, what expenses may be allocated to the unrelated business income?

Per IRC § 512(a)(1), the organization may deduct only those expenses which are directly related to the production of the unrelated business income.

The organization identified the following transactions as directly related to damage caused by the logging trucks.

While these transactions are directly related to the unrelated business activity, they may not bee deducted in the year ended April 30, 20XX as they were not incurred until the following year. However, these costs are fully deductable in the following year as valid road maintenance expenses.

The organization may take deduction of a portion of the years total road maintenance expenses as allocated to the unrelated business activity. Using a slightly modified version of the allocation method provided by ORG, the road maintenance costs may be allocated using the estimated road use by logging trucks shown below.

Estimated Road use by Logging Trucks

The estimated number of trips made by logging trucks was calculated using the following calculation method provided by ORG.

Estimated number of Trips by Logging Trucks

The explanation for the damage severity factor per ORG is as follows, “A large logging truck does much more damage to a road than a passenger car or pickup truck. For purposes of this analysis, it is assumed that a logging truck does twice as much damage as a passenger car or pickup truck.” The organization used a damage severity factor of 3 to represent this increased damage. The agent disagrees with the damage factor used by the organization as it would represent three times as much damage rather than twice as much damage. As such, the agent has used 2 as the damage factor.

The estimated number of trips by property owners was calculated using the following calculation method provided by ORG.

Estimated number of Trips by Property Owners

In addition to the allocation factor shown above, the agent also allocated the portion of road maintenance expenses that would have been incurred during the logging assuming that the maintenance expense was incurred evenly over the course of the year. This calculation has been shown below.

Allocated Total Maintenance Expenses

This maintenance cost figure is then multiplied by the estimated use by logging trucks to calculation the total maintenance expense allocable to the logging activity as shown below.

Given the above calculation the organization may deduct a total of $* * * from the income received from the logging trucks using the roads.

ISSUE # 3

What is the total unrelated business income tax due?

Per the calculations shown in Issue #1 and 2, the organization owes $* * * in unrelated business income tax. This figure has been calculated as follows: Unrelated business income tax is a * * *% tax on the unrelated income less any directly related expenses.

Allocation of Income and Expenses from the Logging Company

Unrelated Business Income Tax

CONCLUSION

ORG allowed a logging company to use their roads for a fee. As this transaction is not typical of organizations defined under IRC § 501(c)(4) it is considered to be unrelated to the exempt purpose of the organization and is therefore subject to Unrelated Business Income Tax In this case the total tax due was calculated at $* * * for the transaction in question.

IRS LTR: University's Tax-Exempt Status Is Revoked.

Citations: LTR 201329020

The IRS revoked the tax-exempt status of an online university, concluding that the university's net earnings routinely and continuously inured to its president, vice president, and secretary.

Person to Contact: * * *

Employee Identification Number: * * *

Employee Telephone Number:

(Phone): * * *

(Fax): * * *

501-03.00

Release Date: 7/19/2013

Date: January 7, 2013

Taxpayer Identification Number: * * *

LEGEND:

ORG = organization name

xx = Date

Address = address

Officer — 1-3 = 1st, 2nd & 3rd Officer

Dear * * *:

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code. Our favorable determination letter to you dated February 3, 20XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reason(s):

Organizations described in IRC 501(c)(3) and exempt under section 501(a) must be both organized and operated exclusively for exempt purposes. You must establish that you are operated exclusively for exempt purposes and that no part of your net earnings inures to the benefit of private shareholders or individuals.

Your earnings have inured to the benefit of three of your officers, Officer-1, Officer-2, and Officer-3. This inurement totaled $* * * during the years 20XX, 20XX, and 20XX. This is a substantial amount of inurement, and violates section 1.501(c)(3)-1(c)(2) of the Treasury Regs. Given the routine and continuous nature of the inurement, this warrants revocation of your 501(c)(3) status effective January 1, 20XX.

Contributions to your organization are no longer deductible under IRC § 170 after January 1, 20XX.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

* * *

You also have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

* * *

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Nanette M. Downing

Director, EO Examinations

* * * * *

Person to contact/ID number: * * *

Contact numbers: * * *

Manager's name/ID number: * * *

Manager's contact number: * * *

Response due date: * * *

Date: July 24, 2012

Taxpayer Identification Number: * * *

Form: * * *

Tax year(s) ended: * * *

LEGEND:

ORG = * * *

ADDRESS = * * *

Dear * * *:

WHY YOU ARE RECEIVING THIS LETTER

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

WHAT YOU NEED TO DO IF YOU AGREE

If you agree with our proposal, please sign the enclosed Form 6018, Consent to Proposed Action — Section 7428, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We'll issue a final revocation letter determining that you aren't an organization described in section 501(c)(3).

After we issue the final revocation letter, we'll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

IF WE DON'T HEAR FROM YOU

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

EFFECT OF REVOCATION STATUS

If you receive a final revocation letter, you'll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

WHAT YOU NEED TO DO IF YOU DISAGREE WITH THE PROPOSED REVOCATION

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, How to Appeal an IRS Decision on Tax-Exempt Status, and page six of the enclosed Publication 3498, The Examination Process. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

CONTACTING THE TAXPAYER ADVOCATE OFFICE IS A TAXPAYER RIGHT

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service

Office of the Taxpayer Advocate

* * *

FOR ADDITIONAL INFORMATION

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing

Director, EO Examinations

Enclosures:

Report of Examination

Form 6018

Publication 892

Publication 3498

* * * * *

LEGEND:

ORG = Organization name

XX = Date

Address = address

City = city

State = state

President = president

Vice-President = vice president

Secretary = secretary

CPA = CPA

Founder = founder

RA-1 = 1st RA

CO-1 through CO-11 = 1st through 11th COMPANIES

ISSUE

Should ORG'S 501(c)(3) status be revoked on the grounds that its net earnings inured to the benefit of its president, vice-president, and secretary?

FACTS

ORG, formerly known as CO-1 ("ORG"), is an online university. Its corporate office is located at Address, City, State. It offers degrees in * * * and * * *. Its enrollment was approximately 200 students during the years under examination. ORG also conducts live training seminars approximately 30 times throughout each school year. These seminars are held in locations throughout the United States and Canada.

During the years under examination, ORG's president and vice-president were President and Vice-President (husband and wife), respectively. ORG's board secretary was Secretary.

ORG filed with the IRS a Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, on May 13, 20XX. On February 3, 20XX, the IRS issued a ruling letter to ORG, recognizing it as a tax-exempt public charity under section 501(c)(3) of the Internal Revenue Code ("Code"), effective April 26, 20XX.

On April 28, 20XX, ORG filed a Plan of Conversion with the State of State to convert back to for-profit status as of June 1, 20XX. The State of State certified this conversion. According to a valuation prepared by CO-2 ORG's value was appraised to be zero. This was primarily due to ORG's outstanding debt of $$* * * to CO-3 ("CO-3"). President owns * * *% of CO-3's stock. At conversion, the debt was extinguished in exchange for ORG's stock. ORG formally changed its name from CO-1 to ORG on December 13, 20XX.

The examining IRS agent contacted ORG president President on December 8, 20XX and advised him of the audit of ORG's year 20XX Form 990. The agent mailed the audit letter to ORG on December 10, 20XX. The agent conducted the field audit at the City office of ORG's representative, CPA, CPA on January 10, 20XX. CPA was replaced as representative by CPA, CPA, on March 2, 20XX.

BACKGROUND OF ORG

ORG operated as a for-profit corporation from 19XX until 20XX. ORG was incorporated in City, State on December 13, 19XX. It was a correspondence school organized to train individuals in various self-improvement techniques developed by its founder, Founder. Founder is the father of President.

CO-3 was ORG's predecessor. It was incorporated November 12, 19XX as a for-profit State corporation. All of the rights, title and interest in programs, training, books, recordings and videos were held either by CO-3 or Founder, personally. Ownership of CO-3 passed from Founder to President in 20XX.

According to ORG's meeting minutes dated September 18, 20XX, ORG's board voted unanimously to remove Founder from his position as president of the board of ORG. President was voted to take the position as president.

Following Founder' termination, he demanded that ORG and CO-3 cease using his registered marks, name and likeness. ORG and CO-3, however, continued to use his marks, name and likeness in their print advertisements and on their web sites. As a result, President brought suit against ORG, CO-3, President, and Vice-President. Founder was granted a Motion for Temporary Restraining Order on March 6, 20XX.

Forms 990 and Payments to Officers

ORG's Forms 990 for the years under examination reported as follows:

Figure 1: Forms 990

Among the disbursements ORG made during the years under examination were the following:

Figure 2 — Payments 20XX

Figure 3 — Payments 20XX

Figure 4 — Payments 20XX

Secretary' City Apartment

The payments to CO-4, in 20XX and 20XX, were for ORG board secretary Secretary' apartment at Address in City, State. ORG did not report these payments as compensation to Secretary on its own Forms 990, or on Secretary' Forms W2.

The revenue agent asked ORG, in Information Document Request ("IDR") #3, issued March 16, 20XX, the following question regarding these payments:

Question: What was the reason for not including the value of the City apartment in the W2 of Secretary as a fringe benefit?

ORG's response to IDR #3, received May 16, 20XX, included the following answer to the above question:

Answer: We did not include the value of the City apartment in the W2 of Secretary due to an oversight. We would be issuing a 1099 for this.

On December 13, 20XX, Secretary sent the agent an email regarding the $$* * * in apartment payments in the year 20XX, which stated as follows:

Unfortunately, I was unable to locate the email correspondence via my old laptop as the PC was non-functional. I had hoped to find the email stating that I was accepting the position with the information included that housing was a condition of employment. As such, for now, I have paid the $$* * * to ORG and have attached evidence of this.

Attached to the email was a scanned check written by Secretary to ORG for $$* * *, and a scanned letter from ORG, signed by President, acknowledging receipt of the check.

On February 8, 20XX, Secretary sent the agent an email regarding the $$* * * in apartment payments in the year 20XX, which stated as follows:

ORG did not report the payment to me of the apartment I resided in as compensation. As I stated in my earlier correspondence with you, as well as, via telephone, provision of housing was offered by the university as part of my original offer of employment. I also indicated to you previously, that the correspondence which references this is unavailable.

There is no discussion in ORG’s Board Meeting minutes of paying for Secretary’ apartment as part of her compensation or as a condition of her working for ORG.

Payments to President and Vice-President

The agent requested source documents (e.g. invoices or receipts) to support the payments made to President and Vice-President in 20XX via IDRs #2 and #3. ORG did not initially provide any source documents.

With respect to check #* * * for $* * * ORG stated that $* * * of this went to President “for his 20th anniversary gift in 20XX, to be included in his 20XX payroll”. ORG stated that the other $* * * went to Vice-President “for her 10th anniversary gift in 20XX, included in her 20XX payroll”.

Regarding the $* * * payment to CO-5, ORG’s explanation was as follows:

The payment to CO-5 was classified as consulting fee due to the styling, makeup and other tips they were giving us during the big public relations push to increase marketing. Once we understood the styling tips there were (sic) no need for their services anymore. Their services include hair maintenance and make up services. These were for the benefit of President, President and Lead Trainer.

With respect to check #* * * for $* * *, ORG stated that $* * * of it went to two employees’ payroll, and the other $* * * went to Vice-President for “personal” purposes. ORG stated that this amount was “to be included in her 20XX payroll”.

On October 11, 20XX, the agent sent reports to President and Vice-President, proposing excise taxes on excess benefit transactions (“EBTs”), as described in Code section 4958, for the year 20XX disbursements shown in Figure 2, above.

On January 17, 20XX, CPA responded to the reports on behalf of the President and Vice-President1. The response had attached to it five “employee expense reports”, none of which are legible. It also had attached about 30 receipts, many of which are also not legible. The response included the following statements:

Taxpayers will agree to reimburse the Company for $* * * for the watch that was purchased for Vice-President.

Taxpayers will agree to reimburse the Company for the $$* * * 20th Anniversary gift to President.

The response argued that the $$* * * payment to CO-5 was justified because, at the time, President was having to make TV appearances to talk about RA-1 (a former ORG student) and the deaths at his State sweat lodge, in an effort to save ORG’s public image. The examining agent later viewed footage of President’ TV appearances, including one on the CO-6 show.

The response argued that the $$* * * of the $$* * * from check ##* * * that went to Vice-President was included in her reported 20XX compensation prior to the examining agent’s January 10, 20XX initial audit appointment, and that it should therefore not be included in EBTs.

Finally, the response went on to state that the President and Vice-President could only produce $$* * * of the requested receipts2. It argued, however, that all of the remaining disbursements to the

President and Vice-President were for reimbursements of travel expenses related to conducting ORG's exempt activities, and that the per diem for the dates and locations of this travel amounts to $$* * * for President and $$* * * for Vice-President. The response argues that these per diem amounts, when added to the receipts, comes to $$* * * ($$* * * + $$* * * + $$* * *) and that, compared to this amount, the disbursements made to the President and Vice-President in the year 20XX were reasonable.

On March 26, 20XX, the agent requested source documents to support the disbursements to the President and Vice-President in 20XX and 20XX (in Figures 3 and 4) via IDRs #6 and #7. On May 10, 20XX, ORG responded by providing a CD with a number of receipts and invoices. Many of these receipts are either illegible or bear no relationship to carrying out ORG's exempt activities. For example, ORG submitted, in support of checks #* * * and #* * *, two receipts from CO-7, a luxury watch dealer in City, State and City, State. The receipts reflect the purchase of four Rolex watches; two "Oyster" models" one "Yachtmaster", and one "Submariner", totaling $$* * *. For check #* * *, ORG submitted $$* * * in receipts from CO-8, CO-9, and the CO-10 boutique in City. In support of check #* * *, ORG produced a receipt for a $$* * * CO-11 men's bag.

The agent reviewed all legible receipts that could conceivably be related to ORG's exempt activities, and subtracted them from the corresponding disbursements in Figures 3 and 4. The detailed analysis of valid and invalid receipts is attached as Exhibit A. The results are as follows:

Figure 5 — Unsubstantiated Payments 20XX

Figure 6 — Unsubstantiated Payments 20XX

Figure 7 — Unsubstantiated Payments 20XX

LAW

Internal Revenue Code

Section 501(c)(3) of the Internal Revenue Code provides for exemption from Income Tax for corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 4958(c) defines the term "excess benefit transaction" as any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. For purposes of the preceding sentence, an economic benefit shall not be treated as consideration for performance of services unless such organization clearly indicated its intent to so treat such benefit.\

Section 4958(e) defines "applicable tax-exempt organization" as an organization described in either section 501(c)(3) or 501(c)(4) of the Internal Revenue Code or an organization which was so described at any time during the five-year period ending on the date of the excess benefit transaction.

Section 4958(f)(1) defines a "disqualified person" as (A) any person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, (B) a member of the family of a disqualified person, and (C) a

35% controlled entity.

Section 4958(f)(6) of the Code defines “correction”, with respect to any excess benefit transaction, as the undoing of the excess benefit to the extent possible, and taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

Treasury Regulations

Section 1.501(c)(3)-1(a)(1) of the Treasury Regulations (“Regs”) provides that, in order to be exempt as an organization described in Section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(2) of the Regs provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(f)(2)(ii) of the Regs provides that, in determining whether to continue to recognize the tax-exempt status of an applicable tax-exempt organization described in section 501(c)(3) that engages in one or more excess benefit transactions that violate the prohibition on inurement under section 501(c)(3), the Commissioner will consider all relevant facts and circumstances, including, but not limited to, the following:

(A) The size and scope of the organization’s regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;

(B) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization’s regular and ongoing activities that further exempt purposes;

(C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons;

(D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and

(E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6) and section 53.4958-7), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.

Section 53.4958-3(c)(2) of the Regs describes individuals having “substantial influence over the affairs of the organization” (per Code section 4958(f)(1)) as including presidents, chief executive officers, chief operating officers, or any person who, regardless of title, has ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization. A person who serves as president, chief executive officer, or chief operating officer has this ultimate responsibility unless the person demonstrates otherwise. If this ultimate responsibility resides with two or more individuals (e.g., co-presidents), who may exercise such responsibility in concert or individually, then each individual is in a position to exercise substantial influence over the affairs of the organization.

Section 53.4958-4(a)(4) provides that certain economic benefits are disregarded for purposes of section 4958, including (i) Nontaxable fringe benefits. An economic benefit that is excluded from income under section 132, except any liability insurance premium, payment, or reimbursement that must be taken into account under paragraph (b)(1)(ii)(B)(2) of this section, and (ii) Expense reimbursement payments pursuant to accountable plans. Amounts paid under reimbursement arrangements that meet the requirements of section 1.62-2(c) of this chapter.

Section 53.4958-4(c)(1) provides that an economic benefit is not treated as consideration for the performance of services unless the organization providing the benefit clearly indicates the intent to treat the benefit as compensation when the benefit is paid. An applicable tax exempt organization is treated as clearly indicating its intent to provide an economic benefit as compensation for services only if the organization provided written substantiation that is contemporaneous with the transfer of the economic benefit at issue. If an organization fails to provide this contemporaneous substantiation, any services provided by the disqualified person will not be treated as provided in consideration for the economic benefit for purposes of determining the reasonableness of the transaction. In no event shall an economic benefit that a disqualified person obtains by theft or fraud be treated as consideration for the performance of services.

Section 53.4958-4(c)(3)(i)(A) provides that an organization’s reporting constitutes contemporaneous substantiation to treat a benefit as compensation if the organization reports the benefit as compensation on an original Federal tax information return with respect to the payment (e.g., Form W-2 or 1099); or the recipient disqualified person reports the benefit as income on the person’s original Federal tax return (e.g., Form 1040); or there is an approved written employment contract executed on or before the date of the transfer indicating the benefit is compensation; or there is documentation by the organization’s authorized body approving the transfer as compensation for services on or before the date of the transfer; or there was written evidence in existence before the due date of the applicable Federal tax return indicating a reasonable belief by the organization that the benefit was a nontaxable benefit as described in Regs section 53.4958-4(c)(2).

Section 53.4958-7(e) provides that when the applicable tax-exempt organization is no longer described in section 501(c)(3), the disqualified person must make correction to another organization described in sections 501(c)(3) and 170(b)(1)(A) (other than sections 170(b)(1)(A)(vii) or (viii)) which has been so described for at least 60 months ending on the date of correction. It further provides that the disqualified person must not be a disqualified person with respect to the organization which receives the correction, and that the organization receiving the correction amount must not allow the disqualified person to make or recommend any grants or distributions by the organization.

Section 1.62-2(b) provides that for purposes of determining “adjusted gross income,” section 62(a)(2)(A) allows an employee a deduction for expenses paid by the employee, in connection with the performance of services as an employee of the employer, under a reimbursement or other expense allowance arrangement with a payor. Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) if —

(1) Such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) Such arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

(c) Reimbursement or other expense allowance arrangement — (1) Defined. For purposes of sections 1.62-1, 1.62-1T, and 1.62-2, the phrase “reimbursement or other expense allowance arrangement” means an arrangement that meets the requirements of paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of this section.

(2) Accountable plans — (i) In general. Except as provided in paragraph (c)(2)(ii), if an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, all amounts paid under the arrangement are treated as paid under an “accountable plan.”

(ii) Special rule for failure to return excess. If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e) of this section, only the amounts paid under the arrangement that are not in excess of the substantiated expenses are treated as paid under an accountable plan.

(3) Nonaccountable plans — (i) In general. If an arrangement does not satisfy one or more of the requirements of paragraphs (d), (e), or (f) of this section, all amounts paid under the arrangement are treated as paid under a “nonaccountable plan.” If a payor provides a nonaccountable plan, an employee who receives payments under the plan cannot compel the payor to treat the payments as paid under an accountable plan by voluntarily substantiating the expenses and returning any excess to the payor.

(ii) Special rule for failure to return excess. If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e) of this section, the amounts paid under the arrangement that are in excess of the substantiated expenses are treated as paid under a nonaccountable plan.

(4) Treatment of payments under accountable plans. Amounts treated as paid under an accountable plan are excluded from the employee’s gross income, are not reported as wages or other compensation on the employee’s Form W-2, and are exempt from the withholding and payment of employment taxes.

(5) Treatment of payments under nonaccountable plans. Amounts treated as paid under a nonaccountable plan are included in the employee’s gross income, must be reported — as wages or other compensation on the employee’s Form W-2, and are subject to withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax). See paragraph (h) of this section. Expenses attributable to amounts included in the employee’s gross income may be deducted, provided the employee can substantiate the full amount of his or her expenses (i.e., the amount of the expenses, if any, the reimbursement for which is treated as paid under an accountable plan as well as those for which the employee is claiming the deduction) in accordance with sections 1.274-5T and 1.274(d)-1 or section § 1.162-17, but only as a miscellaneous itemized deduction subject to the limitations applicable to such expenses (e.g., the 80-percent limitation on meal and entertainment expenses provided in section 274(n) and the 2-percent floor provided in section 67).

(d) Business connection — (1) In general. Except as provided in paragraphs (d)(2) and (d)(3) of this section, an arrangement meets the requirements of this paragraph (d) if it provides advances, allowances (including per diem allowances, allowances only for meals and incidental expenses, and mileage allowances), or reimbursements only for business expenses that are allowable as deductions by part VI (section 161 and the following), subchapter B, chapter 1 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer. The payment may be actually received from the employer, its agent, or a third party for whom the employee performs a service as an employee of the employer, and may include amounts charged directly or indirectly to the payor through credit card systems or otherwise. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(3) Reimbursement requirement — (i) In general. If a payor arranges to pay an amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) business expenses of a type described in paragraph (d)(1) or (d)(2) of this section, the arrangement does not satisfy this paragraph (d) and all amounts paid under the arrangement are treated as paid under a nonaccountable plan. See paragraphs (c)(5) and (h) of this section.

(ii) Per diem allowances. An arrangement providing a per diem allowance for travel expenses of a type described in paragraph (d)(1) or (d)(2) of this section that is computed on a basis similar to that used in computing the employee's wages or other compensation (e.g., the number of hours worked, miles traveled, or pieces produced) meets the requirements of this paragraph (d) only if, on December 12, 1989, the per diem allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the per diem allowance, or a per diem allowance computed on that basis was commonly used in the industry in which the employee is employed. See section 274(d) and section 1.274(d)-1. A per diem allowance described in this paragraph (d)(3)(ii) may be adjusted in a manner that reasonably reflects actual increases in employee business expenses occurring after December 12, 1989.

(e) Substantiation — (1) In general. An arrangement meets the requirements of this paragraph (e) if it requires each business expense to be substantiated to the payor in accordance with paragraph (e)(2) or (e)(3) of this section, whichever is applicable, within a reasonable period of time. See section 1.274-5T or section 1.162-17.

(2) Expenses governed by section 274(d). An arrangement that reimburses travel, entertainment, use of a passenger automobile or other listed property, or other business expenses governed by section 274(d) meets the requirements of this paragraph (e)(2) if information sufficient to satisfy the substantiation requirements of section 274(d) and the Regs thereunder is submitted to the payor. See section 1.274-5. Under section 274(d), information sufficient to substantiate the requisite elements of each expenditure or use must be submitted to the payor. For example, with respect to travel away from home, section 1.274-5(b)(2) requires that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor. Similarly, with respect to use of a passenger automobile or other listed property, section 1.274-5(b)(6) requires that information sufficient to substantiate the amount, time, use, and business purpose of the expense must be submitted to the payor. See section 1.274-5(g) and (j), which grant the Commissioner the authority to establish optional methods of substantiating certain expenses. Substantiation of the amount of a business expense in accordance with rules prescribed pursuant to the authority granted by section 1.274-5(g) or (j) will be treated as substantiation of the amount of such expense for purposes of this section.

(3) Expenses not governed by section 274(d). An arrangement that reimburses business expenses not governed by section 274(d) meets the requirements of this paragraph (e)(3) if information is submitted to the payor sufficient to enable the payor to identify the specific nature of each expense and to conclude that the expense is attributable to the payor's business activities. Therefore, each of the elements of an expenditure or use must be substantiated to the payor. It is not sufficient if an employee merely aggregates expenses into broad categories (such as "travel") or reports individual expenses through the use of vague, nondescriptive terms (such as "miscellaneous business expenses"). See section 1.162-17(b).

(f) Returning amounts in excess of expenses — (1) In general. Except as provided in paragraph (f)(2) of this section, an arrangement meets the requirements of this paragraph (f) if it requires the employee to return to the payor within a reasonable period of time the amount paid under the arrangement in excess of the expenses substantiated in accordance with paragraph (e) of this section. The determination of whether an arrangement requires an employee to return amounts in excess of substantiated expenses will depend on the facts and circumstances. An arrangement whereby money is advanced to an employee to defray expenses will be treated as satisfying the requirements of this paragraph (f) only if the amount of money advanced is reasonably calculated not to exceed the amount of anticipated expenditures, the advance of money is made on a day within a reasonable period of the day that the anticipated expenditures are paid or incurred, and any amounts in excess of the expenses substantiated in accordance with paragraph (e) of this section are required to be returned to the payor within a reasonable period of time after the advance is received.

GOVERNMENT'S POSITION

ORG's 501(c)(3) status should be revoked, effective January 1, 20XX, based on the substantial inurement evidenced by the payments shown in Figures 5, 6, and 7 above. The examining agent has requested documentation and explanations for the above payments. ORG, the President and Vice-President, and Secretary have provided what documentation and explanations they could. The payments to or for these individuals that have either been acknowledged as benefiting them, or that still remain unsubstantiated total $* * * for 20XX, $* * * for 20XX, and $* * * for 20XX. This inurement violates section 501(c)(3) of the Internal Revenue Code and section 1.501(c)(3)-1(c)(2) of the Treasury Regulations.

The payments for Secretary' City apartment constitute inurement and EBTs. They benefited her through the provision of free housing. There was no contemporaneous substantiation that it was ORG'S intent to treat these payments as compensation for services.

The $$* * * from check ##* * * constitutes inurement and an EBT to President. It was not reported as compensation to President on any Form W2 issued to him, nor on any of ORG's Forms 990s filed prior to the December 20XX commencement of the IRS examination. This payment should have been included in President' year 20XX Form W2, issued in January of 20XX. The President and Vice-President acknowledged in the January 17th response that this $$* * * "gift" should be reimbursed.

The $* * * from check #* * * constitutes inurement and an EBT to Vice-President. The January 17th response acknowledged that this was for the purchase of a watch for Vice-President, and that it should be reimbursed.

The $$* * * from check ##* * * constitutes inurement and an EBT to Vice-President. It was not reported as compensation to Vice-President on any Form W2 issued to her, nor on any of ORG's Forms 990s filed prior to the December 20XX commencement of the IRS examination. This payment should have been included in Vice-President' year 20XX Form W2, issued in January of 20XX. In any event, ORG's issuing of Vice-President' 20XX W2 in January 20XX came after the commencement of the IRS examination. It therefore does not meet the contemporaneous substantiation requirement of Regs section 53.4958-4(c)(3)(i)(A). ORG's inclusion of this amount on President and Vice-President compensation for the year 20XX is not a mitigating factor.

The rest of the unsubstantiated payments to President and Vice-President, shown in Figures 5, 6, and 7 also constitute inurement and EBTs. They benefited the President and Vice-President in the form of outright cash payments, mostly in $* * * denominations. These payments were not part of an accountable plan. They failed, variously, sections (d), (e), and (f) of Regs section 1.62-2. The shopping at CO-11 and other boutiques, and purchases of multiple Rolex watches fail the section 1.62-2(d) business connection requirement. And the rest of the unexplained excess reimbursements fail both the section 1.62-2(e) and (f) substantiation and return of excess requirements.

The argument in the January 17th response to the Code section 4958 reports that the total of receipts should be added to the total of per diem is not logical. Reimbursement arrangements are either “actual” or “per diem”. To the extent that ORG had a particular reimbursement arrangement in place, it is clear, from the fact that it used “employee expense reports”, that it was not based on per diem. It should be noted that this report only cites the excess of reimbursements over what has been substantiated as having a business connection. An employee would never be entitled to “reimbursement” of both actual and per diem, as was suggested in the response. The unsubstantiated payments in Figures 5, 6, and 7 thus constitute inurement and EBTs.

With respect to section 1.501(c)(3)-1(f)(2)(ii) of the Treasury Regs, the analysis of the five factors set forth therein is as follows:

(A) The size and scope of the organization’s regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions

No evidence was gathered during the examination to suggest that there was any fluctuation in ORG’s activities. Furthermore, due to the frequency of the payments at issue, being evenly spread throughout each year, no distinction can be made between ORG’s activities “before and after” these payments. The qualification of ORG’s activities for 501(c)(3) status are not being challenged in this report. Thus, this factor weighs neither in favor of, nor against, revocation.

(B) The size and scope of the excess benefit transaction or transactions in relation to the size and scope of the organization’s regular and ongoing exempt activities

ORG does not have any “ongoing” exempt activities. It voluntarily became a for-profit entity on June 1, 20XX. Inasmuch as ORG’s revenues reflect its exempt activities, its revenues during the years under examination, while it was still exempt, was $* * *. The inurement and EBTs cited above total $* * *, or about * * *%. This is a significant amount of inurement and EBTs, and weighs in favor of revocation.

(C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons

ORG engaged in over sixty EBTs during the years under examination. These transactions involved three different officers; President, Vice-President, and Secretary. This weighs in favor of revocation.

(D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions

ORG forfeited its own 501(c)(3) exemption June 1, 20XX. At issue, then, is whether its exemption should also be revoked for the period of January 1, 20XX to May 31, 20XX. It is evident that no safeguards were put in place to prevent EBTs from 20XX to 20XX, or from 20XX to 20XX. On the contrary, President has even more unfettered control over ORG’s assets, now that ORG is owned by his wholly-owned company, CO-3. This factor weighs in favor of revocation.

(E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6)), or the organization has made good faith efforts to seek correction from those who benefited from the excess benefit transaction

As of the date of this report, ORG is no longer described in section 501(c)(3) of the Internal Revenue Code. Repayments to ORG would not qualify as “correction” within the meaning of section 4958(f)(6). Therefore, per Regs section 53.4958-7(e), any correction to be made by the President and Vice-President or Secretary would have to go to a different 501(c)(3) organization. As of the date of this report, no correction has been made to such a 501(c)(3) organization. Therefore, applying this factor would weigh in favor of revocation.

TAXPAYER'S POSITION

ORG has not yet taken a position with respect to this report.

CONCLUSION

ORG's earnings have inured to the benefit of three of its officers, President, Vice-President, and Secretary. This inurement totaled $* * * during the years 20XX, 20XX, and 20XX. This is a substantial amount of inurement, and violates section 1.501(c)(3)-1(c)(2) of the Treasury Regs. Given the routine and continuous nature of the inurement, this warrants revocation of ORG's 501(c)(3) status effective January 1, 20XX. ORG should file Form 1120, U.S. Corporation Income Tax Return, for the years 20XX and 20XX, and for the period ended May 31, 20XX. If the proposed revocation becomes final, appropriate State officials will be notified in accordance with Code section 6104(c).

FOOTNOTES

1 CPA also represented the President and Vice-President in their Code section 4958 examinations until March 20XX, when they appointed CPA as their representative.

2 The agent found that the legible receipts only totaled $$* * * which included $$* * * in hotel receipts. The $$* * * CO-5 invoice was discussed separately and so presumably was not included in the $$* * *.

FAF to Conduct Post-Implementation Review of GASB Standard on Impairment of Capital Assets.

Norwalk, CT, July 17, 2013—The Financial Accounting Foundation (FAF) today announced that it will conduct a Post-Implementation Review (PIR) of an accounting and financial reporting standard for state and local governments regarding the impairment of capital assets and insurance recoveries.

Issued in 2003, Governmental Accounting Standards Board (GASB) Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries, http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175824062940&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs establishes measurement guidance for capital asset impairments and requires governments to report the effects of those impairments when they occur, rather than as a part of the ongoing depreciation expense for the capital asset or upon disposal of the capital asset. It also provides uniform reporting guidance for insurance recoveries of state and local governments.

Stakeholders who would like the opportunity to participate in PIR surveys on GASB Statement 42, conducted by an independent survey firm on behalf of the FAF, should register online. http://www.accountingfoundation.org/cs/ContentServer?c=Page&pagename=Foundation%2FPage%2FFAFSectionPage&cid=1176159648816

The PIR team recently completed its review of GASB Statements No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175824062544&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs and No. 30, Risk Financing Omnibus, http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175824063444&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs which establish accounting and financial reporting standards for risk financing and insurance-related activities of state and local governments, including public risk pools. The FAF expects to issue the review report in August.

SEC Announces Compliance Outreach Program Regional Seminars for Investment Adviser and Investment Company Senior Officers.

The Securities and Exchange Commission today announced the schedule for its upcoming Compliance Outreach Program regional seminars in several cities around the country for investment adviser and investment company senior officers, including chief compliance officers (CCOs).

The SEC's Office of Compliance Inspections and Examinations (OCIE), Division of Investment Management, and Division of Enforcement's Asset Management Unit are jointly sponsoring the regional seminars for investment companies and investment advisers. The seminars highlight areas of focus for compliance professionals. They provide an opportunity for the SEC staff to identify common issues found in related examinations or investigations and discuss industry practices, including how compliance professionals have addressed such matters.

The Compliance Outreach Program was created to promote open communication on mutual fund, investment adviser, and broker-dealer compliance issues. The program, formerly known as the CCOutreach Program, was redesigned in 2011 to include all senior officers, not just CCOs, underscoring the importance of compliance throughout a firm's business operations.

The series of regional seminars kicked off in Boston on May 16 with panel discussions on the priorities for the SEC's National Examination Program, current topics in money management regulation, and OCIE's process for assessing risks and selecting firms for examination.

The remaining seminars:

Chicago – August 28: This seminar will present an overview of the examination process, including how registrants are selected for examination and the most commonly identified deficiencies. There also will be three discussion panels on traded and non-traded real estate investment trusts, on investment companies with special emphasis on alternative investment funds and money market funds, and on current enforcement actions in the investment management industry. Lastly, there will be a breakout session focusing on custody and compliance for small advisers.

Register for this event:

https://www.surveymonkey.com/s/RegisterFor2013ComplianceOutreachProgramChicagoIL

New York – September 13: This seminar will be most relevant to newly registered investment advisers, to dual registrants and to investment advisers affiliated broker-dealers. The topics most relevant to newly registered advisers will include the SEC's examination process, priorities, risk surveillance, and examination selection process. In addition, the staff will discuss Form PF and other filing requirements and recent industry and regulatory developments. The topics most applicable to dual registrants or advisers with affiliated broker-dealers will address the staff's coordinated examination process, common examination findings, and controls that some firms use to address conflicts of interest.

Register for this event:

https://www.surveymonkey.com/s/RegisterFor2013ComplianceOutreachProgramNewYorkNY

Atlanta – September 25: This seminar will discuss the importance of enterprise risk management and effective compliance and will identify key issues noted during examinations, including conflicts of interests and issues associated with fees, such as undisclosed remuneration, miscalculation, and layering. Additional discussion topics include the changing demographics of SEC-registered investment advisers and key examination program initiatives to address such changes.

Register for this event:

https://www.surveymonkey.com/s/RegisterFor2013ComplianceOutreachProgramAtlantaGA

San Francisco – November 6: This seminar will feature an overview of the SEC's examination processes and procedures and a discussion of OCIE and AMU priorities. Emphasis also will be placed on valuation issues, including best practices for valuing assets by private and registered investment funds.

Register for this event:

https://www.surveymonkey.com/s/RegisterFor2013ComplianceOutreachProgramSanFranciscoCA

If registrations exceed capacity at an event location, investment company and investment adviser CCOs will be given priority on a first-come, first-registered basis. Instructions on registering for the regional seminars will be sent to each SEC-registered investment adviser using the e-mail account on the adviser's Form ADV filing. For more information, contact: ComplianceOutreach@sec.gov

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FICA Replacement Plans Phone Forum Now Available.

The June 27 recording of the "FICA Replacement Plans" Phone Forum, is available. The 60-minute presentation covers:

- Social Security Coverage laws
- Qualified Employer's Retirement systems
- Defined Benefit and Defined Contribution Plan
- Revenue Procedure 91-40
- FICA replacement plans

You will have access to a transcript with links to sites and forms for your convenience.

http://www.irsvideos.gov/Governments/Employers/FICAReplacementPlans

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SIFMA Social Media Seminar – October 16 – NYC.

SIFMA is pleased to announce the next Social Media Seminar on October 16, 2013, in New York.

This one-day event will bring together experts to explore the rapidly evolving tools of social media.

The seminar will feature in-depth panels on marketing, business, and practitioner social media experience, as well as practical advice on the legal and compliance issues faced by the expanding use of interactive technology for business purposes.

Whether you’re considering social media initiatives or want to take your investor engagement to the next level, join us on October 16 to learn best practices for the financial services industry and to address compliance issues with regulatory experts.

Who Should Attend:

- Business and Client Management Professionals
- Compliance Professionals
- Financial Advisors
- Attorneys
- Marketing Directors
- Sales Managers
- Training Leaders

Register at:

https://mbrservices.net/ConferenceRegistration/MeetingRegistration.aspx?meetingid=1131

Basel III Rules Likely to Curb Big Banks' Muni Purchases.

U.S. banking regulators this month published two rules that may damp investment by banks in municipal bonds.

The more significant change will require the largest banks to account for any credit or interest-rat--related price drops in their investments, including municipals, in their available-for-sale portfolios, thus reducing capital available to back further investments. Smaller banks or savings and loans can opt out of the rule.

Under the other rule, adopted over objections from the muni industry, revenue bonds will maintain a 50% risk weighting, making it more expensive for banks to hold them than general obligation bonds, which retain a 20% risk weighting.

The changes stem from the combined efforts of the Office of the Comptroller of the Currency within the Department of the Treasury, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation to revise risk-based and leverage capital requirements for banks as required by the Third Basel Accord. The final rule, published in two stages on July 2 and one week later, consolidates three separate notices of proposed rulemaking that the OCC, the Fed, and the FDIC published last year.

The regulating government agencies’ set a mandatory compliance date of Jan. 1, 2014, for the largest banking organizations that are not savings and loan holding companies. All other covered banking organizations must be in compliance one year later.

Banks’ muni bond holdings have increased to about 10% of total bonds outstanding in the $3.73

trillion market from 6% in 2007, according to the latest Fed flow of funds numbers. Through the first quarter of 2013, they've risen 85%, to $374.2 billion from $202.0 billion in the six years.

The change in capital treatment for the largest banks doesn't sit well with the American Bankers Association, their trade association. It's unclear, though, just how institutions will choose to handle it, said Cecelia Calaby, a senior vice president for the ABA's center for securities, trust and investments.

"We don't think this is a good thing that the larger banks have to flow unrealized gains and losses through capital, because we believe it exacerbates the volatility of bank capital in a way that is not useful or helpful to investors," Calaby said.

When banks hold securities, they have to place them into held-to-maturity or available-for-sale portfolios for accounting purposes. Marking to market a security in a bank's held-to-maturity portfolio is unnecessary. It's required for those securities held in its available-for-sale portfolios.

There are two approaches to capital treatment in the new rule for banks. The advanced approach applies to banks generally with consolidated total assets of at least $250 billion, or consolidated total on-balance-sheet foreign exposures of at least $10 billion.

All other banks fall under the standard approach, which lets them opt out of the treatment for "accumulated other comprehensive income." This amount consists of accrued unrealized gains and losses on certain assets and liabilities that haven't been included net income, yet are included in equity under U.S. generally accepted accounting principles, such as those gains and losses on securities designated as available-for-sale, according to the specifics of the rule.

"All but the advanced approach banks can elect not to flow unrealized gains and losses through capital," Calaby said. "We expect most will take that decision."

Long-term muni purchases at the largest banks will be affected as a result of the accounting requirement for their available-for-sale portfolios, a managing director in the muni group at a large bank said. The largest banks control about 50% of banking assets in long-term fixed-rate municipal paper, he said, while the 8,000 banks that comprise the other half of the banking system still have the ability to buy those without having them affect regulatory capital.

"If it was believed that the top-10 banks in the country were going continue adding munis at the rate they had been adding them for the last two years, I'd guess that rate of increase in purchases has to decline with this," the banker said.

This is because, as the value of an asset dropped, banks would have to effectively take a charge against capital for that drop in market value, said Michael Decker, a managing director and co-head in the municipal securities division of the Securities Industry and Financial Markets Association. "And they would be able to treat as added capital an increase in the value of their assets," he added.

As interest rates rise and banks incur unrealized losses in their muni holdings, thus reducing capital, they will have to meet their capital ratios some other way or must have buffers against those losses, Calaby said. "One technique or tool they may use to better position themselves from an interest-rate risk perspective is to shorten the maturity of the securities in their available-for-sale portfolio," she said.

Regarding the risk weightings of GO and revenue bonds, GO bonds remain in a relatively low risk-weighting category, Sifma's Decker said. Revenue bonds do as well, but are in a higher category than GOs.

Still, banks would have to hold two-and-a-half times as much capital against revenue bond assets as they would for GO bonds.

Sifma was disappointed that the Fed chose to disregard arguments the association made in October that there is no significant difference in credit performance between GO and revenue bonds, Decker said.

“This rule, once it’s fully implemented, will affect some banks’ decisions on which municipals they might want to hold and what volume of municipals they might want to hold,” he said. “In that respect, there are going to be some market implications.”

Banks’ increase in their muni holdings has been particularly significant in the last several years, Decker said. Their participation in the market has had the effect of keeping borrowing costs for state and local governments lower than they might otherwise be.

Others in the industry said the effects of the rule changes will probably be marginal.

For one thing, many banks have regarded the rules as inevitable and have planned accordingly, said Peter Hayes, head of municipal bond portfolio management, trading and research at BlackRock. Furthermore, he added, banks are likely to view the low risk weighting of municipals relative to other securities in a favorable light.

“Across the investment-grade spectrum, munis do carry a lower risk weight than other asset classes,” Hayes said. “And some banks I talk to think it’s going to be beneficial, in terms of a contribution to their bottom line.”

NYT: Public-Private Partnerships Could Be a Lifeline for Cities.

Cities like Detroit with crumbling infrastructure and deteriorating public services could find help from private investors.

Detroit is fighting for its fiscal survival. Over the last four years, the city has spent $100 million more each year than it has collected. Long-term liabilities are estimated to be as high as $20 billion. Gov. Rick Snyder of Michigan installed an emergency manager, who most assume is preparing for a Chapter 9 filing, which would be the largest municipal bankruptcy in United States history.

In May, the manager, Kevyn Orr, was considering selling parts of the permanent collection at the Detroit Institute of Arts to pay creditors. Mr. Orr later backed off that threat, but no doubt he wanted to scare city fathers into getting serious about averting financial disaster. But new worries followed that he would have to unload the city’s collection of 62 classic cars.

Detroit’s plight may be extreme, but its problems are increasingly common in cities across the United States. Municipalities are struggling to make public payroll, maintain basic services or meet pension fund obligations. Many of the hard choices Detroit has to make will be repeated in towns in the Midwest, Rust Belt, California and throughout the Northeast.

In truth, Detroit does not have to part with its Diego Rivera murals or its vintage Mustangs and Cadillacs. Instead, it should be taking an inventory of revenue-producing public assets — including on-street and off-street parking systems, water systems, toll bridges, solid waste disposal plants, utilities and airports — to lease or divest with help from private partners willing to invest capital in improving them.

Public-private partnerships are the ideal solution for the fiscal problems plaguing many American cities. In a so-called P3 transaction, private equity investors make a large up-front payment to run a public service or utility — often for hundreds of millions of dollars. In return, they gain a concession to operate the service under a contract that can last for decades.

Gaining much needed cash and operating efficiency are prime incentives for municipalities to undertake such transactions. Chicago entered into a concession for 36,000 parking meters a few years ago through a 75-year contract valued at more than $1 billion. Besides streamlining the costs of running the citywide program, the new concession exposed abuses of handicapped parking permits and led to the passage of a law preventing abuses. Today, the Chicago Metered Parking System is considered one of the world’s best.

Does Detroit’s lurch toward bankruptcy make it a less-desirable candidate for a public-private transaction? Not necessarily. A municipality that has already filed Chapter 9 may have greater impetus to privatize infrastructure assets to restructure its balance sheet just like any business trying to work through insolvency.

P3 deals are also effective for cities on the brink. Not only can they generate substantial revenue to stave off defaults, but they need not involve an outright sale of assets. Ownership of the services often remains with the city, avoiding the prospect of a fire sale. As for cities in good financial shape, they should consider private partnerships as a means of undertaking long-term civic improvements at a time when the fiscal roof isn’t leaking.

How does a city ensure that it’s receiving fair value in a P3? These deals are subject to external market forces. Bidders for public infrastructure assign a value based on prospects for long-term revenue collection — will there be enough drivers crossing a toll bridge or parking their cars on city streets? In reality, infrastructure assets are in general relatively straightforward to value and represent a long-term, income-producing annuity for the right investor.

Privatization often ignites fears of price-gouging by Wall Street. In fact, your corner grocery store or nail salon has more power to raise prices than a private equity fund operating a public service. The assets at the center of these deals — parking garages, utilities, toll roads — operate under tight regulatory regimes. Rates are adjusted according to inflation and can’t be raised without an arduous process of public hearings and agency approvals. Bayonne, N.J., contracted a 40-year concession for its water and waste system through a partnership with Kohlberg Kravis Roberts and United Water, which abides by a strict scheduled rate protocol.

Some people have a knee-jerk aversion to allowing private enterprise to manage public works. The truth is that cities have terrible track records in maintaining their bridges and roadways. Gas and electric utilities have long been run by private entities. If a city can trust private business to operate its nuclear power plant, it has nothing to fear in allowing an investment fund to manage its parking meters.

Privatizing municipal services is not a hand-off of the public trust. The assets in a P3 rely on millions of paying customers for their revenue stream, not city coffers. If the assets remain in the hands of near-bankrupt municipalities, crucial services and infrastructure will become melting ice cubes financed by a vastly shrinking tax base.

Harrisburg, Pa., has been teetering on the edge of bankruptcy for several years, having to service $370 million in debt tied to a trash incinerator built a decade ago. Had the incinerator been developed through a concession with a private investor, Harrisburg’s balance sheet would look a lot brighter today.

What about jobs? Don’t private operators of public infrastructure torch contracts with municipal unions? In fact, the jobs needed to run these services remain unionized after a P3, typically governed by collective bargaining terms. Yet private concessions frequently create jobs through capital programs that had been sidelined by broke city governments.

Public-private partnerships have gotten a bad rap because of some highly publicized failures. In 2008, when Gov. Ed Rendell of Pennsylvania tried to lease the state’s turnpike to an infrastructure fund, the legislature killed the $12.8 billion deal. In Pittsburgh, the city council rejected a $500 million bid for a municipal parking concession that would have more than covered a $350 million shortfall in parking revenue.

These failures did not reflect inherent problems with the P3 structure — the transactions were derailed because of political grudges and fear-mongering. The reality is that government agencies are so constrained they can’t meet their responsibilities to operate and maintain — much less build new – public infrastructure. P3s regularly replace aging infrastructure and provide state-of-the-art services. The private operator of the Chicago parking meter system replaced all coin operated meters with credit card devices, which will soon feature pay-by-cellphone options. This would not have been possible had the city continued to manage the meters.

This should be a golden age of public-private partnerships — the need exists in cities across the country. And the capital is there, from private investors seeking long-term returns. American infrastructure has fallen behind countries like France, Italy, Spain, Portugal, Poland, Hungary and countries that have long embraced privatization of urban systems. Ironically, the United States has become an emerging economy when it comes to developing P3 projects — in which opportunity needs to be matched with political will and bold thinking to undertake.

Ultimately, Detroit and other stressed cities don’t have much choice. They must land on solid ground and use new revenue to pay off existing debt. The marvel of public-private partnerships is that a significantly reduced debt load and shift of responsibility to the private sector can allow a city to turn to other priorities, like buying more textbooks for students or enhancing local parks that are a city’s true public trust. Divesting noncore assets may be the best way for many towns — not just Motown — to regain their momentum.

NYT: Possibly Unfair, but Not Necessarily Fraudulent.

When someone has access to a service that is not equally available to others, the immediate response is often to say, “That’s not fair!” And when the securities markets are involved, the first thought seems to be that any informational advantage is not only unfair but potentially fraudulent.

Of course, there are advantages everywhere. Airlines sell access to early boarding, and you can buy a pass at Universal Studios to skip the lines. Few seem troubled that someone who bundled millions of dollars in donations receives an invitation to an inaugural ball while common contributors might receive a token souvenir.

While we are accustomed to paying extra for things that were once free, like checked baggage on airlines, when it comes to the public markets for stocks, bonds and commodities, the reaction to those buying preferential access is to cry foul.

That became clear last week when New York's attorney general, Eric T. Schneiderman, announced an agreement with Thomson Reuters concerning a closely watched economic indicator. Thomson Reuters agreed that it would no longer sell access to the University of Michigan's consumer confidence index to high-frequency trading firms two seconds before other subscribers. Mr. Schneiderman described this as a step toward creating a "level playing field" in the markets by ending an "unfair business practice."

His office is investigating whether other firms are violating the law, particularly with regard to New York's broad Martin Act, in how they sell data to subscribers who can trade in advance of its public release. And Mr. Schneiderman is not the only one looking at disclosures of this type of information.

Senator Charles E. Grassley sent a letter to the University of Michigan asking questions about its arrangement "to allow preferential access" to the information. DealBook reported that the Securities and Exchange Commission was also investigating how Thomson Reuters released manufacturing data milliseconds before its public disclosure, giving high-frequency trading firms an opportunity to profit on it.

Although it is natural to think that having access to information that influences the markets before others is always wrong, the laws on fraud do not go that far. Instead, they focus on whether someone has been deceived, either through a misstatement or by a failure to disclose information.

The Martin Act, adopted in 1921, is considered one of the broadest antifraud laws available to police the securities markets. It does not require proof of intentional misconduct, and there is even a possibility that a misdemeanor violation could be proved without showing any intent — known as strict liability. That gives Mr. Schneiderman a powerful tool to go after companies like Thomson Reuters for disclosures that affect the market.

But the core of any violation is still about proving fraud, which includes not just false statements but also any "deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale" of securities. A 1926 decision by the New York Court of Appeals on the scope of the Martin Act stated that the law reaches acts "which do by their tendency to deceive or mislead the purchasing public."

Is selling access to proprietary information to those willing to pay a premium a species of fraud when it allows traders to reap profits at the expense of those unwilling to pay the premium?

Thomson Reuters and others who selectively disclose information to subscribers are not hiding what they do. Indeed, it is the exact opposite — they tell the world that only those willing to pay will get the advantage of an early peek at the information.

There is a tiny universe of potential customers who would want access to financial data two seconds ahead of others. No individual would ever be able to take advantage of that time period, but high-frequency traders certainly can. As James B. Stewart reported, dropping the two-second advantage last week resulted in a steep drop in the amount of trading in the milliseconds before the broader release of the index.

Some informational advantages are fraudulent, as the recent spate of insider trading cases shows. Unlike companies that sell an informational advantage, however, the key to insider trading is keeping the information confidential and not letting anyone know you are using it to profit. It is the failure to publicly disclose the information before using it that brings about the violation, not just the fact that the information is confidential.

Still, it appears anomalous that someone at Thomson Reuters who used its confidential market information without permission to trade profitably would be guilty of insider trading, but the company can sell that same advantage to a select few willing to pay for it without violating the law. The difference is that insider trading requires proof of a breach of fiduciary duty, so that the proprietor of the information can do whatever it wishes so long as it does not deceive the investing public.

In a famous case in the 1980s, Carpenter v. United States, the Supreme Court upheld the conviction of a former Wall Street Journal reporter for trading on confidential information about companies before it was published. While the reporter breached his fiduciary duty, the court noted that The Journal had a proprietary interest in the information its reporters gathered, and could do with it as it saw fit.

Consumers of the information sold by media companies would not be subject to any claim of fraud because they are not trading on it in breach of a duty. When a company obtains the information through legitimate means, like the agreement Thomson Reuters has with the University of Michigan to distribute its index, then there is no violation of any duty by selling advance access to the data.

The S.E.C. does have a rule in place, Regulation FD, which requires public companies to disclose information to everyone at once and not just to select recipients. But this rule applies only to internal corporate information and not to the type of research data about the economy that is sold by companies.

The issue then is whether Mr. Schneiderman or the S.E.C. can police these types of arrangements by companies that sell information they obtain legally. It is notable that, even though the two-second advantage has stopped, Thomson Reuters continues to sell the information five minutes before its release to the general public, undermining the idea that any early disclosure is somehow fraudulent.

There is no broad mandate for the government to ensure that the markets are “fair” or that they offer a “level playing field” without any informational disparities, at least under the fraud laws. While fraudulent transactions are certainly unfair, simply asserting that buying access to information in advance of others is somehow unfair does not necessarily make it illegal.

The issue may be more about how high-frequency trading firms can take advantage of information in just a few milliseconds to garner profits far beyond what might have been possible before computerized trading. If that is the case, then the focus should be on policing how these firms trade rather than cracking down on the sale of information to those willing to pay. Otherwise, perhaps the airlines should not be allowed to let so many people board ahead of me.

Bond Insurer Sues Credit-Rating Agencies.

Bond insurer ACA Financial Guaranty Corp. sued the major credit-rating firms for allegedly falsely representing that their letter-grade ratings were free of conflicts of interest.

The lawsuit is the second fraud lawsuit filed against the firms in as many weeks and comes as the Justice Department’s lawsuit against Standard & Poor’s Ratings Services is gathering steam. The liquidators of two Bear Stearns Cos. hedge funds sued S&P, Moody’s Investors Service and Fitch Ratings last week on nearly identical claims.

The ACA lawsuit, like the Bear Stearns case, appears to be timed to beat the statute of limitations for fraud cases in New York state, which is six years, say lawyers not involved in the case. The three major rating firms began their downgrades of hundreds of mortgage-linked securities in July 2007.

ACA sued S&P, Moody's and Fitch in New York State Supreme Court on Tuesday, seeking $359 million in damages, according to a filing. The filing, like the Bear Stearns filing, is a four-page summons and notice, not a full-fledged complaint.

"In carrying out their fraud," the filing alleges, the rating firms "falsely represented that relevant credit ratings reflected their true current opinion regarding the credit risks" the securities presented. The rating firms "falsely represented that the ratings provided were objective, independent, and uninfluenced by any conflicts of interest," the filing alleges.

Spokesman for S&P and Fitch both said the allegations were without merit and the companies would defend themselves vigorously. A spokesman for Moody's and a lawyer representing ACA didn't immediately respond to requests for comment.

Spokesmen for Moody's and Fitch didn't immediately respond to requests for comment. A lawyer representing ACA didn't immediately respond to a request for comment.

ACA is tangled in another crisis-era lawsuit.

An ACA executive is expected to take the stand in the civil trial of former Goldman Sachs Group Inc. executive Fabrice Tourre that has captured Wall Street's attention this summer. The Securities and Exchange Commission claims Mr. Tourre lied to investors about the risk of a crisis-era deal, a charge he denies.

ACA acted as the portfolio-selection agent on that deal.

ACA's lawsuit against the credit-rating firms comes as the U.S. federal government's case against S&P is gathering momentum. A U.S. district judge ruled Tuesday that the government's fraud case against S&P could proceed, rejecting S&P's request that he throw out the entire lawsuit.

Water Agencies Urge Against Limiting Tax-Exempt Bond Financing of Water Systems.

Limiting or ending tax-exempt municipal bond financing of drinking or waste water systems would result in higher costs for consumers and impede water infrastructure investment, according to a July report from the National Association of Clean Water Agencies and Association of Metropolitan Water Agencies.

http://www.amwa.net/galleries/leginfo/AMWA-NACWA_MuniBondAnalysis_July13.pdf

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WSJ: Detroit Bankruptcy Plan Called Unfair to Bondholders.

The bond market's main trade group warned Michigan's governor that Detroit's bankruptcy plan unfairly punishes bondholders.

The Securities Industry and Financial Markets Association, the bond market's main trade group, warned Michigan's governor that Detroit's bankruptcy plan unfairly punishes bondholders whose debt is supposed to be guaranteed under state law.

In a letter Thursday, the bond-market trade group told Gov. Rick Snyder and state Treasurer Andy Dillon that the bankruptcy "could have potentially significant, negative municipal securities market implications," including raising borrowing costs for municipalities across the state. The letter was signed by Sifma General Counsel Ira Hammerman.

Detroit filed for the largest municipal bankruptcy in history Thursday with estimated liabilities of about $18 billion, overtaking Jefferson County, Ala., which filed in November 2011 with about $4 billion in debt.

Sifma is taking issue with Detroit's emergency manager Kevyn Orr's proposed treatment of some of the city's "unlimited tax general obligation bonds," which would be repaid at pennies on the dollar under a restructuring plan Mr. Orr presented in June.

Such treatment "ignores the appropriate priority that should be given to these bonds," Sifma said. The Michigan Constitution also states that some of Detroit's bonds are guaranteed, it said.

General-obligation bonds are viewed as one of the safest types of muni investments because they are backed by a government's "full faith and credit" pledge to raise taxes as necessary to repay the bonds. That backing as well as their tax-exempt status have made those types of municipal bonds popular, particularly among individual investors.

The group warned that bondholders might sell other Michigan municipal debt and be reluctant to buy debt from Michigan cities and towns, "causing the cost of financing infrastructure projects to rise."

"We understand Detroit has serious financial issues," but hurting bondholders will only provide a temporary salve, the letter said.

Sifma added that other states have considered alternatives to help their distressed localities, including enacting laws that protect local government debt, "to ensure that the markets' perception of what investors are due matches the outcome."

Sifma's outcry follows similar complaints recently from some Detroit creditors. Bond insurer Ambac Assurance Corp., which backs the principal and interest payments of some of the city's bonds, said last week that the city's proposed treatment of general-obligation bonds "is harmful to Detroit and the interest of taxpayers in Michigan." It added a "successful revitalization" of Detroit will depend on access to "cost-effective financing," and "such access will be needlessly imperiled as a result of the emergency manager's approach."

In a report last month, Nuveen Asset Management, which owns some of the city's debt, said Mr. Orr's proposed actions could be replicated in one or more of Michigan's other distressed cities or towns, also hurting bondholders .

The firm estimated that nearly 10% of Michigan's population lives in a community that is under the control of an emergency manager or is under some stage of state oversight due to its fiscal problems.

WSJ: Some Detroit Bonds Hit by Bankruptcy Filing.

General-Obligation Bonds, Considered Among Safest, Take Hit After Being Targeted for Cuts

Some Detroit bond prices fell sharply on Friday, as the municipal-bond market took a hit one day after the city filed the largest municipal bankruptcy ever.

Debt tied to Detroit's retirement system traded on Thursday, before the city's bankruptcy filing, at 38.5 cents on the dollar, according to Electronic Municipal Market Access. On Friday morning, the bid price, or the price that a dealer is willing to pay for the debt, was listed at 37 cents on the dollar, a 1.5 cent decline, said Gary Pollack, managing director at Deutsche Asset & Wealth Management.

A general-obligation bond issued by the city traded at 84.575 cents on Friday, down from 95 cents on Thursday, even though that particular bond carries insurance, according to the EMMA website.

Bond investors are particularly rankled that the city appears poised to seek significant cuts on general-obligation bonds, which are backed by a municipality's taxing authority. Previously, this debt has been considered one of the safest types of munis.

Overall, yields on highly rated, long-dated muni bonds were up 0.11 percentage point Friday, according to a benchmark scale from Thomson Reuters Municipal Market Data. Prices move inversely to yields, so a higher yield indicates a lower price. The price move "is a reflection of some uncertainty in the market right now," said Domenic Vonella, managing analyst at MMD.

"The weakness today could be attributed to a number of things, but Detroit, Chicago, those are a couple of the bigger concerns in the market right now," said Mr. Vonella, also referring to a decision by Moody's Investors Service this week to downgrade Chicago's credit rating.

Mr. Pollack said that although Detroit's troubles had been well-telegraphed, the bankruptcy filing "is not a positive news item, and at a time when people are withdrawing money from bond funds to begin with, it makes me nervous as an investor." Mr. Pollack, who oversees $12 billion in investments, said he didn't hold Detroit bonds.

Muni investors said Detroit's bankruptcy petition could hurt demand for bonds from all Michigan localities. Michigan Gov. Rick Snyder authorized Detroit's bankruptcy filing, and it is expected that bondholders stand to take significant losses. The governor also previously appointed an emergency manager, Kevyn Orr, who has steered the city into bankruptcy court.

The Securities Industry and Financial Markets Association, a trade group of securities firms, banks and asset managers, took issue with the proposed treatment of the general-obligation bonds, which would be repaid at pennies on the dollar.

In a letter Thursday, the group implored Gov. Snyder to "act deliberately and be aware that your actions … could have potentially significant, negative municipal securities market implications."

In Portage, Mich., which is planning to sell $3.13 million in general-obligation bonds next week, finance director Daniel Foecking said he didn't think the bankruptcy would derail his city's sale. Mr. Foecking, whose city of about 46,000 is about 140 miles west of Detroit, acknowledged the filing could result in slightly higher interest rates for Portage, but he didn't think the increase would be significant.

Mr. Foecking pointed out there are key differences between Detroit and Portage. For one, Standard & Poor's gives Portage a double-A rating. Detroit's rating is single-C.

"It's been my personal philosophy, when you start budgeting, the first thing you do is factor in debt service," Mr. Foecking said.

Some investors said the filing, though not necessarily a surprise, seemed almost out of character for the state.

"Michigan has been touted for years as one of the most bond-friendly states out there," said Robert Miller, senior portfolio manager at Wells Capital Management, which oversees $32 billion in munis. "That reputation is shot."

Mr. Miller said his firm didn't own any general-obligation bonds, but it did have some exposure to Detroit's sewer bonds. He said he felt more comfortable owning the sewer debt because the sewer system serves not just the city, but the surrounding area. Those bonds are backed specifically by sewer-system revenues.

Nonetheless, Standard & Poor's downgraded the city's water and sewer bonds to double-B-minus earlier in this month. And on Friday, S&P placed those bonds on CreditWatch negative. The general-obligation bonds were previously at double-C, but were lowered to single-C on Thursday after the bankruptcy.

"Why would you own a Michigan general-obligation bond if the state's letting Kevyn Orr take a very aggressive approach to existing debtholders?" said Anthony Valeri, fixed-income strategist at broker-dealer LPL Financial. "We would certainly caution investors about investing in Michigan GOs. Or if you do, that you're compensated for the risk."

Not all investors were overly perturbed. Matt Dalton, chief executive of Belle Haven Investments, said his firm was still comfortable holding bonds from Michigan municipalities, despite the harsh line Mr. Orr is taking with some bondholders.

"The state has had a good history of fiscal oversight of communities and they've already done a lot for Detroit," said Mr. Dalton, whose firm oversees about $1.6 billion in assets and owns some Detroit school-district debt, as well as of the city's water and sewer bonds.

WSJ: Bondholders, Public Pensioners Square Off in Detroit.

The bankruptcy case in Detroit could be titled Bondholders v. Pensioners.

The city's emergency manager has said his goal is to spread the pain around. That means goring two sacred cows: general obligation debt and public employee pension benefits.

Both sides are fighting fiercely to prevent that from happening, with each warning of dire consequences.

Last month bondholders winced at the restructuring plan floated by Detroit Emergency Manager Kevyn Orr, who proposed breaking the city's promises to general obligation bond holders.

Backed by the full faith and credit of the issuer, general-obligation debt is regarded as the gold standard of the municipal bond market. But under Mr. Orr's plan, bondholders would stand to lose about $500 million.

That's just a small part of the $11.5 billion in unsecured debt that Mr. Orr put on the chopping block. But it set off investor alarms.

"We believe breaking the promise to GO bondholders and treating all unsecured creditors equally could set a dangerous precedent with far-reaching implications — in Detroit, in Michigan and beyond," wrote Peter J. Hayes, managing director and head of the Municipal Bonds Group for BlackRock, in an op-ed in Thursday's Detroit Free Press.

"This is Wall Street's worst nightmare," Richard Brodsky, a former Democratic New York assemblyman who is advising the mayor of Yonkers, N.Y., on managing the city's finances, told Law Blog. "They have to sit at the table like an equal with the unions and the taxpayers."

Pushing back just as hard against the restructuring plan are Detroit's unions and the city pension boards, which sued to block Thursday's bankruptcy filing.

Slashing retiree health-care benefit plans is one thing. Cutting pension payments to active and retired employees would be a deeply traumatic development for public-sector unions in Detroit and beyond. Estimating a $3.5 billion shortfall in the city's two retirement funds, Mr. Orr has said the city has no choice but to roll back pension benefits.

Like New York, Michigan is constitutionally prohibited from "diminishing" pension benefits already granted to current and retired workers. But federal law could very well trump state law here. The question is whether a federal judge would approve it.

It's all part of Mr. Orr's goal of shared sacrifice. "He really has made enemies with everyone," Stephen Eide, a public-finance analyst at the Manhattan Institute, a conservative think tank in New York City, told Law Blog. "He's made good on that approach."

- *Bluebonnet Hotel Ventures, LLC v. Wachovia Bank, N.A.*, in which the court declined to rescind interest rate swap contract – entered into by developer at bank's suggestion – in connection with bond issuance, finding that swap was not contingent upon extension of letter of credit by bank, which was never executed.
- *Kane v. Township of Williamstown*, holding that a resolution that permitted a township to assess an ad valorem special assessment for police protection also permitted the township to assess and implement a uniform-fee special assessment.
- *Borough of Harvey Cedars v. Karan*, in which the Supreme Court of New Jersey held that calculation of just compensation in eminent domain action is required to include benefit that homeowners obtained as a result of storm protection provided by construction of sand dune that was the cause of the eminent domain action.
- *Louisiana Mun. Police Employees' Retirement System v. JPMorgan Chase & Co.*, in which the court found nothing illegal about bank's charging of undisclosed mark-ups on foreign exchange transactions executed for custodial clients.
- US Municipal VRDO and FRN Update, June 2013.
- Brokers Willing to Pay Up for Fiduciary Standard: SIFMA.
- MSRB Releases Report on Municipal Bond Continuing Disclosure Documents.
- MSRB to Launch Disclosure Tool; Will it Lead to Dispute with DAC?

- IRS: FSLG July 2013 Newsletter.
- GFOA: New Pension Numbers for Books, Budgets, and Bonds.
- WSJ: With Palo Alto on Board, OpenGov Aims for Transparency in Dozens More City Governments.
- And finally, a laudable attempt to make soccer entertaining. Assistant soccer coach jumps up, grabs the goal's crossbar, and pulls the entire apparatus down onto his face. I'd watch that.

US Municipal VRDO and FRN Update, June 2013.

A brief historical stat sheet to the municipal VRDO market for the period from July 2009 to June 2013 and the FRN market from January 2011 to June 2013, in excel format only.

http://www.sifma.org/WorkArea/DownloadAsset.aspx?id=8589944354

ZONING - CALIFORNIA

Orange Citizens for Parks and Recreation v. Superior Court

Court of Appeal, Fourth District, Division 3, California - July 10, 2013 - Cal.Rptr.3d - 13 Cal. Daily Op. Serv. 7365

The City of Orange City Council (the City Council) ultimately approved the construction of 39 homes on 51 acres of what had been a golf course (the Project). In connection therewith, the City Council adopted a resolution amending the City's general plan (General Plan Amendment). Among other things, the General Plan Amendment changed the existing designation of the Property on the general plan land use policy map (Policy Map) from "Open Space" to "Other Open Space & Low Density." In response to petitioning activity by its citizens, the City held a referendum on the General Plan Amendment. Voters defeated Measure FF, thereby nullifying the General Plan Amendment.

Plaintiffs (referred to collectively as Orange Citizens) asserted that the referendum essentially undid the City Council's approval of the Project.

Landowner, the City, and the City Council contended that the City's general plan since 1973 had always been to allow low density residential development on the Property. As repeatedly found by the City Council in connection with its approval of the Project, the City's general plan was already consistent with low-density residential units being constructed on the Property, even without the General Plan Amendment and notwithstanding the "Open Space" designation on the Policy Map. The General Plan Amendment simply corrected errors on the Policy Map (and in other documents). Regardless of whether these errors were corrected, the Project was consistent with the City's general plan. The trial court agreed with this position and the appeals court affirmed.

"In 1973, the City Council adopted the Orange Park Acres plan as part of the general plan, and in doing so designated the Property as open space or low density residential. In 1977, the City Council resolved to remove any language in the Orange Park Acres plan inaccurately suggesting it was a specific plan. In 2011, the City Council repeatedly found the Orange Park Acres plan was still part of the general plan and the Property's use designation still allowed low density residential development. The City may fix errors in the Orange Park Acres Plan and the Policy Map by reference to previously adopted resolutions of the City Council. The General Plan Amendment was nullified by the voters, but it does not matter with regard to the major points of contention."

GOVERNMENTAL IMMUNITY - CONNECTICUT

Blonski v. Metropolitan Dist. Com'n

Supreme Court of Connecticut - July 16, 2013 - A.3d - 2013 WL 3368870

Supreme Court of Connecticut considered the scope of governmental immunity that is afforded to a political subdivision of the state that has been sued for allegedly negligent conduct that is alleged to be connected to the proprietary function of operating a water supply company.

After the plaintiff was injured when she rode her bicycle into a pipe gate on property maintained by the defendant, the Metropolitan District Commission, she brought an action claiming that the defendant had negligently maintained the gate in an unsafe and dangerous condition. The jury returned a verdict for the plaintiff and the trial court rendered judgment accordingly.

The questions that the court addressed on appeal were: (1) whether the defendant was immune from liability pursuant to General Statutes § 52–557n (a)(2)(B) because the maintenance of the gate to control the recreational use of the property was a governmental function requiring the exercise of discretion or, instead, the defendant was liable under § 52–557n (a)(1)(B) because its conduct was connected to its proprietary function of operating a water supply company; and (2) if the defendant was not entitled to immunity under § 52–557n (a)(2)(B), whether it is entitled to immunity pursuant to the Recreational Land Use Act (act), General Statutes (Rev. to 2001) § 52–557f et seq.

The Supreme Court of Connecticut concluded that the defendant was liable pursuant to § 52–557n (a)(1)(B) because the maintenance of the gate was inextricably linked to a proprietary function, and that it was not entitled to immunity pursuant to the act. Accordingly, it affirmed the judgment of the trial court.

EMINENT DOMAIN - FLORIDA

Collins v. Monroe County

District Court of Appeal of Florida, Third District - July 10, 2013 - So.3d - 2013 WL 3455608

The Landowners own property in Monroe County, Florida. Pursuant to the Monroe County Year 2010 Comprehensive Plan (the “Plan”), the Landowners filed petitions for a Beneficial Use Determination (“BUD”). A BUD petition requires an applicant to demonstrate that the comprehensive plan and land development regulations in effect at the time of the BUD application deprive the applicant of all reasonable economic use of the property.

Following a lengthy set of appeals, the court held that (a) the issuance of post-BUD building permits, etc. demonstrates that the Plan had not deprived Landowners of all reasonable economic use of their properties, and (b) only that landowner who had obtained building permits prior to the BUD petition was entitled to bring an eminent domain claim.

ZONING AND DEVELOPMENT - IDAHO

Hehr v. City of Mc Call

Supreme Court of Idaho, Boise, May 2013 Term - July 11, 2013 - P.3d - 2013 WL 3466895

Developer brought action against city for inverse condemnation alleging that the conveyance of lots to city in lieu of paying the required community housing fee, which was later declared unconstitutional in a separate proceeding, and the improvements made to those lots constituted an illegal taking.

The Supreme Court of Idaho held that:

- Developer's inverse condemnation claim against city to recover the cost of constructing improvements for the nine lots conveyed to city for community housing was encompassed in its claim to recover the value of those lots;
- Developer's state law takings claim was barred due to developer's failure to present a timely notice of claim to city;
- City never reached a final decision regarding the application of the ordinance to the property at issue as required for federal takings claim;
- Developer forfeited its federal takings claim against city; and
- City was not entitled to attorney fees.

CONTRACTS - IOWA

Horsfield Materials, Inc. v. City of Dyersville

Supreme Court of Iowa - July 5, 2013 - N.W.2d - 2013 WL 3378316

Prospective supplier of materials for public construction project brought action against city, which had excluded prospective supplier from list of preapproved materials suppliers, seeking declatory judgment that preapproval process violated public bidding statute, equal protection, and due process, and seeking relief under open records law based on city's responses to a records request.

Holdings: The Supreme Court, Mansfield, J., held that:

- Prospective supplier lacked standing to seek declaratory judgment that city's list of preapproved materials suppliers violated public bidding statute;
- Prospective supplier met "injury in fact" element of standing to assert that its ongoing exclusion from city's lists of preapproved suppliers violated equal protection and due process;
- City's process of preapproving three suppliers of aggregate and three suppliers of concrete for public construction project did not violate equal protection or substantive due process;
- Prospective supplier had no liberty or property interest at stake in supplying materials for city's construction projects, such that no procedural violation occurred when city excluded prospective supplier from lists of preapproved suppliers;
- Open Records Act provision does not impose an absolute 20-day deadline on a government entity to find and produce requested public records;
- City did not substantially comply with legal obligation under Open Records Act to produce public records promptly by taking from approximately January 25 to April 6 to produce 617 pages of records requested by materials supplier; and
- City's tactical decision as defendant on Open Records Act claim to waive attorney-client privilege with respect to eight emails covered by records request did not show that city violated the act by initially withholding those emails.

City's process of preapproving three suppliers of aggregate and three suppliers of concrete for public construction project served realistically conceivable government interest in quality control, and there was a reasonable fit between the means chosen and the goal of quality control, such that process satisfied rational-basis review on equal protection and substantive due-process challenges asserted by a prospective supplier excluded from preapproved lists. City had 20 to 30 years of positive experience with each of the suppliers on the preapproved lists, and there was no indication that city excluded any suppliers that had a similar track record.

TORT CLAIMS ACT - KANSAS

Continental Western Ins. Co. v. Shultz

Supreme Court of Kansas - July 5, 2013 - P.3d - 2013 WL 3378339

Injured motorist's workers' compensation carrier filed suit against city, city police department, and police officer to recover for amounts paid as result of motorist's accident with officer, due to officer's alleged negligence.

The Supreme Court of Kansas held that:

- Carrier's pre-suit notice of claim substantially complied with statute governing same, and
- Carrier was not required to file revised notice of claim as prerequisite to amended petition that asserted nearly eleven-fold increase in damages from amount asserted in original notice and petition.

Pre-suit notice to city filed by injured motorist's workers' compensation carrier of claim under Kansas Tort Claims Act based on alleged negligence of city police officer, which notice alleged $19,590.07 in damages, substantially complied with statute governing same, despite subsequent amended petition which alleged damages of $228,088.25. Notice provided city with sufficient information to investigate and understand merits of carrier's demand, same damages were alleged in both notice and original petition, carrier's request to amend petition was governed by different rule governing amendment to pleadings, and city did not argue that it was unaware of carrier's claims or that it did not have enough time to investigate claims before suit was brought.

BONDS - LOUISIANA

Bluebonnet Hotel Ventures, LLC v. Wachovia Bank, N.A.

United States District Court, M.D. Louisiana - July 8, 2013 - Slip Copy - 2013 WL 3423106

Bluebonnet was created in order to construct a new hotel in Baton Rouge, Louisiana. Bluebonnet sought to issue tax-exempt Gulf Opportunity Zone ("GO Zone") bonds in order to finance the hotel's construction. Bluebonnet sought a letter of credit from Wells Fargo. A term sheet was executed and signed by a Wells Fargo and Milford Wampold ("Wampold"), the real estate developer and managing member of Bluebonnet.

As Wells Fargo continued evaluating Bluebonnet's application, complications with its proposed contractors forced Bluebonnet to repeatedly delay and change plans for the hotel, which modified essential details as previously laid out in the original term sheet. Due to the change in the plans and information from Bluebonnet, Wells Fargo was not able to go through on the original term sheet. The GO Zone bonds were granted approval in September of 2007, and were issued in May of 2008. Two weeks before the issuance of the bonds in May of 2008, and 13 months after the execution of the original term sheet, Bluebonnet attempted to gain a provisional $2.5 million letter of credit from Wells Fargo in order to preserve its bond allocation. Wells Fargo informed Bluebonnet that it "could not issue a partial or dry closing in the two weeks provided. Bluebonnet closed on alternative, limited financing from Regions Bank to preserve the bond allocation.

After the original term sheet was signed, on May 1, 2007, Wampold signed a swap contract on behalf of Bluebonnet at Wells Fargo's suggestion. The purpose of the swap contract was to hedge the floating interest rates on the anticipated bonds that Bluebonnet intended to issue by adjusting Bluebonnet's "put" payments to a fixed rate. Should the interest rates rise above the fixed rate, Wells Fargo would pay the difference, and if the interest rates fell below the fixed rate, Bluebonnet would pay Wells Fargo the difference. Before Wampold signed the contract, he was made aware that it required his personal guaranty because it would be executed independently of any other financing he might receive from Wells Fargo. Wampold delayed the start date of the swap contract six times, making the effective date May 2, 2008, nearly a year later than the original August 1, 2008 start date. During this time, the interest rates on the bonds dropped significantly, so that Wampold had to pay the difference in the rates.

After securing the funding from Regions Bank to cover the bonds, Wampold returned to Wells Fargo to obtain permanent financing through a letter of credit for the hotel. Wells Fargo was unable to grant a letter of credit under the original term contract due to Wampold's late changes to the hotel design in 2009, which differed from the original 2007 hotel design. Wampold ultimately financed the project from a loan from Regions Bank.

Wampold subsequently brought this action to rescind the swap contract for failure of cause, negligence, and detrimental reliance. Wampold claimed that the principal cause of the swap agreement was the anticipated letter of credit which never materialized. Wells Fargo filed a Motion to Dismiss.

Louisiana law contemplates the possibility that changed circumstances may constitute a failure of cause when the "cause" is within the control of the party seeking to enforce the contract. Nevertheless, the Court found that the record contradicts Bluebonnet's claim that its determined or determinable cause for the swap contract was to fix the rate on its anticipated bond issuance, contingent upon Wells Fargo's extending a line of credit. This financial instrument was intended to, in speculative—and ultimately incorrect—anticipation of rising interest rates, provide Bluebonnet with a stable and potentially cost-effective method of making payments to any bond holders wishing to exercise their "put" rights on bonds that it desired to release

Wells Fargo's motion for summary judgment was granted.

NEGLIGENCE - MARYLAND

[Coleman v. Soccer Ass'n of Columbia]

Court of Appeals of Maryland - July 9, 2013 - A.3d - 2013 WL 3449426

Volunteer coaching assistant brought action against local soccer association, seeking damages for injuries incurred when he jumped and grabbed the metal crossbar of an unanchored soccer goal, causing the goal to tip over and land on his face. After a jury trial at which jury found that coach's own negligence had contributed to his injuries, the Circuit Court, Howard County, entered judgment in favor of association. Coach appealed. Before briefing and argument in the Court of Special Appeals, coach petitioned for writ of certiorari.

The Court of Appeals held that it would decline to abrogate common law principle of contributory negligence in favor of some form of comparative negligence. Thus, coach was not entitled to recover for his injuries since jury found that coach's own negligence had contributed to his injuries. Failure of numerous bills in general assembly that would have abolished or modified the contributory negligence standard was a clear indication of legislative policy to retain the standard.

FIRST AMENDMENT - MARYLAND

Hassay v. Mayor

United States District Court, D. Maryland - July 3, 2013 - Not Reported in F.Supp.2d - 2013 WL 3364692

During every summer from 1995 until June 2012, plaintiff William F. Hassay, Jr., an accomplished violinist, performed as a street artist on the beachfront boardwalk in Ocean City, Maryland. On June 2012, Hassay was warned by an Ocean City police officer that the volume of his music violated an Ocean City noise ordinance enacted in February 2012, which prohibited, inter alia, the audibility of musical instruments and amplified sound at a distance of greater than thirty feet. Faced with the threat of arrest, three months' imprisonment, and a $500 fine, Hassay never returned to the boardwalk to perform.

On April 10, 2013, Hassay filed suit against the Mayor and City Council of Ocean City, Maryland claiming that the 30–Foot Audibility Restriction violated plaintiff's rights under the First Amendment. Plaintiff also filed a motion for a preliminary injunction seeking to enjoin the enforcement of the 30–Foot Audibility Restriction on the boardwalk during the pendency of the case.

After undergoing the traditional First Amendment analysis, the court found that, by restricting the audibility of music on the boardwalk to a distance of thirty feet, Ocean City had effectively banned this form of expression from the boardwalk, a traditional public forum.

Accordingly, as applied to the Ocean City boardwalk, plaintiff had established a likelihood of success on the merits with respect to a violation of the First Amendment based on the 30–Foot Audibility Restriction. A preliminary injunction against the enforcement of the 30–Foot Audibility Restriction, as to the boardwalk, in accordance with Fed.R.Civ.P. 65, was issued.

ZONING - MASSACHUSETTS

Grady v. Zoning Bd. of Appeals of Peabody

Supreme Judicial Court of Massachusetts, Suffolk - July 10, 2013 - N.E.2d - 465 Mass. 725

Neighbor brought action challenging decision of city zoning board of appeals, denying neighbor's request to revoke property owner's building permit on ground that owner had failed to record zoning variance within one year of issuance.

The Supreme Judicial Court of Massachusetts held that variance did not lapse.

Zoning variance did not lapse after property owner failed to record variance within one-year statutory period, but instead variance became effective. Owner was issued a building permit and took substantial steps, including obtaining construction loan and beginning construction operations, within the one-year period in reliance upon an otherwise valid variance. There was no apparent harm to any interested parties, other than any harm resulting from the original, uncontested grant of the variance, and the variance was recorded less than two weeks after the expiration of the one-year period.

SPECIAL ASSESSMENTS - MICHIGAN

Kane v. Township of Williamstown

Court of Appeals of Michigan - July 11, 2013 - N.W.2d - 2013 WL 3481342

The voters in Williamstown Township approved a proposal to allow for “the creation of a special assessment district under 1951 PA 33, as amended, in order to raise money by special assessment for furnishing police protection.”

The Williamstown Township Board of Trustees adopted Resolution 2010–96, which provided that the special assessment on residential property would be $150, the special assessment on commercial property would be $250, and the special assessment on vacant property would be $0.

Thereafter, petitioner received a tax bill requiring payment of $150 on his residential property and $250 on his commercial property. Petitioner appealed to the Michigan Tax Tribunal, arguing that any such special assessment must be based on each property’s taxable value and not a uniform fee.

At issue was whether MCL 41.801, which indisputably permits a township to assess an ad valorem (according to value) special assessment, also permits a township to assess and implement a uniform-fee special assessment. The court of appeals concluded that it does.

The salient portion of the provision requires the township supervisor “to spread the assessment levy on the taxable value of all of the lands and premises in the district that are to be especially benefited by the police and fire protection, *according to benefits received* ….” (Emphasis added.) As a result of the statute’s plain language requiring that any assessments be based “according to the benefits received,” if a township determines that the properties in the district are all to benefit equally, then those properties will need to be assessed equal amounts as a matter of law.

Petitioner contended that because the assessments must be levied “on the taxable value of all the lands,” any such assessments must be ad valorem and not uniform. However, the court held that spreading the assessment levied on taxable value is not the same as basing the assessment on taxable value.

SPECIAL ASSESSMENTS - MICHIGAN

Ashley Ann Arbor, LLC v. Pittsfield Charter Tp.

Supreme Court of Michigan - July 3, 2013 - N.W.2d - 2013 WL 3357686

“The parties shall include among the issues to be briefed whether a public corporation’s special assessment against an individual parcel of property authorized under the Drain Code, MCL 280.490(1), but implemented through the provisions governing special assessments by the public corporation contained in the Public Improvement Act, MCL 41.721, et seq., is subject to the exclusive jurisdiction of the Michigan Tax Tribunal, pursuant to MCL 205.731, in light of the amendment of 1992 PA 172, excluding the drain code from the definition of “property tax laws.'”

“The Michigan Association of Counties, the Michigan Municipal League, and the Public Corporation Law Section of the State Bar of Michigan are invited to file briefs amicus curiae. Other persons or groups interested in the determination of the issues presented in this case may move the Court for permission to file briefs amicus curiae."

Knock yourselves out.

STATUTE OF REPOSE - NEW JERSEY

431 Route 206, LLC v. Township of Montague

Superior Court of New Jersey, Appellate Division - July 11, 2013 - A.3d - 2013 WL 3466561

This matter involved a twenty-four-inch reinforced concrete drainage pipe (the 24–inch pipe) that an employee of defendant Township of Montague installed in the early 1970's. The property's owner alleged that the pipe's defective design and/or negligent construction caused the pipe to fail, allowing water to escape, which destroyed the septic system and damaged buildings on the property.

The Township invoked the statute of repose, the elements of which are:

- The injury sustained by plaintiff resulted from a defective and unsafe condition of an improvement to real property;
- Defendant was responsible for performing or furnishing the design, planning, surveying, supervision of construction, or construction of the improvement; and
- The injury occurred more than ten years after the performance or furnishing of the services.

The court determined that the Township had met all three elements and dismissed the case.

CITY COUNSEL - NEW JERSEY

Booker v. Rice

Superior Court of New Jersey, Appellate Division - July 5, 2013 - A.3d - 2013 WL 3357614

Mayor, city clerk, members of city council, and appointee for vacant council position filed suit against members of city council who voted against appointment and two council members who abstained from vote, seeking order to show cause why declaratory judgment should not enter confirming appointee's appointment to council or, in alternative, why mandatory injunction should not issue to compel council members to attend and vote at special council meeting. With parties' consent, the Superior Court, Law Division, Essex County, Dennis F. Carey, III, J., issued interim order compelling all council members to appear for special vote. Four council members voted yes, two voted no, and two abstained. Mayor voted to break alleged tie, in favor of appointment. The Superior Court then issued ruling that abstention was not yes or no vote, and therefore, there was not "tie" that triggered mayor's authority to vote to break tie. Plaintiffs appealed.

The Superior Court, Appellate Division, held that:

- Abstentions of two city council members on vote to fill vacant position were not "no" votes resulting in tie, so as to trigger statutory authority for mayor to vote in order to break tie;
- City council rule of procedure that council member "may abstain from voting on any matter," and that "such abstention shall not be counted as a yes or no vote but shall be recorded in the minutes," was not arbitrary, capricious, and unreasonable; and
- Abstention on vote was permissible exercise of statutory discretion to choose to have vacancy filled

by election of voters.

Incidentally, Cory Booker was a law school classmate of mine. Probably should have latched on to those coattails, eh?

EMINENT DOMAIN - NEW JERSEY

Borough of Harvey Cedars v. Karan

Supreme Court of New Jersey - July 8, 2013 - A.3d - 2013 WL 3368225

Borough brought condemnation action against beachfront property owners, seeking condemnation of portion of property for purposes of constructing a dune for storm protection.

The Supreme Court of New Jersey held that calculation of just compensation was required to include benefit that homeowners obtained as a result of storm protection provided by dune.

When a public project requires the partial taking of property, just compensation to the owner must be based on a consideration of all relevant, reasonably calculable, and non-conjectural factors that either decrease or increase the value of the remaining property. When a public project requires the partial taking of property, homeowners are entitled to the fair market value of their loss, not to a windfall, not to a pay out that disregards the home’s enhanced value resulting from a public project.

To calculate a homeowner’s loss from a partial taking arising from a public project, a court must look to the difference between the fair market value of the property before the partial taking and after the taking.

ARTICLE 78 REVIEW - NEW YORK

Conners v. Town of Colonie

Supreme Court, Appellate Division, Third Department, New York - July 3, 2013 - N.Y.S.2d - 2013 N.Y. Slip Op. 05033

Town residents petitioned for Article 78 review of town resolution authorizing town to enter into agreement for operation and management of landfill.

The Supreme Court, Appellate Division, held that agreement did not convey any real property rights, and thus was not subject to permissive referendum requirement.

There was no conveyance of real property rights pursuant to town resolution authorizing town to enter into agreement for operation and management of landfill, and thus agreement was not lease and, as such, was not subject to statutory requirement to conduct permissive referendum. The agreement contained no provisions that explicitly conveyed property rights, stated that its purpose was for town to authorize and direct contractor to manage, maintain, and operate landfill in accordance with terms of agreement, preserved town’s unlimited right to enter property, imposed numerous requirements and restrictions on contractor, and reasonably characterized payments that contractor was obligated to town were in consideration for certain revenues that contractor was entitled to retain.

PUBLIC UTILITIES - NEW YORK

Crown Castle NG East Inc. v. Town of Greenburgh, N.Y.

United States District Court, S.D. New York - July 3, 2013 - Slip Copy - 2013 WL 3357169

Plaintiff – a "carrier's carrier" that designs and installs fiber-optic based networks to improve wireless coverage and capacity sought permission to install a Distributed Antenna System ("DAS") in the Town of Greenburgh, New York. The Town, after a protracted negotiation/application process, denied Plaintiff's applications.

Plaintiff sought a declaratory judgment that the Town has violated the provisions of the TCA, and further sought a mandatory injunction requiring the Town to grant such permits or other authority as is necessary to allow Plaintiff to install, operate, and maintain its facilities in the Town's public rights of way as set forth in Plaintiff's application.

After an interminable opinion, the court concluded that, "This is a paradigmatic case where remand would only further and unnecessarily delay the processing of Plaintiff's siting application. Accordingly, the appropriate remedy in equity is an order requiring the issuance of the special permits sought."

SECURITIES - NEW YORK

Louisiana Mun. Police Employees' Retirement System v. JPMorgan Chase & Co.

United States District Court, S.D. New York - July 3, 2013 - Slip Copy - 2013 WL 3357173

Louisiana Municipal Police Employees' Retirement System ("LAMPERS") brought suit against JPMorgan Chase (the "Bank") for charging undisclosed mark-ups on foreign exchange transactions that JPMorgan executed for custodial clients.

Custodial clients of the Bank, including LAMPERS, often invest in multiple securities of foreign issuers and occasionally engage in direct currency trading as well. As a result of these activities, custodial clients regularly need to convert U.S. Dollars into foreign currencies, or foreign currencies into U.S. Dollars. This conversion is accomplished through a Foreign Exchange or "FX" transaction. In an FX transaction one currency is bought or sold in exchange for another currency at a particular rate that is available in the currency market. The Bank offers FX services to its custodial clients and regularly executes FX transactions at its customers' direction. At its core, this case was based on the allegation that the Bank executed certain FX transactions at one rate, but charged the custodial clients a different rate, resulting in profit for the Bank, and that the Bank failed to disclose this practice to its custodial clients.

The crux of the case is whether the execution of FX transactions for the client was a service under the Custody Agreement and whether the rate that the Bank listed on its monthly statements for each of these FX transactions was a "fee" when that rate includes the spread on the Indirect FX transactions.

The court concluded that rates for FX transactions are not fees, and therefore the rates disclosed by the Bank to LAMPERS did not constitute "fees," as that term is used in the Custody Agreement.

Furthermore, because the spreads were evident from the AutoFX Confirmations and publicly available databases, there was nothing secret about the mark-ups.

Finding no violations of the law, the court dismissed the case.

GOVERNMENTAL IMMUNITY - NEW YORK

Middleton v. Town of Salina

Supreme Court, Appellate Division, Fourth Department, New York - July 5, 2013 - N.Y.S.2d - 2013 N.Y. Slip Op. 05119

In an action against a municipality, it is the fundamental obligation of a plaintiff pursuing a negligence cause of action to prove that the putative defendant owed a duty of care. Under the public duty rule, although a municipality owes a general duty to the public at large to perform certain governmental functions, this does not create a duty of care running to a specific individual sufficient to support a negligence claim, unless the facts demonstrate that a special duty was created.

In order for plaintiffs to establish that defendant owed a special duty to them, they were required to establish that defendant voluntarily assumed a duty that generated justifiable reliance by the person who benefitted from the duty. That burden has four elements: (1) an assumption by the municipality, through promises or actions, of an affirmative duty to act on behalf of the party who was injured; (2) knowledge on the part of the municipality's agents that inaction could lead to harm; (3) some form of direct contact between the municipality's agents and the injured party; and (4) that party's justifiable reliance on the municipality's affirmative undertaking.

Here, defendant met its initial burden on the motion by submitting evidence establishing that plaintiffs' alleged reliance upon representations allegedly made by defendant's agents was not justifiable.

However, even assuming, arguendo, that plaintiffs raised a triable issue of fact whether defendant owed a special duty to them, the court concluded that the governmental function immunity defense applied. Defendant established that it was engaged in a governmental function when it engaged in the allegedly negligent conduct, i.e., failing to install a check valve or similar anti-backflow device on plaintiffs' sewer line to prevent sewage from flowing backwards out of the sewer line and into plaintiffs' house.

UNIONS - OREGON

Eagle Point Educ. Ass'n v. Jackson County School Dist. No. 9

United States District Court, D. Oregon, Medford Division - July 1, 2013 - Slip Copy - 2013 WL 3348357

Eagle Point Education Association (the "Union") brought a civil rights action against Jackson County School District No. 9 (the "District"), and the District's board of directors and superintendent. Plaintiffs claimed that defendants infringed on their First Amendment rights to express support for a strike by Union members.

Anticipating a strike, the District's board had adopted a "Resolution on Picketing" and a "Resolution on Signs and Banners."

The Association went on strike. Two instances of enforcement of the signage and picketing resolutions occurred during the strike.

The strike was settled after eight days.

Plaintiffs asked the Court to declare that the School District's policies limiting their presence and strike activities on District property violated plaintiffs' First Amendment right to speech. The Court found that plaintiffs' allegation that their constitutional rights were infringed by defendants, and their accompanying claim for nominal damages, was sufficient to defeat defendant's claim of mootness.

Plaintiffs also asked the Court to enjoin defendants from promulgating or enforcing directives similar to those complained of, now or in the future. The Court found that the Union had pled sufficient facts to invoke the "capable of repetition, yet evading review" exception to the mootness doctrine.

For the reasons stated above, defendants' motion to dismiss plaintiffs' federal law claims and their motion to dismiss plaintiffs' state law claims for injunctive relief were denied.

TAKINGS - TENNESSEE

Phillips v. Montgomery County

Court of Appeals of Tennessee - June 28, 2013 - Slip Copy - 2013 WL 3378952

Landowners wanted to build a subdivision on their property and submitted a preliminary subdivision plat to the Planning Commission in accordance with the applicable zoning resolution and subdivision regulations. The Planning Commission denied the proposed plan because the property lies in the path of a planned future extension of State Highway 374.1 Landowners filed a complaint against Montgomery County and Clarksville Montgomery County Regional Planning Commission in the circuit court, asserting claims for a regulatory taking under the Tennessee Constitution and for inverse condemnation pursuant to Tenn.Code Ann. § 29–16–123.2

The Court of Appeals stated that it had not yet held that a regulatory takings claim can be asserted under Article I, Section 21 of the Tennessee Constitution (as opposed to the U.S. Constitution). Currently, it recognized only two types of takings claims—physical occupation takings claims and nuisance-type takings claims. Since the Supreme Court of Tennessee had declined to hold that a regulatory takings claim can be asserted based upon the Taking Clause of the Tennessee Constitution, The Court of Appeals also declined to do so.

The court denied the County's motion to dismiss Landowners' inverse condemnation claim, remanding for further proceedings.

INVERSE CONDEMNATION - WASHINGTON

Jackass Mt. Ranch, Inc. v. South Columbia Basin Irr. Dist.

Court of Appeals of Washington, Division 3 - July 9, 2013 - P.3d - 2013 WL 3422678

Owners of cherry orchard damaged by landslide resulting from seepage from irrigation wasteway brought claims of inverse condemnation, negligence, res ipsa loquitur, and trespass against irrigation district that operated wasteway.

The Court of Appeals held that:

- There was no evidence that landslide was caused by district's operation of wasteway, as opposed to design and construction of wasteway by United States Bureau of Reclamation (USBR), and, therefore, irrigation district could not be held liable on an inverse condemnation claim;
- There was no evidence that district breached applicable standard of care in its operation of wasteway, as necessary for district to be liable in negligence;
- Doctrine of res ipsa loquitur did not apply so as to relieve owners from proving specific acts of negligence; and
- There was no evidence to support intent element of a trespass claim.

SEC Lifts Ban on Hedge Fund Ads.

Hedge funds and other firms that seek private investments will be allowed to advertise publicly for the first time under a rule adopted Wednesday by the Securities and Exchange Commission.

Adopted by a 4-1 vote, the rule eliminates an 80-year regime of advertising restrictions intended to safeguard small investors from taking on potentially dangerous risk. The rule covers the way issuers raise funds through private offerings, a process that is exempt from requirements to report public financial statements.

While the rule would authorize firms to raise unlimited amounts via mass advertising of private offerings, it would require reasonable steps to ensure that buyers are so-called accredited investors — who are wealthier and deemed better able to gauge investment risks.

The rule would also make it easier for start-up businesses to raise funding without immediately requiring compliance with SEC disclosure rules. The measure is the first adopted by the SEC under a mandate in the 2012 Jumpstart Our Business Startups Act approved by Congress and signed by President Obama.

The SEC adopted the rule while unanimously approving a separate rule to ban most felons and other "bad actors" from involvement in private offerings.

A proposal that could eventually require issuers to notify the SEC 15 days before starting offerings and at the conclusion of sales won a split 3-2 vote approval. The proposal, which will now be opened for public comment, could also require private securities issuers to give the SEC more information about themselves, their companies and the offerings.

"We want this new market, and the private markets in general, to thrive in a safe and efficient manner, and the rules we adopt and propose today are designed to facilitate that objective," said SEC Chairman Mary Jo White.

Commissioner Luis Aguilar dissented on the decision to lift the advertising ban, arguing that it would "come at the expense of investors and place investors at greater risk."

Commissioners Troy Paredes and Daniel Gallagher voted against the proposal that could require companies that use private offerings to provide more information to the SEC. They said it could hinder business growth.

"It threatens real harm to the private markets which are so important to capital formation," said Gallagher.

Jennifer Openshaw, president of Finect, an online network for the financial industry, said the SEC's lifting of the advertising restriction should be followed by strong investor protections.

"It's all the more important to be vigilant against bad actors," said Openshaw. "More information will now be accessible to investors through the use of social media, and the ability of bad actors to pursue unaccredited, unsophisticated investors will grow."

But John Frankel, founding partner of ff Venture Capital, a company that helps fledgling businesses, said the SEC action would "bring the high returns of early-stage investing into the limelight and facilitate more money to early-stage firms and thus to start-ups."

MSRB to Ease Standard of Independence for Board Members.

The Municipal Securities Rulemaking Board has filed rule changes with the Securities and Exchange Commission that would ease the standard of independence for its board.

Some market participants said the MSRB is resisting bringing issuer officials onto the board and wants to keep the board more industry-oriented by choosing retired industry officials as public members. They said the board should not be allowed to loosen or undermine the independence standards. But others claimed the rule changes are needed so that institutional investor representatives can join the board, a current problem because many them have broker-dealer arms to market Section 529 college savings plans, which the SEC has said involves muni securities..

The Dodd-Frank Act mandated the MSRB to have a majority public board. Before the act, the board consisted of 15 members — five from banks, five from securities firms and five from the public, at least one of whom must represent issuers and one of whom must represent institutional investors Members had three-year staggered terms so that five rolled off the board every year.

In Dodd-Frank, Congress said the MSRB must fall in line with other self-regulatory organizations and have more public than industry members, but left it up to the board to determine how to change the board.

The MSRB expanded its board to 21 members, 11 of which are to be independent of any muni broker-dealers, banks or muni advisors, at least of whom represents issuers, one institutional investors, and one who has knowledge or experience in the muni industry. Of the 10 regulated members, at least one must be associated with a non-bank securities broker-dealer, one with a bank. In addition, at least one but not less than 30% of the 10 must be associated with non-dealer or non-bank muni advisors. Board members still serve three-year staggered terms, with seven rolling over every year.

Currently the board defines public members who are "independent of any regulated entities" to mean individuals who have "no material business relationship" with any regulatory entities. The individuals are not, and have not been, associated with a regulated entity for two years and do not have any compensatory or other relationship with a regulated entity that would affect the independence of their decision-making.

But the MSRB told the SEC in its notice, "In practice, this standard has precluded consideration of otherwise viable candidates who are knowledgeable of matters related to the municipal securities market from service as public representatives" because they are associated with regulated entities.

"This standard of independence disqualifies many individuals with expertise and knowledge to represent investors because such persons have a regulated entity within their employer's corporate structure," the board said.

The MSRB told the SEC it is proposing "a more function oriented approach to defining independence" that will specify an individual has "no material business relationship" with a regulated entity such as broker-dealer, bank or muni advisor, if it is not, and within the last two years was not, an officer, director, employee or controlling person of the regulated entity. The term director would not cover independent directors.

"The proposed rule change will … allow the MSRB to consider candidates who are associated with regulated entities solely by virtue of the corporate structure of their employer," the MSRB said.

But Jeanine Rodgers Caruso, president of the National Association of Independent Public Finance Advisors, said, "NAIPFA is disappointed with the MSRB amendment to MSRB Rule A-3. The MSRB is removing the phrase "associated with" from the language of the rule and is replacing it with the phrase officers, employees, etc. of a broker-dealer. The net effect is that employees of broker-dealer affiliates will be considered to be independent for purposes of the board's composition regardless of whether they are currently employed by such an affiliate. In other words, if Goldman Sachs had a non-municipal securities dealer affiliate with employees, that individual would be considered to be independent regardless of their current employment state with the affiliate."

The board told the SEC that all board members, whether public of regulated, "have a fiduciary duty to the MSRB and are bound by a duty of loyalty and duty of care and are obligated to act in the best interests of the organization and to avoid conflicts of interest."

by: LYNN HUME

[Brokers Willing to Pay Up for Fiduciary Standard: SIFMA.]

Financial Planning Coalition says BDs with fiduciary accounts see stronger asset growth; Schwab says RIAs must beware of harmonization.

A uniform fiduciary standard implemented by the Securities and Exchange Commission would hit brokers with $8 million in new compliance costs, according to the Securities Industry and Financial Markets Association.

Updating disclosure documents would cost $3 million, and the initial build-out of compliance systems and training would cost another $5 million, said SIFMA, which represents banks, securities firms and asset managers.

Whether an RIA is SEC or state-registered, the firm must have policies and procedures in effect to protect clients' privacy. Policies and procedures should explicitly require an RIA to send out its privacy notice each year.

Registration Requirements for Investment Advisor Representatives (IARs)

When individuals launch an advisory firm, they must avoid marketing themselves or the firm as investment advisors before they are properly approved and registered. Otherwise, they are subject to severe penalties.

But Ira Hammerman, SIFMA's senior managing director and general counsel, told AdvisorOne on Monday that BDs "are generally willing to incur" the above mentioned additional compliance costs "in order to arrive at a new fiduciary standard."

The Financial Planning Coalition of advisory industry trade groups argues that advisors at BDs who deliver advice under a fiduciary standard experience stronger asset growth, and that the conversion of fee-based brokerage accounts to fiduciary, nondiscretionary advisory accounts would impose "little if any additional cost or burden."

Charles Schwab, however, flipped the scenario around, telling the SEC in its comment letter what it would cost for registered investment advisors to comply with BD rules should the agency decide to include "harmonizing" BD and advisor rules in its fiduciary rule proposal.

Depending on how broadly the commission would apply "harmonized rules — whether to some or all RIAs," harmonized rules could cost the RIA industry a whopping $1 billion, Christopher Gilkerson, Schwab's senior vice president and deputy general counsel, told the SEC.

SIFMA, Schwab and the coalition members — which include the Financial Planning Association, the National Association of Personal Financial Advisors and the CFP Board — expressed their views in comment letters to the SEC as part of the agency's March 1 request for information on the costs and benefits of a uniform fiduciary standard. The comment period ended July 5.

Hammerman told the SEC that "SIFMA remains strongly supportive of a uniform fiduciary standard for broker-dealers and investment advisors when providing personalized investment advice about securities to individual retail clients."

SIFMA surveyed 18 of its member firms — 12 large BDs and six regional ones — to arrive at the $8 million in additional compliance costs under a fiduciary standard. SIFMA said that it focused on two specific areas where its members believe they would be hit hard by a fiduciary rule — the costs of developing and maintaining a disclosure form similar to Form ADV Part 2A, and the costs of developing and maintaining new supervisory systems, procedures and training programs to implement the new standard.

SIFMA noted in its comment letter that as the SEC has not issued a "concrete" fiduciary proposal yet, "it is not possible to adequately identify and estimate all the costs of establishing a uniform fiduciary standard."

The coalition used Cerulli Associates data from 2007 to back up its argument that the conversion of non-fiduciary, fee-based brokerage accounts to fiduciary, nondiscretionary advisory accounts would impose "little if any additional cost or burden."

SIFMA Submits Cost Estimates to SEC on Fiduciary Rulemaking.

SIFMA has released its response to a data request by the Securities and Exchange Commission (SEC) to help inform the agency's cost-benefit analysis of a uniform fiduciary standard for broker-dealers and investment advisers under Section 913 of the Dodd-Frank Act. For the first time, the industry provides estimates on the cost of complying with a uniform fiduciary standard.

“SIFMA remains strongly supportive of a uniform fiduciary standard for broker-dealers and investment advisers when providing personalized investment advice about securities to individual retail clients,” said Ira Hammerman, senior managing director and general counsel. “In our effort to be most helpful and responsive to the SEC, we surveyed our member firms to collect data and information about the costs of creating and updating disclosures, systems and procedures to implement a uniform fiduciary standard. We also suggest the types of data and information the SEC should consider in their cost-benefit analysis. While the costs projected by our members clearly are not insignificant, these are costs our industry is generally willing to bear in order to benefit retail clients with a fiduciary standard.”

The letter reiterates SIFMA’s long-held support for a uniform fiduciary standard of conduct, as well as its support for broader harmonization of broker-dealer and investment adviser regulations.

SIFMA’s letter also raises concerns about potential rulemaking by the Department of Labor to expansively redefine fiduciary under the Employee Retirement Income Security Act. SIFMA points out that the DOL’s proposal could conflict with the SEC’s potential rulemaking under Section 913, and could otherwise have a broad and negative impact on small investors’ access to cost-effective advice in IRA accounts.

In response to the SEC’s explicit request, SIFMA’s letter also details and clarifies why simply overlaying the Advisers Act fiduciary duty onto broker-dealers would create a high risk of confusion and misapplication, and will negatively impact client choice and access to the products and services that best suit their needs. SIFMA reiterated its strong opposition to this approach.

Lastly, SIFMA provided estimates as to the cost of implementing a uniform fiduciary standard for brokers-dealers in two specific ways. The estimates were derived from a survey of 18 SIFMA member firms (12 large broker-dealers, 6 regional broker-dealers)

The costs of developing and maintaining a disclosure form and customer relationship guide.

Responding firms said they would need to furnish the broker-dealer relationship guide to a combined total of approximately 50.6 million retail customers;

Over 75 percent said they planned to hire outside legal counsel to help prepare the guide;

The vast majority of firms’ estimated costs fell into out-of-pocket expenses and employee and staff-related costs, which included:

$1.2 to $3.9 million to initially developing the BD relationship guide and maintaining it for the first year. The average cost was $2.6 million

The average per annum cost of updating and maintain the relationship guide was estimated to be about $631,000

The costs of developing and implementing a new, comprehensive compliance and supervisory system and procedures and related training programs to adapt to the uniform fiduciary standard.

The largest cluster of firms, a group of 9 firms, estimated the total costs of initially developing the necessary infrastructure and maintain and implementing it for one year in the range of approximately $1 to $6 million. The average was approximately $5 million.

Those same firms estimated that it would cost an estimated $2 million per year to update, maintain and implement those systems, procedures and programs.

As a point of comparison, we asked firms to report the total costs incurred to date to implement FINRA's new suitability rule, Rule 2111, which took effect in July 2012.Of 17 responding firms, the average firm estimated it had spent approximately $4.6 million to comply with the new rule.

The full letter can be found at the following link: http://www.sifma.org/issues/item.aspx?id=8589944317.

Finra Postpones Action on Recruitment Disclosure Rule.

Proposal would require brokerages to inform customers about incentive deals with reps.

The Financial Industry Regulatory Authority Inc. has postponed action on a controversial proposal to require disclosure to customers of broker recruitment deals.

As reported earlier, a notice on Finra's site said the Finra board would "consider an updated [disclosure] proposal" at its board meeting July 11.

But Finra spokesperson Nancy Condon said the organization's board had pushed off consideration of the rule to a later date, due to tight scheduling. She had no further information.

The SRO's board must give its approval before Finra staff can file rules with the Securities and Exchange Commission.

In January, the industry regulator asked for comment about its initial disclosure proposal. The plan would require a brokerage firm to disclose to customers the upfront or back-end bonuses, accelerated payouts and other forms of transition assistance given to a new recruit. The disclosure rule would apply to customers who are solicited for a period of one year following that broker's transfer to the new firm. The rule, as initially proposed, would not apply to incentives totaling less than $50,000.

Several hybrid advisers said they wanted Finra to act on the rule.

"I think it's very much needed and long overdue," said Jonathan Heller, founder of JG Heller Private Wealth Advisors Inc.

"Reps get an enormous amount of money, and the [recruiting] firms counsel the adviser to just focus on the positives of the new firm," Mr. Heller said. "But in reality, if there's a multimillion-dollar check involved, clients have no knowledge of that."

"I'm in full favor of it," Gerard Gloisten, president of GBS Financial Corp., said about Finra's proposal. "The reality is, there are a certain number of reps who hop from firm to firm for the bonus. It's not fair for anyone involved."

Finra's initial plan generated over 60 comment letters. In comments, industry trade groups said they supported disclosure, but wanted the proposal narrowed or changed.

The Securities Industry and Financial Markets Association urged Finra to adopt a plain-English disclosure model focusing on potential conflicts for firms to use.

The National Association of Insurance and Financial Advisors wanted Finra to increase the compensation threshold for disclosure to $100,000, and decrease the time frame to less than one year.

The Financial Services Institute Inc. said disclosure should also apply to retention bonuses as well as to recruiting deals.

GAO: Most SEC-registered Advisers Not Subject to Surprise Exams.

Most of the investment advisers registered with the Securities and Exchange Commission who maintain custody of their clients' investment funds are not subject to surprise annual examinations, according to a new federal report.

A study released on Monday by the Government Accountability Office. found that 4,446 of the 9,982 SEC-registered advisers had control over client money as of April 1, amounting to more than $14 trillion in client assets.

Of those who had custody, 1,321 are subject to annual surprise examinations by independent public accountants. A total of 2,956 advisers with custody do not have to undergo surprise exams.

Advisers can be exempted from surprise inspections if they have custody of client assets only to deduct fees from client accounts or are "operationally independent" of the custodian.

There are 169 advisers who have possession of client funds but don't have to undergo annual surprise audits because they are "operationally independent" from their custodian, even though the adviser and custodian are owned by the same entity. In these cases, the adviser and the custodian cannot have common supervision or share the same premises.

The GAO conducted a performance audit of 12 investment advisers from September through July to determine the costs of the inspections. It found that the firms paid anywhere from $3,500 to $31,000 for the surprise examinations.

The charge for the audits is based on a number of factors, including the number of clients and the amount of assets in custody. The advisers reviewed had between one and more than 1 million clients under custody.

Internal control reporting requirements cost between $25,000 and $500,000, according to accounting firms the GAO interviewed.

The GAO custody study was mandated by the Dodd-Frank financial reform law.

Most investment advisers house their clients' assets with a third-party custodian such as Charles Schwab & Co. Inc. or TD Ameritrade Inc.

In 2009, the SEC amended the custody rule to expand surprise inspections in response to the Ponzi scheme perpetrated by Bernard Madoff that bilked investors of more than $50 billion. The scheme revolved in part around the fact that Mr. Madoff's firm had custody of his clients' money.

In a March investor alert, the SEC said that roughly one-third of advisory firms examined last year — about 140 — were flagged for problems with how they held or had access to their clients' assets.

The SEC exams found that many advisers didn't know that they had inadvertently become custodians. The designation can be triggered by actions such as serving as a trustee for a client, signing checks on clients' behalf or withdrawing funds from client accounts to pay bills.

http://www.investmentnews.com/article/20130709/FREE/130709930

MSRB Releases Report on Municipal Bond Continuing Disclosure Documents.

The Municipal Securities Rulemaking Board (MSRB) has released a report summarizing the type and number of continuing disclosure documents submitted by issuers of municipal securities to the MSRB's Electronic Municipal Market Access (EMMA®) website between July 2009 and March 2013.

Continuing disclosures report the financial or operating condition of a municipal bond issuer over time, as well as specific events occurring after issuance that can affect the ability of the issuer to repay the bond. The EMMA website has been the official repository for municipal security continuing disclosure documents since July 1, 2009.

Between July 2009 and March 2013, the MSRB received 505,395 continuing disclosure documents, according to the Continuing Disclosure Statistical Summary. The report shows a steady increase in the annual number of disclosure documents submitted to the MSRB by municipal bond issuers and obligated persons.

Other highlights of the report include:

- Bond calls accounted for 38 percent of all continuing disclosure documents submitted to EMMA between July 2009 and March 2013.
- The State of California and its municipalities continued to submit the largest share of the continuing disclosure documents to the MSRB, accounting for nearly 12 percent, or 61,441, of all disclosures between July 2009 and March 2013.
- With the exception of December 2012, the number of financial and operating disclosure submissions received by the MSRB over the last three years has increased every month over the same month in the previous year.

The MSRB's EMMA website is a centralized online database that provides free public access to more than 800,000 official disclosure documents and data on more than 70 million trades associated with municipal bonds issued in the United States. The EMMA website makes available real-time trade prices, primary market and continuing disclosure documents, and current credit ratings for more than one million outstanding securities, as well as current interest rate information, liquidity documents and other information for most variable rate municipal securities.

http://msrb.org/msrb1/pdfs/MSRB-Continuing-Disclosure-Report-July-2013.pdf

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MSRB to Offer New Email Reminder Tool for Recurring Financial Disclosures.

The Municipal Securities Rulemaking Board (MSRB) will soon launch a new tool to help issuers of municipal securities keep track of due dates for recurring financial disclosures to the Electronic Municipal Market Access (EMMA®) website. State and local governments and other entities with annual or quarterly disclosure deadlines will be able to schedule email reminders to alert multiple recipients when it is approaching the time to make a financial disclosure submission to EMMA. Look for more information and resources on financial disclosures from the MSRB soon.

MSRB to Launch Disclosure Tool; Will it Lead to Dispute with DAC?

The Municipal Securities Rulemaking Board announced that it will soon launch a new tool to help municipal securities issuers keep track of the dates they must file periodic financial disclosures to its EMMA website.

But the announcement, which did not contain any details, has led some market participants to question whether this new tool will cause a dispute between the MSRB and Digital Assurance Certification, which sued the operator of a predecessor disclosure system in part because it alerted issuers when their disclosure documents were to be filed.

Asked about the this issue, MSRB Executive Director Lynnette Kelly wrote in an email on Wednesday, “We have assured ourselves that what we propose to do will not be precluded by any intellectual property claims of DAC.”

Kelly said also that the MSRB has not entered into any arrangements with DAC.

Paula Stuart, chief executive officer of Orlando-based DAC, could not be reached for comment.

DAC sued the Texas Municipal Advisory Council, which operated the Central Post Office, a central collection place for issuers’ secondary market disclosure documents, in January 2007, less than a month after DAC obtained a patent for its disclosure services.

The CPO was created by the Texas MAC for the Muni Council, about 20 muni market groups trying to improve muni bond disclosure. It began operating in September 2004 and was billed as a “one-stop” system for muni issuers or their agents to file secondary market disclosure documents.

The Securities and Exchange Commission’s Rule 15c2-12 bars firms from underwriting muni securities unless the issuers have contractually agreed in writing to file annual financial information and operating data, as well as notices when material events occur.

Initially issuers had to file the documents with several nationally-recognized municipal securities information repositories, but issuers complained about the duplicative efforts. Additionally, the NRMSIRs operated their systems and filed the documents differently, making it hard to some dealers and banks to meet their disclosure obligations, which included checking issuers’ material event notices and determining if issuers were filing financial disclosures on the dates they had specified for bondholders.

So the Muni Council worked with the Texas MAC to create the CPO, which collected issuers disclosures and sent them to the NRMSIRs.

In its lawsuit against the Texas MAC, which was filed in a federal court in Florida, DAC claimed that it had created a disclosure collection and dissemination system about three years before the CPO started operating and that DAC’s system it was designed to be a one-stop filing system for issuers. It asked the court to shut down the CPO.

The Texas MAC fought the suit, claiming the MSRB had started collecting disclosure documents long before DAC began operating.

DAC even forced the SEC to both remove any mention of the CPO from its website and to back away from the idea of essentially requiring issuers to use the CPO in order for firms to underwrite their bonds.

In May 2007, DAC and the Texas MAC agreed to the first of a series of steps to resolve the litigation, including that the Texas MAC would no longer send issuers receipts for their disclosure documents or alerts when those documents were due or not received on time.

The suit was finally settled in June without any money exchanging hands. The Texas MAC agreed to make changes, including disabling a feature that sent emails to CPO customers alerting them to filing deadlines for their annual financial and operating information.

In December, the SEC designated the MSRB's EMMA system as a free, central repository to which issuers must file bond-related secondary market documents beginning on July 1, 2009. At that time, the MSRB essentially replaced the CPO and the NRMSIRs as a collector and repository of secondary market disclosure filings. MSRB had been collecting and maintaining primary disclosure documents — official statements and escrow agreements for refundings — for many years before that.

by: LYNN HUME

[SEC Approves JOBS Act Requirement to Lift General Solicitation Ban.]

The Securities and Exchange Commission has adopted a new rule to implement a JOBS Act requirement to lift the ban on general solicitation or general advertising for certain private securities offerings.

Fact Sheet:

http://www.sec.gov/news/press/2013/2013-124-item1.htm

In connection with this new rule, the Commission voted to issue a rule proposal requiring issuers to provide additional information about these securities offerings to better enable the SEC to monitor the market with that ban now lifted. The proposal also provides for additional safeguards as this market changes and new practices develop.

The SEC also adopted rules that disqualify felons and other bad actors from participating in certain securities offerings as required by the Dodd-Frank Act.

[Comments Requested on Information Return for Tax Credit Bonds.]

The IRS has requested comments on Form 8038-TC, "Information Return for Tax Credit Bonds"; comments are due by September 6, 2013.

http://services.taxanalysts.com/taxbase/eps_pdf2013.nsf/DocNoLookup/16344/$FILE/2013-16344-1.pdf

[Comments Requested on Regs on Remedial Actions for QZABs.]

The IRS has requested comments on regulations (T.D. 9339) on the maximum term and permissible use of proceeds of qualified zone academy bonds and on specified remedial actions for curing some violations of the rules for those bonds; comments are due by September 6, 2013.

http://services.taxanalysts.com/taxbase/eps_pdf2013.nsf/DocNoLookup/16360/$FILE/2013-16360-1.pdf

[IRS: FSLG July 2013 Newsletter.]

Inside This Issue

- IRS Guidance on Sick Leave Plans
- Severance Pay and FICA
- Taxpayer Identification Number (TIN) On-Line Matching
- Recorded Webinars for Government Employers
- EHR Reporting
- Directory of FSLG Specialists

http://www.irs.gov/Government-Entities/Federal,-State-&-Local-Governments/Current-Edition-of-the-FSLG-Newsletter

[IRS LTR: Supporting Organization's Ownership Interest in For-Profit Won't Jeopardize Exemption.]

The IRS ruled a supporting organization’s ownership interest in a newly formed holding company resulting from a restructuring transaction won’t adversely affect its tax-exempt status.

Employer Identification Number: * * *

LEGEND:

Center = * * *

Group = * * *

Network = * * *

Health = * * *

Dear * * *:

This is in reply to your letter of June 30, 2011, in which you request a ruling on the effect to your tax-exempt status of your proposed ownership (through a wholly-owned disregarded entity) in a for-profit Subchapter S corporation.

FACTS

You are tax-exempt under I.R.C. § 501(c)(3), and a § 509(a) supporting organization of the Center and its School of Medicine. The Center is part of a state-chartered university system. You are a faculty group practice that assists the Center in carrying out its mission, particularly as it relates to the Center's clinical practice function. You consist of the faculty of the clinical departments of the Center. Through you, the Center's faculty is able to enter into contractual relationships with health plans, community providers, and businesses to provide health care services and thereby operate a health care delivery system. The health care delivery system, which you facilitate, promotes the charitable, educational, and research programs of the Center by providing it with the clinical programs and patient populations with which to educate its students and conduct research, while also providing healthcare services to the public regardless of ability to pay.

You are the sole member of the Group, a wholly owned subsidiary that is treated as a disregarded entity for federal tax purposes. The Group provides professional medical services as a participating independent physician association ("IPA") in the Network. The Network is organized as a for-profit corporation, and serves as a third party administrator providing medical necessity review organization services to its clients under state licenses. The Group owns * * * percent of the issued and outstanding common shares of the Network. The Network has six additional IPA shareholders that are unrelated to the Group. The Network is currently a C corporation for federal income tax purposes. These six additional IPA shareholders comprise for-profit corporations and a partnership.

The Network has four wholly owned subsidiaries. Three of the subsidiaries are limited liability companies that are disregarded as separate entities for federal income tax purposes. The fourth subsidiary, Health, is a C corporation and insurance company for federal income tax purposes. All four wholly owned subsidiaries are involved in healthcare or healthcare related services.

In addition to being a participant IPA in, and shareholder of, the Network, the Group has an exclusive management agreement with the Network under which the Network provides certain administrative and contract services to the Group. These services include collecting revenue, paying claims, contracting with healthcare providers, and performing other administrative functions necessary to manage the Group. For its services, the Network collects * * *% of all collected revenues. At the year-end, the Network reconciles its actual management costs incurred on behalf of the Group and remits any overpayments to the Group. The Group remits to you the overpayments it receives from the Network.

Proposed Restructuring Transaction

In order to achieve an ownership structure that is eligible for S corporation status, the following restructuring transaction is proposed:

A new entity, the "Holding Company," will be established, and will make an "S" election as of the date of formation.

The Group and the other shareholders of the Network will contribute their shares of the Network to the capital of the Holding Company, thus making the Network a wholly owned subsidiary of the Holding Company.

The Holding Company will make a qualified subchapter "S" subsidiary ("QSSS") election for the Network.

The Network will distribute its membership interests in its three subsidiaries that are disregarded entities for federal tax purposes to the Holding Company. The Network will continue to own all of the issued and outstanding common shares of Health.

Once the proposed transaction is completed, the Group will hold * * *% of the Holding Company. The remaining * * * % will be owned by the 54 individuals that currently own the six other shareholders of the Network. All of the entities involved in the proposed transaction will continue to operate for the same business purposes as they did prior to the transaction.

The Holding Company will have a board or directors consisting of seven members. The Group will have the right to elect one board member and the other unrelated shareholders will elect the remaining six board members. The Network will have a board of directors consisting of 14 members. The Group will have the right to elect two board members and the other unrelated shareholders will elect the remaining 12 board members.

Health will have a board of directors consisting of six members. Three of the members will be selected by the Network's board of directors from among its members, and the other three members will be selected from the Network's senior management team. The three subsidiaries of the Holding Company that are disregarded entities for federal income tax purposes will be managed by a non-shareholder manager selected by the Holding Company.

The Holding Company and its subsidiaries will each develop, maintain, and manage its own financial systems independent of you and the Group. The Holding Company and its subsidiaries will each by operated by a professional staff with expertise in the relevant business areas, which are independent and unrelated to you. Neither you nor the Group will be involved in the day-to-day management of the Holding Company or any of its subsidiaries.

RULING REQUESTED

You have requested the following ruling:

Your ownership, through your wholly-owned disregarded entity, Group, in a for-profit Subchapter "S" corporation, together with the flow-through allocation of "S" tax items subject to the unrelated business income tax, has no effect on the your tax exempt status.

LAW

I.R.C. § 501(c)(3) provides for the exemption from federal income tax of organizations that are organized and operated exclusively for religious, charitable, scientific, or educational purposes, provided no part of the net earnings inure to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to qualify as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it does not qualify for exemption.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it is engaged primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

I.R.C. § 511(a) imposes a tax on the unrelated business taxable income of organizations exempt from federal income tax under I.R.C. § 501(c).

I.R.C. § 512(e) provides that if an organization described in § 1361(c)(6) holds stock in a S corporation — (A) such interest shall be treated as an interest in an unrelated trade or business; and, (B) notwithstanding any other provisions of this part — (i) all items of income, loss, or deduction taken into account under § 1366(a), and (ii) any gain or loss on the disposition of the stock in the S corporation shall be taken into account in computing the unrelated business taxable income of such organization.

I.R.C. § 1361(c)(6) provides that, for purposes of subsection (b)(1)(B) (which defines the term "small business corporation"), an organization which is (A) described in § 401(a) or 501(c)(3), and (B) exempt from taxation under § 501(a), may be a shareholder in an S corporation.

In Moline Properties, Inc. v. Comm'r, 319 U.S. 436, 438-39 (1943), the Supreme Court said that "[t]he doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. . . . In general, in matters relating to the revenue, the corporate form maybe disregarded where it is a sham or unreal. In such situations the form is a bald and mischievous fiction." In response to the argument that a corporation is a mere agent of its sole stockholder, the court said that "the mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities, does not make the corporation the agent of its stockholders. Id. at 440.

In National Carbide Corp. v. Comm'r, 336 U.S. 422, 437 (1949), the Supreme Court said that a finding of a "true agency" relationship turns on several factors. "Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists. If the corporation is a true agent, its relations with the principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purposes must be the carrying on of the normal duties of an agent."

In National Investors Corp. v. Hoey, 144 F.2d 466, 468 (2nd Cir. 1944), the court said that "to be a separate jural person for purposes of taxation, a corporation must engage in some industrial, commercial, or other activity besides avoiding taxation; in other words, that the term 'corporation' will be interpreted to mean a corporation which does some 'business' in the ordinary meaning; and that escaping taxation is not 'business' in the ordinary meaning."

In Britt v. U.S., 431 F.2d 227, 237 (5th Cir. 1970), the court said that "business activity is required for recognition of the corporation as a separate taxable entity; the activity may be minimal."

In Krivo Indus. Supply Co. v. Nat'l Distillers & Chem. Corp., 483 F.2d 1098, 1106 (5th Cir. 1973), the Court said that "the control required for liability under the 'instrumentality' rule amounts to total domination of the subservient corporation, to the extent that the subservient corporation manifests no separate corporate interests of its own and functions solely to achieve the purposes of the dominant corporation."

ANALYSIS

For taxable years beginning before January 1, 1998, tax exempt organizations described in § 501(c)(3) could not be shareholders in an S corporation. In 1996, Congress enacted the Small Business Job Protection Act, Pub. L. No. 104-188, 110 Stat. 1755, authorizing the ownership of S corporation stock by tax-exempt organizations described in § 501(c)(3). The Joint Committee on Taxation's General Explanation of Tax Legislation Enacted in the 104th Congress (JCS-12-96), December 18, 1996, Sec. 1316, p. 130, describes the reason for the change in law as follows —

The Congress believed that the present-law prohibition of certain tax-exempt organizations being S corporation shareholders may have inhibited employee ownership of closely-held businesses, frustrated estate planning, discouraged charitable giving, and restricted sources of capital for closely-held businesses. The Congress sought to lift these barriers by allowing certain tax-exempt organizations to be shareholders in S corporations. However, the provisions of subchapter S were enacted in 1958 and substantially modified in 1982 on the premise that all income of the S corporation (including all gains on the sale of the stock) would be subject to a shareholder-level income tax. This underlying premise allows the rules governing S corporations to be relatively simple . . . because of the lack of concern about "transferring" income to non-taxpaying persons. Consistent with this underlying premise of subchapter S, the provision treats all the income flowing through to a tax-exempt shareholder, and gains and losses from the disposition of the stock, as unrelated business taxable income.

As a result of the legislation, tax-exempt organizations described in § 501(c)(3) are allowed to be shareholders in an S corporation under § 1361(c)(6). Furthermore, under § 512(e), items of income or loss of an S corporation will flow through to tax-exempt shareholders as unrelated business taxable income regardless of the source or nature of such income. In addition, gain or loss on the sale or other disposition of stock of an S corporation will be treated as unrelated business taxable income. These provisions, however, do not cause the for-profit activities of the S corporation to be attributed to the tax-exempt shareholder. See Moline Properties, Inc., 319 U.S. at 440. In determining whether the activities of a for-profit S corporation subsidiary is attributable to its tax-exempt parent, the separate identity principles annunciated in Moline Properties, Inc. v. Comm'r should apply lest the intent of Congress to remove barriers for investment in S corporations by tax-exempt entities be frustrated.

For federal income tax purposes, a parent corporation and its subsidiaries are treated as separate and distinct taxable corporate entities as long as each entity has a valid business purpose and engages in at least a minimal amount of business activity. See Moline Properties, Inc., 319 U.S. at 438; National Investors Corp., 144 F.2d at 468; Britt, 431 F.2d at 234. However, where the parent corporation so controls the affairs of the subsidiary that it is merely an instrumentality of the parent, the corporate identity of the subsidiary may be disregarded. See, Krivo, 483 F.2d at 1106.

Hence, the activities of a for-profit subsidiary will not be attributed to its tax-exempt parent unless (1) the subsidiary lacks a business purpose, or (2) the subsidiary is an arm or agent of the parent.

In your case, your relationship with the Holding Company does not fail the first prong, i.e., that the subsidiary have a business purpose and conduct some amount of business activity. The Holding Company and its four subsidiaries have been, or will be, organized to perform bona fide and substantial business functions. The Holding Company and all of its subsidiaries maintain activities that are separate, distinct, and independent from you. Therefore, their existence may not be disregarded for tax purposes.

Additionally, your relationship with the Holding Company does not fail the second prong, i.e., that the parent not control the day-to-day operations of the subsidiary. The Holding Company has its own corporate identity and interests, and its own independent board of seven directors, only one of which is chosen by you. The other six directors are chosen by unrelated shareholders. Furthermore, each of the Holding Company's subsidiaries has its own management and employees independent of you. Furthermore, neither your investment in the Holding Company nor your management agreement with the Network exhibits any of the attributes of a “true agency” relationship identified in National Carbide Corp., 336 U.S. at 437. Therefore, neither the Holding Company nor its subsidiaries can be considered a sham or under your “total domination.” Consequently, the activities of the Holding Company and its subsidiaries would not be attributable to you.

CONCLUSION

In light of the foregoing, we rule as follows:

Your ownership interest in the Holding Company, a for-profit subchapter S corporation, through Group, together with the flow-through allocation of the Holding Company’s “S” tax items subject to the unrelated business income tax, would have no effect on your tax-exempt status as an organization described in § 501(c)(3).

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolved questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Peter A. Holiat

Acting Manager,

Exempt Organizations

Technical Group 1

Citations: LTR 201328035

[IRS LTR: Foundation Granted More Time to Dispose of Stock.]

The IRS granted a private foundation an additional five years to dispose of excess holdings of corporate stock after concluding the foundation made diligent efforts to dispose of the shares but was unable to do so except at a price substantially below the fair market value.

Employer Identification Number: * * *

LEGEND:

Corporation = * * *

Founder = * * *

Brand = * * *

Date 1 = * * *

Date 2 = * * *

Dear * * *:

This is in response to your ruling request dated November 28, 2012, requesting an extension for an additional five years under I.R.C. § 4943(c)(7) for disposing of certain excess business holdings.

FACTS

You are a private foundation organized as a nonprofit corporation to further the charitable interests of your Founder. You have been recognized as an organization exempt under § 501(c)(3) and are classified as a private foundation within the meaning of § 509(a). You state that you operate exclusively for charitable and educational purposes through the making of grants and contributions to charities. You acquired * * * percent of Corporation stock as a donation from your Founder after his death. You have excess business holdings in Corporation under § 4943(c)(1). Your initial five-year period for disposing of these excess business holdings will end on Date 1.

During the initial five-year period for disposing of excess business holdings under § 4943(c)(6), you have created a more formal management and governance structure for Corporation, and taken steps to unify the Brand with respect to * * *. Your managers have consulted with advisors, valuation specialist and legal counsel to discuss the various disposition options available to you.

You represent that, because of the size, value, nature, and complexity of this business holding, you have, despite your best efforts, been unable to complete the sale of Corporation stock within the prescribed five-year period except at a price substantially below fair market value. You represent that you will be better able to determine and realize the full fair market value of your interest in Corporation after the expiration of the initial five-year period.

Your directors have established a plan of disposition that includes either selling your Corporation stock to an unaffiliated third party or donating Corporation shares to one or more charitable organizations. Your directors expect that they can dispose of the Corporation stock no later than Date 2. You submitted the plan to your appropriate state Attorney General and are waiting for a response. If and when a response is received from the Attorney General, a copy will be submitted to the Secretary in accordance with § 4943(c)(7)(B)(ii).

Prior to the end of the initial five-year period for disposing of excess business holdings under § 4943(c)(6), you submitted a request to the Internal Revenue Service for an extension of five years to complete the required disposition.

RULING REQUESTED

You requested a ruling extending the five-year period of time for disposing of excess business holdings for an additional five years under § 4943(c)(7).

LAW

I.R.C § 4943(a)(1) imposes excise taxes on the excess business holdings of any private foundation in a business enterprise.

I.R.C. § 4943(c)(1) provides that the term “excess business holdings” means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

I.R.C. § 4943(c)(2) provides in part that the permitted holdings of any private foundation in an incorporated business enterprise are 20 percent of the voting stock, reduced by the percentage of the voting stock owned by all disqualified persons.

I.R.C. § 4943(c)(6)(A) provides that, if there is a change in the holdings in a business enterprise (other than by purchase by the private foundation or by a disqualified person) which causes the private foundation to have excess business holdings in such enterprise, the interest of the foundation in such enterprise (immediately after such change) shall (while held by the foundation) be treated as held by a disqualified person (rather than by the foundation) during the 5-year period beginning on the date of such change in holdings.

I.R.C. § 4943(c)(7) provides that the Internal Revenue Service may extend for an additional five years the initial five-year period for disposing of excess business holdings in the case of an unusually large gift or bequest of diverse business holdings or holdings with complex corporate structures if:

(A) The foundation establishes that: (i) it made diligent efforts to dispose of such holdings during the initial five-year period, and (ii) disposition within the initial five-year period has not been possible (except at a price substantially below fair market value) by reason of such size and complexity or diversity of holdings;

(B) Before the close of the initial five-year period: (i) the private foundation submits to the Internal Revenue Service a plan for disposing of all of the excess business holdings involved in the extension, and (ii) the private foundation submits the plan to the Attorney General (or other appropriate State official) having administrative or supervisory authority or responsibility with respect to the foundation’s disposition of the excess business holdings involved and submits to the Internal Revenue Service any response the private foundation received during the five-year period; and

(C) The Internal Revenue Service determines that such plan can reasonably be expected to be carried out before the close of the extension period.

ANALYSIS

You are subject to § 4943, which imposes a tax on the excess business holdings of private foundations. Generally, under § 4943(c)(2)(A), a private foundation and its disqualified persons are permitted to hold twenty percent of the voting stock in a business enterprise, with any excess constituting excess business holdings. However, if a private foundation acquires holdings in a business enterprise other than by purchase (e.g., by gift) which causes the foundation to have excess business holdings, then the interest of the foundation in such business enterprise shall be treated as held by a disqualified person (rather than the foundation) for a five-year period beginning on the date such holdings were acquired by the foundation, under § 4943(c)(6)(A).

Under § 4943(c)(7), the Internal Revenue Service may extend the initial five-year period for disposing of excess business holdings for an additional five years if a foundation establishes that: (i) it made diligent efforts to dispose of such holdings during the initial five-year period, and disposition within the initial five-year period has not been possible (except at a price substantially below fair market value) by reason of the size and complexity or diversity of holdings, (ii) before the close of the initial five-year period it submits to the Internal Revenue Service, and to the Attorney General (or other appropriate State official) having administrative or supervisory authority or responsibility with respect to the foundation's disposition of the excess business holdings, a plan for disposing of all of the excess business holdings involved during the extension and (iii) the Internal Revenue Service determines that such plan can reasonably be expected to be carried out before the close of the extension period.

You received a donation of * * *% of the Corporation stock from Founder, a disqualified person under § 4946. You have stated that you consequently have excess business holdings in Corporation under § 4943(c)(1). Therefore, you are required under § 4943(c)(6) to dispose of these holdings during the initial five-year period that will end on Date 1. You have established that during the initial five-year period you have made diligent efforts to dispose of the Corporation stock, but disposition within this period has not been possible (except at a price substantially below fair market value) because of the size and complexity or diversity of your holdings. Before the end of the initial five-year period, you submitted a request to the Internal Revenue Service under § 4943(c)(7) for an additional five-year period within which to dispose of your excess business holdings in Corporation and you described your plan for disposing of these holdings. You also submitted the plan to the Attorney General of your state, who is expected to approve the plan. Based on the information submitted, we have determined that your plan to dispose of your excess business holdings in Corporation within an additional five-year period can reasonably be expected to be carried out. Therefore, we conclude that you do meet the requirements under § 4943(c)(7) for an extension of five years to dispose of your excess business holdings in Corporation.

RULING

Under § 4943(c)(7), the period during which you may dispose of your excess business holdings in Corporation is extended for an additional five years, until Date 2.

We are not ruling on whether your interest in Corporation constitutes excess business holdings.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald Shoemaker

Manager, Exempt Organizations

Technical Group 2

Citations: LTR 201328034

FASB to Propose New Definition of Public Businesses.

As part of a project on determining which entities qualify for alternative private company accounting rules, the Financial Accounting Standards Board on July 10 decided to propose guidance that would help define what constitutes a public business

At a meeting in Norwalk, Conn., the board unanimously supported a staff recommendation not to amend the existing definitions of a nonpublic entity in the Accounting Standards Codification (ASC). Rather, the board agreed to propose a new definition of a public business entity that would be added to the ASC master glossary for use in future guidance.

According to the staff, a business entity would be regarded as public if it has met any of the criteria established in prior board decisions for determining which entities should be excluded from the alternative rules developed for private companies. Those criteria include a requirement to file or furnish financial statements with the SEC or another regulatory agency for purposes of issuing securities.

FASB member Thomas Linsmeier supported the staff recommendation, saying that the board must gain more experience making scope decisions about the companies that FASB and its advisory group, the Private Company Council (PCC), will not be considering for potential rulemaking differences.

Linsmeier added, however, that the new definition of a public business entity that will be proposed will create some differences from the existing general definition. “We should think about the entities that will be affected by those differences — if at all possible — and try to seek them out for comment,” he said.

According to Linsmeier, FASB should make an effort to gather feedback from those entities offering unrestricted securities that would be classified as public because they must provide periodic financial reports to the public under a legal or regulatory requirement.

FASB decided that the proposed guidance on defining a public business entity would be released for a 45-day public comment period.

Elizabeth Gagnon, a FASB project manager, said that if the proposal can be released later this month, the timing of the comment period should allow for the feedback to be received before the PCC's meeting scheduled for October.

New Pension Numbers for Books, Budgets, and Bonds.

Public pension data have become more complex as GASB, the rating agencies, and governments themselves may all be using different sets of pension numbers for different purposes. The GFOA and other leading national associations representing state and local governments, agencies, and officials have developed a one-page summary to help everyone concerned understand the differences among these numbers, the intended purpose and audience, and new resources available to lawmakers to address pension funding.

http://gfoa.org/downloads/JointFundingGuidelinesOverview.pdf

Registration Opens for Two FASB Webcasts on Insurance Contracts.

Webcasts Examine Different Aspects of FASB Proposal

Registration is now open for two live webcasts hosted by the Financial Accounting Standards Board (FASB).

IN FOCUS: The Insurance Contracts Project—Part I, Scope will take place on Tuesday, July 30, 2013, from 1:00 to 2:00 p.m. EDT. Participants in the live broadcast will be eligible for up to 1 hour of CPE credit.

IN FOCUS: The Insurance Contracts Project—Part II, The Models will take place on Thursday, August 1, from 1:00 to 3:05 p.m. EDT. Participants in the live broadcast will be eligible for up to 2.5 hours of CPE credit.

(Please note that CPE credit is not available for group viewing of the live broadcasts.)

IN FOCUS: The Insurance Contracts Project—Part I, Scope (1 CPE credit)

The first Insurance Contracts webcast will feature Hal Schroeder, FASB member; Jennifer Weiner, FASB senior practice fellow; and Lauren Alexander, FASB associate practice fellow discussing the scope of FASB's June 27th Exposure Draft on Insurance Contracts. The proposed guidance would apply to all companies that issue insurance contracts as defined in the Exposure Draft, including those that are not insurance companies, unless those contracts are specifically excluded from the scope. The webcast will cover the following areas:

- Why the proposed guidance would apply to all companies issuing insurance contracts rather than just to insurance companies
- Contractual features that may require contracts to be accounted for using the proposed guidance
- Examples of contracts issued by noninsurance companies to which the proposed guidance would apply

- How the proposal improves existing accounting
- Next steps in the project.

Register at:

http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1176163088722

IN FOCUS: The Insurance Contracts Project—Part II, The Models (2.5 CPE credits)

The second Insurance Contracts webcast will feature Tom Linsmeier, FASB member; Marc Siegel, FASB member; Jennifer Weiner, FASB senior practice fellow; Christopher Irwin, FASB practice fellow; and Lauren Alexander, FASB associate practice fellow. Topics of discussion will include:

- Why the FASB has an insurance contracts project on its agenda
- When investment and service components should be disaggregated from the insurance component and accounted for using the financial instruments or revenue recognition guidance, respectively
- Determining which approach to apply: the building block approach or the premium allocation approach
- Details of the two approaches, including measurement of the insurance contracts liability/asset and the recognition of revenue and expenses
- How the proposal improves existing accounting
- Next steps in the project.

An archive of each webcast will be available on the FASB website through October 28 and October 30, respectively. (CPE credit will not be available to those who view only the archived webcast.)

Register at:

http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1176163088783

[FASB Issues Standard Deferring Some Disclosures for Nonpublic Employee Benefit Plans.]()

The Financial Accounting Standards Board (FASB) has published a new Accounting Standards Update that defers indefinitely certain disclosures about investments held by nonpublic employee benefit plans in their plan sponsors' own nonpublic equity securities. The Update, which was approved on June 12, is available to download at no cost on the FASB website.

Accounting Standards Update No. 2013-09, Fair Value Measurement (Topic 820): Deferral of the Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in Update No. 2011-04, applies to disclosures of certain quantitative information about the significant unobservable inputs used in Level 3 fair value measurement for investments held by certain employee benefit plans.

The deferral applies specifically to employee benefit plans—other than those plans that are subject to Securities and Exchange Commission filing requirements—that hold investments in their plan sponsors' own nonpublic entity equity securities, including equity securities of their nonpublic affiliated entities.

“The Update addresses private company stakeholder concerns that certain disclosure requirements would potentially provide proprietary information when their employee benefit plans’ financial statements are posted on the plan regulator’s website,” said FASB Chairman Russell G. Golden.

The deferral is effective immediately for all financial statements that have not yet been issued.

The full Update is available at:

http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1176156316498

SIFMA 2013 Annual Meeting.

President Clinton and Gov. Bush to deliver keynote addresses — Nov 11-12, NYC

SIFMA’s 2013 Annual Meeting — Helping Americans Succeed, Helping Main Street Prosper — brings the leaders of the financial-services industry together with prominent policymakers, thought leaders and financial media. Join us as we explore the role of financial services in providing the capital to fuel the U.S. economy and enhance prosperity for all Americans. We are honored to have President Bill Clinton and Governor Jeb Bush provide our keynote addresses. Confirmed speakers to date include Richard G. Ketchum, chairman and chief executive officer of FINRA; Karen B. Peetz, president of BNY Mellon; and Paul E. Purcell, chairman, president and CEO of Robert W. Baird & Co., Inc. This year, we will introduce deep-dive breakout sessions for specific business, legal, compliance and operational professionals on critical issues affecting our financial markets — CLE credits will be available.

View the program at:

http://www.sifma.org/annual2013/program/

Register at:

http://www.sifma.org/events/2013/sifma_annual_meeting_2013/register/

Moody's Teleconference: California State and Local Governments Update.

On Wednesday, July 17, 2013, 10:00 AM PDT, Moody’s Investors Service will hold a teleconference to discuss recent developments for the State of California and its local governments.

The discussion will be led by:

Eric Hoffmann- Senior Vice President, Public Finance Group (Moderator)

Emily Raimes- Vice President, Senior Credit Officer, Public Finance Group

The following topics will be discussed:

- Assessment of the state’s improved revenue and economic picture
- Implications of the state’s improved fiscal prospects for local governments
- Local governments still struggling: Stockton and others
- Update on Redevelopment Agencies
- Moody’s Adjusted Pension Calculations Implications for California

You must register for the event in order to receive the dial in numbers.

A replay of this discussion will be available via a post event follow up email once the event has been completed.

Register at:

https://www.cvent.com/events/moody-s-teleconference-california-state-and-local-gove-
nments-update/registratio-
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Two More Wisconsin Cities Weigh Redemptions of New CREBs, BABs.

The cities of Kaukauna and Oshkosh Wis. have announced they can redeem taxable direct-pay bonds because their redemption provisions were triggered by federal subsidy reductions that went into effect in March.

The cities disclosed the potential redemptions in event notices filed with the Municipal Securities Rulemaking Securities Board’s EMMA system on July 1 and 2.

Kaukauna issued $25.35 million in taxable new clean renewable energy bonds in 2012. It also issued $3.665 million of taxable electric system revenue Build America Bonds in 2010, of which about $3.29 million remains outstanding, and another $6.775 million of taxable electric system revenue BABs the same year, of which $6.025 million remain outstanding.

Oshkosh issued $5.74 million in taxable water revenue BABs in 2010, of which $5.55 million remain outstanding.

Kaukauna and Oshkosh are the latest in a handful of issuers who have announced their intent to take advantage of their extraordinary redemption provisions to refund their direct-pay bonds because their subsidy payments were reduced by 8.7% from the $85 billion in federal sequestration budget cuts for the current fiscal year.

The Bond Buyer first reported in April that at least 12 small Wisconsin cities were weighing their options for redeeming their BABs or other direct-pay debt. Eleven of those issuers were clients of advisory firm Ehlers Inc., which considered redemptions at par plus accrued interest. Ehlers Inc. also advised Oshkosh. Baird was underwriter and Chapman and Cutler LLP was bond counsel for Oshkosh.

Quarles & Brady LLP served as bond counsel on those 12 original transactions. The firm also bond counsel for the Kaukauna’s new CREBs. Hutchinson, Shockey, Erley & Co. was underwriter.

Kaukauna wrote in its new CREB event notice that it “has determined that the extraordinary redemption provision has been triggered,” but added: “At this point, the governing body of the issuer has not taken any action to redeem the obligations but may do so in the future."

The obligations are subject to redemption prior to maturity, in whole or in part, at the option of the issuer, on any day, at a redemption price equal to 100% of the principal amount redeemed plus accrued interest to the date of redemption, both the Oshkosh and Kaukauna notices said.

The new CREBs were issued to pay a portion of the costs of a hydroelectric project, according to bond documents. Kaukauna Utilities historically operated a hydroelectric plant on the Fox River. The project was to decommission a more than 100-year-old powerhouse and another powerhouse built in 1928 in order to construct a new powerhouse 150 feet upstream from the two locations.

The project would modify the power canal and install two new identical 3.6 megawatt turbines. The estimated cost for all related hydroelectric improvements was $37 million, according to bond documents.

The BABs were issued for the acquisition of a hydroelectric generating facility and funding the reserve account.

New CREBs are taxable bonds that can be used either as direct-pay or as a tax-credit bond. CREBs are used by state and local governments, as well as public providers and electric cooperative companies, to finance renewable energy projects. Their subsidy payments are equal to 70% of interest costs.

In March the Treasury Department, in coordination with the Internal Revenue Service's chief counsel's office, announced they would issue guidance for a new process of allocating unused volume cap authority for new CREBs.

The new process will emphasize the allocation of volume-cap authority to issuers who demonstrate a readiness to timely issue bonds to finance projects. The Treasury Department has not yet issued the guidance.

Oshkosh wrote in its event notice that the city made the interest payment on the bonds on July 1 in full with the direct pay subsidy it received along with other available funds. Therefore there is no interest payment delinquency on the bonds.

"At this time, the city has not made any decision whether or not to redeem the bonds, but reserves its right to do so," the notice said.

Oshkosh's BABs were issued to provide funds for the public purpose of financing improvements and extensions to the city's water system, bond documents said.

BABs were first issued in 2009 as part of the American Recovery and Reinvestment Act but expired in 2010. Almost $188 billion of BABs were issued since they were created.

by: JENNIFER DEPAUL

WSJ: Investors Yank Money from Municipal-Bond Funds.

June's $13.5 Billion Outflow Is Second Largest on Record

Investors yanked $13.5 billion from mutual funds that invest in municipal bonds in June, according to Lipper FMI, a retreat that is making it harder for several cities, states and towns to raise money.

Individual investors are big buyers of municipal bonds for their tax-free status and their usually stable prices. But as Treasury bond prices fell last month, sparking a broad bond market rout, some of the largest mutual fund companies managing municipal bond funds saw huge amounts of money march out their doors.

June's outflow is about 2.2% of the $680.7 billion managed by the funds and the second largest monthly outflow of cash from the market on record, said Matt Lemieux, senior research analyst at Lipper, which has been tracking fund flows since 1992.

The selloff sent borrowing costs higher for municipalities, causing some to delay plans to raise money. The yield on 10-year, triple-A-rated municipal debt rose to 2.74% Tuesday from 2.08% on June 3, according to Thomson Reuters Municipal Market Data. The 2.74% yield is near levels last seen two years ago.

The Coatesville Area School District in Pennsylvania wanted to refinance $25 million of debt about three weeks ago but waited to see if rates would decline, said Tom Kozlik, director at investment bank Janney Montgomery Scott LLC, which is an underwriter of the bond sale. Rates have stabilized somewhat, and the deal is rescheduled for Wednesday. A Coatesville school district representative couldn't immediately be reached for comment.

Health-services company Geisinger Health System of Danville, Pa., has put plans to sell $284.4 million of bonds on a "day-to-day" status, "waiting to determine whether attractive fixed rates will return," said Timothy Fitzgerald, vice president of treasury management at the company.

The pace of redemptions from funds is mellowing as benchmark interest rates pause amid a two-month march higher, said fund managers, but big investor withdrawals mean they must sell bonds quickly, hurting prices further.

Managing investor redemptions was difficult, said Alex Grant, who manages two mutual funds totaling about $700 million in assets for RS Investment Management Co. He got through the end of the month and the end of the second quarter in part because he "was sitting on some cash," he said.

Investors saw returns suffering in June as trading became trying. Barclays's municipal bond index saw a negative return of 2.83% last month, the biggest loss since September 2008, when the index saw a negative total return of 4.69%.

Vanguard Group Inc., which has about $100.6 billion in municipal bond assets, saw the most money exit its municipal bond funds last month, about $2.3 billion, Lipper said. The funds had enough cash reserves to meet investor redemptions, said spokesman John Woerth, adding the company's money-market funds saw money pour in.

OppenheimerFunds Inc., Fidelity Management & Research Co. and Nuveen Fund Advisors Inc. each saw more than $1 billion exit their municipal bond funds, Lipper said.

OppenheimerFunds' municipal bond fund assets total about $33.3 billion, while Fidelity's are $29.3 billion and Nuveen's are about $26.7 billion, according to Lipper.

Christine Thompson, chief investment officer of Fidelity's bond group, said its funds met investors' demands for redemptions, in part because the firm ensured it had cash on hand. Representatives for OppenheimerFunds and Nuveen declined to comment.

The June pullback is only surpassed by a $16.6 billion outflow in December 2010, when investors were spooked by banking analyst Meredith Whitney's predictions of large numbers of defaults by states and municipalities, a projection that so far has been unfounded.

The outflow figure includes weekly and monthly reporting of open-ended municipal bond mutual funds as well as exchange-traded funds. Lipper said more than 95% of the funds it tracks have reported June data.

WSJ: With Palo Alto on Board, OpenGov Aims for Transparency in Dozens More City Governments.

When the managers of the City of Palo Alto cast around last year for technology that could power their initiative to open up the municipal budget to the public, the options were meager.

To implement its vision, Palo Alto managers met with founders of a fledgling startup, now called OpenGov, that offered to develop a new system from scratch that would gather all of the city's financial data and organize it into visually appealing and clear graphics, giving the viewer, whether a citizen or a city employee, insight into spending trends or budget overruns.

"If you are transparent and accountable, you build trust," said Jonathan Reichental, chief information officer for the city, about the reasons Palo Alto chose to open up its books. It also had to comply with a state law mandating a 10-day response from local governments to citizen requests for information. There are "a lot of people involved, and a lot of cost involved" in compliance, said Mr. Reichental.

Open data, he said, "cuts out the middleman" and allows interested parties to find what they are looking for online on their own.

The founders of OpenGov are well familiar with the problems and opportunities of using technology for government transparency through their work at California Common Sense, a nonprofit they had founded and run. The startup set to work on the project for the City of Palo Alto, for free, in exchange for collaboration with the city. It also worked three other beta partners in California–Saratoga, Salinas and Monterey.

The resulting product led to awards for the city managers, and is now the basis of a software-as-a-service offering that OpenGov is rolling out to municipalities across the country, including South Orange, N.J., as well as Palo Alto neighbor Mountain View.

In the meantime, OpenGov raised $7 million from investors Formation 8, Founders Fund, Valiant Capital, Thrive Capital, and angels, as VentureWire reported recently.

"Local governments spend more money than the federal government on [information technology]," said Zachary Bookman, chief executive of OpenGov. "It's one of the largest software markets in the world."

Using the technology, citizens can find information on firefighters' salaries and compare them to those of the police force, for example, in a few clicks of the button, instead of having to rummage through cumbersome PDF files, the standard for city budget information.

This year marked the first time when all 50 states post their checkbooks online, up from 32 in 2009, according to research by Frontier Group and U.S. PIRG Education Fund. But "only a small fraction" of municipalities currently have this level of information about their spending and budgets online, said Phineas Baxandall, of U.S. PIRG, or U.S. Public Interest Research Group, who co-wrote recent reports on open data in local governments. Municipal open-data initiatives are accelerating.

Such efforts, found Benjamin Davis, of think tank Frontier Group, are saving cities and states money, instances of which he has documented in his research. For example, "if other companies can see the payments [a city makes] to other companies, it creates a more competitive bidding atmosphere," said Mr. Davis. There's also a greater push from bipartisan public interest groups, he said. Finally, "we now live in this age when there's mobile banking, we have so much information at the click of the mouse, it only makes sense that governments should follow suit."

Even as there's a greater willingness, the market is still thorny. It might be hard to identify the right person in the government who is most receptive to the idea of opening up the books, as the interest stems from very different departments in each instance. "Sometimes it's the legislative, sometimes it's executive, sometimes it could be a [result of a] competition between two independently elected executives," said Mr. Baxandall, about the sources of open-records initiative in the local governments he has researched.

Most importantly, not every bureaucrat is ready to open up the kimono in the philosophical sense. Giving citizens "unfettered direct access feels a little uncomfortable [to some officials]," said Mr. Reichental of the City of Palo Alto. "Change is uncomfortable. I think that, more than anything, is what holds people back." And sometimes legislation might intervene rather than encourage opening up the records. The current budget bill in California, in fact, is making compliance with its open records act optional.

OpenGov, for its part, sees a large market, partly because its product is cheap, and partly because it's early days in open government and the benefits will become more apparent and accounted for.

Down the line, said Mr. Bookman, the company hopes to offer a capability for municipalities to compare their spending and budgets to other similarly sized cities around the country.

"Technology won't replace good decision making and good planning," said Mr. Bookman, but it could serve as a tool.

- *Los Angeles Unified School District v. County of Los Angeles*, in which the court held that the share of a school district's property tax revenue that was diverted from Educational Revenue Augmentation Funds (ERAF) by virtue of the Triple Flip and Vehicle Licensing Fee Swap legislation is to be counted as ERAF revenue in calculating district's property tax allocation base, thus avoiding either a decrease in the school district's passthrough payment allocation or an increase in a city or county's passthrough payment allocation.
- *Village of Sugar Grove v. F.D.I.C.*, in which the FDIC denied village's deposit-insurance claim, reasoning that the LOC's issued by failed bank were not "deposits" under 12 U.S.C. § 1813; noting that tax-exempt bonds backed by unfunded LOC's would become taxable if those LOC's were deemed "deposits."
- SEC Cracks Down on Disclosure in Municipal Bond Sales.
- Reminder: Amendments to MSRB Rules G-37 and G-8 Become Effective July 1.
- IRS LTR: Issuance of New Bonds Determined to Be Refunding of Existing Bonds.
- IRS: Exempt Organization Update.

- GASB Issues Proposal Addressing Transition Issue in Pension Standards.
- GFOA Executive Board Approves Best Practice on Actuarial Valuation Reports.
- From the I Swear I Am Not Making This Up Department comes the classic tale of a New Jersey police officer on disability leave who is fired after beating up an off-duty police officer at the Blarney Stone in Oklahoma following a disparaging remark about the NJ officer's cowboy hat. And why is there something inherently funny about falling down a manhole? See also, Mel Brooks' "If I get a paper cut, that's tragedy. If you fall down a manhole and die, that's comedy."

TAX - CALIFORNIA

Los Angeles Unified School District v. County of Los Angeles

Court of Appeal, Second District, Division 4, California - June 26, 2013 - Cal.Rptr.3d - 13 Cal. Daily Op. Serv. 6811

School district petitioned for writ of mandate to compel county, city, and several community redevelopment and other local agencies to increase school district's allocation of passthrough payments from property tax increment from redevelopment.

The Superior Court denied the petition. District appealed, and the Court of Appeal reversed. On remand, the Superior Court required county to include Educational Revenue Augmentation Funds (ERAF) revenue that was actually received by school district in the calculation of district's property tax allocation base, but rejected district's contention that its property tax allocation base should also include its share of the property tax revenue that was diverted from the ERAFs by virtue of the Triple Flip and Vehicle Licensing Fee (VLF) Swap legislation as ERAF revenue. School district appealed.

The Court of Appeal held that share of district's property tax revenue diverted from ERAF by Triple Flip or VLF Swap legislation was counted toward district's property tax base.

Diversion of revenue from an ERAF neither increases the recipient entity's property tax revenue base, nor decreases the donor ERAF's property tax revenue base. Cal. Health & Safety Code § 33607.

The share of school district's property tax revenue that was diverted from the ERAF by virtue of the VLF Swap legislation was counted as ERAF revenue in calculating district's property tax allocation base, thus avoiding either a decrease in the school district's passthrough payment allocation or an increase in a city or county's passthrough payment allocation. Cal. Health & Safety Code § 33607.5; Cal. Rev. & Tax. Code §§ 97.68(e).

INVERSE CONDEMNATION - GEORGIA

Walleye, LLC v. City of Forest Park

Court of Appeals of Georgia - July 1, 2013 - S.E.2d - 2013 WL 3286399

Walleye, LLC, owned property in the City of Forest Park at which tenant operated the Crazy Horse Saloon, a nude dancing business with private rooms and on-site alcohol service.

In March 2009, the City enacted a new ordinance, which repealed the previous sexually-oriented businesses code and enacted a revised code, banning the sale of alcohol and the use of private booths at nude dancing establishments.

The Crazy Horse closed and the property owner filed a lawsuit alleging an inverse condemnation claim because (1) there was no viable uses of the property other than that previously operated; and (2) the City had deprived the property owner of all viable economic use of the property.

The City filed a motion for summary judgment, which the trial court granted, finding that the property owner did not have vested property rights in renewed adult business or alcohol licenses, and therefore, they failed to establish a regulatory taking by the City.

The court of appeals affirmed, finding that property owner failed to state a claim for which it could recover because not only did it fail to present any evidence that their property could not be converted to a use other than an adult business, but because the zoning for the particular parcels allows for adult business. The property owner also failed to show that it could not continue leasing its buildings to other businesses in the same category that would not have violated the City's licensing rules and could operate legally within the City.

TORT CLAIMS ACT - GEORGIA

Georgia Dept. of Transp. v. Griggs

Court of Appeals of Georgia - June 28, 2013 - S.E.2d - 2013 WL 3242531

Motorist stopped her car in the emergency lane of I–285 to help a friend who had been in an automobile accident. As she walked from her friend's car back to her car, she went to the passenger's side door because it was away from the traffic lanes. As she opened the door, she stepped back onto a plywood board that was covering a manhole. The plywood gave way and she fell into the manhole, fracturing her elbow and knee, receiving cuts and bruises, and hurting her lower back. Apparently, the grate that was supposed to cover the manhole had been removed by thieves who had then placed a thin plywood board over the hole. There were no warning cones around the hole and trash from the roadway partially obscured the plywood cover.

Motorist filed a personal injury complaint against the Department of Transportation (DOT). The DOT filed a motion to dismiss. The trial court denied the motion. The DOT appealed.

Strict compliance with the notice provisions is a prerequisite to filing suit under the Georgia Tort Claims Act (GTCA), and substantial compliance therewith is insufficient.

The court found that motorist adequately complied with ante litem notice requirements. Motorist identified the portion of interstate on which she fell though a piece of plywood covering a manhole or storm drain on the shoulder of interstate, and after the notice was filed the Department of Transportation conducted an investigation and made motorist an offer of settlement.

MUNICIPAL FINANCE - ILLINOIS

Village of Sugar Grove v. F.D.I.C.

United States District Court, N.D. Illinois, Eastern Division - June 27, 2013 - Slip Copy - 2013 WL 3274583

Benchmark Bank issued a Letter of Credit ("LOC") in favor of the Village of Sugar Grove in the amount of $2,454,807.00 and a second LOC in favor of the Village in the amount of $4,538,634.00. The two LOC's secured the obligation of Hannaford Farm, LLC ("Hannaford"), the bank's customer, to construct certain property improvements. The LOC's obligated Benchmark to pay the Village upon demand certifying that Hannaford had defaulted in the manner described in the LOC's.

The Village, citing defaults by Hannaford, presented sight drafts to Benchmark demanding payment pursuant to the LOC's. Benchmark did not honor the Village's drafts, prompting the Village to file a lawsuit for wrongful dishonor in state court. The Illinois Department of Financial and Professional Regulation subsequently closed Benchmark and the FDIC was appointed as its receiver. The FDIC, as receiver for Benchmark ("FDIC–R"), removed the case to this court after it was substituted for Benchmark as the defendant.

Meanwhile, the Village submitted a proof of claim to the FDIC–R predicated on Benchmark's failure to honor the Village's drafts. The FDIC–R allowed the Village's claim in the full face amount of the LOC's as a "Tier 3" general creditor claim. The Village disputed that categorization, arguing that it should instead be treated as a depositor.

The FDIC denied the Village's deposit-insurance claim, reasoning that the LOC's were not "deposits" as that term is defined by 12 U.S.C. § 1813.

The court concluded that there was nothing arbitrary or capricious about the FDIC's reasonable conclusion that the notes backing the LOC's were "contingent," and thus not deposits.

The FDIC also stated that tax-exempt bonds backed by unfunded LOC's would become taxable if those LOC's were deemed "deposits," as bonds are not eligible for tax exemption if they are federally guaranteed). This could, the FDIC reasoned, negatively impact the market for municipal bonds, which are often backed by unfunded letters of credit.

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PUBLIC UTILITIES - KANSAS

Rural Water Dist. No. 4, Douglas County, Kan. v. City of Eudora, Kan.

United States Court of Appeals, Tenth Circuit - July 1, 2013 - F.3d - 2013 WL 3288083

Rural water district filed § 1983 action, alleging that city violated its exclusive right to provide water service to properties within its service area after city annexed certain properties within that area. City filed counterclaims for tortious interference with business advantage, fraud, abuse of process, and declaratory relief.

The Court of Appeals held that:

- Amendment to Kansas statute governing district's powers did not apply retroactively;
- Court had discretion to take up summary judgment denial on appeal; and
- District failed to demonstrate that loans were absolutely necessary or necessary to completing project.

Rural water district may only obtain federal statutory protection from poaching while repaying a loan from the United States Department of Agriculture (USDA) if state law authorizes it to do so. Agricultural Act of 1961, § 306(b), 7 U.S.C.A. § 1926(b).

Amendment to Kansas statute governing powers of rural water districts, which eliminated requirement that districts demonstrate necessity of obtaining USDA loan guarantees in order to show entitlement to federal protection from poaching while repaying such loans, constituted substantive amendment that did not apply retroactively, and thus district was required, in its § 1983 suit against city for alleged poaching of its customers, to show such necessity. Prior to the amendment, the city had the right to take district's customers if district's USDA-backed loans were unnecessary, and retroactive application of statute would strip city of that right. 42 U.S.C.A. § 1983; Agricultural Act of 1961, § 306(b), 7 U.S.C.A. § 1926(b); K.S.A. 82a–619(g).

DISABILITY PAYMENTS - LOUISIANA

Paul v. Jefferson Parish Public School System

Court of Appeal of Louisiana, Fifth Circuit - July 3, 2013 - So.3d - 13-132 (La.App. 5 Cir. 7/3/13)

Claimant, Ms. Paul, was employed by the Jefferson Parish School Board as a custodial worker. On March 6, 2009, she injured her neck and left shoulder during the course and scope of her employment. She reported this injury to the School Board and began receiving temporary total disability benefits.

Ms. Paul was paid temporary total disability benefits covering the period from her injury in March of 2009 until July 2, 2009. She prevailed in a disputed claim for compensation filed on December 1, 2010, alleging that her benefits had been wrongfully terminated. A February 13, 2012 Consent Judgment awarded Ms. Paul supplemental earnings benefits from the date of her injury until January

31, 2012, at which time supplemental earnings benefits payments were continued until Ms. Paul was "placed in a job that has been approved by her treating physician."

The only issue Ms. Paul presented for review was whether under La. R.S. 23:1209, the School Board's payment of supplemental earnings benefits to her interrupted prescription as to her claim for temporary total disability benefits.

The Court of Appeal found that Ms. Paul continuously received indemnity benefits (first temporary total disability benefits, followed by supplemental earnings benefits) for the injury that the School Board deemed compensable from the date of her initial injury on March 6, 2009 until April 12, 2012, when she underwent surgery for a condition related to the initial injury. She was unable to work after the surgery. Because of her total disability status following the surgery, the School Board terminated her supplemental earnings benefits. On July 11, 2012, within one year of termination of her supplemental earnings benefits, Ms. Paul filed a disputed claim for compensation, seeking temporary total disability benefits.

Applying the rules of statutory interpretation to the particular facts of this case, the court found that the workers' compensation court judge erred in finding that Ms. Paul's claim for temporary total disability benefits had prescribed. It also found that it would go against the legislatively-declared policy and intent of the Louisiana Workers' Compensation Laws, including La. R.S. 23:1209(A)(1) and (2), to find that Ms. Paul's claim for temporary total disability benefits had prescribed when she became temporarily totally disabled as a result of surgery for a condition related to her initial injury that the employer deemed compensable, in light of the fact that she had been receiving indemnity benefits (first temporary total disability benefits, followed by supplemental earnings benefits) continuously from the date of her initial injury until the date of the surgery.

FIRST AMENDMENT - MARYLAND

Greater Baltimore Center for Pregnancy Concerns, Inc. v. Mayor and City Council of Baltimore

United States Court of Appeals, Fourth Circuit - July 3, 2013 - F.3d - 2013 WL 3336884

In suit challenging facial validity of ordinance requiring limited-service pregnancy centers to post disclaimers that they did not provide or make referrals for abortions or certain birth-control services, the District Court dismissed claims of church and archbishop for lack of standing, and granted summary judgment in favor of co-plaintiffs, permanently enjoining enforcement of ordinance on ground that it was invalid under the Free Speech Clause, and parties cross-appealed.

In an en banc opinion, the Court of Appeals held that district court erred by entering a permanent injunction without allowing city defendants discovery or adhering to the applicable summary judgment standard.

As a general proposition, summary judgment is appropriate only after adequate time for discovery; discovery is usually essential in a contested proceeding prior to summary judgment because a party asserting that a fact is genuinely disputed must support the assertion by, inter alia, citing to particular parts of materials in the record, including depositions, documents, electronically stored information, affidavits or declarations, stipulations, admissions, interrogatory answers, or other materials.

Even if strict scrutiny proved to be the applicable First Amendment standard, city was entitled to opportunity to develop evidence relevant to the compelling governmental interest and narrow tailoring issues, including, inter alia, evidence substantiating the efficacy of the ordinance in promoting public health, as well as evidence disproving the effectiveness of purported less restrictive alternatives to the ordinance’s disclaimer.

Disclosure requirements aimed at misleading commercial speech need only survive rational basis scrutiny under First Amendment, by being reasonably related to the state’s interest in preventing deception of consumers. Absence of the speaker’s economic motivation does not preclude classification of the speech as commercial for purposes of First Amendment analysis.

Genuine issues of material fact existed as to whether limited-service pregnancy center’s advertising constituted commercial speech for purposes of First Amendment analysis, precluding summary judgment in favor of pregnancy center on its claim challenging validity of ordinance requiring limited-service pregnancy centers to post disclaimers that they did not provide or make referrals for abortions or certain birth-control services.

ZONING - MARYLAND

Pringle v. Montgomery County Planning Bd. M-NCPPC

Court of Special Appeals of Maryland - June 27, 2013 - A.3d - 2013 WL 3233337

Challenger of town’s employment area sector plan sought judicial review of a decision of the county planning board adopting resolutions relating to a development project to revitalize town’s central employment corridor.

The Court of Special Appeals held that substantial evidence supported board’s finding that locating “big box” retailer on internal network of streets relatively near proposed transit station, rather than on certain streets specified in town’s employment area sector plan, was consistent with the sector plan.

While sector plan specified that big box retailers, if proposed, “should” have active storefronts with multiple entrances and small retail uses facing certain specified streets, this provision was aspirational, rather than mandatory. Planning board found that natural drain location of site where sector plan called for retail frontage, and the grades of that intersection made locating the retail uses on these streets unfeasible, and that, due to this constraint, an internal network of streets relatively near the proposed transit station was consistent with the sector plan.

ZONING - MINNESOTA

Douglas A. Ruhland, Appellant, v. City of Eden Valley, Respondent.

Court of Appeals of Minnesota - July 1, 2013 - N.W.2d - 2013 WL 3285019

On appeal from the district court’s summary-judgment order confirming city’s decision to rezone certain property from “single and two-family residential” to “commercial reserve,” neighbor who objected to the zoning change argued that the city (1) failed to follow its comprehensive plan; (2) failed to comply with its zoning ordinance; (3) did not make sufficient findings of fact to support its decision and the record does not support the findings that it did make; (4) made a decision that constitutes impermissible spot zoning; and (5) made a decision that was improperly impacted by conflicts of interest.

In conclusion, the court of appeals observed that a city is required to provide reasons for a zoning decision or risk not having its decision sustained. See *Honn*, 313 N.W.2d at 416 ("The municipal body need not necessarily prepare formal findings of fact, but it must, at a minimum, have the reasons for its decision recorded or reduced to writing and in more than just a conclusory fashion. By failing to do so, it runs the risk of not having its decision sustained."). "We also observe that the reasons for the city's decision in this case are minimal and that greater explanation would have been desirable. However, given our deferential standard of review, we are satisfied that the city's zoning decision was not unreasonable, arbitrary, or capricious. We therefore affirm."

EMPLOYMENT - NEW JERSEY

Ruroede v. Borough of Hasbrouck Heights

Supreme Court of New Jersey - July 1, 2013 - A.3d - 2013 WL 3284218

Non-civil service borough police officer sought judicial review of a decision of a hearing officer recommending his termination based on officer's engaging in conduct unbecoming a police officer and public employee, disorderly conduct, willful violations of departmental rules and regulations, dishonesty, untruthfulness, and withholding information. The Borough affirmed hearing officer's recommendation. Officer appealed. The Superior Court, Law Division, Bergen County, reinstated officer on basis that his due process rights had been violated at disciplinary hearing.

The Supreme Court of New Jersey held that:

- Trial court was required to conduct an independent, de novo review of the quantum and quality of evidence presented at disciplinary hearing;
- Failure to call eyewitnesses to altercation to testify at disciplinary hearing, and relying instead on witness statements, did not violate officer's due process rights;
- Appropriate remedy to account for trial court's failure to conduct an independent, de novo review of the quantum and quality of the evidence presented at disciplinary hearing was for Supreme Court to exercise its original jurisdiction over the matter; and
- There was sufficient, competent evidence to support conclusion that officer engaged in misconduct.

OPEN MEETINGS ACT - NEW MEXICO

Palenick v. City of Rio Rancho

Supreme Court of New Mexico - June 27, 2013 - P.3d - 2013 WL 3226758

City manager brought action against city alleging his termination was in violation of the Open Meetings Act (OMA) and seeking payment pursuant to employment agreement.

The Supreme Court of New Mexico held that:

- Whether city manager waived right to pursue breach of contract claim under OMA was a question of law subject to de novo review, and
- Demand and acceptance of severance payment constituted waiver of breach of contract claim under OMA.

City manager's demand and acceptance of severance package from the city constituted a waiver of city manager's right to pursue breach of contract action against city based on alleged violation of OMA stemming from termination of manager's employment, where manager's demand and acceptance of a severance payment was inconsistent with his assertion that he was still an employee at the time of the alleged OMA violation, and manager failed to comply with statutory requirement to alert city council of alleged OMA violation.

ELECTIONS - OHIO

Krummen v. City of North College Hill, Ohio

United States District Court, S.D. Ohio, Western Division - June 26, 2013 - Slip Copy - 2013 WL 3270372

This lawsuit concerned the constitutionality of a recently passed Charter Amendment creating term limits for all elected officials in the City of North College Hill, Ohio. In addition to setting term limits for future elected officials, Section 13.09 explicitly imposed term limits retroactively on all current and past officials for years they had already served.

The District Court struck down the retroactive application of term limits to city council members holding office prior to the effective date of the amendment on the basis that such provision violated the Ohio Constitution. In addition, the retroactivity provision would also constitute an undue burden on plaintiffs' First and Fourteenth Amendment rights under the United States Constitution.

EMPLOYMENT - OHIO

Brockmeier v. Greater Dayton Regional Transit Authority

United States District Court, S.D. Ohio, Western Division - July 2, 2013 - Slip Copy - 2013 WL 3337403

Bus driver claimed that his employer, Greater Dayton Regional Transit Authority ("GDRTA"), violated the Americans with Disabilities Act ("ADA") and the corollary provision of Ohio law, when GDRTA did not allow him to drive a bus for almost two years after it received a physician's report-stating that he did not meet Department of Transportation ("DOT") medical certification guidelines for operation of a commercial vehicle due to symptoms associated with his multiple sclerosis ("MS").

This was an unusual ADA claim in that Plaintiff did not seek an accommodation or challenge the reasonableness of the accommodation his employer offered him; rather, Plaintiff claimed he should have been permitted to continue driving a bus, despite the fact that he failed a medical exam. To that end, the Court noted that this a highly regulated area of the law—likely on account of the significant safety concerns involved with public bus drivers and their transportation of citizens of the community. Quite likely indeed.

Plaintiff alleged that he submitted to GDRTA a number of physicians' certificates determining that he was able to return to work during his unpaid leave, but was not allowed to return to work. Notably, however, Plaintiff did not allege that any of these reports specifically opined whether or not he met the DOT Medical Certification guidelines for operating a commercial motor vehicle. Further, Plaintiff did not allege that he attempted to resolve the conflicting opinions through the established administrative procedure.

The court dismissed the case, noting that in order to determine whether Plaintiff was qualified for his position, the court would have to resolve the disagreement between the divergent medical opinions and this was not the appropriate forum in which to do so.

LIABILITY - RHODE ISLAND

Lombardi v. City of Providence

Supreme Court of Rhode Island - July 2, 2013 - A.3d - 2013 WL 3337000

Plaintiff tripped over a portion of a sidewalk adjacent to 180 South Main Street, Providence, Rhode Island. After serving notice upon the Providence City Council, plaintiff filed suit against the city, alleging that it negligently failed to maintain or repair the portion of the sidewalk where she fell and that she had suffered serious injuries as a result. The plaintiff later amended her complaint to add the state as a defendant.

The state answered plaintiff's complaint but, significantly, did not assert a cross-claim for contribution or indemnification against the city.

The city moved for summary judgment, arguing that it did not owe a duty to plaintiff because the state, and not the city, was responsible for the maintenance and repair of the sidewalk. The city contended that the state may assume full legal responsibility for designated roadways within a municipality and had done just that with respect to the sidewalks on South Main Street by virtue of P.L.1985, ch. 364, §§ 1–2.4.

Final judgment on plaintiff's claim was entered in favor of the city. The state filed a motion for reconsideration of the grant of summary judgment in favor of the city. The Supreme Court of Rhode Island held that the state was not entitled to this motion, as it was not a "party aggrieved by" the final judgment under G.L.1956 § 9–24–1, having chosen not to file a cross-claim against the city.

EMPLOYMENT - TEXAS

City of Houston v. Bates

Supreme Court of Texas - June 28, 2013 - S.W.3d - 2013 WL 3240206

Retired city firefighters brought action against city, alleging that city had made unauthorized deductions from their termination pay upon retirement.

The Supreme Court of Texas held that:

- Statute governing calculation of overtime required that only paid leave, and not unpaid leave, be included in calculation of hours, but
- Statute governing calculation of termination pay preempted city ordinances excluding premium pay from definition of "salary" for purposes of termination pay calculation.

Sections of local government code entitling city firefighters to a lump-sum payment for accumulated but unused vacation and sick leave upon retirement, requiring accumulated vacation and sick leave to be valued at the firefighter's "salary" at the time firefighters accumulated the leave, preempted city ordinances excluding certain types of premium pay from definition of salary for purposes of calculating accumulated benefit leave for termination pay due to firefighters upon retirement.

Statute requiring that time spent on “authorized leave” be included in calculating the number of hours city firefighter worked during a work cycle for purposes of overtime compensation, required that only paid leave, and not unpaid leave, be included in calculation of hours. The phrase “any other authorized leave” was preceded in statute by six categories of paid leave, sick time, vacation time, meal time, holidays, compensatory time, death in the family leave, indicating that legislature intended term to have the limited meaning of encompassing only other forms of paid leave.

Reminder: Amendments to MSRB Rules G-37 and G-8 Become Effective Today.

Effective today, MSRB Rules G-37 and G-8 require the public disclosure of additional information related to bond ballot campaign contributions and the municipal securities business engaged in by dealers resulting from voter approval of the bond ballot measure to which such contributions relate. The MSRB reminds brokers, dealers and municipal securities dealers that the additional quarterly disclosures must be submitted to the MSRB no later than October 31, 2013 for the quarter commencing on July 1, 2013 and each quarter thereafter.

Read the original approval notice:

http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-09.aspx

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MSRB's Proposal to Change Rules Related to Retail Order Periods Published in Federal Register.

The Municipal Securities Rulemaking Board (MSRB)’s request for approval on a proposed rule change to MSRB Rule G-8, Rule G-11 and Rule G-32 has been published in the Federal Regiser.http://www.gpo.gov/fdsys/pkg/FR-2013-06-28/pdf/2013-15492.pdf

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FINRA Selects Morningstar for Re-Launch of Market Data Center.

The Financial Industry Regulatory Authority (FINRA) announced today that it selected Morningstar, Inc. to provide financial data, technology and design for the re-launch of FINRA’s Market Data Center. FINRA’s Market Data Center makes available to retail investors a wealth of information on a broad spectrum of financial instruments. With an emphasis on bond market information, including price information from FINRA’s Trade Reporting and Compliance Engine (TRACE), the Market Data Center has brought retail investors unprecedented transparency to the corporate bond market. By working with Morningstar, FINRA’s revamped Market Data Center is now a comprehensive and powerful platform offering expansive market data as well as FINRA Investor Education materials and tools.

“FINRA is pleased to work with Morningstar to give retail investors new resources and features to help them make better-informed investing decisions. TRACE has been vital to bringing transparency to the bond market, and our updated Market Data Center will make it easier for investors to use and understand this and other information,” said FINRA Vice President Ola Persson.

Morningstar designed the new Market Data Center and provides comprehensive intra-day pricing and fundamental data for U.S. fixed income securities, equities, options, indexes, mutual funds and exchange-traded funds (ETFs).

"We are pleased that FINRA selected us to redesign the Market Data Center," Kunal Kapoor, head of global client solutions for Morningstar, Inc., said. "We share a common commitment with FINRA to improve transparency in the bond markets, an area where investors have traditionally had a hard time finding timely and meaningful information. The newly redesigned Center offers investors a wide breadth of financial data and tools, and better surfaces the rich set of information FINRA has to offer."

The Market Data Center provides retail investors with information on a range of financial instruments, including:

- a comprehensive source for unbiased financial information provided without advertising;
- information on a broad spectrum of financial instruments, including equities, options, mutual funds, ETFs and bonds;
- the most comprehensive free bond market information on the Web, with advanced screening tools allowing investors more flexibility to conduct searches and find the information they need;
- bond data that includes descriptions of corporate bonds, municipal securities and treasury and agency bonds, credit rating information from the three major rating agencies, TRACE- and MSRB-reported price information, scrolling real-time tickers for most recently traded bonds and links to the Municipal Securities Rulemaking Board's (MSRB) Electronic Municipal Market Access (EMMA); and
- improved graphing capabilities to give investors more tools to understand market data.

FINRA is dedicated to educating investors and demystifying the bond market. To that end, FINRA has developed a comprehensive online learning center – Smart Bond Investing – where retail investors can become familiar with the full range of bond types, features and considerations when investing in bonds. FINRA Investor Alerts, including a recent warning highlighting the importance of duration risk, give investors timely information and helpful tools to assist them in making smarter financial choices.

FINRA, the Financial Industry Regulatory Authority, is the largest independent regulator for all securities firms doing business in the United States. FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services. FINRA touches virtually every aspect of the securities business – from registering and educating all industry participants to examining securities firms, writing rules, enforcing those rules and the federal securities laws, informing and educating the investing public, providing trade reporting and other industry utilities, and administering the largest dispute resolution forum for investors and firms. For more information, please visit www.finra.org.

LTR: Issuance of New Bonds Determined to Be Refunding of the Bonds.

The IRS ruled that the issuance of new bonds is a refunding of the bonds within the meaning of reg. section 1.150-1(d)(1), notwithstanding that the technical termination of a partnership that held the principal under reg. section 1.708-1(b)(2) occurred within six months of the date of the refinancing.

Citations: LTR 201326007

LEGEND:

Issuer = * * *

Borrower = * * *

Facility = * * *

Principal = * * *

Partnership = * * *

Holding Company = * * *

Bank A = * * *

Bank B = * * *

Date 1 = * * *

Date 2 = * * *

Date 3 = * * *

Bonds = * * *

New Bonds = * * *

Dear * * *:

This responds to your request for a ruling that notwithstanding the purchases on Date 1 and Date 3 (as described below) and the technical termination of Partnership under § 1.708-1(b)(2) of the Income Tax Regulations, all within six months of the date of the Refinancing (as described below), the issuance of the New Bonds is a refunding of the Bonds within the meaning of Treas. Reg. § 1.150-1(d)(1).

FACTS AND REPRESENTATIONS

You make the following representations. Issuer is a governmental agency constituting a public benefit corporation authorized to issue bonds and responsible for providing low-income housing.

Borrower is a limited-liability company formed for the purpose of constructing and developing Facility, a multi-family rental housing development. For Federal income tax purposes, Borrower is a disregarded entity. Through several single-member limited liability companies that are disregarded for Federal income tax purposes, Principal (or New Principal, as described below) at all relevant times has owned all of the capital and profits interest in Borrower. At all relevant times, Partnership (or New Partnership, as described below) directly has owned * * * percent of Principal.

Immediately prior to Date 1, Bank A and Bank B owned approximately * * * percent of Partnership, and Holding Company owned approximately percent of Partnership. Third parties that include certain Partnership employees and officers unrelated to Bank A, Bank B, or Holding Company (the "Third Parties"), owned the remaining approximate * * * percent of the capital and profits interest in Partnership.

On Date 1, Holding Company exercised an option to acquire half of the capital and profits interests in Partnership that had been owned by Bank A and Bank B (the “Date 1 Purchase”). Thus, after Date 1, Bank A and Bank B owned approximately * * * percent and * * * percent of the capital and profits interests in Partnership, respectively. Holding Company owned approximately * * * percent of the capital and profits interests in Partnership. The Third Parties continued to own the remaining approximate * * * percent of the capital and profits interest in Partnership.

Facility is financed by a mortgage loan (the “Mortgage Loan”) from Issuer to Borrower. The Bonds were issued by Issuer to provide a portion of the funding for the Mortgage Loan. Because Borrower is a disregarded entity for Federal income tax purposes, Principal is treated as the obligor on the Bonds. On Date 2, less than four months after Date 1, the Bonds were remarketed such that a reissuance occurred (the “Refinancing”). Borrower is the obligor on the reissued bonds (the “New Bonds”) but because Borrower is a disregarded entity, Principal is treated as the obligor on the New Bonds. The proceeds of the New Bonds were used to pay the principal of the Bonds.

On Date 3, less than six months after Date 1, Holding Company acquired from Bank A and Bank B, respectively, their remaining * * * percent and * * * percent of the capital and profits interests in Partnership (the “Date 3 Purchase”). Thus, as of Date 3 Holding Company owned * * * percent of Partnership, and the Third Parties owned the approximate * * * percent of Partnership which remained. Neither Borrower nor Issuer had any control over the sales by Bank A and Bank B of their interests in Partnership.

Borrower represents that the Refinancing was not related to, or contingent in any way upon, the Date 1 Purchase or the Date 3 Purchase, and that the Date 1 Purchase and the Date 3 Purchase were not related to, or contingent in any way upon, the Refinancing. Borrower represents that the Refinancing would have occurred regardless of whether the Date 1 Purchase or the Date 3 Purchase occurred.

Issuer represents that it is applying Prop. Treas. Reg. § 1.150-1(d)(2)(ii) and (v), 67 Fed Reg 17509 (April 10, 2002), to the New Bonds.

LAW AND ANALYSIS

Treas. Reg. § 1.150-1(a)(1) provides that the definitions of § 1.150-1 apply for all purposes of I.R.C. §§ 103 and 141 through 150. Treas. Reg. § 1.150-1(d)(1) provides, in general, that a refunding issue is an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue (a prior issue, as more particularly defined in paragraph (d)(5)), including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue.

Treas. Reg. § 1.150-1(b) defines related party in part to mean, with reference to any person that is not a governmental unit or 501(c)(3) organization, a related person (as defined in § 144(a)(3)). Section 144(a)(3) provides in part that a person is a related party to another person if the relationship between such persons would result in a disallowance of losses under §§ 267 or 707(b). Section 707(b)(1)(B) states that no deduction shall be allowed in respect of losses from sales or exchanges of property (other than an interest in the partnership), directly or indirectly, between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests. Section 707(b)(3) provides that for this purpose, the ownership of a capital or profits interest in a partnership shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) other than paragraph (3) of such section. Section 267(c)(1) provides, in part, that stock owned, directly or indirectly, by or for a partnership shall be considered as being owned proportionately by or for its partners.

Issuers may apply proposed regulations amending Treas. Reg. § 1.150-1(d) published in the Federal Register on April 10, 2002 (67 Fed. Reg. 17509) (the “Proposed Regulations”), in whole, but not in part, to any issue that is sold on or after April 10, 2002, and before the applicability date of the final regulations.

Prop. Treas. Reg. § 1.150-1(d)(2)(ii)(A) provides in part that an issue is not a refunding issue to the extent that the obligor (as defined in paragraph (d)(2)(ii)(B)) of one issue is neither the obligor of the other issue nor a related party with respect to the obligor of the other issue. The determination of whether persons are related for this purpose is generally made immediately before the issuance of the refinancing issue.

Prop. Treas. Reg. § 1.150-1(d)(2)(ii)(B) provides in part that the obligor of an issue means the actual issuer of the issue, except that the obligor of the portion of an issue properly allocable to an investment in a purpose investment means the conduit borrower under that purpose investment.

Prop. Treas. Reg. § 1.150-1(d)(2)(ii)(C) provides in part that if, within six months before or after a person assumes (including taking subject to) obligations of an unrelated party in connection with an acquisition transaction (other than a transaction to which § 381(a) applies), the assumed issue is refinanced, the refinancing issue is not a refunding issue. An acquisition transaction is a transaction in which a person acquires assets (other than an equity interest in an entity) from an unrelated party.

Section 708(a) provides that, for purposes of subchapter K, an existing partnership shall be considered as continuing, if it is not terminated.

Section 708(b)(1)(B) provides that, for purposes of § 708(a), a partnership shall be considered as terminated only if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

Treas. Reg. § 1.708-1(a) provides that for purposes of subchapter K, chapter 1 of the Code, an existing partnership shall be considered as continuing if it is not terminated. Section 1.708-1(b)(2) provides, in part, that a partnership shall terminate when 50 percent or more of the total interest in partnership capital and profits is sold or exchanged within a period of 12 consecutive months. Moreover, if the sale or exchange of an interest in a partnership (upper-tier partnership) that holds an interest in another partnership (lower-tier partnership) results in a termination of the upper-tier partnership, the upper-tier partnership is treated as exchanging its entire interest in the capital and profits of the lower-tier partnership. If the sale or exchange of an interest in an upper-tier partnership does not terminate the upper-tier partnership, the sale or exchange of an interest in the upper-tier partnership is not treated as a sale or exchange of a proportionate share of the upper-tier partnership’s interest in the capital and profits of the lower-tier partnership.

Treas. Reg. § 1.708-1(b)(4) provides, in part, that if a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in a new partnership; and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership, either for the continuation of the business by the new partnership or for its dissolution and winding up.

Issuer is applying the Proposed Regulations to the New Bonds. At the time of the Refinancing on Date 2, the obligor of the Bonds was Borrower/Principal and the obligor of the New Bonds was Borrower/Principal. No change occurred at that time in the ownership of either Principal or

Partnership. However, on Date 3, within 6 months of the Refinancing, a termination and transfer of assets and liabilities of Partnership occurred pursuant to § 708(b), when Holding Company acquired Bank A's and Bank B's remaining shares in Partnership. Further, Partnership is treated as exchanging its percent interest in Principal, resulting in a termination and transfer of assets and liabilities of Principal.

Under Prop. Treas. Reg. § 1.150-1(d)(2)(ii)(C), a refinancing issue is not treated as refunding issue if, within six months before or after a person assumes (including taking subject to) obligations of an unrelated party in connection with an asset acquisition from an unrelated party, the assumed obligation is refinanced. That section requires an analysis of whether the debt was assumed by, and the deemed transfer of the assets was to, an unrelated party.

As a result of the technical termination, the assets and liabilities of Partnership were deemed transferred to a new partnership ("New Partnership"), * * * percent of which is owned by Holding Company. Immediately prior to the Date 3 purchase, Holding Company owned * * * of Partnership. Therefore, because Holding Company's ownership interests in Partnership and in New Partnership are both greater than * * * percent, Partnership and New Partnership are related parties for purposes of § 1.150-1(b). Similarly, the assets and liabilities of Principal were deemed transferred to a new partnership ("New Principal"). Thus, Partnership owned * * * percent of Principal before the Date 3 purchase and New Partnership owned * * * percent of New Principal after the Date 3 purchase. Because of Holding Company's interests in Partnership and New Partnership, Principal and New Principal also are related parties.

Accordingly, the New Bonds are refunding bonds because the obligors of the Bonds and the New Bonds were the same on Date 2 and the transfers of assets and liabilities of Principal and Partnership on Date 3 were between related parties.

CONCLUSION

Under the facts and circumstances of this case, notwithstanding the technical termination of Partnership under Treas. Reg. § 1.708-1(b)(2) (all within six months of the date of the Refinancing), we conclude that the New Bonds are refunding bonds

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to the authorized representative of Issuer and Borrower.

The ruling contained in this letter is based upon information and representations submitted by Issuer and Borrower and accompanied by penalty of perjury statements executed by the appropriate parties. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel

(Financial Institutions & Products)

By: Timothy L. Jones

Senior Counsel, Branch 5

IRS: Exempt Organization Update.

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1. IRS announces Optional Expedited Process for certain 501(c)(4) Exemption Applications
2. IRS Nationwide Tax Forums begin next week
3. Check out this summer's IRS phone forums
4. Register for EO workshops
5. Section 509(a)(3) Supporting Organizations pages updated
6. IRS accepting applications for Low Income Taxpayer Clinic grants
7. IRS Electronic Tax Administration Advisory Committee delivers report to Congress

1. IRS announces Optional Expedited Process for certain 501(c)(4) Exemption Applications

The IRS announced an optional expedited process for certain Section 501(c)(4) applications. To qualify, organizations must have applied for 501(c)(4) exempt status, their application must be pending for more than 120 days as of May 28, 2013, and their cases must involve possible political campaign intervention or issue advocacy.

http://www.irs.gov/Charities-&-Non-Profits/New-Review-Process-and-Expedited-Self-Certification-Option

2. IRS Nationwide Tax Forums begin next week

The IRS Nationwide Tax Forums, which begin next week in Orlando, Fla., offer three full days of seminars with the latest word from IRS leadership and experts in the fields of tax law, compliance and ethics.

Attendees can:

- Select from more than 40 seminars and workshops
- Earn up to 18 continuing professional education credits
- Explore the expo hall for the latest tax professional products and services

http://www.irs.gov/Tax-Professionals/IRS-Nationwide-Tax-Forum-Information

3. Check out this summer's IRS phone forums

For a list of upcoming phone forums, go to the phone forums section of the Calendar of Events page.

"Charities and their Volunteers" – July 24

We've scheduled an encore session! The registration link on our phone forums page will be live soon.

"Veterans Organizations – Complying with IRS Rules" — July 30

Veterans organizations occupy a special place in the world of exempt organizations. Not only are most veterans organizations exempt from tax, but contributions to them may be deductible, and some are permitted to set aside amounts that are used to provide insurance benefits to members.

This combination — tax-exempt status, deductibility of contributions and the ability to pay benefits to members — is relatively rare and is evidence of Congress's intent to provide special tax treatment for veterans organizations. This phone forum provides information to help them stay tax exempt.

Topics include:

- Requirements for exemption
- Recordkeeping
- Filing and reporting
- Unrelated business income tax
- Exempt activities
- Bona fide guests

"What's Special about Schedule K (Form 990)?" – July 31

Topics covered include:

- Helpful resources for completion of Schedule K
- Detailed discussion of Schedule K information requirements
- Helpful compliance monitoring procedures
- Space is limited so register quickly.

http://www.irs.gov/Charities-&-Non-Profits/Phone-Forums-Exempt-Organizations

4. Register for EO workshops

Register for upcoming workshops for small and medium-sized 501(c)(3) organizations:

August 13 – Highland Heights, KY

Hosted by University of Kentucky

August 15 – Lexington, KY

Hosted by University of Kentucky

August 20-21 – San Francisco, CA

Hosted by Golden Gate University

August 28-29 – Anaheim, CA

Hosted by Trinity Law School

September 9 – St. Paul, MN

Hosted by Hamline University

September 10 – Minneapolis, MN

Hosted by University of St. Thomas

http://www.irs.gov/Charities-&-Non-Profits/Upcoming-Workshops-for-Small-and-Medium-Sized-501(c)(3)-Organizations

5. Section 509(a)(3) Supporting Organizations pages updated

These updated pages illustrate the new rules for certain organizations that carry out their exempt purposes by supporting other public charities. This classification is important because it is one means by which a charity can avoid classification as a private foundation, a status that is subject to a more restrictive regulatory regime.

http://www.irs.gov/Charities-&-Non-Profits/Section-509(a)(3)-Supporting-Organizations

6. IRS accepting applications for Low Income Taxpayer Clinic grants

The IRS recently announced the opening of the 2014 Low Income Taxpayer Clinic grant application process. Read news release.

http://www.irs.gov/uac/Newsroom/IRS-Accepting-Applications-for-Low-Income-Taxpayer-Clinic-Grants-2013

7. IRS Electronic Tax Administration Advisory Committee delivers report to Congress

The Electronic Tax Administration Advisory Committee recently presented its 2013 Annual Report to Congress. The report discusses five groups of recommendations on issues in electronic tax administration.

http://www.irs.gov/pub/irs-pdf/p3415.pdf

IRS Grants Extension of Expenditure Period for Qualified Zone Academy Bond Proceeds.

The IRS granted a city an extension of the expenditure period for available project proceeds of qualified zone academy bonds on determining that the city's failure to spend its bond proceeds was due to reasonable cause and that the city would spend its remaining proceeds for qualified purposes with due diligence.

Citations: LTR 201326001

This is in response to your request under Section 54A(d)(2)(B)(iii) of the Internal Revenue Code for an extension of the expenditure period for the available project proceeds of qualified tax credit bonds.

FACTS AND REPRESENTATIONS

You make the following factual representations. City is a municipal corporation of State and is largely responsible for the financing of local primary and secondary educational expenditures. The Board of Education (the "Board") is the official policy making body of District. Board is composed of members appointed by the Mayor of City, and administers City's school system within District. The school system collectively operates a elementary, middle, and high schools. Board's operations are solely funded through City appropriations, Federal and State aid to education, grants, and locally generated revenues of Board.

The Bonds were issued on Date 1 by City, and were designated by City as qualified zone academy bonds within the meaning of § 54E(a). Pursuant to § 54E (c)(4), State allocated to the Bonds $b of its carryforward allocation of the national zone academy bond limitation from Year 1. In preparing to issue the Bonds, District identified a pool of public school facilities located within District that met the requirements for being treated as qualified zone academies within the meaning of § 54E(d)(1) and were in urgent need of rehabilitation and repair, and equipment. The Bond proceeds were allocated among 17 public school facilities of such previously identified pool of public school facilities located within District (the “Project”).

Each of these school facilities was budgeted a specific stated amount of the Bond proceeds. The original three-year expenditure period for the Bonds under § 54A(d)(2)(B)(i) will expire on Date 2. However, several unexpected events have resulted in an unforeseen delay in the expenditure of the available project proceeds of the Bonds. As of Date 3, the date of your request for a ruling, $c of the available project proceeds of the Bonds remains unspent.

With respect to five of the 17 school facilities, although the rehabilitation work has been completed, the State-required “as-built” drawings from electrical contractors installing wiring and electrical equipment at those five schools have not been received by District. District is working with the electrical contractors to receive these drawings. Also, reduced clerical staffing necessitated by budget cutbacks has resulted in unexpected delays in various areas of project administration, including the processing of the documentation for, and payments for, contracts with respect to another five of the 17 school facilities under which the rehabilitation and repair work had already been completed. District expects to expend the allocated available project proceeds with respect to these 10 school facilities by Date 4.

A lengthy review process by State with respect to the rehabilitation and repair design plans of another one of the 17 school facilities has resulted in a delay in the rehabilitation work with respect to that facility. At the time the Bonds were issued, District did not foresee that this review process, which includes delays associated with the project designer’s plans and specifications, would take such an extended period of time. District expects the repair and rehabilitation of this school facility and the expenditure of available project proceeds allocated thereto to be completed by Date 5.

The reduced clerical staffing referenced above has also caused an unexpected delay in title transfer and control of the land and thus rehabilitation work with respect to one of the 17 school facilities. District cannot commence the rehabilitation of the school facility without the ownership and possession of the property. District will reallocate the available project proceeds for this project to the “Rehabilitation Project” described below.

The rehabilitation and repair work at another one of the 17 school facilities has been completed. This project, however, is subject to litigation that arose after the work was completed but before the allocable available project proceeds was expended. This expenditure is delayed until the lawsuit is resolved. District will reallocate the available project proceeds for this project to the Rehabilitation Project described below.

At another one of the 17 school facilities, the rehabilitation and repair work was proceeding towards timely completion until it was discovered that the facility was contaminated with polychlorinated biphenyl (“PCB”). The PCB contamination was unexpected and has significantly expanded the scope of the project at this school, and has also significantly increased its cost (collectively referred to herein as the “Rehabilitation Project”) to approximately $d from the $e budgeted for the original rehabilitation and repair project. Both the original portion and the expanded portion of the Rehabilitation Project may not be completed, and the allocable available project proceeds may not be expended, prior to Date 2. District expects to completely spend the available project proceeds allocated to the Rehabilitation Project not later than Date 6.

The actual costs of the rehabilitation and repair of several of the 17 schools, some of which are described above, unexpectedly were less than the original budgeted amounts. The available project proceeds that were originally budgeted for those projects but were not expended, will be reallocated to the Rehabilitation Project.

This unexpected series of events has resulted in an unforeseen delay in the spend-down of the available project proceeds.

City submitted this request for a ruling prior to Date 2.

LAW AND ANALYSIS

Section 54A(d)(1) provides that a qualified zone academy bond is treated as a qualified tax credit bond for purposes of Section 54A.

Section 54A(d)(2)(B)(i) provides in part that to the extent that less than 100 percent of the available project proceeds of the issue are expended by the close of the expenditure period for 1 or more qualified purposes, the issuer shall redeem all of the nonqualified bonds within 90 days after the end of such period.

Section 54A(d)(2)(B)(ii) provides that for purposes of this subpart, the term "expenditure period" means, with respect to any issue, the 3-year period beginning on the date of issuance. Such term shall include any extension of such period under clause (iii).

Section 54A(d)(2)(B)(iii) provides that upon submission of a request prior to the expiration of the expenditure period (determined without regard to any extension under this clause), the Secretary may extend such period if the issuer establishes that the failure to expend the proceeds within the original expenditure period is due to reasonable cause and the expenditures for qualified purposes will continue to proceed with due diligence.

Section 54A(d)((2)(C)(iv) provides that for purposes of this paragraph, in the case of a qualified zone academy bond, a "qualified purpose" means a purpose specified in § 54E(a)(1).

Section 54A(e)(4) of the Code defines "available project proceeds" to mean (A) the excess of (i) the proceeds from the sale of an issue, over (ii) the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds), and (B) the proceeds from any investment of the excess described in subparagraph (A).

The Project was identified prior to the issuance of the Bonds and District reasonably expected to spend all of its allocable available project proceeds within the three-year period. The failure to spend all the available project proceeds of the Bonds by the expiration of the three-year period on Date 2 was caused by events that were not reasonably expected at the time the Bonds were issued and were beyond the control of either City or District. However, City and District to the extent possible considering all of the described unexpected external events that resulted in unforeseen delays, have and will continue to exercise due diligence in spending the remaining available project proceeds on the Project. City and District expect to spend all available project proceeds not later than Date 6.

CONCLUSION

Under the facts and circumstances of this case, we conclude that District's failure to expend its allocable portion of the available project proceeds of the Bonds was due to reasonable cause and that District's expenditures of the proceeds for qualified purposes will proceed with due diligence. Therefore, City is granted an extension of the expenditure period with respect to the Bonds until Date 6.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to City's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by City and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel

(Financial Institutions & Products)

By: Timothy L. Jones

Senior Counsel, Branch 5

ACA Provisions: What You Need to Know Phone Forum Recording Now Available.

If you want to listen to the April 30th ACA Provisions: What you need to know! Phone Forum, click the link below. The 60 minute presentation covers:

What is included in the cost of coverage (i.e. health, dental/vision, FSA benefits).

Additional Medicare Tax: application, calculation, and reporting.

http://www.irsvideos.gov/Governments/Employers/ACAProvisionsWhatYouNeedtoKnow

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TEB Phone Forum: What's Special about Schedule K (Form 990)?

The Office of Tax Exempt Bonds will host a free phone forum on July 31, 2013 at 2:00 p.m. (Eastern Time) to discuss Schedule K (Form 990). To learn more and register, click the following link.

What's Special about Schedule K (Form 990)?

http://ems.intellor.com/index.cgi?p=204720&t=71&do=register&s=&rID=427&edID=305

McDermott Calls on IRS to Update Safe Harbor Guidelines for Health Care Facilities to Better Implement Affordable Care Act.

In a letter to Assistant Secretary for Tax Policy Mark Mazur, Congressman Jim McDermott (D-WA) today called on the IRS to review outdated “safe harbor” provisions that inhibit the ability of certain new payment models, such as accountable care organizations, to flourish. Updated provisions would help clear obstacles to many of the innovative and more efficient payment models outlined by the Affordable Care Act (ACA), and improve efforts to coordinate care between hospitals and health care professionals.

IRS Revenue Procedure 97-13, which creates safe harbors that protect the tax-exempt status of certain bonds issued by health care facilities, was issued in 1997. Since then, new compensation models, such as bundled payments, have shown promising results for improving care and reducing costs. Updates to the safe harbors will give providers and bondholders certainty that new payment models are protected under the IRS guidance.

“Stakeholders generally structure arrangements to fit squarely within a safe harbor with respect to their compensation arrangements, as they are aware that the IRS is closely scrutinizing these issues,” wrote McDermott. “As a result, hospitals have some anxiety with entering into new and innovative arrangements encouraged by the ACA.”

As the ACA ramps up to full implementation, any revisions to the relevant tax guidance should be made in time to provide certainty so that the new models can be quickly adopted. “It is imperative that the IRS begin to consider such modifications immediately, since under the Affordable Care Act, models that emerge as successful from [Center for Medicare and Medicaid Innovation] can be rapidly expanded throughout the country,” urged McDermott.

* * * * *

July 1, 2013

Mr. Mark Mazur

Assistant Secretary for Tax Policy

Department of Treasury

1500 Pennsylvania Ave N.W.

Washington, DC 20220

Re: Potential Updates to Rev. Proc. 97-13

Dear Mr. Mazur:

As Ranking Member of the Subcommittee on Health of the Committee on Ways and Means, I am deeply interested in initiatives that advance better coordinated care among hospitals, physicians, and other health care professionals. Such coordinated care is not only good for the patient, it is also good for the economy since coordinated care results in a decrease in the number of duplicative tests performed on patients, and can decrease the potential for medical errors that lead to readmissions and other negative consequences.

Many of the reforms in the Affordable Care Act are intended to promote better care coordination. In fact, the Center for Medicare and Medicaid Innovation ("CMMI") was tasked with developing new, replicable models where health care professionals and hospitals provide high quality care at a lower cost on a population-wide basis. CMMI is now in the process of testing various permutations of accountable care organizations, as well as various bundled payment initiatives. It is my hope that these programs result in savings to the Medicare program and that patients see demonstrable, measurable improvements in the quality of care that they are provided.

However, I am aware that stakeholders are concerned about the implications that participating in such innovative programs may have on tax-exempt bond financed facilities. As you know, facilities that are financed with tax-exempt bonds attempt to structure their contractual arrangements to fit within the safe harbors of Rev. Proc. 97-13. The safe harbors are narrow and limit the terms of such arrangements. Also, the safe harbors limit the types of permissible compensation arrangements and may not address innovative payment methods such as payment bundles. Because of the limited nature of the safe harbors, some of the newly emerging innovative methods by which a hospital may want to compensate a physician do not fit squarely within the existing safe harbors. Of course, this does not automatically make the bonds that finance the health care facility taxable. However, stakeholders generally structure arrangements to fit squarely within a safe harbor with respect to their compensation arrangements, as they are aware that the IRS is closely scrutinizing these issues, particularly since it is easier to do so given the Form 990 redesign. As a result, stakeholders may have some anxiety with entering into new and innovative arrangements encouraged by the Affordable Care Act.

While I understand and fully support the intended purpose behind Rev. Proc. 97-13 and believe it should be retained, I believe it should be updated to recognize the newly emerging compensation models between hospitals and physicians. It is imperative that the IRS begin to consider such modifications immediately, since under the Affordable Care Act, models that emerge as successful from CMMI can be rapidly expanded throughout the country. Thus, it is important to update the guidance and allow providers time to gain an understanding of how they can fit squarely within a safe harbor before such programs are expanded on a nationwide basis.

Thank you for your consideration of this important matter. Should you wish to discuss this matter further, please do not hesitate to contact Tiana Korley on my staff at (202) 225-3106 or at tiana.korley@mail.house.gov.

Regards,

Hon. Jim McDermott

Member of Congress

GASB Issues Proposal Addressing Transition Issue in Pension Standards.

Norwalk, CT, July 2, 2013—The Governmental Accounting Standards Board (GASB) today issued for public comment a proposed Statement regarding the transition provisions of GASB's new pension standards for state and local governments. The proposal would eliminate a potential source of understatement of restated beginning net position and expense in a government's first year of implementing GASB Statement No. 68, Accounting and Financial Reporting for Pensions.

To correct this potential understatement, the proposed Statement would require a state or local government, when transitioning to the new pension standards, to recognize a beginning deferred outflow of resources for its pension contributions made during the time between the measurement date of the beginning net pension liability and the beginning of the initial fiscal year of implementation. This amount would be recognized regardless of whether it is practical to determine the beginning amounts of all other deferred outflows of resources and deferred inflows of resources related to pensions.

The provisions would be effective simultaneously with the provisions of Statement 68, which is required to be to be applied in fiscal years beginning after June 15, 2014.

The Exposure Draft is available on the GASB website, www.gasb.org. Stakeholders are encouraged to review the proposal and provide comment by August 26, 2013.

Read the Exposure Draft at:

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175827275726&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

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GFOA Executive Board Approves Best Practice on Actuarial Valuation Reports.

At its recent meeting in San Francisco, the GFOA Executive Board approved a new best practice, titled Reviewing, Understanding and Using the Actuarial Valuation Report and Its Role in Plan Funding. This new best practice, forwarded by the Committee on Retirement and Benefits Administration, recommends that state and local government finance officials and others with decision-making authority carefully review and understand their actuarial valuation report and use the information it contains to make policy decisions that ensure that pension benefits are funded in a sustainable manner.

http://www.gfoa.org/downloads/GFOABestPracticeonActuarialValuationReports.pdf

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SEC Cracks Down on Disclosure in Municipal Bond Sales.

The Securities and Exchange Commission is cracking down on municipalities that it suspects of hiding information from investors when they sell bonds to them, with more cases expected to be announced in the coming months.

The effort reflects the agency's frustration about its limited authority in a market that's especially popular with ordinary Americans, who don't pay federal taxes on interest on municipal bonds. Today, retail investors directly hold about half of the $3.7 trillion in municipal debt, which is used to finance schools, roads, hospitals and other projects.

While the SEC oversees the investment banks that localities hire to make bond offerings, it does not directly oversee the municipalities or review the bonds before they're offered to the public. Last year, the agency urged Congress to grant it more muscle in that arena.

But with congressional action nowhere in sight, the agency has turned to the most powerful tool in its arsenal: enforcement actions. After creating an enforcement unit devoted solely to muni bonds in 2009, the SEC ramped up its scrutiny of the market.

The agency filed its first securities case against a state in 2010, charging New Jersey with misleading investors about two major pension funds. That year, the agency also fined four former San Diego officials for misleading investors about the city's fiscal problems. The SEC said it had never before secured penalties from city officials in a municipal bond fraud case.

Last year, the SEC launched an inquiry into internal audits by the D.C. Office of the Chief Financial Officer that were not released to bondholders. And this year alone, the agency has brokered settlements with Illinois and three localities, an unusual pace for these kinds of cases, muni bond experts said.

"There's more in the pipeline," said SEC Commissioner Elisse B. Walter, who led the effort to produce a lengthy report last year detailing the agency's concerns about the way that market operates. "You're seeing the marketplace sitting up and taking notice."

The scrutiny comes at a time of turbulence in the muni bond market because of bankruptcies in a handful of major cities, such as Detroit, and a rash of bond-selling triggered by uncertainties about the end of the Federal Reserve's stimulus policy.

The SEC's cases have focused on lapses in disclosure.

Localities that issue bonds agree to continuously disclose their finances and certain material events, defined as those that a reasonable investor would consider significant.

In its report last year, the SEC concluded that the muni bond market is so opaque that investors who purchase these bonds can't make fully informed decisions about what they're buying. The enforcement cases aim to remedy that phenomenon.

One of the more notable ones this year involved Pennsylvania's capital city, which the SEC accused of making fraudulent statements about its financial condition. Harrisburg had failed for years to file the disclosures for investors, so the SEC held the city liable for what it said in its State of the City address and other online documents.

WSJ: Detroit Sues Bond Insurer Amid Effort to Reach Deal With Creditors.

The cash-strapped city of Detroit has filed suit against a bond insurer it alleges is standing in the way of an agreement it is trying to strike with some of its largest creditors.

The suit, filed in state court on Friday, is part of an ongoing effort by the city's powerful emergency manager to streamline the process for a potential bankruptcy by cutting as many deals as possible before any court filing, which could come in a matter of months. A filing by Detroit would be the nation's largest municipal bankruptcy.

In the latest skirmish, the city filed suit against Syncora Guarantee Inc., a bond insurer, over access to the city’s casino tax revenue estimated at $170 million a year. The city claims Syncora improperly told a bank controlling the funds to keep the money from Detroit.

The city sees the insurer as a roadblock to a proposed deal to pay UBS AG and Bank of America Merrill Lynch more than 70 cents on the dollar on nearly $340 million in secured debt, according to people familiar with the matter. In exchange, the city would get back $11 million a month in tax revenue from the city’s three casinos originally used as collateral to back the debt.

The pending deal would be the first time a debtor with the city has agreed to new terms since Emergency Manager Kevyn Orr took office in March. Mr. Orr may have a tougher time reaching agreement with the city’s unsecured creditors who he has offered roughly 10 cents on the dollar.

In the middle are insurers like Syncora Guarantee trying to recoup as much as they can of what the city owes. The insurer is concerned that it may have to make up the difference between what the city is willing to pay its secured creditors and the amount originally owed by the city, according to a person familiar with the matter.

Syncora also insures other debt associated with the city, another person familiar with the matter said.

The offices for Syncora were closed on Friday and a spokesman did not immediately respond to a request for comment.

Wayne County Circuit Judge Jeanne Stempien issued a temporary restraining order saying the casino money could be released to the city and set a hearing for July 26, according to the emergency manager’s office.

In 2011, the city had used the casino tax revenue as collateral to secure swap agreements, interest-rate bets the city made with Wall Street banks years ago in the hopes of avoiding higher rates. Detroit’s swap agreements are tied to $1.4 billion in bonds the city issued to help address funding shortfalls in its pension funds. In court papers, the city argues that Syncora will not be harmed by the release of the funds because it does not have a right to control them.

Mr. Orr has said Detroit needs significant and fundamental debt relief to shore up the city’s finances and avoid bankruptcy. Such relief could include extending the time period for debt repayment, reducing interest rates or cutting the principal owed. The city has already skipped a debt payment of almost $40 million in June, saying it was unsure whether it could continue to make payments on more than $2 billion of secured debt.

The total bill for the city’s long-term liabilities is nearly $20 billion, and the city is now insolvent, according to Mr. Orr. Mr. Orr’s proposal also calls for using the savings from the cuts to invest $1.25 billion in public safety and blight removal to revive a city beset by a dwindling tax base, entrenched crime and population loss.

Talks between the city and its creditors will continue next week. Mr. Orr’s team will take about 40 representatives of creditors on a bus tour of some of the city’s most blighted areas in a effort to demonstrate the severity of the crisis in the city of 700,000.

By MATTHEW DOLAN

Flexible Bond Funds Offer Harbor as Rates Rise.

Funds with the flexibility to pick and choose among all categories of bonds are attracting investors' money–some of it at the expense of their more constrained peers–as fears of rising interest rates increase.

"I think the risk of losses from rising interest rates is at the top of most advisers' minds," said Nadia Papagiannis, director of alternative fund research at Morningstar Inc.

In many cases, investors are shifting money out of core bond funds into these so-called nontraditional bond funds, which have more tools available to navigate the now-treacherous bond environment, she said.

Investors, who since 2008 funneled billions of dollars into bond funds to avoid stocks and other riskier assets, have poured more than $21.46 billion into nontraditional bond funds this year through May 31, up from $5.82 billion in 2012 and $9.9 billion in 2010, according to Morningstar.

Interest rates have come into focus in recent weeks as investors try to gauge if or when the Federal Reserve will wind down its debt-buying program. The mere speculation has already prompted a spike in Treasury yields.

Rising rates mean big cuts to a bond's principal. But unlike core bond funds, which own U.S. investment-grade bonds, managers of unconstrained or "go-anywhere" bond funds have the ability to invest in a wide variety of fixed-income investments, including emerging-market, convertible, and municipal bonds.

Pimco Unconstrained Bond Fund (PUBAX), for example, normally seeks a duration–a measure of interest-rate sensitivity–from negative three years to positive eight years. The longer a security's duration, the more sensitive it is to interest-rate risk.

The Pimco fund can invest in a diversified fixed-income portfolio, including municipal bonds, mortgage-backed securities, U.S. government agencies, sovereign issues, convertible bonds, preferred securities and reverse purchase agreements, among other investments. It can also invest without limitation in derivative instruments, such as options, futures contracts and swap agreements.

The flexibility afforded managers of such funds makes it doubly important that advisers vet them well.

Avani Ramnani, director of financial planning and investment management at Francis Financial, said she has been using the Pimco Unconstrained Bond Fund for about a year.

"There's been fear of inflation kicking in for a long time," said Ms. Ramnani, whose New York firm manages just under $100 million. "It's really, really important for a portfolio to have that fixed-income exposure, but also the flexibility to get the right fixed-income exposure."

In a very conservative portfolio, she may invest as much as 15% of a client's assets in the unconstrained fund. But for a very aggressive equity-oriented portfolio, she might invest 2% or 3% of assets in the fund. She prefers to use the fund's institutional shares, which charge expenses of 0.90%, for clients when possible.

Yield is difficult to obtain in this environment, Ms. Ramnani said. She nevertheless considers the combination of yield and return when weighing a fund. The Pimco fund yields 2.85%, and has gained about 1.6% in the 12 months through Wednesday, while the Barclays U.S. Aggregate Bond Index has lost 1.2%, according to Morningstar.

For a client in retirement, the goal is to create a diversified portfolio and then determine the best place from which to take distributions, Ms. Ramnani said. With this year's huge stock gains, it made sense to take profits. In another year, higher bond yields may provide the needed cash, she said.

Beth Gamel, co-founder and executive vice president at Pillar Financial Advisors Inc., began using the JPMorgan Strategic Income Opportunities fund (JOSAX) in 2011 in combination with more traditional bond funds for clients who had relatively large allocations to taxable bonds.

For others, she had for years paired an intermediate-term or core bond fund with a shorter-duration bond fund. But last year, she saw the need for a tactical fund that could be more responsive to the bond market's changing conditions, and began using the JPMorgan fund more widely.

"Someone who has a requirement within their fund to be shorter duration isn't all of a sudden going to bring that duration down to six months or own different kind of instruments in their portfolio," as the opportunities fund can, said Ms. Gamel, whose Waltham, Mass., firm manages $603 million.

The fund's opportunistic approach, along with its one-year duration, provides protection on the downside and some participation on the upside, Ms. Gamel said. She feels confident that William Eigen, the fund's manager and a former hedge-fund manager, is capable of moving in and out of different markets effectively.

The fund yields 3.3%, and has gained 5.5% in the 12 months through Wednesday, according to Morningstar.

Among the nontraditional bond funds Ms. Papagiannis of Morningstar likes are Driehaus Active Income (LCMAX), Driehaus Select Credit (DRSLX) and BlackRock Global Long/Short Credit (BGCAX).

Experts: Muni Community Should Have No Problem Making Case to Save Exemption From 'Blank Slate'.

The Senate Finance Committee's top two tax writers asked their 98 colleagues on Thursday to submit detailed proposals justifying which tax breaks should be kept in the code as they move forward on comprehensive tax reform.

Committee chairman Max Baucus, D-Mont., and ranking minority member Orrin Hatch, R-Utah., called for a "blank slate" approach to tax reform, stripping all existing tax deductions, exemptions and credits including the tax exemption for municipal bonds from the code.

"This blank slate is not, of course, the end product, nor the end of the discussion," Hatch and Baucus wrote in a "dear colleague" letter to senators. "Indeed, we both believe that some existing tax expenditures should be preserved in some form. But the tax code is also littered with preferences for special interests."

Both Baucus and Hatch are meeting with their respective members this afternoon to discuss the plan, sources said. Senators have until July 26 to submit their proposals.

Baucus and Hatch said “special attention” will be given to bipartisan proposals. They said they plan to operate from the assumption that all special provisions are “out” unless there is clear evidence that they help expand the economy, make the tax code fairer or effectively promote other important policy objectives.

Mike Nicholas, chief executive officer of the Bond Dealers of America, said that the muni bond tax exemption accomplishes at least two of those three issues.

“You think about infrastructure, jobs, or capital improvement growth, Nicholas said. “That’s been done for 100 years by issuing tax exempt debt.” Nicholas added that if the goal is to simplify or make the tax code more fair, “the muni bond tax exemption is not one of the extra layers that has made the code more complicated. It has been in the tax code since there was a tax code.”

Chuck Samuels, a lawyer at Mintz Levin, Michael Decker, managing director of the municipal securities group at SIFMA and other market participants said the muni bond community should have no problem making the case on the merits of the tax exemption so that it will be retained.

To aide senators with their submissions, the nonpartisan Joint Committee on Taxation and the Finance Committee staff analyzed the relationship between tax expenditures and the current tax rates if the current level of progressivity is roughly maintained.

“The blank slate approach would allow significant deficit reduction or rate reduction, while maintaining the current level of progressivity,” Baucus and Hatch wrote. They warned that each tax preference inserted back into the code reduces the amount of deficit reduction or revenue that could go towards lowering individual and corporate tax rates. “As we work to craft a tax reform bill, we will bear these trade-offs in mind,” they wrote. The letter omits how much revenue the plan would raise or how low they aim to get tax rates.

Some market participants were skeptical. “There are so many details that need to be filled in that we are not optimistic that the Senate could act in this Congress,” said Lars Etzkorn, program director for the National League of Cities’ center for federal relations, who expressed support for a simplified tax structure and the plan’s “noble” policy goals. “The clock is ticking and time is limited for the Senate to act.”

Etzkorn said he hoped that the Senators would include state and local groups like the NLC in the conversation beceause there could be serious consequences with a comprehensive overhaul.

“If the muni bond exemption was eliminated it would be detrimental to home towns,” Etzkorn said. “We don’t need a local tax increase as part of federal tax reform.”

The framework is similar to the “Zero Plan” used by the National Commission on Fiscal Responsibility and Reform in 2010, co-chaired by Erskine Bowles and Alan Simpson. The Bowles-Simpson Zero Plan would establish three individual income tax rates of 8%, 14% and 23%. It would repeal all individual and corporate tax expenditures and would tax capital gains and dividends as ordinary income.

by: JENNIFER DEPAUL

B of AML, PFM Top First-Half Tables

Bank of America Merrill Lynch remained the leading senior manager of municipal bonds in the first half of 2013, outpacing its competitors by a considerable margin.

The bank was credited with underwriting 208 issues, totaling $25.1 billion by par amount, according to Thomson Reuters data. That number is slightly down from the 238 issues totaling $25.6 billion that B of A worked on during the first half of 2012.

The decline is part of the broader 11.5% decrease in total amount of municipal market long-term issuance. Despite the decrease, B of A increased its market share from 13.4% last year to 14.8% this year.

The bank also came in first place among senior managers working on both negotiated issues, with $17.2 billion in par value, and competitive issues, with $8 billion. B of A was also the top co-manager on all issues.

The top four underwriters remained unchanged compared to the first half of 2012, with JPMorgan coming in second, followed by Citi and Morgan Stanley. Wells Fargo jumped up to fifth place from sixth, while Goldman Sachs dropped to seventh from fifth.

JPMorgan worked on 172 issues totaling $19.7 billion, for an 11.6% market share. Last year the firm worked on 198 issues totaling $22 billion with an 11.5% market share.

Paul Palmeri, managing director and head of public finance at JPMorgan, said the firm has continued to focus on its banking efforts and capital commitment over the past few years.

"We've continued to improve our banking coverage by leveraging our industry specialists with geographic expertise," Palmeri said.

In addition to slightly increasing its total market share, JPMorgan also increased its market share of negotiated issues to 11.2% from 10.4% last year. The firm worked on 110 negotiated issues, totaling $14.6 billion, keeping its number two spot. In the competitive issue category the firm dropped to third place from second last year, with 62 issues totaling $5.1 billion.

Among co-managers, JPMorgan jumped to second place from sixth last year, with 168 issues totaling $5.6 billion.

Within specific industries, the firm has made significant strides in the transportation, utilities, healthcare, and higher education sectors, Palmeri said. JPMorgan focuses on those four industries, as well as general municipal finance and housing.

Palmeri said there's still a tremendous amount to get done both on the new money side and on the refunding side.

"Both on the taxable and tax-exempt side a number of deals have been temporarily sidelined, and with a bit more rate stability, we're confident that those deals will come to market," Palmeri said.

Third-ranked underwriter Citi was credited with 207 issues totaling $18.7 billion during the first half. Citi also came in third place among negotiated issues, and second place among competitive issues.

RBC Capital Markets jumped two spots from last year to sixth place, credited with 347 issues totaling $10.4 billion.

While the industry total declined during the first half of the year, RBC actually saw an increase in the total value of issues it worked on from the $7.8 billion during the year before. The firm also saw its market share increase to 6.2% from 4.1%.

Among negotiated deals, the firm jumped to fifth place from eighth place last year, with 333 deals totaling $9.9 billion.

Mark Maroney, head of the RBC U.S. rates, municipals and securitized products business lines, said that RBC's goal is to be among the top five underwriters of negotiated deals.

"We've had a nice mixture of our local middle market business with some large issuer transactions throughout the first half of the year," Maroney said. "You can tell by the number of transactions that we've been busy with 333 negotiated deals."

Some of the larger deals RBC worked on this year included a $540 million transaction for Denver Public Schools, $372 million for Dallas Fort Worth Airport, and a $328 million Phoenix excise tax deal.

"If you look across our activity we had a broad base of business across the United States," Maroney said. "There were some large issuer deals out west, in Colorado, Texas and California, and also in the middle markets, in particular, in Texas and Pennsylvania. We've had a good number of deals sprinkled across the U.S."

Among financial advisors, Public Financial Management Inc. kept its number one spot on the Thomson Reuters table. The firm worked on 398 issues during the first half of the year, totaling $18.8 billion and a 15% market share.

"It's nice to have these kinds of results and so consistently, but they're not the beginning and the end for how we measure ourselves," said John Bonow, chief executive officer of PFM. "It's our client satisfaction and the trust our clients have in us that really matters to us."

Behind the firm's consistent success is a focus on building, earning, and keeping the trust of its clients, as well as helping them navigate through tough times, especially during the last five or six years, he said.

"I think our clients know that we've got solutions to offer them, not just better mechanics or a better mouse-trap," Bonow said. "Over time it's our ability to focus on solutions and be comprehensive in our advice that has caused many of our clients to be with us for decades, and many more to come our way as these challenges arise for them."

Bonow said the first half of the year was typified by the dramatic decline in interest rates, before the last few weeks in June, as well as new regulations in the money market. The low interest rate environment allowed PFM to help its clients lower their borrowing costs to take advantage of the refinancing market.

The firm also experienced recent expansion in the Northwest region with its acquisition of SDM Advisors, a Seattle-based advisory firm. Bonow said PFM is well-structured at present and is looking more toward internally-generated growth, and not necessarily looking for further acquisitions. Though, he added, PFM is always alert for opportunities.

Bonow said he believes the challenges for the industry include new regulations and the overhang of retiree-related costs, such as pensions and other post-employment benefits.

“We’ve got groups focused on solving those problems systematically for our clients so that they have sustainable finances going forward and I think that’s where the growth is going to come from in our industry—the ability to be a comprehensive advisor to municipalities and non-profits,” Bonow said. “And if debt transactions occur because they’re prudent and they’re a good piece of the financial management puzzle, then I think we’re well-positioned to assist clients there as well.”

The top four financial advisors remained the same as the first half of 2012, with Public Resources Advisory Group coming in second place, FirstSouthwest third, and Lamont Financial Services Corp coming in fourth.

by: TONYA CHIN

Reuters: U.S. Investment Industry Groups Scuffle Over Ethics, Costs.

Wall Street’s brokerages would spend an average of $8 million each to implement a plan being considered by the U.S. Securities and Exchange Commission to impose higher ethical standards on brokers who give financial advice, according to estimates by the securities industry’s largest trade group.

The Securities Industry and Financial Markets Association will present its figures to the SEC in a letter on Friday, the last day for interested parties to respond to a sweeping public request for information that could help the agency determine whether to impose a new standard, known as the so-called fiduciary rule.

SIFMA’s findings and others could further delay the standard that has been long discussed and deferred by the SEC. At issue is a long-running controversy about the differences in responsibilities toward clients for securities brokers, who register with the self-regulatory Financial Industry Regulatory Authority, or FINRA, and registered investment advisers, or RIAs, another type of financial adviser overseen by the SEC.

Imposing traditional fiduciary standards for investment advisers on brokerages could mean big changes for the industry’s business practices, such as possibly disclosing to investors when the “best” investment choices are available elsewhere.

Typically, brokers are compensated by sales commissions and must only meet a “suitability” standard by suggesting investments that are suitable for their clients. But RIAs, typically paid by clients, must be fiduciaries – they must put their clients’ interests above their own at all times. The SEC is considering whether to streamline those standards through a new rule.

Developing and maintaining new compliance procedures to adhere to a fiduciary rule – everything from training staff to monitoring transactions – would run an average of $5 million per firm during the first year, Kevin Carroll, SIFMA associate general counsel, said in an interview with Reuters.

A potentially new broker disclosure brochure under consideration by the SEC would cost each brokerage, on average, about $3 million to develop and update during the initial year, he said.

SIFMA has faced criticism that it is pushing the SEC to adopt a fiduciary standard in name only, because it wants rules that would accommodate traditional brokerage business practices, such as selling brokerage-branded funds that can be more expensive than alternatives.

Some Washington insiders are skeptical that the SEC will ever develop a fiduciary rule for brokers, given intense lobbying by the industry. On Tuesday, for example, the National Association of Insurance and Financial Advisors (wrote in a letter to the SEC that imposing a fiduciary standard on brokers would make their services pricier for middle class investors. NAIFA represents insurance agents who also sell securities.

The group developed the figures based on estimates it collected from 12 large firms and six regional firms. While the identities of those firms are unclear, SIFMA's membership includes the largest brokerages, such as Morgan Stanley and Bank of America Corp.'s Merrill Lynch unit.

The $8 million estimate represents a fraction of each firm's annual budget.

At least one fiduciary advocate is skeptical of SIMFA's figures. A $3 million price tag for a brochure of disclosures is "questionable on its face," said Knut Rostad, president of the Institute for the Fiduciary Standard, a group that promotes imposing a traditional fiduciary standard on brokerages.

The Investment Adviser Association, which supports imposing a traditional fiduciary standard on brokers who give investment advice, is concerned about how the agency's process for reviewing the varying ethical standards may affect SEC-registered advisers. The discussion in the SEC's data request "appears to favor imposing the broker-dealer regulatory regime on investment advisers," wrote David Tittsworth, the group's executive director.

A spokesman for the Financial Planning Coalition, a trade group that also supports imposing a traditional fiduciary standard on brokers who give investment advice, said it will file a letter with the SEC on Friday. He declined to comment on SIFMA's remarks.

WSJ: Though Colorado and Washington Allow Recreational Marijuana, Many Municipalities Are Seeking to Bar Businesses Selling It.

Like Coloradans as a whole, voters in Colorado Springs voted to legalize recreational pot last fall. Nonetheless, their city leaders held a packed public meeting Thursday to seek opinions on whether local businesses should be able to sell it.

Colorado Springs, the state's second-largest city with roughly 426,000 residents, is one of numerous municipalities in Colorado that are considering opting out of part of the state's new marijuana law. The legislation allows anyone 21 and older to possess and grow pot in small amounts but also gives local authorities the right to bar pot plantations and stores.

More than two dozen cities and towns, including Calhan and Woodland Park near Colorado Springs, have already prohibited marijuana retail stores, according to the Colorado Municipal League, a lobbying group for the state's cities. Others, like Aurora outside of Denver, decided to postpone a decision on whether to allow sales. In Denver, leaders want to allow pot sales, but have said they want to push back the starting date for new businesses other than medical-pot outlets.

The opt-out clause included in the Colorado pot law doesn't exist in Washington, which also legalized recreational pot last November. But local officials there have some control over rules such as licensing and zoning, and some are using that authority to keep pot shops at bay.

Richland, a city of roughly 49,000 people in southeastern Washington, passed an ordinance that requires marijuana stores to comply with federal laws, for example, which is impossible because of pot's continued federal status as an illegal substance.

Local power to determine how the marijuana trade operates, or whether it exists at all, will likely be included in measures that pot advocates attempt to pass in other states as they seek to broaden pot legalization.

Part of the reason some municipalities in Washington and Colorado have been reluctant to allow pot sales, experts say, is uncertainty over how those states will handle the new marijuana market. Both are still setting up regulatory systems for recreational pot.

In Washington, where rules won't be finalized until August, applicants for pot licenses have a 30-day window in September to file paperwork that is supposed to include where they plan to set up shop. That means jurisdictions would have only about a month to study the state's rules and come up with their own in time for locals to apply for licenses.

"It's going to be a little bit bumpy as we roll out this new legalized system," said Brian Smith, a spokesman at the Washington State Liquor Control Board, which is now tasked with also regulating marijuana.

In Colorado, a pending issue is taxation of pot, which will be used to fund the state marijuana enforcement agency. Voters in November are set to vote on a 25% tax rate proposed by lawmakers. Until then, local officials won't know what kind of resources state officials will have to oversee marijuana businesses.

The discussion in Colorado Springs is complicated by local politics. The city at the base of the Rocky Mountains is home to large socially-conservative groups that are against marijuana use, but is also a stronghold for libertarians, who view pot smoking as a personal freedom government shouldn't interfere with.

In El Paso County, where Colorado Springs is located, voters passed the marijuana amendment by only 10 votes, 141,696 to 141,686. The Colorado Springs City Council is expected to take a vote on pot stores next month.

Keith King, the council's president, said he favors a moratorium, but added that the council is evenly divided between that option, a ban and allowing sales.

Mayor Steve Bach, who doesn't have a vote, wants a full ban. He and others in the business community said allowing sales amounts to endorsing marijuana use, which would alienate military facilities and religious nonprofits that make up a large portion of the local economy.

"We have to give a message to our employers that we are not going to promote a drug that is federally illegal," Mr. Bach said.

But others said prohibiting sales would deny expansion opportunities to the 50 or so medical-pot dispensaries in the city, which would have the first shot at recreational licenses, and go against the town's traditional hands-off approach to government. "This is more than just about pot," said Liz Oldach, who chairs the local chapter of the Libertarian Party of Colorado. "It's about freedom."

The prospect of a ban in one of the state's biggest cities isn't discouraging the activists that pushed for legalization. "Marijuana will be legal for adults…regardless of whether businesses are allowed in their localities," said Mason Tvert, a spokesman for the Marijuana Policy Project.

- *Hilgers v. Jefferson County*, in which the court held that a County's power to set sewer-service charges, etc. was not limited to only that portion of those charges that arose from the repayment of the bonds issued pursuant to the Amendment to State constitution that provided county could incur bonded indebtedness exceeding the then 3.5% debt limit in order to finance improvements to its sewer system.
- *Koontz v. St. Johns River Water Management Dist.*, a case of potentially immense significance in which the Supreme Court limited the ability of municipalities to condition land use permits on landowner's funding of offsite mitigation projects. See also, NYT: A Legal Blow to Sustainable Development.
- FINRA Fines StateTrust Investments $1 Million and Orders $353,000 in Restitution for Charging Unfair Prices in Bond Transactions.
- IRS Publication: Voluntary Compliance for Tax-Exempt and Tax-Credit Bonds.
- GASB Issues Implementation Guide for Pension Plans.
- SIFMA Compliance & Legal Society San Francisco Regional Seminar.
- Fairly interesting week. Those of you who work with municipalities should familiarize yourselves with *Koontz*, above, due to its potential to dramatically alter existing land-use and development protocols. Otherwise, the week's most significant development arose in *Southern California Edison Company v. City of Victorville*, in which the city's cross-complaint named "Moes 1-30" (pending Curly's deposition?), ushering in a new era of Stooges-based jurisprudence. "Your honor, permission to poke the witness in the eye?" We're gonna miss the good old days of mere badgering.

ZONING - ALABAMA

Birmingham Derby Club, Inc. v. City of Birmingham

Court of Civil Appeals of Alabama - June 21, 2013 - So.3d - 2013 WL 3155025

Applicant for lounge liquor license and dance permits pertaining to planned adult-entertainment establishment sought judicial review of city council's denial of applications.

The Court of Civil Appeals held that:

- Applicant failed to timely seek judicial review of denial of liquor license application, and
- City properly denied application for dance permit.

City properly denied applicant's application for dance permit pertaining to planned adult-entertainment establishment involving semi-nude dancing, where, at hearing, city council heard statements from owners of residences located within 750 feet of the proposed adult establishment who noted the adverse effects on traffic and parking that had resulted during the two-year operation of the former adult establishment on the subject premises and their concerns that similar problems would result if application was to be granted. Subject property had been zoned for light industrial use and had been sold for the purpose of being used as a tire store, and 449 signatures had been affixed to petitions seeking denial of the application.

PUBLIC UTILITIES - ALABAMA

Hilgers v. Jefferson County

Court of Civil Appeals of Alabama - June 21, 2013 - So.3d - 2013 WL 3155015

County brought five separate actions to enforce liens for unpaid sewer-service charges against five separate parcels owned by property owners.

The Court of Civil Appeals held that:

- County's power to set sewer-service charges, to collect sewer-service charges, and to impose a lien against a parcel of property serviced by the sewer system for unpaid sewer-service charges was not limited to only that portion of those charges that arose from the repayment of the bonds issued pursuant to the Amendment to State constitution that provided county could incur bonded indebtedness exceeding the then three and one half percent debt limit in order to finance improvements to its sewer system or that arose from the reasonable expenses of extending, improving, operating, and maintaining the sewer system;
- State Act that provided county commission with the right to set sewer-service charges, state that unpaid sewer-service charges were a lien upon the real property to which sewer services were provided, and granted county commission the power to enforce such liens, provided a basis for county to impose a lien for unpaid sewer-service charges on properties provided sewer services;
- Liens for unpaid sewer-service charges against five separate parcels owned by property owners, including any portion that might have been intended to repay Kelly Act indebtedness, were properly imposed under the power provided to county under the Amendment and State Act; and
- Circuit Court was not required to rule on property owners' motion to compel before entering summary judgment in favor of County.

The Supreme Court made it clear in *Lunsford v. Jefferson County* that even after bonds issued under the amendment had been paid, county could continue to level and collect sewer-service charges to cover expenses of needed improvements and extensions and maintenance and operation of sewers and sewerage treatment and disposal plants.

MUNICIPAL CONTRACTS - ARIZONA

Alpha, LLC v. Dartt

Court of Appeals of Arizona, Division 1, Department D - June 27, 2013 - P.3d - 2013 WL 3242220

Rather than undertaking a competitive bidding process, police department established a list of towing companies that would be contacted on a rotating basis for service calls. The towing regulations permitted any business satisfying the stated criteria to appear on the rotation list.

After customer complaints were filed, plaintiff was removed from the rotation list. Plaintiff then filed suit, alleging that the town had violated its constitutional due process and equal protection rights.

The appeals court ruled that the towing company did not have a property interest in remaining on a towing rotation list created and administered by the municipal police agency. Because there was no underlying legislative enactment, and the regulations governing the list were modifiable at the administrator's discretion, no constitutionally protected property interest exists.

ATTORNEYS' FEES - ARKANSAS

Collins v. City of Bryant

Court of Appeals of Arkansas - June 19, 2013 - S.W.3d - 2013 Ark. App. 409

Landowners brought action against city to enforce alleged easement agreement with city engineer for construction of drainage on landowners' property. Following a jury trial, the Saline County Circuit Court entered judgment for landowners in the amount of $70,000, and in a separate judgment, awarded landowners attorney fees and costs. City appealed first judgment. The Court of Appeals reversed. Following reversal, the city moved to set aside judgment for attorney fees and costs, and to enter judgment in its favor. The Circuit Court granted city's motion to set aside attorney fee and costs award, but denied motion to enter judgment in city's favor. Landowners appealed and city cross appealed.

The Court of Appeals held that:

- 90-day period for Circuit Court to vacate attorney fee and costs award began to run on the date of the entry of the order, and
- City was not entitled to have a judgment entered in its favor.

PUBLIC UTILITIES - CALIFORNIA

Southern California Edison Company v. City of Victorville

Court of Appeal, Fourth District, Division 2, California - June 17, 2013 - Cal.Rptr.3d - 13 Cal. Daily Op. Serv. 6241

After automobile accident, passenger brought action against city, county, and electric utility for allegedly placing utility pole in unsafe location. Electric utility cross-complained against city for equitable indemnity.

The Court of Appeal held that:

- Superior court had jurisdiction over automobile passenger's claim against electric utility, but
- Utility's failure to comply with claims presentation requirements barred its cross-complaint against city.

If the Public Utilities Commission (1) has the authority to regulate or otherwise establish policy in a given area, and (2) has exercised that authority by regulation or policy, then the superior court may do nothing that hampers or interferes with that exercise of jurisdiction, including awarding damages in a private action. Cal. Pub.Util.Code §§ 1759, 2106.

The statute providing that a superior court may not interfere with the PUC in the performance of its official duties did not deprive the superior court of jurisdiction over automobile passenger's action against electric utility for allegedly placing utility pole in unsafe location, even though PUC had approved a tariff applicable to the utility which contained a release of liability as to actions taken in compliance with the tariff, absent evidence of any specific PUC policy, regulation, decision or study which indicated that it had exercised authority over the siting of street lights. Cal. Pub.Util.Code §§ 1759, 2106, 2902.

Electric utility was required to comply with claims presentation requirements of the Government

Claims Act before filing cross-complaint against city for equitable indemnity, since utility's cross-complaint was not solely defensive in nature, even if city's cross-complaint naming "Moe" cross-defendants could be construed as a cross-complaint against utility, where utility's cross-complaint went beyond the set of facts upon which the city defended passenger's complaint and upon which the city's cross-complaint was premised. Cal. Gov. Code §§ 905, 911.2(a).

PROPERTY TAX - CONNECTICUT

Kasica v. Town of Columbia

Supreme Court of Connecticut - June 25, 2013 - A.3d - 2013 WL 3071943

In separate actions, taxpayer appealed decisions of town Board of Assessment Appeals upholding town assessor's interim valuations of property for two tax years based on partially completed construction.

The Supreme Court of Connecticut held that:

- Town assessor had statutory authority to conduct interim assessment of real property and to assign value based on partially completed construction, and
- Statute governing assessment of property with newly completed construction, for purposes of taxation, did not apply to preclude assessment of value of real property with partially completed construction.

LAND USE - IDAHO

Telford Lands LLC v. Cain

Supreme Court of Idaho, Pocatello, May 2013 Term - June 20, 2013 - P.3d - 2013 WL 3064935

Purported dominant estate owners brought action against purported servient estate owner seeking to enforce alleged oral agreement permitted them to construct irrigation pipeline.

The Supreme Court of Idaho held that:

- Reasonable necessity existed for condemnation;
- Fact that dominant estate owners were currently under irrigation did not preclude condemnation;
- Dominant estate owners were required to make good faith effort at purchase only prior to lawsuit;
- Lessee of dominant estate had standing to maintain condemnation action;
- Judgment failed to limit length of lessee's easement;
- Servient estate owners did not abandon counterclaim for trespass;
- Statute governing costs in eminent domain proceedings provided for award of court costs, not attorney fees; overruling State ex rel. Winder v. Canyon Vista Family Ltd. Partnership, 228 P.3d 985; and
- Servient estate owners were not entitled to award of attorney fees as prevailing parties.

Reasonable necessity existed so as to permit dominant estate owners to condemn easement over servient estate for construction of irrigation pipeline, where dominant estate owner suffered conveyance losses of 35% to 40% by using a nearby canal rather than using irrigation pipeline, and public policy of state was to secure maximum use and benefit, and least wasteful use, of its water resources. Article I, § 14, of the Idaho Constitution.

PROPERTY - LOUISIANA

Davis v. Brent

Court of Appeal of Louisiana, Second Circuit - June 19, 2013 - So.3d - 48, 088 (La.App. 2 Cir. 6/19/13)

Landowner filed a petition for declaratory judgment against neighbors, alleging that neighbors had a right-of-way over, and did not possess fee ownership of, a strip of land used as driveway.

The Court of Appeal held that deed granted a servitude of passage and did not grant fee ownership of the driveway.

Deed conveying tract of land and granting a “fifty foot driveway” in a certain location across land adjacent to tract granted a servitude of passage, and did not grant fee ownership of the driveway. Deed language referring to driveway did not refer to a “parcel” or “strip,” did not specifically describe where driveway ended, and required reference to the description of adjacent land to determine where the driveway began.

In deciding whether a fee simple title to land has been conveyed or a servitude thereupon has been granted by a deed, the intention of the parties must be determined from the stipulations in the entire instrument, giving effect to all of the provisions therein contained.

The general rule is that if an instrument is so ambiguous as to leave doubt about the parties’ intent, the court may resort to extrinsic evidence as an aid in construction.

ZONING - MASSACHUSETTS

Drummey v. Town of Falmouth Zoning Bd. of Appeals

Superior Court of Massachusetts, Barnstable County - June 18, 2013 - Not Reported in N.E.2d - 2013 WL 3205142

The Town of Falmouth constructed a wind turbine, known as Wind I, at the waste water treatment facility which it owns and operates. The building permit for Wind I was issued by the town’s building commissioner on June 30, 2009 after he determined that a special permit was unnecessary. Wind I became operational in March of 2010. Thereafter, on October 4, 2010, the plaintiffs appealed to the Falmouth Zoning Board of Appeals (ZBA) which, on March 3, 2011, affirmed the issuance of a building permit for Wind I without a special permit.

Plaintiffs appealed the ZBA’s decision, seeking an order that the Town cease operation of Wind I until a special permit was applied for and issued.

The court found that it was not irrational for the Town to conclude that in most cases a windmill is a use with such potential to impact neighbors so as to require special permission, but in the case of a municipal windmill, the benefits of the use justify allowance as of right. Accordingly, the Court could not conclude that the Building Commissioner erred in issuing a building permit under § 240–30B without a special permit.

The plaintiffs also contended that the Town was required to obtain a special permit under § 240–33G(5) of the Bylaw, which requires a special permit for enumerated accessory uses in a Public Use District, including windmills. However, the Court agreed with the Town that where a municipal purpose use is allowed as of a right in a particular district, it is permitted regardless of whether it is a primary or accessory use. It would make little sense to authorize the Town to construct a windmill as the primary use on the site as of right while requiring it to obtain a special permit for a windmill constructed as a less intensive accessory use.

CODE ENFORCEMENT - MISSISSIPPI

Vazzana v. City of Greenville

Court of Appeals of Mississippi - June 25, 2013 - So.3d - 2013 WL 3185891

Property owner appealed the Washington County Circuit Court's order affirming the decision of the City Council of Greenville, Mississippi, which found that several properties owned by him were a menace. He argued that (1) he received insufficient notice of the hearing; and (2) the city council's actions were arbitrary and capricious.

The Court of Appeals found no error and affirmed.

STATUTE OF LIMITATIONS - NEW JERSEY

Town of Kearny v. Brandt

Supreme Court of New Jersey - June 20, 2013 - A.3d - 2013 WL 3064600

After structural failures, town brought action against engineers and architects, asserting claims of negligence and breach of contract concerning design and construction of public safety facility.

The Supreme Court of New Jersey held that:

- Issuance of temporary certificate of occupancy triggered running of statute of repose, and
- As a matter of first impression, Comparative Negligence Act and Joint Tortfeasors Contribution Law authorized allocation of fault to engineers, who obtained summary judgment on ground of statute of repose.

RENT CONTROL - NEW JERSEY

Heyert v. Taddese

Superior Court of New Jersey, Appellate Division - June 25, 2013 - A.3d - 2013 WL 3184626

Tenants claimed that landlords violated the New Jersey Consumer Fraud Act (CFA), N.J.S.A. 56:8–1 to –195, by charging rent in excess of that allowed by local rent control ordinances, and that the municipality erred in granting the landlords a hardship rent increase. The landlords claimed that the municipality's rent control ordinance is unconstitutional and that the legal base rent calculated under the ordinance was arbitrary, capricious and unreasonable.

The appeals court held that:

- The CFA applied to the landlords;
- The landlords committed an affirmative act of unlawful conduct by charging the tenants rent in excess of that allowed by the City's rent control ordinance;
- The landlords violated the CFA;
- The tenants were not required to seek reimbursement prior to filing suit; and
- The City's rent control ordinance is not unconstitutionally vague.

ZONING - NEW JERSEY

Kane Properties, LLC v. City of Hoboken

Supreme Court of New Jersey - June 26, 2013 - A.3d - 2013 WL 3197164

Property owner brought action in lieu of prerogative writs, challenging city's disapproval of variances for owner to build a multiple unit residential building in an area zoned for industrial use.

The Supreme Court of New Jersey held that:

- Appearance of impropriety standard applied to review of attorney's actions in advising city council;
- Incomplete recusal irretrievably tainted city council's actions; and
- Appropriate remedy was de novo review of zoning board's decision by trial court.

Incomplete recusal of city's conflicted corporation counsel, who had previously represented principal objector to grant of variances in same proceeding, irretrievably tainted, due to the appearance of impropriety, city council's adjudication in matter concerning property owner's appeal from zoning board's denial of request for zoning variances, where attorney sent initial letter to counsel for property owner involved in the appeal, attorney prepared a generic memorandum that his substitute counsel forwarded, along with his own, to the governing body, and attorney appeared at meeting concerning the appeal, in his capacity as corporation counsel, during which he answered questions about voting procedures and then signed the resolution on the line designating him as having approved the city council's action.

ZONING - NEW JERSEY

Price v. Himeji, LLC

Supreme Court of New Jersey - June 25, 2013 - A.3d - 2013 WL 3184784

Landowner filed complaint against developer to bring action in lieu of prerogative writs to set aside zoning board's approval of variances for developer's multi-unit residential building.

The Supreme Court of New Jersey held that:

- Application for variance required evaluation of whether use would promote the general welfare, not that there was no other potential location for the use;
- Appellate division properly exercised original jurisdiction; and
- Zoning board demonstrated compliance with negative criteria for developer's application.

The Municipal Land Use Law exhibits a preference for municipal land use planning by ordinance rather than by variance, which is accomplished through the statute's requirements that use variances be supported by special reasons and proof of the negative criteria.

Proof of the negative criteria requires the applicant for use variance to demonstrate, in accordance with the enhanced quality of proof, both that the variance can be granted without substantial detriment to the public good and that it will not substantially impair the intent and the purpose of the zone plan and zoning ordinance.

LABOR - NEW YORK

Cordero v. New York Institute of Technology

United States District Court, E.D. New York - June 20, 2013 - Slip Copy - 2013 WL 3189189

Current and former employees of the New York Institute of Technology (NYIT) initiated an action on behalf of themselves and a purported class of others similarly situated, alleging that NYIT violated the Fair Labor Standards Act (FLSA), 29 U.S.C. §§ 201, et seq., and the New York Labor Law (NYLL), N.Y. Lab. Law §§ 190, et seq., by: (1) failing to pay plaintiffs one and one half (1.5) times their hourly rate for all hours worked in excess of forty (40) hours per week; (2) retaining charges to customers purporting to be gratuities for plaintiffs; and (3) failing to reimburse plaintiffs for the costs of purchasing and maintaining their uniforms.

The District Court declined NYIT’s motion to dismiss, finding that a not-for-profit educational corporations are not exempt from the Hospitality Wage Order.

GOVERNMENTAL IMMUNITY - NEW YORK

Applewhite v. Accuhealth, Inc.

Court of Appeals of New York - June 25, 2013 - N.E.2d - 2013 N.Y. Slip Op. 04727

Patient who suffered anaphylactic shock caused by allergic reaction to prescribed medication brought action for personal injuries sustained as result of allegedly negligent treatment rendered by city’s emergency medical technicians (EMTs).

The Court of Appeals held that:

- Provision of 911 referrals and emergency medical service responses was governmental function, and
- Fact issues regarding existence of special duty precluded summary judgment on patient’s negligence claim against city.

For purposes of a negligence claim against a municipality, a government entity performs a purely proprietary role when its activities essentially substitute for or supplement traditionally private enterprises; in contrast, a municipality will be deemed to have been engaged in a governmental function when its acts are undertaken for the protection and safety of the public pursuant to the general police powers. For purposes of a negligence claim against a municipality, the distinction between governmental functions and private, proprietary conduct is that the government will be subject to ordinary tort liability if it negligently provides services that traditionally have been supplied by the private sector.

Provision of 911 referrals and emergency medical service responses were within traditional responsibilities of municipal government, and thus were governmental, rather than proprietary, function. Services existed for protection and safety of public and not as substitute for private enterprises. Purportedly negligent EMTs were employees of city's fire department using city resources in an effort to fulfill city's obligation to answer emergency 911 dispatch and attempt to save patient's life. EMTs employed by city fire department and deployed via 911 system received training in basic life support techniques and their range of approved emergency services was limited by law.

ANNEXATION - TENNESSEE

State ex rel. Allen v. City of Newport

Court of Appeals of Tennessee - June 18, 2013 - Slip Copy - 2013 WL 3148260

The City of Newport sought to annex certain properties in Cocke County, Tennessee. A number of affected parties objected to the annexation and filed a complaint against the City. The trial court allowed the plaintiffs to amend their complaint to allege that the City was barred from annexing their properties because it had defaulted on a prior plan of services from an earlier annexation.

The following issues were raised on appeal:

- Whether a municipality, after the enactment of Tennessee Code Annotated section 6–51–102(b)(5), may annex "any new territory" if it is in default on "any plan of services?"
- Whether the appellants were entitled to a jury trial to determine any material facts at issue in this declaratory judgment action?

The court found that the 1998 provisions do include compliance with the City's earlier plans of service and concluded that the trial court erred in dismissing the appellants' declaratory judgment claim on the basis of improper retroactive application of Tennessee Code Annotated section 6–51–102(b)(5). Thus, it reversed the judgment and remanded to the trial court. "We express no opinion as to the eventual result of this litigation after further proceedings."

The court also found that a jury was authorized.

PROPERTY - WISCONSIN

Blanc v. City of Janesville

Court of Appeals of Wisconsin - June 27, 2013 - Slip Copy - 2013 WL 3213297

This case involved a claim for relocation assistance and related benefits after the City of Janesville considered purchasing, but did not ultimately acquire, a property owned by Marc Blanc and rented by Schulz Automotive Machine, Ltd. Blanc and Schulz Automotive appealed an order granting summary judgment in favor of the City, which effectively denied Schulz Automotive's claim for relocation assistance and Blanc's claims for rental losses and legal expenses.

On appeal, Schulz Automotive argued that it met the definition of a "displaced person" and thus was entitled to relocation assistance. Blanc argued that he was entitled to recovery of rental losses and legal expenses under constitutional and estoppel theories.

The appeals court concluded that Schulz Automotive did not move from the property as a direct result of any circumstances set forth in WIS. ADMIN. CODE § ADM 92.01(14)(a) (Dec.2011) and thus is not a "displaced person" under the Wisconsin statutes and administrative code. It also concluded that Blanc was not entitled to rental losses or legal expenses under any of the theories on which he relied.

FIRST AMENDMENT - SUPREME COURT OF THE UNITED STATES

Agency for Intern. Development v. Alliance for Open Society Intern., Inc.

Supreme Court of the United States - June 20, 2013 - S.Ct. - 13 Cal. Daily Op. Serv. 6326

Domestic organizations that received funding under United States Leadership Against HIV/AIDS, Tuberculosis, and Malaria Act brought action against United States, seeking declaration that Act's provision requiring organizations that receive funding under Act to have policy expressly opposing prostitution violated their First Amendment rights.

The Supreme Court held that requirement that organizations receiving funding under the Act have a policy expressly opposing prostitution, by compelling as a condition of federal funding the affirmation of a belief that by its nature could not be confined within the scope of the Government program, violated First Amendment free speech protections.

"If there is a fixed star in the constitutional constellation, it is that no official, high or petty, can prescribe what shall be orthodox in politics, nationalism, religion, or other matters of opinion or force citizens to confess by word or act their faith therein."

EMINENT DOMAIN - SUPREME COURT OF THE UNITED STATES

Koontz v. St. Johns River Water Management Dist.

Supreme Court of the United States - June 25, 2013 - S.Ct. - 13 Cal. Daily Op. Serv. 6557

Landowner brought action in Florida state court against water management district, alleging that district's denial of land use permits unless he funded offsite mitigation projects on public lands amounted to a taking without just compensation.

The Supreme Court held that:

- District could not evade limitations of the unconstitutional conditions doctrine by conditioning approval of a land use permit on landowner's funding of offsite mitigation projects on public lands, and
- "Monetary exactions" as a condition of a land use permit must satisfy requirements that government's mitigation demand have an essential nexus and rough proportionality to the impacts of a proposed development, abrogating McClung v. Sumner, 548 F.3d 1219.

Extortionate demands for property in the land-use permitting context run afoul of the Takings Clause not because they take property but because they impermissibly burden the right not to have property taken without just compensation. As in other unconstitutional conditions cases in which someone refuses to cede a constitutional right in the face of coercive pressure, the impermissible denial of a governmental benefit is a constitutionally cognizable injury.

Water management district's request that landowner spend money to fund offsite mitigation projects on public lands, rather than give up an easement on his land, as a condition of a land use permit was subject to requirement that government's mitigation demand have an essential nexus and rough proportionality to the impacts of a proposed development.

[IRS: Employee Plans News - Issue 2013-2, June 24, 2013.]

In this edition of the Employee Plans News:

- IRS Nationwide Tax Forums
- How Much Salary Can You Defer if You're Eligible for More than One Retirement Plan?
- Is a frozen defined benefit plan subject to the top-heavy minimum benefit rules?
- 403(b) Pre-Approved Plan Program
- 403(b) Plans With Operational Failures
- New 403(b) Fix-It Guide
- Voluntary Correction Program Fees for Multiple Failures
- New Phone Number to Check the Status of VCP Submissions
- Tips to Avoid Processing Delays with your Voluntary Correction Program Submission
- Updated submission kits for plans that missed the EGTRRA deadlines
- Form 5300 – Use April 2011 Version
- Employee Plans Determination Letter Program Reminders
- Determination Letter Review Process
- Employee Stock Ownership Plans Determination Letter Application Review Process
- Employee Plans Compliance Unit (EPCU) – Non-Governmental 457(b) Plans Project
- Examination Tips for Hardship Distributions
- SEP Plan Eligibility Requirements
- DOL Corner
- PBGC Insights

The full edition is available at:

http://www.irs.gov/pub/irs-tege/epn_2013_2.pdf

[FINRA Fines StateTrust Investments $1 Million and Orders $353,000 in Restitution for Charging Unfair Prices in Bond Transactions.]

Head Trader and Chief Compliance Officer Fined and Suspended

WASHINGTON — The Financial Industry Regulatory Authority (FINRA) announced today that it has fined StateTrust Investments, Inc. $1.045 million and sanctioned the firm's head trader, Jose Luis Turnes, for charging excessive markups and markdowns in corporate bond transactions and, 85, in particular, that operated as a fraud or deceit upon the customers. FINRA also ordered StateTrust to pay more than $353,000 in restitution, plus interest, to customers who received unfair prices. In addition, Turnes was suspended for six months and fined $75,000. In a related April 2012 action, Jeffrey Cimbal, StateTrust's Chief Compliance Officer, was fined $20,000 and suspended for five months in a principal capacity for failing to supervise Turnes.

FINRA found that StateTrust charged excessive markups/markdowns to customers in a total of 563 transactions. In 227 instances, the markups or markdowns exceeded 5 percent. In 85 of those instances, StateTrust, acting through Turnes, charged excessive markups and markdowns, ranging from 8 percent to over 23 percent away from the prevailing market price, which operated as a fraud or deceit upon the customers. In each of the 85 instances, StateTrust either bought bonds from its bank or insurance affiliate and then sold the bonds to customers at a price that was 8 percent or more away from the prevailing market; or bought bonds from customers at prices that were 8 percent or more below the prevailing market, and then sold them to its bank or insurance affiliate at a slight markup. During that period, Turnes was also the chairman and largest indirect shareholder of the bank and its insurance affiliates.

Thomas Gira, FINRA Executive Vice President and Head of Market Regulation, said, "FINRA will continue to aggressively pursue firms and individuals who charge customers excessive markups and markdowns. StateTrust charged customers unfair prices in corporate fixed income transactions, and the firm and the Chief Compliance Officer failed to properly supervise its head trader, who priced these transactions."

In concluding the settlements, StateTrust, Turnes and Cimbal neither admitted nor denied the charges, but consented to the entry of FINRA's findings. FINRA's investigations were conducted by the Departments of Market Regulation, Member Regulation and Enforcement.

Investors can obtain more information about, and the disciplinary record of, any FINRA-registered broker or brokerage firm by using FINRA's BrokerCheck. FINRA makes BrokerCheck available at no charge. In 2012, members of the public used this service to conduct 14.6 million reviews of broker or firm records. Investors can access BrokerCheck at www.finra.org/brokercheck or by calling (800) 289-9999. Investors may find copies of this disciplinary action as well as other disciplinary documents in FINRA's Disciplinary Actions Online database.

FINRA, the Financial Industry Regulatory Authority, is the largest independent regulator for all securities firms doing business in the United States. FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services. FINRA touches virtually every aspect of the securities business – from registering and educating all industry participants to examining securities firms, writing rules, enforcing those rules and the federal securities laws, informing and educating the investing public, providing trade reporting and other industry utilities, and administering the largest dispute resolution forum for investors and firms. For more information, please visit www.finra.org.

IRS Publication: Voluntary Compliance for Tax-Exempt and Tax-Credit Bonds.

Part one of this publication is a summary of highlighted considerations to help issuers of tax-advantaged bonds comply with related federal tax law requirements. Part two is a summary of Tax-Exempt Bonds Voluntary Closing Agreement Program (TEB VCAP) provisions.

http://www.irs.gov/pub/irs-pdf/p5091.pdf

Guidance Clarifies 'Begins Construction' Standard for Renewable Energy Tax Credit, Treasury Says.

Treasury Assistant Secretary for Legislative Affairs Alastair Fitzpayne has advised Rep. Michael Coffman, R-Colo., that recent guidance (Notice 2013-29) clarifies the new "begins construction" standard for wind investment tax credits and provides “the desired degree of certainty” in the marketplace and allows renewable energy projects to move forward.

June 17, 2013

The Honorable Mike Coffman

U.S. House of Representatives

Washington, DC 20515

Dear Representative Coffman:

Thank you for your letter concerning changes made by the American Taxpayer Relief Act of 2012 (ATRA) to the renewable energy production tax credit (PTC) under section 45 of the Internal Revenue Code and the energy investment tax credit (ITC) under section 48.

As you note, ATRA modified the PTC and ITC to apply to projects that “begin construction” by the end of 2013 instead of projects that are “placed in service” by the end of 2013. On April 15, 2013, Treasury and the Internal Revenue Service issued Notice 2013-29 to clarify this new “begins construction” standard. This notice sets forth two ways that a taxpayer can satisfy the standard in 2013:

(1) beginning physical work of a significant nature,

or (2) paying or incurring 5 percent of the total cost of the project.

These tests are similar to those used for payments under section 1603 of the American Recovery and Reinvestment Act of 2009. A copy of the notice is enclosed. We believe this guidance provides the desired degree of certainty in the marketplace and allows renewable energy projects to move forward.

If you have further questions, please contact Sandra Salstrom, Office of Legislative Affairs, at (202) 622-1900.

Sincerely,

Alastair M. Fitzpayne

Assistant Secretary for

Legislative Affairs

Treasury Informs Oklahoma Governor About Relief From Some Bond and Low-Income Housing Credit Requirements.

Treasury Secretary Jacob Lew has informed Oklahoma Gov. Mary Fallin (R) of Treasury’s decision to provide relief (Notice 2013-40) from some low-income housing credit requirements and relief (Notice 2013-39) from some bond requirements due to severe storms and tornadoes in the state.

June 18, 2013

The Honorable Mary Fallin

Governor of Oklahoma

State Capitol Building

2300 N. Lincoln Blvd.

Suite 212

Oklahoma City, OK 73105

Dear Governor Fallin:

Thank you for your letter to me of May 23, 2013, requesting relief from some of the requirements of the low-income housing tax credit program due to the recent tornadoes in Oklahoma.

In response to your letter, the Treasury Department and the Internal Revenue Service (IRS) issued Notice 2013-40, which makes it possible for Low Income Housing Credit projects anywhere in the country to suspend the income limits and provide temporary housing to victims of the Oklahoma tornadoes. At the same time, Treasury and the IRS also issued Notice 2013-39, which makes it possible for qualified residential rental projects financed with exempt facility bonds to provide temporary housing for these victims. These notices, which went into effect on May 20, 2013, are enclosed. Certain filing and payment deadlines have also been extended for affected taxpayers.

We hope that this relief will play a meaningful role in Oklahoma's response to the devastation caused by these terrible disasters. Please contact us again if there are other ways in which we can help.

Sincerely,

Jacob J. Lew

Conditional Donation of Conservation Easement and Cash Precludes Charitable Contribution Deduction.

The Tax Court held that a couple wasn't entitled to charitable contribution deductions for their gift of cash and a conservation easement to an architectural trust, finding that the donation was improperly conditioned on whether the IRS would allow their claimed deductions.

Lawrence Graev agreed to contribute a façade conservation easement on his property to the National Architectural Trust (NAT), a qualified charitable organization. Before the donation, Graev's accountants advised him of Notice 2004-41 and the IRS's increased scrutiny of deductions for conservation easement donations. Graev sought assurances from NAT regarding his donation and his ability to claim deductions. NAT issued Graev a letter in which it agreed to refund any disallowed cash contributions and remove the easement from the property title if the deduction was disallowed.

Graev contributed the easement and made a cash contribution to NAT in 2004. On his 2004 and 2005 joint returns with his wife, Graev claimed charitable contribution deductions for his easement contribution and accompanying cash contribution to NAT. The IRS disallowed the deductions as conditional gifts and imposed accuracy-related penalties against the couple.

The Tax Court, in an opinion by Judge David Gustafson, considered whether the promises made in NAT's letter to Graev made the gift conditional and whether the chance that the condition would occur was so remote as to be negligible under reg. section 1.170A-1(e). Gustafson wrote that "what is determinative under the section 170 'remote' regulations is the possibility, after considering all the facts and circumstances, that NAT's reception and retention of the easement and cash would be defeated."

The court concluded that the IRS's disallowance of the deductions and NAT's return of the cash and removal of the easement was not so remote as to be negligible at the time of the contribution. The court found that there was a substantial risk of disallowance based on the IRS's announcement of increased scrutiny and that the risk was evident based on Graev's request for assurances from NAT. That NAT had issued "comfort letters" to other donors was further evidence of a non-negligible risk that the IRS would disallow the deduction.

Gustafson rejected the Graevs' argument that the letter from NAT was not enforceable under state law, finding that NAT could abandon the easement under the deed. The court also held that NAT intended to honor its promise if the deduction was disallowed. The court rejected the couple's argument that the doctrine of merger extinguished the terms of the letter once the deed for the easement was recorded. Gustafson wrote, "We find that NAT's promises in the side letter to return to the easement and cash were enforceable because we find a clear intent evidenced by the parties that the side letter would survive the deed."

The Tax Court concluded that there was substantial risk that the IRS would challenge the deductions, that enforcement of the letter wasn't precluded by state or federal law, and that NAT would act as promised in the letter. As a result, the gifts were conditional and the charitable contribution deductions should be disallowed, the court said.

LAWRENCE G. GRAEV AND LORNA GRAEV,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

Citations: Lawrence G. Graev et ux. v. Commissioner; 140 T.C. No. 17; No. 30638-08

UNITED STATES TAX COURT

Filed June 24, 2013

Petitioner husband ("P-H") contributed cash and a conservation easement to N, a charitable organization. Before the contribution, N at P-H's request issued to P-H a side letter which promised that, in the event R disallows Ps' charitable contribution deductions, N "will promptly refund your entire cash endowment contribution and join with you to immediately remove the facade conservation easement from the property's title". Ps claimed charitable contribution deductions for the cash and easement donations. R contends the side letter made those contributions conditional gifts that are not deductible under I.R.C. sec. 170, since the likelihood that N would be divested of the cash and easement was not negligible.

Held: Ps’ charitable contribution deductions are not allowed because at the time of P-H’s contributions, the possibility that the deductions would be disallowed and, as a result, that N would return the contributions was not “so remote as to be negligible”, under 26 C.F.R. secs. 1.170A-1(e), 1.170A-7(a)(3), and 1.170A-14(g)(3), Income Tax Regs.

Frank Agostino, Eduardo S. Chung, Jeremy M. Klausner, and Reuben G. Miller, for petitioners.

Shawna A. Early, for respondent.

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III. Conclusion.

GUSTAFSON, Judge: Pursuant to section 6212(a),1 the Internal Revenue Service ("IRS") determined deficiencies in tax for petitioners, Lawrence and Lorna Graev, in the amounts of $237,481 for 2004 and $412,620 for 2005, resulting from the disallowance of charitable contribution deductions the Graevs claimed for those years. The IRS also determined that Mr. and Mrs. Graev are liable for accuracy-related penalties under section 6662(h) and alternatively under section 6662(a) for 2004 and 2005. Mr. and Mrs. Graev petitioned this Court, pursuant to section 6213(a), for redetermination of these deficiencies and penalties. The issue for decision at present is whether the deductions that the Graevs claimed for charitable contributions of cash and a conservation easement they donated to the National Architectural Trust ("NAT") should be disallowed because they were conditional gifts.2 We hold that the Graevs' contributions were conditional, non-deductible gifts.

FINDINGS OF FACT

The parties submitted this issue fully stipulated pursuant to Rule 122, reflecting their agreement that the relevant facts could be presented without a trial.3 The stipulated facts are incorporated herein by this reference. Mr. and Mrs. Graev resided in the State of New York when they filed the petition.

NAT

The parties have stipulated that, "[f]or purposes of the Court's decision regarding" the conditional gift issue, NAT is a "qualified organization" under section 170(h)(3), to which a charitable contribution can be made that is deductible for tax purposes. NAT's stated mission is to preserve historic architecture in metropolitan areas across the United States. NAT solicits the contribution of facade conservation easements by owners of property with historic significance as determined by the National Park Service. When NAT solicits potential donors, it features the potential charitable deductions that owners may receive by contributing a facade conservation easement and a corresponding cash endowment to NAT. In addition, NAT considered it "standard Trust policy", regarding donors of easements and cash, to return a cash contribution to the extent the IRS disallowed a deduction therefor. In numerous instances NAT issued "comfort letters" assuring donors of this policy.

The property

In 1999 Mr. Graev purchased property in a historic preservation district in New York, New York, for

$4.3 million. The property is listed on the National Register of Historic Places. During the years at issue Mr. Graev was the sole fee simple owner of the property, and he held the property subject to a mortgage.

Increased IRS scrutiny of easement contributions

On June 30, 2004, the IRS released IRS Notice 2004-41, 2004-2 C.B. 31, which addressed charitable contributions and conservation easements and stated in part:

The Internal Revenue Service is aware that taxpayers who (1) transfer an easement on real property to a charitable organization, or (2) make payments to a charitable organization in connection with a purchase of real property from the charitable organization, may be improperly claiming charitable contribution deductions under § 170 of the Internal Revenue Code. The purpose of this notice is to advise participants in these transactions that, in appropriate cases, the Service intends to disallow such deductions and may impose penalties and excise taxes. * * *

* * * * * * *

Some taxpayers are claiming inappropriate charitable contribution deductions under § 170 for cash payments or easement transfers to charitable organizations in connection with the taxpayers' purchases of real property.

In some of these questionable cases, the charitable organization purchases the property and places a conservation easement on the property. Then, the charitable organization sells the property subject to the easement to a buyer for a price that is substantially less than the price paid by the charitable organization for the property. As part of the sale, the buyer makes a second payment, designated as a "charitable contribution," to the charitable organization. The total of the payments from the buyer to the charitable organization fully reimburses the charitable organization for the cost of the property.

In appropriate cases, the Service will treat these transactions in accordance with their substance, rather than their form. Thus, the Service may treat the total of the buyer's payments to the charitable organization as the purchase price paid by the buyer for the property.

Thus, the IRS publicly announced its awareness of abuses related to easement contribution deductions, putting potential donors and donees on notice that easement contribution deductions might be examined and challenged. We find that there was at least a non-negligible possibility that the IRS would challenge an easement contribution deduction thereafter claimed by Mr. Graev.

NAT's solicitation

In the summer of 2004, a representative from NAT contacted Mr. Graev regarding a potential easement donation to NAT. Mr. Graev became aware that he had a "neighbor across the street" who had contributed a facade easement to NAT and who had received from NAT a side letter that promised return of contributions if deductions were disallowed. Mr. Graev evidently expressed to NAT an interest in making an easement contribution like his neighbor's, but on September 15, 2004, he sent an email to NAT explaining a concern that had arisen:

My accountants have referred me to Notice 2004-41 * * * issued by the IRS on June 30, 2004, in which the IRS has indicated that it will, in "appropriate cases", disallow charitable deductions to organizations that promote conservation easements and may impose penalties and excise taxes on the taxpayer. They have not advised me to abandon this idea, but they have advised me to be very cautious. What are your thoughts especially as it relates to the side letter, etc.

(The “side letter” to which Mr. Graev referred was NAT’s comfort letter assuring that it would refund a contribution in the event that the favorable tax results anticipated from a contribution were not achieved.) Mr. Graev indicated that he had consulted his accountants, and in 2004 those accountants would surely have been aware of published court decisions issued over the past decade that disallowed deductions claimed for the contribution of facade easements.4 On his tax returns Mr. Graev listed his occupation as “attorney”, and we infer that he is an individual of above-average sophistication who, with the help of his accountants, was capable of identifying tax risks. We find that Mr. Graev did in fact identify non-negligible risks regarding the deductibility of facade easements, as evidenced by his September 15 email and subsequent dealings with NAT.

In a response to Mr. Graev’s concerns, NAT sent him an email dated September 16, 2004, that stated:

The IRS notices to which you refer were prompted by recently exposed improprieties at the Nature Conservancy, the nation’s largest land conservation easement holding organization. The practice the IRS is concerned with here is when a non-profit acquires property, puts an easement on it and sells it for a reduced price plus a tax-deductible contribution. * * *

It is important to distinguish between these activities, which certainly warrant scrutiny, and those engaged in by the National Architectural Trust. * * * We have been in contact with the IRS since the notices were issued and, based upon our discussion with them, have no reasons to expect that we or any of the donations we have received (easement or cash) will be reviewed.

Thus far not a single donation made to the Trust has been disallowed by the IRS (400+ in New York City alone). * * *

With regard to side letters in particular, NAT wrote:

[W]e don’t believe they compromise the tax-deductibility of cash donations in the present tax year, as they are simply a confirmation of standard Trust policy. However, we do not believe this would be the case with a legal agreement that explicitly made the cash donation contingent on the survival of the deduction. In such a case, we would recommend that the cash donation be treated as tax-deductible once the contingency period has expired. * * *

That is, it was “standard Trust policy” to refund a cash contribution to the extent the IRS disallowed the donor’s deduction for the related easement.

Evidently reassured, Mr. Graev executed a facade conservation easement application to NAT on September 20, 2004. In a cover letter to NAT transmitting the application, Mr. Graev stated: “I will also be looking for the NAT to issue the ‘side’ letter we discussed (similar to the one being issued to my neighbor across the street).”

The side letter

On September 24, 2004 NAT sent the side letter to Mr. Graev. The side letter read in pertinent part:

1. In the event the IRS challenges the appraisal of your facade conservation easement and the tax deductions derived therefrom are reduced as a result, we will make a proportionate reduction to your cash endowment contribution and promptly refund the difference to you.

2. In the event the IRS disallows the tax deductions in their entirety, we will promptly refund your entire cash endowment contribution and join with you to immediately remove the facade conservation easement from the property’s title.

Neither the side letter nor any other evidence in our record suggests that, in the event the IRS disallowed his contribution, Mr. Graev would have to sue NAT in order to induce it to “remove” the easement. Rather, NAT promised upon disallowance to “join with [him] * * * to immediately remove the facade conservation easement from the property’s title”. Mr. Graev took NAT at its word, and so do we. That is, we find that there was at least a non-negligible possibility, if the IRS successfully disallowed Mr. Graev’s easement contribution deduction, that NAT would do what it said it would do.

Appraisal

Mr. Graev retained the firm of Miller Samuel, Inc. (“MSI”), to prepare an appraisal of the facade easement. In October 2004, MSI issued its appraisal report to Mr. Graev appraising the property at $9 million and concluding that the easement would reduce the value by 11% (or $990,000). Thus, the report appraised the easement at $990,000.

Noncash contribution to NAT

In late 20045 Mr. Graev executed a conservation deed granting a facade easement on the property to NAT. The deed in pertinent part provides:

The Property constitutes an important element in the architectural ensemble of the Treadwell Farms Historic District, and the grant of the Easement as set forth in this instrument will, inter alia, assist in preserving this certified historic structure and in preserving open space for the scenic enjoyment of the general public.

* * * * * * *

The Grantor does hereby grant and convey to the Grantee, TO HAVE AND TO HOLD, an Easement in gross, in perpetuity, in, on and to the Property, the Building and the Facade, being an Open Space and Architectural Facade Conversation Easement on the Property * * *

* * * * * * *

A. * * * This Easement shall survive any termination of Grantor’s or the Grantee’s existence. The rights of the Grantee under this instrument shall run for the benefit of an may be exercised by its successor and assigns, or by its designees duly authorized in a deed of Easement.

B. Grantee covenants and agrees that it will not transfer, assign or otherwise convey its rights under this Easement except to another “qualified organization” described in Section 170(h)(3) of the Internal Revenue Code of 1986 and controlling Treasury regulations, and Grantee further agrees that it will not transfer this Easement unless the transferee first agrees to continue to carry out the conservation purposes for which this Easement was created, provided, however, that nothing herein contained shall be constructed to limit the Grantee’s right to give its consent (e.g., to changes in a Protected Facade(s)) or to abandon some or all of its rights hereunder. [Emphasis added.]

C. In the event this Easement is ever extinguished through a judicial decree, Grantor agrees on behalf of itself, its heirs, successors and assigns, that Grantee, or its successors and assigns, will be entitled to receive upon the subsequent sale, exchange or involuntary conversion of the Property, a portion of the proceeds from such sale, exchange or conversion equal to the same proportion that the value of the initial Easement donation bore to the entire value of the property at the time of donation * * *. Grantee agrees to use any proceeds so realized in a manner consistent with the conservation purposes of the original contribution.

* * * * * * *

Citimortgage Inc. (“Mortgagee/Lender”) hereby joins in the execution of this CONSERVATION DEED OF EASEMENT for the sole and limited purpose of subordinating its rights in the Property to the right of the Grantee, its successors or assigns, to enforce the conservation purposes of this Easement in perpetuity under the following conditions and stipulations:

(a) The Mortgagee/Lender and its assignees shall have a prior claim to all insurance proceeds * * * and all proceeds from condemnation, and shall be entitled to same in preference to Grantee until the Mortgage/the Deed of Trust is paid off and discharged, notwithstanding that the Mortgage/the Deed of Trust is subordinate in priority to the Easement.

The deed did not expressly refer to the side letter or incorporate its terms. The City of New York recorded the deed on February 17, 2005.

Cash contribution to NAT

In conjunction with an easement donation, NAT asks a donor to make a cash contribution to NAT equal to 10% of the appraised easement value, in order to pay for NAT’s current operating costs and to fund its long-term monitoring and administration needs. In compliance with NAT’s request, Mr. Graev made an initial deposit of $1,000 to NAT on September 15, 2004. On December 17, 2004, the same day he delivered the signed deed to NAT, Mr. Graev made a $98,000 cash contribution to NAT, bringing his cash contributions to NAT to a total of $99,000. On January 25, 2005, NAT gave Mr. Graev written acknowledgment of his 2004 cash and non-cash contributions. That correspondence also included a copy of Form 8283, executed by the appraiser, MSI, and NAT.

Subsequent communications from NAT

Also on January 25, 2005, NAT sent a letter to Mr. Graev informing him that the U.S. Senate Committee on Finance had announced in a press release their “intent to implement reforms to the tax laws governing facade easements that will increase and create additional fines and penalties on promoters, taxpayers and appraisers who participate, aid or assist in the donation of facade easements that are found to be significantly overvalued.” Several months later, in August 2005, NAT sent Mr. Graev another letter which read:

The purpose of this letter is to bring to your attention a development that may be relevant to the tax deductibility of the cash contributions that you made to the National Architectural Trust * * *

In connection with your donation of a facade conservation easement and cash contribution and per your request, we sent you a letter dated September 24, 2004, stating, among other things, that the cash contribution would be refunded in whole or in part if your tax deduction for the easement were reduced or disallowed by the Internal Revenue Service. It has recently been brought to our attention by our attorney that this offer of a refund may adversely affect the deductibility of the cash contribution as a charitable gift. * * *

We urge you to contact your professional tax advisor to determine the actual impact of the refund offer. Of course, if you determine that you would prefer that we withdraw the refund offer, which according to our attorney should restore the deductibility of your cash contribution, the Trust will promptly do so. * * *

Mr. Graev did not ask NAT to withdraw the refund offer. We find that NAT’s formal offer to withdraw the refund offer — made after NAT consulted with its attorney — further indicates that NAT intended to honor its promises in the side letter (even if the promises may not have been legally enforceable), unless Mr. Graev directed otherwise.

2004 and 2005 Federal income tax returns

Mr. and Mrs. Graev filed joint Forms 1040, U.S. Individual Income Tax Return, for taxable years 2004 and 2005. On their 2004 return, which they filed on or around October 10, 2005 (i.e., after the January and August 2005 letters from NAT, discussed above), Mr. and Mrs. Graev reported a charitable contribution of $990,000 for the facade easement contribution and $99,000 for the cash contribution to NAT. Mr. and Mrs. Graev claimed a deduction for the entire cash contribution in 2004, but because of the limitations on charitable contribution deductions in section 170(b)(1)(C), they claimed a charitable contribution deduction with respect to the facade easement of only $544,449 on their 2004 return.

On their 2005 return, filed on or around October 6, 2006, Mr. and Mrs. Graev claimed a carryover charitable contribution deduction of $445,551 relating to the facade easement contribution in 2004.

Notice of deficiency

By a statutory notice of deficiency dated September 22, 2008, the IRS disallowed Mr. and Mrs. Graev's cash and non-cash charitable contribution deductions relating to their contributions to NAT and determined deficiencies in tax for both 2004 and 2005. In the notice of deficiency the IRS stated: "[T]he noncash charitable contribution of a qualified conservation contribution is disallowed because it was made subject to subsequent event(s)". The notice disallowed the Graevs' cash charitable contribution deduction for the same reason. The IRS also determined that Mr. and Mrs. Graev are liable for accuracy-related penalties under section 6662 for 2004 and 2005.

OPINION

The question now before the Court is whether deductions for Mr. Graev's contributions of cash and the easement to NAT should be disallowed because they were conditional gifts. The answer depends on whether NAT's promises in the side letter made the gifts conditional and whether the chance that the condition would occur was "so remote as to be negligible". See 26 C.F.R. secs. 1.170A-1(e), 1.170A-7(a)(3), 1.170A-14(g)(3), Income Tax Regs.

The Graevs argue that under New York law the agreement in the side letter is unenforceable because conditions in the side letter were not included in the recorded deed and that under Federal tax law the side letter was a nullity. We conclude that NAT's promises in the side letter were not a nullity and were not extinguished and that NAT could and would honor its promises both as to the easement and as to the cash contribution.

I. Charitable contributions

A. Generally

Section 170(a)(1) generally allows a deduction for any "charitable contribution" made during the taxable year. Section 170(c)(2) defines a "charitable contribution" for this purpose to include "a contribution or gift to or for the use of" a trust organized and operated exclusively for charitable or educational purposes. The parties agree for purposes of the conditional gift issue that NAT is such an organization.

Application of the general rule in section 170(a)(1) may be complicated — especially with regard to the amount and timing of a charitable contribution deduction — if a donor contributes a property interest to a charity but, at the time of the contribution, there is uncertainty about the amount of property that will actually reach the charity — e.g., when a donor contributes a remainder interest in property to a charity, or (as in this case) the donor contributes property subject to a condition. Section 170 and the corresponding regulations provide instruction and limitations that, at least in part, ensure that the donor will be able to deduct only what the donee organization actually receives. See, e.g., sec. 170(f)(2), (3), (11). Three such limitations are pertinent in this case: (1) 26 C.F.R. section 1.170A-1(e), which limits deductions for conditional gifts; (2) section 170(f)(3)(A) and the corresponding regulations, which limit deductions for contributions of partial interests in property; and (3) section 170(f)(3)(B)(iii) and corresponding regulations, which provide special rules for conservation easements.

B. Conditional gifts

The general rule of section 170(a)(1) allows a deduction for a charitable contribution only when "payment * * * is made within the taxable year." (Emphasis added.) Regulations corresponding to section 170(a) clarify this rule with a limitation particularly relevant in this case:

If an interest in property passes to, or is vested in, charity on the date of the gift and the interest would be defeated by the subsequent performance of some act or the happening of some event, the possibility of occurrence of which appears on the date of the gift to be so remote as to be negligible, the deduction is allowable. [26 C.F.R. sec. 170A-1(e).]

That is, the deduction may be considered "made" notwithstanding a possibility that the contribution will be defeated by a subsequent event, but only if that possibility is "so remote as to be negligible". Although the parties agree that the side letter recited conditions on Mr. Graev's contributions, the parties disagree about whether this regulation disallows deductions for those contributions.

A brief discussion of the history of 26 C.F.R. section 1.170A-1(e) is helpful in understanding the regulation's application in this case. The Secretary promulgated the first version of this regulation in1959 to correspond to section 170(a) of the 1954 Code.6 The operative language in that 1959 regulation was identical to an older regulation that had limited deductions for estate tax purposes for certain conditional charitable bequests. See 26 C.F.R. sec. 81.46(a), Estate Tax Regs. (1949).7 Given this similarity, we consider interpretations of 26 C.F.R. section 20.2055-2(b), Estate Tax Regs., and its history instructive in construing 26 C.F.R. section 170A-1(e). See Briggs v. Commissioner, 72 T.C. 646, 657 (1979), aff'd without published opinion, 665 F.2d 1051 (9th Cir. 1981).

The Supreme Court in Commissioner v. Estate of Sternberger, 348 U.S. 187, 194 (1955), discussed the estate tax regulations at length, stating:

The predecessor of [26 C.F.R.] s[ec.] 81.46 confined charitable deductions to outright, unconditional bequests to charity. It expressly excluded deductions for charitable bequests that were subject to conditions, either precedent or subsequent. While it encouraged assured bequests to charity, it offered no deductions for bequests that might never reach charity. Subsequent amendments have clarified and not changed that principle. Section 81.46(a) today yields to no condition unless the possibility that charity will not take is "negligible" or "highly improbable." * * *

Similarly, a fundamental principle underlying the charitable contribution deduction is that the charity actually receive and keep the contribution. 26 C.F.R. section 1.170A-1(e) clarifies that principle: no deduction for a charitable contribution that is subject to a condition (regardless of what the condition might be) is allowable, unless on the date of the contribution the possibility that a charity's interest in the contribution "would be defeated" is "negligible".

Accordingly, under section 1.170A-1(e) of the regulations (construing the statutory requirement of section 170(a)(1) that a gift actually "is made"), the Graevs' deductions are not allowable unless the possibility that NAT's interests in the easement and cash would be defeated was "so remote as to be negligible".

C. Partial interests in general

Logically related to but distinct from the disallowance of deductions for conditional gifts is the limitation in section 170(f)(3) on deductions for contributions of partial interests in property. One is generally allowed a deduction only for the contribution of one's entire interest in property. Congress enacted what is now section 170(f)(3)(A) as part of the Tax Reform Act of 1969, Pub. L. No. 91-172, sec. 201, 83 Stat. at 549. Section 170(f)(3)(A) allows a deduction for a charitable contribution "of an interest in property [not made in trust] which consists of less than the taxpayer's entire interest in such property" only to the extent it would be allowable under section 170 "if such interest had been transferred in trust". This is a narrow allowance, since the rules that allow charitable contribution deductions for partial interests transferred in trust allow deductions only for interests that can be valued using prescribed methods (e.g., actuarial tables promulgated in the regulations) and that have assurances that the charity will receive payments from the trust. See, e.g., sec. 170(e)(2); 26 C.F.R. sec. 1.170A-6, Income Tax Regs.

In this case, since Mr. Graev reserved the right to have NAT return the easement and the cash if certain events occurred, the contributions of both the easement and the cash were less than Mr. Graev's entire interest in the contributed property. Accordingly, Mr. Graev's contributions appear subject to the limitation in section 170(f)(3). However, 26 C.F.R. section 1.170A-7(a)(3) provides the following mitigation of this limitation:

A deduction shall not be disallowed under section 170(f)(3)(A) * * * merely because the interest which passes to, or is vested in, the charity may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible. * * *

Thus, under this regulation, even though the contributions did not consist of Mr. Graev's entire interest in the cash and the easement, the Graevs' deductions for contributions would not be disallowed under section 170(f)(3)(A) if the likelihood that NAT's interests in the cash and the easement would be defeated was "so remote as to be negligible".

D. Conservation easements

An easement is "[a]n interest in land owned by another person, consisting in the right to use or control the land, or an area above or below it, for a specific limited purpose". Black's Law Dictionary 585-586 (9th ed. 2009). Consequently, an easement — whether or not it is subject to any condition — is by definition a partial interest in property, and it would therefore be non-deductible under section 170(f)(3)(A), apart from any further statutory provision. However, further provision is made in subsections (f)(3)(B)(iii) and (h) of section 170, the history of which we briefly survey:

The disallowance of a deduction for partial interests was added to the Code as section 170(f)(3) by the Tax Reform Act of 1969. In that provision's original form, the only exceptions to disallowance of a deduction for contributions of partial interests were for contributions of "a remainder interest in a personal residence or farm" and "an undivided portion of the taxpayer's entire interest in property". That is, no exception was made for a qualified conservation contribution. However, the Staff of Joint Committee on Taxation opined in its General Explanation of the Tax Reform Act of 1969, at 80 (J. Comm. Print 1970), that "a gift of an open space easement in gross is to be considered a gift of an undivided interest in property where the easement is in perpetuity."

Congress made explicit an exception for (i.e., permitted a deduction for) certain easements in the Tax Reform Act of 1976, Pub. L. No. 94-455, sec. 2124(e), 90 Stat. at 1919, which amended section 170(f)(3)(B) to provide in clause (iii) that a donor may claim a deduction for the contribution of an "easement with respect to real property of not less than 30 years' duration granted to * * * [a charitable organization] exclusively for conservation purposes". The following year Congress revised that exception, eliminating the "30 years' duration" provision and limiting deductibility to an "easement with respect to real property granted in perpetuity". (Emphasis added.) Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, sec. 309(a), 91 Stat. at 154. In the Tax Treatment Extension Act of 1980, Pub. L. No. 96-541, sec. 6(a), 94 Stat. at 3206, Congress amended section 170(f)(3) and added subsection (h), which have remained in effect since then and work in tandem to keep the perpetuity requirement for conservation easement donations.

Section 170(f)(3)(B)(iii) exempts, from the general disallowance of deductions for contributions of partial interests, contributions of "a qualified conservation contribution" — a term defined in section 170(h)(1) as a contribution of a "qualified real property interest," to a "qualified organization", "exclusively for conservation purposes." A "qualified real property interest" must have "a restriction (granted in perpetuity) on the use which may be made of the real property." Sec. 170(h)(2)(C) (emphasis added).8 Regulations describing the perpetuity requirement provide:

A deduction shall not be disallowed under section 170(f)(3)(B)(iii) * * * merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible. * * * [26 C.F.R. sec. 1.170A-14(g)(3).]

(The "so remote as to be negligible" phrase is the familiar term first used in the 1949 estate tax regulations cited above.) Accordingly, a conservation easement fails to be "in perpetuity" — and is therefore not excepted from the general rule of section 170(f)(3)(A) disallowing deductions for contributions of partial interests — if, on the date of the donation, the possibility that the charity may be divested of its interest in the easement is not so remote as to be negligible.

E. Construing "so remote as to be negligible"

Each of the issues discussed above — i.e., whether a charitable contribution was effectively "made", whether it consisted of an "entire interest", and whether it was a "qualified conservation contribution" — essentially turns on the same question: At the time of Mr. Graev's contributions, was the possibility that NAT's interest in the cash and the easement would be defeated "so remote as to be negligible"? In prior cases, we have defined "so remote as to be negligible" as "'a chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction.'" 885 Inv. Co. v. Commissioner, 95 T.C. 156, 161 (1990) (quoting United States v. Dean, 224 F.2d 26, 29 (1st Cir. 1955)). Stated differently, it is "a chance which every dictate of reason would justify an intelligent person in disregarding as so highly improbable and remote as to be lacking in reason and substance." Briggs v. Commissioner, 72 T.C. at 657. What is determinative under the section 170 "remote" regulations is the possibility, after considering all the facts and circumstances, that NAT's reception and retention of the easement and cash would be defeated.

II. Analysis

The side letter provides that the occurrence that would defeat NAT's interest in the easement and cash is the IRS's successful disallowance of the Graevs' charitable contribution deductions and NAT's consequent promised "removal" of the easement and return of the cash. We hold that at the date of the contribution the possibility that the IRS would disallow the deductions and that NAT would return the cash to Mr. Graev and “remove” the easement was not “so remote as to be negligible”.

A. The possibility of disallowance by the IRS

1. The possibility of disallowance as a matter of fact

The Graevs argue that as of December 2004, the caselaw supported an easement valuation of 10% to 15% of Mr. Graev’s property and that it was therefore reasonable to conclude that Mr. Graev’s easement donation had a value of $990,000 (i.e., 11% of the appraised value of the property). They assert that the possibility the IRS would disallow their deductions was so remote as to be negligible. However, on the undisputed facts of this case, it is self-evident that the risk of IRS disallowance was not negligible.9 A substantial risk obviously arose from the IRS’s then-announced intention to scrutinize charitable contribution deductions for facade easement contributions, and that risk is evident from Mr. Graevs’ insistence on NAT’s issuing the side letter. We need not wonder how a donor or donee would have responded to this risk if he had foreseen it; we know how Mr. Graev did respond when he did foresee it: He did not “disregard” or “ignore[ ]” it, see 885 Inv. Co. v. Commissioner, 95 T.C. at 161; Briggs v. Commissioner, 72 T.C. at 657, but rather went out of his way to address it and hedge against it.

a. Increased IRS scrutiny

The Graevs note that at the time of their contribution in December 2004, no charitable contribution deduction arising from a contribution to NAT had been disallowed (to their knowledge). However, the enforcement landscape regarding deductions for facade easement donations was visibly changing at the time of his contribution. As is discussed above, the IRS released Notice 2004-41, supra, on June 30, 2004. In that notice the IRS stated:

The Internal Revenue Service is aware that taxpayers who (1) transfer an easement on real property to a charitable organization, or (2) make payments to a charitable organization in connection with a purchase of real property from the charitable organization, may be improperly claiming charitable contribution deductions under § 170 of the Internal Revenue Code. The purpose of this notice is to advise participants in these transactions that, in appropriate cases, the Service intends to disallow such deductions and may impose penalties and excise taxes. * * *

Notice 2004-41 goes on to give a specific example of the second instance, i.e., a taxpayer makes a cash contribution to a charitable organization in addition to purchasing (at a discount) from the same organization real property that was subject to a conservation easement, where the total amount of contribution and purchase price equals the charity’s initial cost of the real property. The Graevs argue that since Notice 2004-41 specifically described a transaction that did not apply in their case, the notice was not applicable to them.

We disagree. While Notice 2004-41 did list one specific transaction that the Commissioner had determined was inappropriate, the Commissioner’s general warning against “improperly claiming charitable contribution deductions” connected with transfers of conservation easements to charities was still very much applicable to the Graevs. Notice 2004-41 made clear before Mr. Graev’s transfer that his transaction with NAT would be subject to heightened scrutiny and that if any of the Graevs’ positions were susceptible to challenge, the Commissioner would likely enforce a contrary position. Mr. Graev’s September 15, 2004, email to NAT reflects his understanding of this possibility, stating that in light of Notice 2004-41 his accountants “have advised [him] to be very cautious.”

The Graevs argue that their valuation of the contributed easement was reasonable. Since the valuation issue will be resolved by the parties' stipulation to be bound by the outcome of another case that is still pending, see note 2 above, we do not decide valuation now but assume that the Graevs' valuation was reasonable. However, the fact that a valuation is reasonable does not mean that it is correct; a reasonable but incorrect valuation may be challenged and disallowed; consequently, someone who assigns a reasonable value to his donation may nonetheless face a non-negligible risk of disallowance.

Moreover, valuation is not the only potential issue faced by a taxpayer claiming a deduction for a contributed easement, and it was not the only issue as to which NAT promised to return Mr. Graev's contributions. The first numbered paragraph of the side letter did address valuation ("In the event the IRS challenges the appraisal"), but the second numbered paragraph made the distinct promise to return the contributions "[i]n the event the IRS disallows the tax deductions in their entirety". There are multiple requirements in section 170 and the corresponding regulations that, if not followed, may lead to disallowance — and valuation is only one of them. For example, an easement contribution may be disallowed where —

The donee fails to be a "qualified organization" described in section 170(h)(3).

The property subject to the easement fails to be of a "historically important land area" or a "certified historic structure." Sec. 170(h)(4)(iv); see Turner v. Commissioner, 126 T.C. 299, 316 (2006).

The taxpayer fails to contribute a "qualified real property interest". Sec. 170(a)(2); see Belk v. Commissioner, 140 T.C. __ (Jan. 28, 2013).

The easement fails to preserve conservation purposes "in perpetuity". Sec. 170(h)(5); see Carpenter v. Commissioner, T.C. Memo. 2012-1; Herman v. Commissioner, T.C. Memo. 2009-205.

The parties fail to subordinate the rights of a mortgagee in the property "to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity." 26 C.F.R. sec. 1.170A-14(g)(2); see Mitchell v. Commissioner, 138 T.C. 324, 331-332 (2012).

The taxpayer fails to "[a]ttach a fully complete appraisal summary * * * to the tax return". 26 C.F.R sec. 1.170A-13(c)(2)(B). But see Kaufman v. Shulman, 687 F.3d 21, 28-30 (1st Cir. 2012), aff'g in part, vacating in part, and remanding in part Kaufman v. Commissioner, 136 T.C. 294 (2011), and 134 T.C. 182 (2010).

The appraisal fails to be a "qualified appraisal". 26 C.F.R. sec. 1.170A-13(c)(3); see Friedberg v. Commissioner, T.C. Memo. 2011-238.

The appraiser fails to be a "qualified appraiser". 26 C.F.R. sec. 1.170A-13(c)(5); see Rothman v. Commissioner, T.C. Memo. 2012-218 (reserving the question on whether an appraiser was "qualified").

The parties fail to record the easement or otherwise fail to effect "legally enforceable restrictions". 26 C.F.R. sec. 1.170A-14(g)(1); see Satullo v. Commissioner, T.C. Memo. 1993-614, aff'd without published opinion, 67 F.3d 314 (11th Cir 1995).

The taxpayer fails to "[m]aintain records" necessary to substantiate the charitable contribution. 26 C.F.R. sec. 1.170A-13(c)(2)(C), Income Tax Regs.

Mr. Graev's September 15, 2004, correspondence with NAT reflects his clear understanding that charitable contribution deductions for contributions "to organizations that promote conservation easements" were going to be the subject of IRS scrutiny and could be disallowed for failing to satisfy any one of the requirements in section 170. Mr. Graev's accountants advised him "to be very cautious" with such transactions. Clearly, the risk that the IRS might disallow a deduction for the contribution of an easement was well above "negligible".

b. The side letter

Informed by his accountants' warning, Mr. Graev initially asked NAT about the possibility of a side letter from NAT that promised the return of contributions if deductions were disallowed. NAT eventually gave Mr. Graev such a letter on September 24, 2004. The mere fact that he required the side letter is strong evidence that, at the time of Mr. Graev's contribution, the risk that his corresponding deductions might be disallowed could not be (and was not) "ignored with reasonable safety in undertaking a serious business transaction." 885 Inv. Co. v. Commissioner, 95 T.C. at 161.

Mr. Graev was not alone in his assessment of the risk of disallowance. NAT considered it "standard Trust policy" to return a cash contribution to the extent a deduction therefor was disallowed by the IRS. In numerous instances NAT issued "comfort letters" assuring donors of this policy. The very essence of a comfort letter implies a non-negligible risk; and the author uses the letter to induce the recipient to enter into a transaction. In this case the risk was either partial or complete disallowance of Mr. Graev's claimed charitable contribution deductions. NAT's course of dealing confirms that the possibility that the IRS might disallow Mr. Graev's deductions was not "so remote as to be negligible". See 26 C.F.R. secs. 1.170A-1(e), 1.170A-7(a)(3), 1.170A-14(g)(3).

3. Disallowance as a subsequent event

The Graevs argue:

Forty-four years ago, this Court ruled that the [subsequent] events referred to by Treas. Reg. § 1.170A-1(e) do not include contingencies created by Respondent's examination or contingencies within Respondent's control. O'Brien v. Commissioner, 46 T.C. 583, 592 (1966), acq., 1968-1 C.B. 2.[10]

O'Brien v. Commissioner, 46 T.C. 583 (1966), did involve a charitable contribution that was contingent on subsequent favorable tax treatment; but the Graevs' characterization of our ruling in O'Brien is flatly incorrect, and their reliance on it is therefore mistaken.

O'Brien addressed two issues — a charitable remainder trust issue (which we describe here first) and a related but distinct tax-treatment contingency issue. The taxpayers created a charitable remainder trust in June 1964 — of which they made themselves trustees with broad powers to manage the trust — and then made contributions to the trust in December 1964. Id. at 584. The Commissioner argued that the taxpayers were not entitled to charitable contribution deductions derived from the taxpayers' contributions to the trust because the complete management power given to the donor-trustees enabled them to defeat the remainder interests and therefore prevented the deduction. Id. at 591. We rejected that argument and concluded —

that it is highly improbable that the petitioners in their fiduciary capacity will ever perform an act which will defeat the charitable remainders they have created in the trust. All of the conditions and circumstances surrounding the transfers of property interests to the trust persuade us that the named charities, or other qualified ones, will eventually receive the beneficial enjoyment thereof. * * * [Id. at 596; emphasis added.]

We thus decided this remainder trust issue under "[t]he guidelines * * * set forth in section 1.170-1(e), Income Tax Regs."11 Id. at 594.

The Commissioner’s tax contingency argument (discussed first in O’Brien) was based on paragraph 16 of the trust instrument, under which contributions to the trust were “subject to the condition that such contribution shall be repaid to the contributor by the Trustees * * * only in the event and to the extent that the Commissioner of Internal Revenue does not allow [it] as a deduction”. Id. at 588. In the notice of deficiency issued in September 1965, the Commissioner had disallowed the charitable contribution deductions (for the sole reason that the donor-trustees had power over the trust). We “disposed of [the contingency issue] summarily”, id. at 591, so it is not entirely clear what the Commissioner had argued; but it appears that the Commissioner’s contention was simply that “the literal meaning of paragraph 16”, id., called for return of the contributions upon the mere act of disallowance by the Commissioner, whether or not the Commissioner’s position was valid or was upheld. This position would have put the contingency “‘within the control * * * of the Commissioner'”, O’Brien v. Commissioner, 46 T.C. at 591(quoting Surface Combustion Corp. v. Commissioner, 9 T.C. 631, 655 (1947), aff’d, 181 F.2d 444 (6th Cir. 1950)),12 without regard to the merits of the Commissioner’s decision. We held, to the contrary, that despite “the narrow wording of the trust instrument”, “[t]he petitioners have a right to litigate respondent’s determination”, so that the contributions would not be subject to return “unless the petitioners are unsuccessful in this litigation.” Id. at 592.

That is, in O’Brien the Commissioner evidently argued that the charitable contribution deductions were improper simply because, under the trust instrument, the charitable contributions were defeated by the IRS’s mere disallowance (whether or not that disallowance was upheld in litigation). We held, however, that if the taxpayers successfully challenged that disallowance, then the contributions were not defeated (and the contribution deductions could therefore be allowed). We thus held that a contingency expressed in terms of “disallowance” of a deduction actually looked to the merits of the deduction. Contrary to the Graevs’ argument, our O’Brien Opinion did not analyze the tax contingency issue under the section 170 regulations,13 and we did not hold that a tax-treatment contingency can never be a subsequent event that will defeat a contribution and a deduction. We simply did not address that issue.

This case, unlike O’Brien, clearly presents the issue of whether the promised return of a charitable contribution upon the disallowance of the charitable contribution deduction can constitute a subsequent event the possibility of which, if not negligible, renders the deduction not allowable. O’Brien sheds no light on that question.

B. The possibility of return of the contributions

If the risk of IRS disallowance was non-negligible, then so was the prospect that NAT would be called on to honor its side letter and “promptly refund * * * [Mr. Graev’s] entire cash endowment contribution and join with * * * [Mr. Graev] to immediately remove the facade conservation easement from the property’s title”. Given that non-negligible risk, Mr. Graev’s contributions fell afoul of the section 170 regulations implementing the statutory requirements that a gift be effectively “made”, that it consist of an “entire interest”, and that it be a “qualified conservation contribution”. The Graevs argue, however, that as a matter of law NAT could not be held to the promises it made in its side letter, so that there was in fact no possibility that the property would be returned.

The Graevs contend that NAT could not be divested of its interest in the easement because the side letter is not enforceable under New York law and that, as a result, the contributions were not really conditional.14 In particular, the Graevs argue that New York’s environmental conservation statutes, N.Y. Envtl. Conserv. Law secs. 49-0301 to 49-0311 (McKinney 2008 & Supp. 2013), would prevent the side letter from being enforced, and alternatively, that the common law doctrine of merger extinguished the side letter upon NAT’s recording the easement deed. They also contend that under principles of tax law the promises in the side were a nullity. We disagree.

1. Conservation easements under New York law

In general, property interests are determined by State law. United States v. Nat'l Bank of Commerce, 472 U.S. 713, 722 (1985). In 1983 New York enacted the New York Conservation Easement Statute. See N.Y. Envtl. Conserv. Law secs. 49-0301 to 49-0311. For purposes of these statutes a "conservation easement" is defined as:

an easement, covenant, restriction or other interest in real property, created under and subject to the provisions of this title which limits or restricts development, management or use of such real property for the purpose of preserving or maintaining the scenic, open, historic, archaeological, architectural, or natural condition, character, significance or amenities of the real property * * * [Id. sec. 49-0303(1).]

Under these New York statutes, a conservation easement is enforceable even though "[i]t is not appurtenant to an interest in real property" and even though "[i]t can be or has been assigned to another holder".15 N.Y. Envtl. Conserv. Law sec. 49-0305(5). Since an easement with these characteristics would not have been enforceable under New York common law, see Gross v. Cizauskas, 385 N.Y.S.2d 832 (App. Div. 1976), a conservation easement in New York is authorized only by statute and thus is subject to several statutory restrictions. We assume the easement in this case is enforceable only under New York's Environmental Conservation Law and (as the Graevs contend) is subject to the restrictions therein, especially restrictions on how an easement can be extinguished.

The manner and circumstances in which parties can modify or extinguish a conservation easement under New York's Environmental Conservation statutes are clear:

A conservation easement shall be modified or extinguished only pursuant to the provisions of section 49-0307 of this title. Any such modification or extinguishment shall be set forth in an instrument which complies with the requirements of section 5-703 of the general obligations law or in an instrument filed in a manner prescribed for recording a conveyance of real property pursuant to section two hundred ninety-one of the real property law. [N.Y. Envtl. Conserv. Law sec. 49-0305(2).]

The Graevs argue that NAT's promise in the side letter to "remove the facade conservation easement from the property's title" purports to retain for Mr. Graev a right to extinguish the easement that does not comply with the provisions of N.Y. Envtl. Conserv. Law section 49-0307, and as a result, any attempt to remove the easement pursuant to the promise in the side letter would be unlawful.

Pursuant to N.Y. Envtl. Conserv. Law section 49-0307, cross-referenced in the statute quoted above, a conservation easement held by a "not-for-profit conservation organization"16 may be modified or extinguished only: (1) "as provided in the instrument creating the easement"; (2) "in a proceeding pursuant to section nineteen hundred fifty-one of the real property actions and proceedings law"; or (3) "upon the exercise of the power of eminent domain." NAT's promise in the side letter to remove the easement, standing alone, does not appear to comply with any of the three permissible modification or extinguishment methods provided in N.Y. Envtl. Conserv. Law section 49-0307.

The Commissioner argues that the side letter should be considered part of "the instrument creating the easement". That argument fails because the side letter was not "subscribed by the person * * * granting [the deed]", N.Y. Gen. Oblig. Law sec. 5-703 (McKinney 2012), nor was it recorded, which are both required under N.Y. Envtl. Conserv. Law section 49-0305 (cross-referencing N.Y. Gen. Oblig. Law sec. 5-703) in order for a document to be considered an "instrument creating the easement".

However, we hold that NAT had the ability to honor its promises in the side letter because the subscribed and recorded deed — which clearly is “the instrument creating the easement” — reserved for NAT the power to do so. Paragraph IV.B. of the duly recorded deed granting the easement explicitly gives NAT the right to “abandon” the easement, and that deed does comply with one of the three permissible methods — i.e., the first (allowing modification or extinguishment “as provided in the instrument creating the easement”). The recorded deed provides:

Grantee further agrees that it will not transfer this Easement unless the transferee first agrees to continue to carry out the conservation purposes for which this Easement was created, provided, however, that nothing herein contained shall be constructed to limit the Grantee’s right to give its consent (e.g., to changes in a Protected Facade(s)) or to abandon some or all of its rights hereunder. [Emphasis added.]

We have found that at the time Mr. Graev made the contribution, NAT intended to honor its promise to “join with * * * [Mr. Graev] to immediately remove the facade conservation easement from the property’s title”, and we hold that NAT had the ability to honor this promise by exercising its right to abandon the easement as set forth in paragraph IV.B. of the recorded deed.17

Accordingly, we find that the Commissioner has shown that the possibility that NAT would actually abandon its rights was more than negligible.

2. Merger doctrine

Alternatively, the Graevs argue that the entire side letter was extinguished under the common law doctrine of merger. This argument is also without merit. While the doctrine of merger generally extinguishes terms of preliminary contracts or negotiations upon the recording of a deed, so that only the terms in the recorded deed remain, there are exceptions to this general rule. 91 N.Y. Jur. 2d Real Property Sales and Exchanges, sec. 140 (2011). Assuming the doctrine of merger applies to the side letter, the provisions in the side letter would fall within one of these exceptions and survive the deed.

The merger rule does not apply where there is a clear intent evidenced by the parties that a particular provision of the contract shall survive the deed. See Novelty Crystal Corp. v. PSA Institutional Partners, L.P., 850 N.Y.S.2d 497, 500 (App. Div. 2008). “Intention of the parties may be derived from the instruments alone or from the instruments and the surrounding circumstances”. Goldsmith v. Knapp, 637 N.Y.S.2d 434, 436 (App. Div. 1996). In Seibros Fin. Corp. v. Kirman, 249 N.Y.S. 497, 499 (App. Div. 1931), a New York court held that because an agreement giving the purchaser a right to reconvey property that was claimed to be the “inducing cause which persuaded the plaintiff to purchase the property * * * [, t]he contract clearly shows that there was no intention on the part of the parties to merge the contract in the deed. A contract for the sale of real estate is merged in the deed only when the latter is intended to be accepted in full performance of the former.”

Likewise, we find that the side letter was an inducing cause that persuaded Mr. Grave to contribute the conservation easement and cash to NAT. Before he even filled out his application to NAT, Mr. Graev emailed NAT asking for its thoughts on the side letter; and after receiving NAT’s assurances that the side letter would not affect the deductibility of his contribution, he specifically requested the side letter. Moreover, after the donation, when NAT recognized that the side letter might be detrimental to Mr. Graev’s tax deductions, NAT offered to rescind the side letter and Mr. Graev did not accept NAT’s offer, indicating that the parties understood the side letter had survived the deed. Accordingly, we find that NAT’s promises in the side letter to return to the easement and cash were enforceable because we find a clear intent evidenced by the parties that the side letter would survive the deed.

3. Nullity

The Graevs appear to argue that NAT's side letter is a nullity and should be disregarded for tax purposes because it provides for the donor's potential recovery of the contributions in the event of unwanted tax consequences. In support of this argument the Graevs rely primarily on Commissioner v. Procter, 142 F.2d 824, 827-828 (4th Cir. 1944), rev'g a Memorandum Opinion of this Court. The holding of the Court of Appeals in Procter, however, is inapposite to this case.

In Procter the donors assigned to their children gifts of remainder interests in two trusts, subject to the following clause:

[I]n the event it should be determined by final judgment or order of a competent federal court of last resort that any part of the transfer in trust hereunder is subject to gift tax, it is agreed by all the parties hereto that in that event the excess property hereby transferred which is decreed by such court to be subject to gift tax, shall automatically be deemed not to be included in the conveyance in trust hereunder and shall remain the sole property of * * * [the taxpayer] * * *. [Id. at 827.]

Under that clause, if the gifts were held by the courts to be taxable, then the gifts would be undone, and the donors would then be not liable for the tax for which the courts had held them liable. The clause purported not only to undo the gifts but also to undo the judicial decision.

The Court of Appeals for the Fourth Circuit held that the clause in Procter was "clearly a condition subsequent and void because contrary to public policy", id., for three reasons:

(1) Such a clause "has a tendency to discourage the collection of the tax by the public officials charged with its collection", thereby discouraging efforts to collect the tax. Id.

(2) "[T]he effect of the condition would be to obstruct the administration of justice by requiring the courts to pass upon a moot case". Id.

(3) "[T]he condition is to the effect that the final judgment of a court is to be held for naught because of the provision of an indenture necessarily before the court when the judgment is rendered." Id. That is, a final judgment would cause the condition to be operative, but the condition should not be allowed to operate to undo the judgment, since the instrument containing the condition was before the court, and all matters pertaining thereto merged in the judgment. Id. at 827-828.

None of these three reasons would apply to nullify NAT's side letter:

First, the conditions in NAT's side letter would not discourage the collection of tax. This Opinion decides that the Graevs are not entitled to charitable contribution deductions (and that there are therefore deficiencies in their income tax), and the return of the contributions to the Graevs would not at all undo or contradict that holding but would instead be consistent with that holding. In order for the condition in the side letter to be triggered, the deductions must be disallowed, and income tax will thereafter be owing whether or not the contribution is returned.

Second, the possibility of the subsequent return of the contributions does not render this case moot. The Graevs claimed deductions; the IRS disallowed them and determined deficiencies of tax; the Graevs challenged that determination, and we must decide the matter. If we had upheld the deductions, the condition in the side letter would never have been met, the gift would be complete, the contribution would be deductible (assuming other qualifications are met), and we would enter decision in favor of the Graevs to overturn the IRS's deficiency determination. Because instead we disallow the deductions and enter decision in the IRS's favor, upholding the deficiency determination, the condition in the side letter is triggered and the gift presumably reverts to the donor. However, in this case, unlike Procter, the reversion to the donor would not be inconsistent with the court's holding — i.e., the tax collector in our case, unlike Proctor, would collect the tax consistent with the judgment even if the condition become operative and the gift were returned to the donor.

Third, although the final judgment in the IRS's favor would cause the side letter to be operative, the return of the contribution pursuant to the side letter would not operate to undo the judgment, as was the case in Procter. The return would have no effect on the Graevs' tax liabilities.

Other cases have similarly distinguished Procter and have held that certain tax contingency provisions are not void as against public policy. See Estate of Christiansen v. Commissioner, 130 T.C. 1, 8 n.7, 17-18 (2008) (a clause that "increases the amount donated to charity should the value of the estate be increased", "would not make us opine on a moot issue [i.e., the value of the estate], and wouldn't in any way upset the finality of our decision in this case"), aff'd, 586 F.3d 1061 (8th Cir. 2009); Estate of Dickinson v. Commissioner, 63 T.C. 771, 777 (1975) (stating that the "agreement makes no attempt to nullify * * * [the Court's] determination" (citing Surface Combustion Corp. v. Commissioner, 9 T.C. 631, and O'Brien v. Commissioner, 46 T.C. 583)); Estate of Petter v. Commissioner, T.C. Memo. 2009-280 ("a judgment adjusting the value of each unit will actually trigger a reallocation of the number of units between the trusts and the foundation under the formula clause. So we are not issuing a merely declaratory judgment"), aff'd, 653 F.3d 1012 (9th Cir. 2011).

4. Voluntary removal of the easement

The event that might defeat the contribution to NAT is the "removal" of the easement and the return of the cash pursuant to NAT's side letter. Even if, as a matter of law, the side letter was not enforceable for any of the reasons the Graevs advance, the question would remain whether, as a matter of fact, in December 2004 there was a non-negligible possibility that the IRS would disallow the Graevs' contribution deduction and NAT would voluntarily remove the easement. We have found that there was. Mr. Graev evidently concluded that NAT's promise should be believed; he took deliberate steps to obtain its promise; and his conclusion is evidence of what was likely. NAT made such promises to Mr. Graev and others precisely because it was soliciting contributions from within a community of potential donors, and the ability of such an organization to obtain solicitations might well be undermined if it got a reputation for failing to keep its promises. To decide that there was no non-negligible possibility that NAT would voluntarily extinguish the easement and return the cash would require us to find that, in order to induce Mr. Graev to make his contribution, NAT made cynical promises that it fully intended to break. Our record will not support such a finding; the stipulated evidence simply shows a non-profit organization going about accomplishing its purpose. If we speculate (without evidence) that NAT might have reneged on its promise, or even if we assume that NAT probably would have reneged on its promise, that still leaves us with at least a non-negligible possibility that NAT would have done what it said it would do. That possibility is fatal to the Graevs' contribution deductions.

III. Conclusion

Thus, on the evidence before us, we find that there was a substantial possibility that the IRS would challenge the Graevs' easement contribution deductions. We hold that neither State nor Federal law would prevent enforcement of the side letter. And we find that apart from any legal enforceability of the side letter, it reflected what NAT was likely to do in the event of IRS disallowance.

For these reasons, we conclude that at the time of Mr. Graev's contributions to NAT, the possibility that the IRS would disallow the Graevs' deductions for the contributions and, as a result, that NAT would "promptly refund * * * [Mr. Grave's] entire cash endowment contribution and join with * * * [Mr. Graev] to immediately remove the facade conservation easement from the property's title" (as it promised) was not "so remote as to be negligible". Accordingly, under 26 C.F.R. sections 1.170A-1(e) and 1.170A-7(a)(3) the deduction relating to the cash contributions is disallowed. Likewise, under 26 C.F.R. sections 1.170A-1(e), 1.170A-7(a)(3), and 1.170A-14(g)(3), the easement contribution deductions are disallowed.

To reflect the foregoing,

An appropriate order will be issued.

FOOTNOTES

1 Unless otherwise indicated, all section references are to the Internal Revenue Code (26 U.S.C.; "the Code"), as amended, and all Rule references are to the Tax Court Rules of Practice and Procedure.

2 In January 2010 the parties entered into a stipulation to be bound, by which they agreed that if in this case the Court decides the conditional gift issue in the Graevs' favor, the outcome of some the other issues in this case (chiefly, the valuation of the contributed easement) will follow the outcome of a then-pending case. That case was decided in favor of respondent in July 2010, appealed to the U.S. Court of Appeals for the Second Circuit, vacated and remanded, and decided again in favor of respondent in January 2013. See Scheidelman v. Commissioner, T.C. Memo. 2010-151, vacated and remanded, 682 F.3d 189 (2d Cir. 2012), remanded to T.C. Memo. 2013-18. Decision in that case was entered April 12, 2013, and the time to appeal has not yet expired; but we are able to resolve the issue addressed herein without awaiting the resolution of the Scheidelman issues. We do not resolve here the issue of the Graevs' liability for the penalties, which will be a subject of future proceedings.

3 The burden of proof is generally on the taxpayer, see Rule 142(a)(1), and the submission of a case under Rule 122 does not alter that burden, see Borchers v. Commissioner, 95 T.C. 82, 91 (1990), aff'd, 943 F.2d 22 (8th Cir. 1991). However, the burden of proof can be shifted when the Commissioner's position implicates "new matter" not in the notice of deficiency, see note 8 below, addressing the Graevs' contention about supposed "new matter" in this case.

4 For pre-2004 cases involving facade easements, see Richmond v. United States, 699 F. Supp. 578 (E.D. La. 1988) (upholding partial disallowance of contribution deduction where the taxpayer's valuation of facade easement was found excessive); Satullo v. Commissioner, T.C. Memo. 1993-614 (upholding disallowance of contribution deduction where the facade easement was unenforceable in the year at issue because it had not been recorded, and where a mortgage had not been subordinated to the donee's interest), aff'd without published opinion, 67 F.3d 314 (11th Cir. 1995); Dorsey v. Commissioner, T.C. Memo. 1990-242 (upholding partial disallowance of contribution deduction where the taxpayer's valuation of facade easement was found excessive); Griffin v. Commissioner, T.C. Memo. 1989-130 (same), aff'd, 911 F.2d 1124 (5th Cir. 1990); Losch v. Commissioner, T.C. Memo. 1988-230 (same); and Hilborn v. Commissioner, 85 T.C. 677 (1985) (same). For pre-2004 cases involving conservation easements generally, see Strasburg v. Commissioner, T.C. Memo. 2000-94 (upholding partial disallowance of contribution deductions where the deductions claimed exceeded the taxpayer's pro rata basis in the property and valuation of the easement was found excessive); Fannon v. Commissioner, T.C. Memo. 1986-572 (upholding partial disallowance of contribution deductions where the taxpayer's valuation of scenic easement was found excessive); Akers v. Commissioner, T.C. Memo. 1984-490, aff'd, 799 F.2d 243 (6th Cir.

1986) (same); and Great N. Nekoosa Corp. v. United States, 38 Fed. Cl. 645, 654 (1997) (holding that conservation easements were not exclusively for conservation purposes when the plaintiffs retained the right to extract sand and gravel).

5 The deed recites that it was executed October 11, 2004, but Mr. Graev's signature on the deed was notarized on December 16, 2004, and he delivered it to NAT one day later. NAT's then president, James Kearns, signed the deed on NAT's behalf on December 28, 2004.

6 26 C.F.R. section 1.170-1(e), Income Tax Regs. (1959), provided:

If as of the date of a gift a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an interest passes to or is vested in charity on the date of the gift and the interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable on the date of the gift, the deduction is allowable. The deduction is not allowed in the case of a transfer in trust conveying a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. * * *

7 26 C.F.R. sec. 81.46(a), Estate Tax Regs. (1949), provided:

If as of the date of decedent's death the transfer to charity is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that charity will not take is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of decedent's death and such right or interest would be defeated by the performance of some act or the happening of some event which appeared to have been highly improbable at the time of decedent's death, the deduction is allowable.

The current version of this regulation is in 26 C.F.R. sec. 20.2055-2(b)(1), Estate Tax Regs.

8 In his reply brief, Mr. Graev complains that an IRS argument invoking the perpetuity requirement is "new matter" as to which the IRS should bear the burden of proof under Rule 142(a)(1). We do not believe that the burden of proof affects the resolution of this issue, since the material facts are not actually in dispute, and the outcome is the same no matter which party has the burden. See Dagres v. Commissioner, 136 T.C. 263, 279 (2011). More important, however, the argument that the gifts were subject to a subsequent event — an issue plainly stated in the notice of deficiency — is by its nature an argument that the gifts failed to be perpetual. One reason a conservation easement may fail to be a perpetual gift to the donee, and may thus fail to be deductible, is that it is subject to a condition that creates a non-remote possibility that the easement may revert to the donor. See 26 C.F.R. sec. 1.170A-14(g)(3), Income Tax Regs. The issue of perpetuity is not new matter in this case.

9 We do not address the circumstance in which a hyper-cautious donor conditions his gift on non-disallowance where there is no non-negligible possibility of disallowance.

10 The Graevs also cite an IRS private letter ruling. We decline to consider it, in light of section 6110(k)(3), which provides: "(3) Precedential status. — Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent." See Abdel-Fattah v. Commissioner, 134 T.C. 190, 202 (2010); Vons Cos., Inc. v. United States, 51 Fed. Cl. 1, 12 (2001).

11 For the remainder trust issue we cited 26 C.F.R. section 1.170-1(e) (1961) (see note 6 above for

the 1959 version which was identical to the 1961 regulation); but the limitations now set forth in 26 C.F.R. sections 1.170A-1(e), 1.170A-7(a)(3), and 1.170A-14(g)(3), Income Tax Regs., are equivalent.

12 In Surface Combustion Corp. v. Commissioner, 9 T.C. 631 (1947), aff’d, 181 F.2d 444 (6th Cir. 1950), we held that a provision in an employee trust allowing an employer to reclaim his contributions to the trust if the contributions were determined to be nondeductible did not prevent the employer from deducting his contributions to the trust since the contingency was in the control of the Commissioner. Surface Combustion did not involve charitable contributions, section 170, nor any regulations with a “so remote as to be negligible” standard.

13 Our Opinion in O’Brien v. Commissioner, 46 T.C. 583, 592 (1966), indicates that the Commissioner also cited — but we distinguished — Jones v. United States, 252 F. Supp. 256 (N.D. Ohio 1966), aff’d in part, rev’d in part, 395 F.2d 938 (6th Cir. 1968), a case not involving a tax-treatment-contingent contribution, in which (as we noted) the District Court held that the possibility that a contribution at issue there would be defeated “was not ‘so remote as to be negligible’ under section 1.170-1(e), Income Tax Regs.” This description of Jones includes our only mention of that regulation in our discussion of this issue in the O’Brien Opinion, and our discussion does not address any relation between the regulation and the tax-treatment-contingent deduction at issue in O’Brien.

14 In this argument the Graevs do not distinguish between the contribution of the easement (which was subject to the statutes that the Graevs cite) and the contribution of the cash (which was not). Reliance on New York real estate principles to argue that the side letter is not enforceable as to the cash contribution is misplaced. Even if the side letter were not enforceable as to the easement, for the reasons the Graevs advance, so that they could not require NAT to “remove” it, the Graevs show no reason that the side letter would not be enforceable so as to require the return of the cash.

15 The legislative history of these provisions suggests that they were included in the statutes so that the conservation easements would satisfy the perpetuity requirement of 26 C.F.R. sec. 170A-14(g). See John C. Partigan, “New York’s Conservation Easement Statute: The Property Interest and Its Real Property and Federal Income Tax Consequences”, 49 Albany L. Rev. 430, 452 n.87 (1985).

16 The Commissioner does not dispute that NAT is a “not-for-profit conservation organization” for purposes of New York’s Environmental Conservation Law.

17 Our holding here is distinguishable from Commissioner v. Simmons, 646 F.3d 6, 10 (D.C. Cir. 2011), aff’g T.C. Memo. 2009-208, which looked at similar abandonment language in an easement deed and concluded “deductions cannot be disallowed based upon the remote possibility * * * [the charity] will abandon the easements.” See also Kaufman v. Shulman, 687 F.3d 21, 28 (1st Cir. 2012), aff’g in part, vacating in part, and remanding in part Kaufman v. Commissioner, 136 T.C. 294 (2011), and 134 T.C. 182 (2010). In Commissioner v. Simmons, 646 F.3d at 10, the Court of Appeals for the D.C. Circuit stated that “the Commissioner has not shown the possibility * * * [the charity] will actually abandon its rights is more than negligible. [The charity] * * * has been holding and monitoring easements in the District of Columbia since 1978, yet the Commissioner points to not a single instance of its having abandoned its right to enforce.” In the instant case, however, NAT gave Mr. Graev an explicit, written promise that it would abandon its rights in the easement if certain events occurred. We find nothing to indicate that NAT did not intend to comply with its written promises.

[Report Outlines Changes for IRS To Ensure Accountability, Chart a Path Forward; Immediate Actions, Next Steps Outlined.]

WASHINGTON — Internal Revenue Service Principal Deputy Commissioner Danny Werfel today issued a report outlining new actions and next steps to fix problems uncovered with the IRS' review of tax-exempt applications and improve the wider processes and operations in place at the IRS.

The three-part report covers a wide range of areas Werfel and his leadership team examined during the past month. The report cites actions to hold management accountable and identifies immediate steps to help put the process for approving tax-exempt applications back on track. Werfel also outlines actions needed to protect and improve wider IRS operations, ranging from compliance areas to taxpayer service.

"It is critical that the IRS takes steps to ensure accountability, address the problems uncovered in recent weeks and improve the operations of the IRS to continue to carry out our critical mission on behalf of the public," Werfel said. "We have made a number of changes already, more are in the works and even more will develop as we move forward."

Importantly, the initial IRS review shows no signs of intentional wrongdoing by IRS personnel or involvement by parties outside the IRS in the activities described in the recent TIGTA report. However, the report notes that investigations are ongoing, and that the IRS is committed to a full fact-finding effort to provide the public answers to these and other important questions.

"The IRS is committed to correcting its mistakes, holding people accountable, and establishing control elements that will help us mitigate the risks we face," Werfel said. "This report is a critical first step in the process of restoring trust in this critical institution. We have more work in front of us, but we believe we are on the right track to move forward."

Werfel's report, titled "Charting a Path Forward at the IRS: Initial Assessment and Plan of Action," covers three primary areas:

Accountability. This covers the steps being taken to ensure accountability for the mismanagement described in last month's Treasury Inspector General for Tax Administration (TIGTA) report:

• The report finds that significant management and judgment failures occurred, as outlined in the TIGTA report. These contributed to the inappropriate treatment of taxpayers applying for tax-exempt status.

• To address this, new leadership has been installed across all five executive management levels involved in the chain of command connected to these matters. In addition, the IRS has empaneled an Accountability Review Board to provide recommendations within 60 days (and later as needed) on any additional personnel actions that should be taken.

Fixing the Problems with the Review of Applications for Tax-Exempt Status. This part covers several process improvements underway to ensure that taxpayers are treated appropriately and effectively in the review of applications for tax-exempt status:

The report outlines a new voluntary process to help certain applicants gain fast-track approval to operate as a 501(c)(4) tax-exempt entity if they are being reviewed for advocacy questions and have been in our application backlog for more than 120 days. This self-certification process allows them a streamlined path to tax-exempt status if they certify they will operate within specified limits and thresholds of political and social welfare activities. In addition, the IRS has added new technical and program staff to assist with reviewing 501(c)(4) applications.

The IRS also suspended the use of any “be-on-the-lookout,” or BOLO lists in the application process for tax-exempt status.

Review of IRS Operations and Risks. The report identifies a series of actions to ensure taxpayers that selection criteria across the IRS are appropriate and that taxpayers are aware of how they can seek assistance if they have concerns about the IRS. The report further outlines steps underway to ensure that critical program or operational risks within the IRS are identified early, raised to the right decision-makers and shared timely with key stakeholders.

The report calls for establishing an Enterprise Risk Management Program to provide a common framework for capturing, reporting and addressing risk areas across the IRS. This will improve timeliness in bringing information to the attention of the IRS Commissioner and other IRS leaders as well as key stakeholders to help prevent future instances of inappropriate treatment or mismanagement.

Although there is no current evidence that selection criteria in other IRS organizations is inappropriate, the nature of the problems identified in the tax-exempt application process warrants a review of certain process controls within the IRS. The IRS will initiate a comprehensive, agency-wide review of compliance selection criteria. Results will be shared with the Department of the Treasury, the IRS Oversight Board, and the Chairpersons of the House Ways and Means Committee and the Senate Finance Committee.

The IRS will initiate additional internal and external education and outreach about the role of the National Taxpayer Advocate in assisting taxpayers in resolving problems they encounter with the IRS.

In addition to posting the report on IRS.gov, the IRS will regularly update the progress made on the TIGTA report’s recommendations and provide other developments related to this effort.

GASB Issues Implementation Guide for Pension Plans.

Norwalk, CT, June 27, 2013—The Governmental Accounting Standards Board (GASB) today published an Implementation Guide for the new GASB standards regarding financial reporting for state and local government pension plans. The Guide to Implementation of GASB Statement 67 on Financial Reporting for Pension Plans is an authoritative resource designed to assist preparers and auditors of state and local government pension plan financial reports as they prepare to implement the standards, which are effective for periods beginning after June 15, 2013.

Prepared by the GASB staff, the Implementation Guide answers key questions about putting the new standards into practice. Topics addressed in the Guide include:

- The scope and applicability of GASB Statement No. 67, Financial Reporting for Pension Plans
- The classification of pensions as defined benefit or defined contribution
- The determination of the number of pension plans that should be reported
- The recognition of certain transactions and other events in defined benefit pension plan financial statements
- Note disclosures and required supplementary information
- The calculation of the net pension liability

"During the development and after the issuance of Statement 67, users, preparers, and auditors of pension plan financial reports posed questions to the GASB staff regarding the application of the standards," said GASB Chairman Robert H. Attmore. "This Implementation Guide is written in a question and answer format and provides illustrative examples to assist stakeholders when applying the new standards for pension plan reporting."

Mr. Attmore continued, "We are also pleased to announce that a digital version of the Guide will be the first guide to be offered on the GASB website as a download at no cost. Furthermore, all subsequent guides will be available on the GASB website at no cost moving forward."

A hard copy bound edition of the Guide can be ordered for $46.50 plus shipping by visiting the GASB store, or by calling the GASB Order Department at (800) 748-0659.

An additional implementation guide for GASB Statement No. 68, Accounting and Financial Reporting for Pensions, will be available in early 2014. The provisions in Statement 68 are effective for periods beginning after June 15, 2014.

The Implementation Guide is available at:

http://www.gasb.org/cs/ContentServer?c=Page&pagename=GASB%2FPage%2FGASBSectionPage&cid=1176163026371

SIFMA Compliance & Legal Society San Francisco Regional Seminar.

We cordially invite you to attend the SIFMA Compliance & Legal Society San Francisco Regional Seminar to be held at Charles Schwab on Thursday, August 1st, 2013. This one day seminar will feature presentations by leading securities regulators and industry professionals.

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NYT: A Legal Blow to Sustainable Development.

Lost amid the Supreme Court's high-profile decisions on affirmative action, voting rights and same-sex marriage was another ruling that may turn out to have a profound impact on American society. The court handed down a decision on Tuesday that, in the words of Justice Elena Kagan, will "work a revolution in land-use law."

While that may sound obscure, the decision in Koontz v. St. Johns River Water Management District will result in long-lasting harm to America's communities. That's because the ruling creates a perverse incentive for municipal governments to reject applications from developers rather than attempt to negotiate project designs that might advance both public and private goals — and it makes it hard for communities to get property owners to pay to mitigate any environmental damage they may cause.

The court's 5-to-4 decision, with Justice Samuel A. Alito Jr. writing for the majority, arose from an order issued by a Florida water management district denying an application by Coy A. Koontz Sr. to fill more than three acres of wetlands in order to build a small shopping center. The district made clear that it was willing to grant the permit if Mr. Koontz agreed to reduce the size of the development or spend money on any of a variety of wetlands-restoration projects designed to offset the project's environmental effects. Because Mr. Koontz declined to pursue any of these options, the district denied the permit.

Mr. Koontz, who is now deceased, went to court and claimed that the permit denial constituted a "taking" under two Supreme Court precedents, Nollan v. California Coastal Commission and Dolan v. City of Tigard. These cases established that when the government approved a development subject to certain conditions, like a requirement that a developer dedicate an easement to the public, the conditions would be deemed an appropriation of private property unless the government could show a logical relationship and a "rough proportionality" between the conditions imposed and the projected effects of the development.

The Florida Supreme Court rejected Mr. Koontz's takings argument on two grounds. First, it interpreted Nollan and Dolan as being limited to cases in which the government has issued a permit subject to a condition — not in those in which a permit has been denied. Second, it ruled that Nollan and Dolan applied only when the government's condition took an interest in some tangible property (like demanding an easement, for example), not when a government imposed a generalized requirement on someone to spend money.

In what can fairly be described as a blockbuster decision, the Supreme Court has reversed the Florida court on both points.

Leaving the majority's legal reasoning aside, the Supreme Court's ruling is likely to do some serious real-world damage. As Justice Kagan correctly explains in her dissent, the decision will very likely encourage local government officials to avoid any discussion with developers related to permit conditions that, in the end, might have let both sides find common ground on building projects that are good for the community and environmentally sound. Rather than risk a lawsuit through an attempt at compromise, many municipalities will simply reject development applications outright — or, worse, accept development plans they shouldn't.

"Nothing in the Takings Clause requires that folly," Justice Kagan said. But arguably it does now.

As for the second part of the majority's ruling, that Nollan and Dolan apply to permit conditions requiring the general expenditure of money, that will also have unfortunate consequences. Cities and towns across America routinely attach fees and other payment obligations to permits, for example, to support wetlands mitigation banks, to finance roads, to pay for new schools or to build affordable housing.

While, to be sure, such mandates must be reasonable under the Constitution, the revolutionary and destructive step taken by the court in Koontz is to cast the burden on the government to justify the mandates according to the heightened Nollan-Dolan standard. This is contrary to the traditional court approach of according deference to elected officials and technical experts on issues of regulatory policy. Moreover, this heightened standard will result in a huge number of costly legal challenges to local regulations.

Consider the challenges of waste disposal. Many communities impose development-impact fees on developers if a proposed project would require expanding waste-disposal sites or building new ones. Before Koontz, a developer could raise a constitutional challenge if the charges were unreasonable, but judges typically deferred to local governments in such cases.

After Koontz, developers have a potent new legal tool to challenge such charges because now the legal burden of demonstrating their validity is on the communities themselves.

In the wake of this under-the-radar ruling, the cost of protecting a community from a harmful building project now lies not with the developer but with the local residents and taxpayers. It's hard to fathom that the framers of the Constitution would call this either fairness or justice.

Reuters: Cash Hard to Raise as Fed Jars Credit Markets.

Prospective borrowers ranging from U.S. companies to county governments on Monday shelved a raft of deals to raise new capital or refinance debt as a suddenly uncertain interest rate environment dented demand.

In the municipal bond market, half a dozen deals aimed at raising collectively more than $300 million were postponed, while several companies pulled plans to refinance syndicated bank loans. Corporate bonds, meanwhile, passed a fourth day with no deals brought to market, either in the risky high-yield sector or the safer investment-grade sphere.

Raising capital has been challenging to say the least since last Wednesday when Federal Reserve Chairman Ben Bernanke sent interest rates soaring by outlining a plan to wind down the central bank's massive stimulus program.

Known as quantitative easing and consisting of $85 billion a month in bond purchases, the program was instrumental in a rally of bonds, equities and commodities, and had driven interest rates to record lows. But since Bernanke's comments last week, the yield on the benchmark 10-year U.S. Treasury Note has shot up 37 basis points, briefly touching a two-year high of 2.67 percent on Monday.

“We need to have panic selling (in Treasuries) out of the way and a stable level on the 10-year Treasury,” before the new-issue market can return, said Scott Schulte, senior investment-grade corporate bond syndicate manager at Citigroup.

That needs to be followed by borrowers willing to sell bonds at higher yields than they had to under the Fed’s easy-money regime.

Corporate bonds had been flying off the shelves until recently as companies looked to refinance at record low rates and yield-hungry investors were ready to sign checks. Since Bernanke first floated the notion last month of a pull back from bond buying, corporate bonds have fallen hard and are now down for the year by 3.74 percent on a total return basis, according to the Barclays investment-grade index.

“The level to which investment grade corporate bonds are interest rate sensitive will certainly be an eye-opener to many total return investors when they open up their quarterly statements on June 30,” said Edward Marrinan, head of Royal Bank of Scotland’s US research.

Said CrediCorp Capital CEO Christian Laub: “What we know is that we won’t see cheap financing like we did in the early half of the year.”

MUNI BOND SALES STALL; LOAN REFINANCINGS SHELVED

Municipal issues have also slowed to a crawl, with bond sales worth $331 million postponed on Monday. That brought the total value of deals shelved since mid-June to $2.6 billion.

A steep price drop in the $3.7 trillion municipal bond market has lifted yields on bonds due in 10 and 30 years to levels not seen since 2011.

“Public officials do not want be the ones selling a deal at yields which result to be top of the market,” said a municipal bond analyst who declined to be named. “They prefer to wait for the market to calm down and become more stable before pushing ahead with their sales.”

Loop Capital, a muni bond underwriter, recently cut its estimate for 2013 muni issuance to $360 billion from $400 billion, but Loop Managing Director Chris Mier said they may cut their forecast more if present conditions persist.

Still, the two big munis deal of the week remain on the calendar for now: $1.3 billion each from the state of Illinois and the city of Los Angeles.

The Economist: What Do the Woes of Detroit Mean for Muni Bonds?

Choosing the bleakest statistic from a report issued by Kevyn Orr, Detroit’s emergency manager, on his city’s financial health is like choosing the wettest raindrop in a monsoon. It could be the $1.3 billion general-fund deficit Detroit is forecast to run, absent restructuring, by the 2017 fiscal year. It could be the $200m revenue decline since 2008, the roughly $3.5 billion in unfunded pension liabilities or its $5.7 billion in non-pension retiree liabilities.

On June 14th Mr Orr announced that Detroit would miss a $40m unsecured-bond payment, and proposed a restructuring that would mean some holders of the city’s unsecured debt receiving pennies on the dollar. If creditors reject Mr Orr’s offer bankruptcy looms. Detroit would be the largest-ever American city to go bust, but hardly the first. In recent years issuers of municipal bonds that have filed for Chapter 9 protection from creditors have included Stockton, Vallejo and San Bernardino in California; Central Falls, Rhode Island; Jefferson County, Alabama; and Harrisburg, Pennsylvania. Others have defaulted without going bust. America's $3.7 trillion muni-bond market has long had its doomsayers. Is this their moment?

The situation remains grim. According to the National League of Cities, an advocacy group, American cities in 2012 experienced their sixth straight year of constant-dollar declines in general-fund revenues. Year-on-year sales-tax collections rose modestly in 2012 but income-tax collections fell for the third year in a row. So did property-tax collections, despite a recovery in housing markets; assessed values, which determine property-tax rates, usually lag the market by at least 18 months. Cash reserves have fallen by almost 50% since 2007 to 12.7% of expenditures, their lowest level since 1996. (The picture is a bit rosier for states, which tend to have more flexibility in raising revenue than cities do.)

Borrowing costs are going the wrong way. Municipal-bond yields have been rising in anticipation of the Federal Reserve scaling back its bond-buying. American municipal-bond funds saw billion-dollar outflows during the weeks ending June 5th and June 12th. Some may also be worried by Barack Obama's proposal, released in his budget in April, to limit the tax-exempt status that most municipal bonds enjoy (although getting that passed would require a degree of backbone currently absent from American politics).

None of this means a wave of defaults is around the corner, however. Assured Guaranty, a municipal-bond insurer, has exposure to roughly 11,000 different municipal bonds; it expects to take losses on fewer than 12. The high-profile cases of Detroit and Jefferson County are idiosyncratic. Detroit has been shedding population for years, and the decline of its car industry has destroyed its tax base. The woes of Jefferson County—which this month proposed a plan to emerge from bankruptcy that also involved creditors taking losses—stemmed from a sewer project that stank of corruption and mismanagement.

Bart Mosley, a co-president of Trident Municipal Research, calls these cases "exceptions that prove the rule that state and local-government credits are solid…[and] highlight the extent to which state and local governments have been much more fiscally responsive" than the federal government during the crisis. Mr Mosley points to narrowing yield spreads over the past two years between A-rated and AAA-rated municipal bonds as evidence that fear of default has been priced in.

The concern for the municipal-bond market is less about an imminent deluge of defaults, and more about the lasting precedents set by places like Detroit. Cities and states face huge long-term pressures from health-care costs and pension obligations. Investors are used to seeing governments raise taxes and cut spending to ensure repayment. They are learning that "full faith and credit" has its limits.

Advisors Focusing More on Government Policy.

Government policy is becoming a more prominent topic of conversation between financial advisors and their clients, according to a recent study as well as anecdotal reports — and remarks by the Federal Reserve chairman last week on the future of the Fed's stimulus policy have spurred even more discussions about government policy.

“When Bernanke says what he says, it becomes a top-of-mind topic of discussion for us,” says Paul Tramantano, chief executive of Constellation Wealth Advisors in New York. But Constellation isn’t adjusting portfolios in response, he cautions: “Our clients’ portfolios are positioned the way we want them to be.”

Concerns about government policy ranked second among the most popular topics of conversation — behind portfolio rebalancing but ahead of portfolio performance, retirement concerns and estate planning, according to Russell Investments’ latest quarterly Financial Professional Outlook survey.

And among topics initiated by clients, government policy tied for the top spot with concerns about the stock market, advisors reported.

The increasing concern with government policy “is an interesting shift for advisors,” the Russell report states. “We believe the most likely reason … is interest rates. We believe that as long as the Fed maintains its current interest rate policy, advisors should be prepared to continue having similar conversations with clients.”

While advisors at New York-based Altfest personal Wealth Management generally do not bring up government policy with clients, they welcome the conversation when clients initiate it, says Karen Altfest, co-principal of the firm.

“Sometimes they need to be reassured, and sometimes we have to check the accuracy of what they thought they heard,” Altfest says. “But it’s a good opportunity to listen to them and hear their concerns. They bring up something that’s on their mind like health care which we didn’t hear about before.”

The Russell survey also found that nearly 90% of advisors are optimistic about their ability to attract and retain clients this year, primarily through referrals.

With Few Young Recruits, Advisor Workforce Shrinks.

Despite rankings that say being a financial advisor is one of the best careers, people are leaving the industry faster than they join. Cerulli Associates says U.S. advisors have decreased 1.3% during the past year, and contraction is expected through 2016. The average age of an advisor is 51, and most expect to retire at 68.

There’s a shortage of younger advisors entering the field, and it’s only going to get worse. Firms need to beef up their training programs and explore new sources of talent.

Wendy started out as a sales associate for a wirehouse in the Southeast. After four years in that role, she was encouraged by the advisor she worked for to get licensed as an advisor. She had already established solid relationships with clients and knew she could learn the rest of the business. After working for three years as a junior, Wendy decided to take the clients that she had built on her own, and now eight years later, Wendy has a successful book of business with nearly $150 million in assets under management.

But this scenario is rare in this industry. Several studies have been published warning of the impending shortfall of advisors entering the field, and the growing percentage of baby boomer advisors nearing retirement.

Over the past year, advisor headcount has declined by 1.3 percent, according to Cerulli Associates, due to terminations, retirements and advisors exiting the industry by choice, and Cerulli expects the decline to continue through 2016. Meanwhile, the average age of an advisor was 51 in 2012, with most looking to retire at 68.

Despite the fact that the financial advisor profession is consistently ranked as one of the top career paths, college graduates are reluctant to enter the field because of the high failure rate of those who have gone before them. And for females, despite their natural fit for the job as relationship-oriented multi-taskers, the largely male dominated culture has kept far too many away. According to the CFP Board, not only are women not entering the profession, more are leaving it, possibly because of a lack of network, mentors and sponsors, negative stereotypes, and competing priorities.

Before the financial crisis of 2008, the big firms all offered strong training programs and actively recruited into them. While the big firms are now starting to reinvest in those programs to increase the percentage of successful graduates (historically only 40-50 percent), programs lack the attention and resources required because management does not completely embrace them as fertile ground for growing top talent. In an attempt to mentor younger advisors, management sometimes partners them with senior producers, but many of these junior advisors end up feeling like indentured servants—essentially building someone else's brand and book—not a business of their own.

It is my belief that business-minded, second career professionals—especially women—are an appropriate place to mine for talent. These folks, perhaps a decade older and more seasoned than their newly graduated counterparts, can be CPAs, MBAs, attorneys, etc. They have a natural Rolodex, maturity and life experience. Client sales associates, too, should be nurtured and encouraged to move into advisor positions given their front line support experience, industry knowledge and ability to hit the ground running. But to attract all of these potential candidates, firms need to have better compensation models to incent them, structured mentoring programs and women's networking groups.

While there is a serious advisor shortfall, there is also a deep bench of talent sitting on the industry sidelines. Take Cindy, who started out as a teacher. After teaching for three years, Cindy determined that she wanted to build a business of her own. She had friends who were financial advisors, and she believed that she could transfer many of her skills to that profession, make a far greater living, and build a clientele of professional women. Today, Cindy is in her second decade as a wirehouse advisor with nearly $750 million in AUM. She has a robust support staff, which enables her to focus on her core competencies and spend time with her three children.

Between young people not choosing financial services as a career and firms not having enough young talent to meet their growing needs, the industry has reached a critical point. Let's see if firms answer the call.

Higher Yields May Boost Bond Insurers.

The bond insurance industry is one segment of the municipal market that stands to benefit as interest rates continue to rise.

Assured Guaranty Ltd., one of the two active bond insurers in the municipal market, has already noticed increasing interest in its product in the relatively short period since rates have gone up, according to Robert Tucker, head of investor relations and communications.

“As interest rates rise and credit spreads widen, we would expect an increase in demand for bond insurance as investors become less focused on yield alone and increasingly incorporate the benefits of insurance in their investment decisions,” he said.

The bond insurance industry was all but wiped out during the financial crisis, which left Assured Guaranty as the only active bond insurer for years to follow. At its peak, the industry was responsible for insuring more than half of muni bond issuance in a year. Last year, only 3.5% of new issues carried insurance. Low interest rates, among other limiting factors, have prevailed for the past four years, reducing both investment income for insurers and the amount of absolute spread available for issuers to fund insurance.

Interest rates have finally reversed direction in recent months, taking off Thursday in response to Federal Reserve chairman Ben Barnanke’s comments that hinted the Fed may start tapering its bond purchasing program by the end of the year. Following Thursday’s close, yields on the Municipal Market Data triple-A scale were up 90 basis points in 10-year maturities, and 104 basis points in 30-year maturities since May 1, with much of the increase taking place since June 3.

“Higher rates probably increase our opportunity to save issuers money as a logical consequence of wider spreads between credits,” said Sean McCarthy, managing director and chief executive officer of the newest bond insurance company, Build America Mutual, which launched in July.

“That said, today in any interest rate environment, BAM’s success is primarily driven by providing greater access for small- to medium-sized issuers, who benefit from the name recognition and liquidity the AA/stable guaranty provides.”

National Public Finance Guarantee Corp., MBIA Inc.’s municipal-only insurer, also said rising interest rates would be a positive for bond insurers.

“As rates rise and spreads widen, insurers will be better positioned to create value for more issuers while charging premiums sufficient to achieve an acceptable return on the capital deployed,” said Adam Bergonzi, a managing director at National.

The currently inactive bond insurer is a subsidiary of MBIA Inc. and was formed in 2009 when MBIA separated its municipal bond insurance business from its other, mostly asset-backed business. National has been preparing to re-enter the market, and the company has said it expects to do so sometime in the near future.

“Over a longer period of rising rates, debt buyers can be expected to become increasingly selective, as they will have more options to satisfy their investment goals,” Bergonzi said. “And as the market becomes more discerning over credit, insurance becomes compelling in a greater number of circumstances.”

Until recently, yields had been declining to historic lows, creating a challenging environment for the declining bond insurance industry. With borrowing costs already very low, municipal bond issuers find the bond insurance product — which provides credit enhancement to help issuers save on borrowing costs — less valuable.

In November of 2012, the Bond Buyer 20-bond index — a selection of mostly double-A general obligation bonds maturing in 20 years — dropped to 3.29%. That was its lowest level since Sept. 2, 1965, when it was also 3.29%.

Interest rates ended 2012 lower than they began at 1.72% in the 10-year, and 2.83% in the 30-year. The 20-bond index was at 3.58% as of Dec. 27, slightly down from the beginning of the year, when it was at 3.83%.

“It’s a positive development,” said Alan Schankel, managing director at Janney Capital Markets. “I don’t think there will be an overnight change, or a rush to embrace insurance because rates are a little higher, but in general, it’s a positive point for insurers and one of the things they need going forward to grow their business and grow their market share.”

In assigning ratings to bond insurers, credit rating agencies have cited the low interest rates as a limiting factor in bond insurers’ ability to generate new business.

Standard & Poor’s, for example, has assigned Assured Guaranty a financial strength rating of AA-, saying the company has a strong competitive position and strong capital, but limited business growth prospects due to the low interest rates.

Moody’s Investors Service rates the company lower at A2, also citing the low interest rates, among other factors.

Analysts at Moody’s say the rise in interest rates is a positive sign for the industry, but it also has to overcome other problems.

“There are two primary reasons why new business volume has been so low,” said James Eck, vice president and senior credit officer at Moody’s. “One is the low absolute interest rate environment, which has led some issuers to feel that since they’re able to issue at such low rates, the additional savings from bond insurance either aren’t there, or do not produce meaningful savings. The other potential reason is general investor skepticism of the value proposition.”

Stanislas Rouyer, associate managing director in the financial institutions group at Moody’s, said that the investor skepticism is based on the fact that the industry almost disappeared during the financial crisis and that, until recently, there has only been one active bond insurer.

“Now, with BAM being active, and National possibly re-entering the market, there is more of an industry,” he said. “More players appears to be a good thing for the industry overall. It gives more of a sense of the durability of the product.”

The other issue that causes investor skepticism is the legacy exposures of guarantors. Situations like Detroit remind people of the risks in the industry, Rouyer said. But at the same time, they can also highlight why the product is useful.

Schankel also believes events in Detroit, as well as Jefferson County and other troubled municipalities, will help illustrate the value of bond insurance. He says that time is also a factor that will help the industry to grow.

“The further away we get from 2008 and those bad memories of insurance, I think the better opportunity insurers will have to penetrate the market, at least on the retail level,” he said, adding that he doesn’t think the industry will ever return to the 57% market share it saw in 2005.

Standard & Poor’s analysts said in a July 12 report that the bond insurance industry could see its market share of insured new issues return to 20% to 30% in a “normalized interest-rate environment.”

However, in the current environment, yields aren’t quite there yet.

Matt Fabian, a managing director at Municipal Market Advisors, noted that while yields have increased, they have only risen 1% in the last few months.

“This isn’t nearly what we’re talking about when we say that higher yields would help the insurers,” he said. “Getting back to more ‘normal’ yields, at least for when the insurers had their heyday, might take another 1% or more.”

In addition to a waning investor acceptance, the industry has a few structural factors working against it as well. These include the movement away from direct retail ownership to funds and separately managed accounts, rating recalibration, and the reduction in the use of variable-rate and other products that depended on insurance, Fabian said.

“Lack of issuance, in particular longer fixed rate bond issuance, and the severe downward pressure on underwriting fees” are other limiting factors, he added. “These don’t leave a lot of room to pay an insurer for their services.”

by: TONYA CHIN

NYT: Cost of Public Projects Is Rising, and Pain Will Be Felt for Years.

States and cities across the nation are starting to learn what Wall Street already knows: the days of easy money are coming to an end.

Interest rates have been inching up everywhere, sending America’s vast market for municipal bonds, a crucial source of financing for roads, bridges, schools and more, into its steepest decline since the dark days of the financial crisis in 2008.

For one state, Illinois, the higher interest rates will add up to $130 million over the next 25 years — and that is for just one new borrowing. All told, the interest burden of states and localities is likely to grow by many billions, sapping tax dollars that otherwise might have been spent on public services.

The same concerns about rising rates that have buffeted the world’s stock markets recently have also affected the market for municipal bonds. The muni market, despite a modest rally on Wednesday, is headed for one of its worst months in years.

Much as home mortgage rates are making home buying a bit more costly as they rise, so, too, are the rates at which states and cities borrow money. Public officials — and taxpayers — may feel the effects for years. Perversely, the places with the greatest distress are likely to see their borrowing costs rise most.

Over the last few days Georgia, Philadelphia, the Metropolitan Transportation Authority in New York and others have delayed sales of new bonds, citing the precipitous plunge in prices that is driving up interest rates.

Gov. Pat Quinn of Illinois attributed the extra cost to the state’s failure to shore up its finances, particularly its rickety pension system. Illinois has the lowest credit rating of any state, and as interest rates rise they tend to rise fastest for the weakest borrowers.

“Borrowing money when you’re already in debt doesn’t seem like a good idea to me,” said Felicia Hill, a 44-year-old Chicago woman who wondered how the state could bear the rising cost. “I think it could have waited, when we have bigger problems in Illinois.”

The sell-off in the municipal bond market has followed the general rout in the overall bond market, which was set off when Ben S. Bernanke, the chairman of the Federal Reserve, indicated that the strength of the economic recovery might allow the central bank to pull back on its $85 billion--month bond-buying program earlier than anticipated.

The Fed was not buying municipal bonds, but the market reacted anyway. Investors expected interest rates to rise, and because prices move in the opposite direction, the values of the municipal bonds they already held dropped.

Investors apparently started selling, not wanting to be the last one out. That caused a flood of bond sales. For the week ended June 19, $3.368 billion flowed out of mutual funds that hold tax-exempt municipal bonds, according to the Investment Company Institute. The outflow for the previous week was $3.236 billion.

Such sell-offs tend to hit the municipal bond market hard because it has many individual investors who buy bonds to hold them, either directly or through mutual funds, rather than financial institutions that trade them quickly.

“The mutual fund’s customer has proven to be fickle in these volatile periods, and you get the sticker-shock effect,” said Chris Mauro, the head of municipal bond strategy at RBC Capital Markets. The trend starts to feed off itself and can last for a long time, he said. “As they liquidate, there’s pressure on the mutual funds to raise cash, which puts more selling pressure onto the market.”

Some analysts thought the sell-off was made worse by the actions of Detroit as it flirted with bankruptcy. The city’s emergency manager, Kevyn Orr, proposed inflicting severe losses on its bondholders earlier this month as he struggled to keep the city from declaring what would be the largest municipal bankruptcy in history. That prompted investors to sell Detroit bonds, and raised questions about whether Detroit’s approach could set an example that other distressed cities would follow.

Some local governments that had planned to issue bonds this week decided to wait and see whether the market improved. But Illinois was among those that could not afford to wait. It had been conserving money by delaying road maintenance and the building of new schools.

Abdon Pallasch, an assistant state budget director, cited in particular the risk of delaying reconstruction of the city’s commuter rail system in hopes of obtaining better rates on the bonds, which have a total value of $1.3 billion. He said service had been halted on the Red Line, Chicago’s oldest, inconveniencing 80,000 commuters a day.

Mr. Pallasch said that state finance officers had calculated the state’s $130 million market penalty by comparing the rate Illinois will pay on these bonds with the rates being paid on similar bonds issued by states with AA ratings. That, he said, was Illinois’s credit rating before the state’s pension problems boiled up.

Illinois has shortchanged its pension system for many years and has now fallen so far behind that it cannot catch up without diverting money away from other programs. Governor Quinn has tried several times without success to push pension overhauls through the legislature. Moody’s Investors Service downgraded the state’s credit to A3 in June, soon after one failed legislative effort, and Fitch went to A-, the equivalent in its ranking system.

Although those ratings are the lowest of any state, they are still several notches above junk grade.

Governor Quinn said that the state was paying an average interest rate on the bonds of 5.042

percent. He called on lawmakers to enact pension changes "by July 9, so we can stop the bleeding, prevent future downgrades and jump-start Illinois's economy."

Daniel Berger, senior market strategist for Thomson Reuters Municipal Market Data, said the pension-related downgrades cited by the governor were important factors but not the only ones.

He said that market conditions had driven the interest rate on a typical 10-year municipal bond up by more than one percentage point since the beginning of May. The rate for longer-maturity bonds were more than 1.25 percentage points higher.

"He's ignoring the adverse market conditions," Mr. Berger said.

BY MARY WILLIAMS WALSH

- *Sherman v. City of Atlanta*, in which the Supreme Court of Georgia held that the trial court was required to determine objectors' standing before addressing merits of objections in bond validation hearing and that attorney proffers were insufficient to establish objectors' standing; greatest case name ever!
- *Land of Lincoln Goodwill Industries, Inc. v. PNC Financial Services Group*, in which the District Court upheld a prepayment penalty in tax-exempt economic development revenue bond issuance; one-time interest rate reset did not make this a variable-rate loan.
- *Wagner & Stoll, LLC v. City of Schenectady*, in which the court held that funds paid by landowner to school district under PILOT program constituted "excess taxes" for the purpose of refund owed to landowner subsequent to reassessment of property.
- *City of Los Angeles v. Superior Court*, in which the Supreme Court of California held that employee grievances arising from furlough plan are arbitratable under the MOU between city and its employees.
- MSRB Reminder: Amendments to MSRB Rules G-37 and G-8 Become Effective July 1, 2013.
- IRS: Adequate Written Procedures Needed for Post-Issuance Compliance With Bond Requirements.
- Nonlegal Roles of IRS Attorneys May Waive Attorney-Client Privilege.
- GASB Issues Proposals on Concepts for Measurement of Assets and Liabilities and on the Measurement and Application of Fair Value.
- Internet Seminar on the GFOA's New Program for Small Governments that Prepare Modified Cash Basis Financial Reports.
- More Issuers Contemplate BAB Redemptions.
- This week's issue is jam-packed with rich, muni goodness so we'll let you get on with it. But before we go, please note that hitting a disabled man riding an adult tricycle with a pickup truck might be a public relations problem, but it ain't gross negligence. And finally, this week gave us the greatest case name we may ever see – Sherman v. City of Atlanta. My high school history's a little fuzzy, and frankly I don't give a damn, but I seem to recall that Sherman took a more hands-on approach the last time around.

UNIONS - CALIFORNIA

City of Los Angeles v. Superior Court

Supreme Court of California - June 20, 2013 - P.3d - 2013 WL 3064811

Union petitioned to compel arbitration of over 400 employee grievances arising out of city's plan to furlough its employees. The Superior Court, Los Angeles County, granted the petition. City petitioned for writ of mandate. The Court of Appeal granted petition. City petitioned for review. The Supreme Court granted review, superseding the opinion of the Court of Appeal.

The Supreme Court of California held that:

- Arbitration under memorandum of understanding (MOU) would not involve improper delegation of city's power to set salaries or fix budget;
- Employees' grievances were within arbitration clause of MOU;
- MOU provision authorizing grievances about "practical consequences" of exercises of management rights did not preclude arbitration of grievances about furlough; and
- Ordinance limiting grievance process to disputes "concerning the interpretation or application" of an MOU did not preclude arbitration of grievances about furlough.

Under Myers-Milias-Brown Act (MMBA), once a local government approves an MOU, it becomes a binding and enforceable contract that neither side may change unilaterally.

Arbitration of employee grievances arising out of charter city's plan to furlough its employees, pursuant to arbitration provision of MOU stating that employees "shall be compensated for 40 hours per week at the regular hourly rate for their class and pay grade" would not involve an improper surrender or delegation by the city of its discretionary powers under the charter to set salaries and fix the budget, since the arbitrator's role would be limited to interpreting the MOUs for the purpose of determining whether the furlough program violated the terms of those MOUs.

The existence of an annual budget process does not prohibit a governmental entity from entering into multiyear financial commitments, nor does it provide a justification for avoiding or repudiating such commitments.

Where a collective bargaining agreement provides for arbitration of all disputes pertaining to the meaning, interpretation, and application of the collective bargaining agreement and its provisions, any dispute as to the meaning, interpretation and application of any specific matter covered by the collective bargaining agreement is a matter for arbitration.

TAKINGS - CALIFORNIA

Valerio v. City of San Diego

United States District Court, S.D. California - June 17, 2013 - Slip Copy - 2013 WL 3049126

The principal planner in San Diego's Development Services Department ("DSD") historical resources section approved plaintiff's application to advertise on the side of a building. Plaintiff then entered into a lease agreement with the owner of the building.

DSD subsequently notified plaintiff that DSD was revoking the advertising permit, thereby nullifying Plaintiffs' authorization to proceed with the signage.

Plaintiffs sued the city and others, alleging: (1) violation of Fifth and Fourteenth Amendment right to procedural due process; (2) unlawful taking without just compensation; (3) violation of Fifth and Fourteenth Amendment right to substantive due process; (4) intentional misrepresentation; (5) violation of California Civil Code § 52.1, and requesting injunctive relief.

The district court:

- Denied defendants' motion for judgment with respect to qualified immunity;
- Denied defendants' motion for judgment with respect to plaintiffs' takings claim;
- Denied defendants' motion for judgment with respect to plaintiffs' Fourteenth Amendment due process;
- Denied defendants' motion for judgment with respect to plaintiffs' Fourteenth Amendment substantive due process rights;
- Granted defendants' motion for judgment for immunity from intentional misrepresentation as to the city;
- Denied defendants' motion for immunity from intentional misrepresentation as to DSD planner;
- Denied defendants' motion for judgment with respect to plaintiffs' request for injunctive relief; and
- Granted defendants' motion for judgment with respect to California Civil Code § 52.1.

ZONING - CONNECTICUT

DelGobbo v. Town of Watertown

Appellate Court of Connecticut - June 25, 2013 - A.3d – 2013 WL 2993891

This action, commenced as a petition for a writ of mandamus, arose out of the widening of Guernseytown Road in Watertown, an event that necessitated the reconstruction of the plaintiffs' driveway by the town. The plaintiffs argued that the defendants violated the town zoning regulations in the reconstruction of their driveway and that they are entitled to have those regulations enforced. They sought an order requiring the town to enforce its zoning regulations, essentially against itself, so that their driveway will be reconstructed in such a fashion as to bring it into compliance with existing zoning regulations. The plaintiffs also requested that the court order the zoning enforcement officer to inspect and determine whether the existing driveway is in violation of the zoning ordinances, in contrast to an order that the town reconstruct the driveway so as to bring it into compliance with the current zoning regulations.

Essentially, the plaintiffs were arguing that, although the method employed or the decisions made by the zoning enforcement officer in performing her duties may be discretionary, it is not discretionary that she perform her job; the duty to perform her job is a ministerial one. For that argument to withstand scrutiny, however, the plaintiffs needed to establish that the zoning enforcement officer had a mandatory duty to inspect the plaintiffs' driveway, even in the absence of any prior request from them, to ensure that it complied with the zoning regulations.

Although the plaintiffs argued that the lower court erred in concluding that the actions or inactions of the zoning enforcement officer were discretionary and further erred in concluding that the case was controlled by *Greenfield*, the plaintiffs failed to set forth any law that supports their argument that the zoning enforcement officer had a mandatory duty to inspect and to opine on whether the driveway was in compliance with the zoning regulations. Additionally, the plaintiffs admitted that they requested a writ of mandamus without first having asked the zoning enforcement officer to inspect the driveway.

The appeals court concluded that the plaintiffs failed to demonstrate that the lower court abused its discretion in denying their request for a writ of mandamus. The judgment of the trial court was affirmed.

TORT CLAIMS ACT - DELAWARE

Hanson v. Morton

Supreme Court of Delaware - June 11, 2013 - A.3d - 2013 WL 2480248

Attorney, who was appointed by court to represent indigent parents in guardianship proceeding, sought to withdraw from representation due to lack of professional malpractice insurance coverage.

The Supreme Court of Delaware held that:

- Tort Claims Act provides qualified immunity to attorneys appointed by the Family Court to represent an indigent parent in a child dependency and neglect proceeding, and
- For purposes of rule of professional conduct providing that court-appointed attorney may only withdraw from appointment for good cause, lack of malpractice insurance is not "good cause" to withdraw from court-appointed representation of indigent parent in a child dependency and neglect proceeding.

ZONING and DEVELOPMENT - FLORIDA

Hillcrest Property, LLP v. Pasco County

United States District Court, M.D. Florida, Tampa Division - April 12, 2013 - F.Supp.2d - 24 Fla. L. Weekly Fed. D 33

Property owner filed § 1983 action challenging constitutionality of county's regulatory regime, which required dedication of property within transportation corridor as precondition for development permit.

The District Court held that:

- Owner's claim was ripe;
- Owner's claim was timely;
- Ordinance violated owner's substantive due process rights;
- Ordinance did not violate owner's equal protection rights;
- Ordinance did not violate owner's right of access to courts; and
- Ordinance did not violate owner's right to trial by jury.

County's regulatory regime, which required dedication of property within transportation corridor as precondition for development permit, improperly used police power and was not rationally related to legitimate governmental purpose, and thus violated property owner's substantive due process rights, even though inverse condemnation remedy existed for each landowner subjected to ordinance. Ordinance required county to prove nothing and empowered it to determine just compensation, if any, it would pay, ordinance did not require county to return any unused property to owner, and ordinance discriminated based on economic aspiration.

"Pasco County has enacted an ordinance that effects what, in more plain-spoken times, an informed observer would call a 'land grab,' the manifest purpose of which is to evade the constitutional requirement for 'just compensation,' that is, to grab land for free. Viewed more microscopically, Pasco County's Ordinance designs to accost a citizen as the citizen approaches the government to apply for a development permit, designs to withhold from a citizen the development permit unless the citizen yields to an extortionate demand to relinquish the constitutional right of 'just compensation,' and designs first and foremost to accumulate—for free—land for which a citizen would otherwise receive just compensation.

SECURITY OF COMMUNICATIONS ACT - FLORIDA

Nunn v. State

District Court of Appeal of Florida, Fourth District - June 12, 2013 - So.3d - 2013 WL 2494161

Defendant was convicted of sexual battery on a child under twelve, six counts of lewd and lascivious molestation of a child under twelve, and lewd and lascivious exhibition in the presence of a child under sixteen. Defendant appealed.

The District Court of Appeal held that officer's recording of controlled telephone call was not rendered unlawful under Florida Security of Communications Act when it was discovered that the crimes occurred beyond officer's jurisdiction, as officer had a good faith belief that she was investigating a crime that occurred within her jurisdiction when the call was made.

BONDS - GEORGIA

Sherman v. City of Atlanta

Supreme Court of Georgia - June 17, 2013 - S.E.2d - 2013 WL 2927578

State petitioned for confirmation and validation of issuance of city bond. Objectors sought to intervene, appearing via counsel at the bond validation hearing. Objectors were not personally present at the hearing and no documentary evidence was introduced regarding their residency, as required under Georgia's Revenue Bond Law. The superior court declined to rule on the issue of standing, instead finding no merit to objectors' claims. After a hearing, the superior court entered judgment confirming and validating the bond issuance. Objectors appealed.

The Supreme Court of Georgia held that:

- Trial court was required to determine objectors' standing before addressing merits of objections;
- Evidence was insufficient to establish objectors' standing;
- Objectors lacked standing to appeal.

Courts are not required to take judicial notice of facts establishing a party's standing to participate in a judicial proceeding.

City was not judicially estopped from protesting whether objectors were citizens of state and residents of city, as required to establish objectors' standing to participate in proceedings on petition to validate proposed city bond. Although city had argued in prior non-bond validation case that objector should not be allowed to file emergency motion seeking to prevent the commencement of bond validation proceeding because objector's ability to intervene in bond validation proceeding was an adequate remedy at law, such statement did not require application of judicial estoppel, since objector could intervene in bond proceeding, provided objector properly established his standing.

GOVERNMENTAL IMMUNITY - GEORGIA

Peach County School Dist. v. Austin

Court of Appeals of Georgia - June 20, 2013 - S.E.2d - 2013 WL 3067579

Spectator filed a complaint against school district, superintendent, assistant superintendent, principal of high school, and the Director of Maintenance of schools, seeking recovery for personal injuries allegedly sustained when she fell on a sidewalk as she was leaving a graduation ceremony at high school.

The Court of Appeals held that:

- School district did not waive its sovereign immunity by purchasing liability insurance, and
- Alleged duties of school officials to inspect, maintain and repair school district property were discretionary, and thus, individual school officials were entitled to qualified immunity.

EMINENT DOMAIN - IDAHO

Alpine Village Co. v. City of McCall

Supreme Court of Idaho, Boise - May 2013 Term - June 14, 2013 - P.3d - 2013 WL 2663852

Property owner brought action against city alleging that city's enforcement of ordinance that had been found to be unconstitutional in a separate proceeding effectuated an unlawful taking of property in violation of federal and state constitutions.

The Supreme Court of Idaho held that:

- Notice provision of Idaho Tort Claims Act (ITCA) applied;
- Notice provision of ITCA was not complied with;
- Notice provision of ITCA was procedural, rather than jurisdictional, bar;
- Application of notice provision of ITCA did not violate equal protection;
- Doctrine of quasi-estoppel did not preclude assertion of notice provision of ITCA as defense;
- City's enforcement of ordinance did not constitute a final decision;
- Property owner did not seek compensation for alleged taking through available state procedures; and
- City was entitled to award of appellate attorney fees.

BONDS - ILLINOIS

Land of Lincoln Goodwill Industries, Inc. v. PNC Financial Services Group

United States District Court, C.D. Illinois - June 5, 2013 - Not Reported in F.Supp.2d - 2013 WL 2446375

Under the terms of a Loan Agreement, County issued $2 million in tax exempt economic development revenue bonds and loaned the proceeds to Goodwill to finance a development project for Goodwill. The loan was evidenced by a promissory note executed by Goodwill.

PNC (as a successor entity) funded the transaction by purchasing the Bonds and accepting the assignment of the County's rights under the Loan Agreement and Note.

Goodwill notified PNC that it intended to prepay the indebtedness in full. PNC notified Goodwill that it would have to pay a prepayment charge in excess of $300,000.00 if it chose to prepay the indebtedness.

Goodwill filed an action to seek a declaratory judgment that the prepayment charge provision of the Loan Agreement – § 9.1(b) – did not apply. Goodwill argued that, pursuant to § 9.1(b), the prepayment penalty can only be assessed only against a note that bears interest at a fixed rate, while this was an adjustable rate loan.

For the first ten years of this loan, the principal was to bear interest at the Initial Rate of 4.79% per annum, and for the last ten years, the principal was to bear interest at the Adjusted Rate determined on October 5, 2017. During each of these ten year periods, the principal bears interest at a fixed rate. The court thus concluded that this was indeed a fixed-rate loan.

In addition, the plain meaning of the documents, viewed as a whole, manifested a general intent that Goodwill could prepay at any time subject to a Prepayment Charge.

The court was also not persuaded by the reference to the "Variable" rate on the Form 8038. According to IRS definitions, a variable yield bond issue is any bond issue that is not a fixed yield issue. A fixed yield bond issue is a bond issue whose yield is fixed and determinable on the issue date. This Bond issue did not have a fixed and determinable yield on the issue date because the parties intended that the rate would be subject to change to a percentage to be determined on October 5, 2017, ten years after the issue date. The County, thus, properly indicated on Form 8038 that the yield was variable. The fact that the yield on the Bond issue was variable for IRS purposes, however, did not affect the applicability of § 9.1(b). The "fixed rate" language in § 9.1(b) did not relate to the overall yield of the Bond issue.

EMINENT DOMAIN - IOWA

Hawkeye Land Co. v. City of Coralville

Court of Appeals of Iowa - June 12, 2013 - Slip Copy - 2013 WL 2637411

The city of Coralville's decided to extend an avenue over railroad tracks in order to provide street access to a developing subdivision.

Prior to beginning construction on the street extension, Coralville did not initiate eminent domain proceedings. Instead, the city engaged in negotiations with Heartland Rail Corporation (Heartland) under the belief that Heartland held the rights necessary to approve the street extension over the railroad tracks. An agreement was reached between Coralville and Heartland.

Hawkeye Land Company then filed an application for a permanent injunction to prevent the city Coralville from constructing the street extension over railroad tracks, claiming that it alone had the right to grant certain easements.

Ownership of various rights with respect to the railroad tracks was the point of contention between the parties. Hawkeye and Heartland both claimed to have received ownership rights from the railroad's original owner, Chicago Pacific Corporation (CPC). Heartland claims to have purchased rights from CPC and then granted the rights to operate the rail line to Iowa Interstate while retaining the right to grant certain types of easements, including easements necessary to construct a street over the tracks. Coralville argues it has purchased such an easement. Hawkeye argues it purchased certain rights from CPC, including the right to grant easements for "transportation and transmission systems" by "whatever means," which it argued includes streets. The dispute is: which entity actually possesses the right to grant easements necessary to extend Coral Ridge Avenue over the tracks and whether that entity has been properly compensated. If Hawkeye possesses the necessary rights, the street extension could constitute a taking under the Iowa Constitution requiring eminent domain proceedings and payment to Hawkeye. If Heartland owns the right to grant easements, eminent domain proceedings are not necessary because Coralville has compensated Heartland.

Regardless, the district court denied Hawkeye's application for a permanent injunction, finding that Hawkeye had failed to show it will suffer irreparable harm and has no adequate remedy at law. The district court further found that Hawkeye's rights, if any, can be determined in an action for money damages, as money damages would be the result regardless of what type of action was brought.

PUBLIC HOUSING - LOUISIANA

Housing Authority of New Orleans v. King

Court of Appeal of Louisiana, Fourth Circuit - June 12, 2013 - So.3d - 2012-1372 (La.App. 4 Cir. 6/12/13)

City housing authority filed rule for possession of premises, seeking to evict public housing tenant for violation of lease agreement's "one strike" provision, which authorized termination of the lease for criminal activity.

The Court of Appeal held that housing authority failed to establish by a preponderance of the evidence that tenant violated lease agreement. The housing authority did not attempt to introduce the lease agreement or the police report of the incident that led to tenant's arrest into evidence at the hearing on housing authority's rule for possession of premises, and housing authority introduced no other testimony or documentary evidence. Housing authority offered argument of counsel only. "Argument of counsel, no matter how artful, is not evidence."

EMPLOYMENT - MASSACHUSETTS

Sheriff of Suffolk County v. Jail Officers and Employees of Suffolk County

Supreme Judicial Court of Massachusetts, Suffolk - June 14, 2013 - N.E.2d - 465 Mass. 584

Union filed grievance, alleging that termination, by county sheriff, of employment of county jail officer violated just cause provisions of collective bargaining agreement. Arbitrator found just cause for discipline, but revoked the discharge and ordered six-month suspension without pay, benefits, or accumulation of seniority.

The Supreme Judicial Court ruled that arbitrator's award would not be vacated. Union filed a complaint for contempt, asking that county sheriff be held in contempt for failing to pay back pay pursuant to trial court's judgment confirming arbitrator's award.

Supreme Judicial Court held that:

- It was irrelevant to the issue of mitigation of damages that officer might have been able to further offset his lost earnings by working on a more permanent basis as a restaurant employee, carpenter, or bouncer, and

- County sheriff would not be assessed postjudgment interest.

When one is under contract for personal service, and is discharged, it becomes his duty to dispose of his time in a reasonable way, so as to obtain as large compensation as possible, and to use honest, earnest and intelligent efforts to this end. He cannot voluntarily remain idle and expect to recover the compensation stipulated in the contract from the other party.

General principle of mitigation of damages is applicable to public employees who are reinstated after having been unlawfully discharged.

When an arbitrator's award of reinstatement and repayment for loss of earnings to a terminated employee is silent on the duty to mitigate damages, court should take into consideration whether the issue of mitigation of damages was explicitly raised before the arbitrator or whether any challenge to the award was waived by a failure to raise the issue of mitigation before the arbitrator or, in a timely fashion, to challenge the award as having exceeded the arbitrator's authority.

LAW ENFORCEMENT - MICHIGAN

Amerson v. Township of Waterford

United States District Court, E.D. Michigan, Southern Division - June 13, 2013 - Slip Copy - 2013 WL 2898222

Plaintiff sued the Township of Waterford, Michigan and several officers within its Department of Police, asserting that he sustained a variety of severe head and bodily injuries following his arrest by the individually identified law enforcement officers.

In their motion for summary judgment, the Defendants argued that (1) plaintiff's allegations of municipal liability were not supported by any evidence; and (2) the individual police officers were entitled to a summary judgment.

The court found that, even if the evidence was sufficient to support plaintiff's inadequate training argument, he had failed to present any other competent evidence with regard to the remaining elements of his failure to train or supervise claim, namely, the municipality's deliberate indifference and a causal connection between the municipality's failure to train or supervise and the alleged constitutional violation. Therefore, Waterford Township was entitled to the entry of a summary judgment.

As to the individual claims, the court found that plaintiff had not established that the officers observed the alleged mistreatment and could have prevented the harm from occurring, and therefore had not established that the officers were involved in the alleged constitutional violations. Therefore, the officers were entitled to summary judgment on this claim.

GOVERNMENTAL IMMUNITY - MICHIGAN

Bilan v. Murchie

Court of Appeals of Michigan - June 13, 2013 - Not Reported in N.W.2d - 2013 WL 2662460

In this claim for damages allegedly arising from the negligent operation of an automobile, defendant Monroe Public School District and the School District's employee appealed the trial court's order denying their motion for summary disposition under MCR 2.116(C)(7) and MCR 2.116(C)(10).

In their motion, the School District and employee argued that they were entitled to the dismissal of plaintiff's claims because his claims were barred by governmental immunity.

The appeals court agreed that the trial court erred when it denied employee's motion because no reasonable jury could find that his driving amounted to gross negligence given the undisputed facts.

However, in response to the School District's motion, plaintiff presented evidence that established a question of fact as to whether his injuries resulted from the accident at issue. Accordingly, the trial court did not err when it denied the School District's motion for summary disposition on the ground that plaintiff failed to establish that his injuries resulted from employee's negligent operation of the pickup truck.

SCHOOLS - MISSISSIPPI

Acadia Ins. Co. v. Hinds County School Dist.

United States District Court, S.D. Mississippi, Jackson Division - June 13, 2013 - Slip Copy - 2013 WL 2897931

Parents brought suit against school district, alleging that a teacher had physically abused their daughter.

The court dismissed all of the parents' claims except their 42 U.S.C. § 1983 claim alleging a violation of their substantive due process right to bodily integrity.

The school district's insurer brought a summary judgment motion, asserting that it did not have a duty to defend under the terms of its insurance policy.

Insurer contended that its policy does not cover the abuse at issue, primarily because there is an exclusion for damages based upon bodily injury. The school district disagreed, pointing to language covering "Mental Distress arising out of a Wrongful Employment Practice," which includes a "violation of an individual's civil rights" relating to "negligent evaluation." It argued that because the student's claims that the superintendent and principal's negligent evaluation of her teacher allowed that teacher to abuse her, thereby violating her civil rights and causing mental distress, that the insurer had a duty to defend it in this litigation.

The court sided with the insurer, as the student had not brought a claim for negligent evaluation. Her complaint alleged claims for negligent supervision, assignment, hiring, and retention, but did not mention her teacher's evaluations.

TAX - NEW YORK

Wagner & Stoll, LLC v. City of Schenectady

Supreme Court, Appellate Division, Third Department, New York - June 13, 2013 - N.Y.S.2d - 2013 N.Y. Slip Op. 04413

Plaintiff entered into a payment in lieu of taxes (PILOT) agreement with the City of Schenectady Industrial Development Agency with respect to certain real property that was exempt from real property taxes. Under the PILOT agreement, plaintiff was obligated to make annual payments to various taxing entities, including the Schenectady City School District, and the amount of those payments was based upon the assessment of the property as determined by the assessor of the City of Schenectady. Plaintiff later commenced two RPTL article 7 proceedings, alleging that the assessment was excessive and unequal. Plaintiff provided notice of both petitions to the school district. The school district did not move to intervene or otherwise appear in the proceedings at that time.

The Supreme Court subsequently issued an order memorializing a stipulation between the City and plaintiff to reduce the assessed value of the property. The order further required the City and various other taxing entities, including the school district, to refund to plaintiff "excess taxes" paid. The City thereafter refunded to plaintiff the excess amount that it was paid pursuant to the PILOT agreement The school district, however, refused to make any refund to petitioner asserting, among other things, that "excess taxes" did not include payments made pursuant to the PILOT agreement.

Plaintiff sought an order to direct the school district to refund the excess payments made by plaintiff under the PILOT agreement. The court granted plaintiff's motion and directed the school district to refund to petitioner excess payments made under the PILOT agreement.

UTILITIES - OKLAHOMA

Rural Water Dist. No. 5 Wagoner County, Okla. v. City of Coweta

United States District Court, N.D. Oklahoma - June 11, 2013 - F.Supp.2d - 2013 WL 2557607

Plaintiff, Rural Water District No. 5 of Wagoner County, Oklahoma ("Wagoner–5"), filed suit, claiming that, as a debtor association under 7 U.S.C. § 1926(b), it had the exclusive right to provide water service to all customers within its service area. Wagoner–5 alleged that it acquired a loan from the USDA and that Wagoner–5 therefore has the exclusive right to serve four customers whose service is at issue in this action: Koweta Indian Clinic; Timber Ridge Crossing Subdivision; Celebration at the Woods Subdivision; and Cedar Creek Village (the "disputed customers"). The City of Coweta was providing water service to the disputed customers, and Wagoner–5 alleged that the City's service to those customers violated § 1926(b).

The court disagreed with the City's argument that the boundaries of Wagoner–5 were diminished by City's annexation of the disputed customers, finding it inconsistent with the law construing § 1926(b) to prohibit municipalities from using their annexation of territory within a rural water district as a springboard for providing water service to residents within the district or to limit the water district's services to the annexed area.

The Tenth Circuit previously had held that a rural water district may maintain claims against a municipality for curtailment after the district becomes indebted, even where the municipality began providing service to disputed properties prior to the district's indebtedness.

GOVERNMENTAL IMMUNITY - SOUTH CAROLINA

Health Promotion Specialists, LLC v. South Carolina Bd. of Dentistry

Supreme Court of South Carolina - June 12, 2013 - S.E.2d - 2013 WL 2631075

Company, which provided preventative dental care to children in schools and which employed dental hygienists who contracted with supervising dentists, brought action against Board of Dentistry, seeking damages resulting from Board's regulation imposing restrictions on hygienists' work in schools.

The Supreme Court of South Carolina held that:

- Company was not entitled to amend complaint to add claim for conspiracy to violate South Carolina Unfair Trade Practices Act (SCUTPA);
- Under Tort Claims Act (TCA), Board was immune from company's tort claims; and
- For purposes of SCUTPA, Board's promulgation of emergency regulation did not constitute "trade or commerce."

Under TCA, Board of Dentistry was immune from tort claims that were asserted by company employing dental hygienists and that arose from Board's emergency regulation requiring clinical examination of patient by supervising dentist within 45 days before hygienist could perform preventative dental care for patient in school setting. Board's promulgation of emergency regulation constituted legislative or quasi-legislative act that was protected from liability under TCA.

For purposes of SCUTPA, Board of Dentistry's promulgation of emergency regulation concerning restrictions on dental hygienists' provision of preventative dental care to children in school setting did not constitute "trade or commerce," and thus Board did not violate SCUTPA. Promulgation of regulation did not involve advertisement, sale, or distribution of services or property within business context.

ZONING - TEXAS

Riner v. City of Hunters Creek

Court of Appeals of Texas, Houston (14th Dist.) - June 20, 2013 - S.W.3d - 2013 WL 3087061

Landowners sought to subdivide their property. The local planning and zoning commission disapproved their preliminary plat. Landowners sought declaratory judgment and a writ of mandamus from the district court.

Landowners sought to subdivide their lot into three lots, and to that end, they filed an application for replat with the City's planning and zoning commission (the "Commission). The application included a preliminary plat of the proposed subdivision. The Commission disapproved Landowners' application, and at Landowners' request, issued an order certifying the reasons for its decision. The Landowners did not appeal the decision to the board of adjustment, but instead filed suit against the Commission in a Harris County district court. According to the Landowners, the Commission disapproved the plat primarily because the Commission misconstrued an ordinance specifying the minimum lot size of residential properties and erroneously excluded the area beneath a public-street easement. Landowners asked the trial court to render a declaratory judgment construing the ordinance and stating that all of the Commission's 14 reasons for disapproving the plat were invalid. In the alternative, the Landowners asked the trial court to issue a writ of mandamus compelling the Commission to approve the plat or to conditionally approve it subject to modification.

The Commission specially excepted to the Landowners' live pleadings on the ground that their allegations failed to establish the trial court's subject-matter jurisdiction over the Landowners claims. The trial court sustained the special exceptions and ordered the Landowners to amend their pleadings within fifteen days to show that (a) they have the right to judicial review of the Commission's denial of their application for approval of the preliminary plat, and (b) their claims are ripe for review.

The Landowners did not further amend their pleadings, and after the Commission moved for entry of judgment, the trial court dismissed the Landowners' suit for lack of subject-matter jurisdiction. The appeals court affirmed.

Charitable Contributions of Property: A Broken System Reimagined.

The charitable deduction for property accounts for 25% of all charitable contributions. Given the substantial direct and indirect costs involved, the uncertain benefit to the donee, and the absence of any affirmative policy in favor of property contributions, it is time to reverse the general rule and not allow a charitable deduction for such contributions. This would provide many benefits—increased revenue, improved tax administration, fewer abusive transactions, a simpler and more equitable tax code, and a preference for cash. Exceptions may be warranted, but should be analyzed according to whether the exception provides a measurable benefit to the donee.

This article was originally published in the Harvard Law Journal, Volume 50, at page 263.

The full document is available at:

http://www.urban.org/UploadedPDF/412846-charitable-contributions-of-property.pdf

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MSRB Reminder: Amendments to MSRB Rules G-37 and G-8 Become Effective July 1, 2013.

SEC APPROVES AMENDMENTS TO REQUIRE THE PUBLIC DISCLOSURE OF ADDITIONAL INFORMATION RELATED TO DEALER CONTRIBUTIONS TO BOND BALLOT CAMPAIGNS UNDER MSRB RULES G-37 AND G-8

The Securities and Exchange Commission ("SEC") has approved amendments to MSRB Rules G-37 (on political contributions and prohibitions on municipal securities business) and G-8 (on books and records to be made by dealers) to require the public disclosure of additional information related to broker, dealer and municipal securities dealer ("dealer") contributions to bond ballot campaigns. Specifically, the amendments to Rule G-37 require the public disclosure of additional information related to contributions made by dealers, their municipal finance professionals ("MFPs"), political action committees ("PACs") controlled by the dealer or their MFPs and non-MFP executive officers to bond ballot campaigns and the municipal securities business engaged in by dealers resulting from voter approval of the bond ballot measure to which such contributions relate. The additional information will be required to be reported on revised MSRB Form G-37 and submitted to the MSRB. The amendments to Rule G-8 require dealers to maintain records pertaining to the additional information disclosed under the amendments to Rule G-37. The effective date of the amendments is the start of the second quarter following the date of SEC approval, which is the quarter beginning July 1, 2013.

BACKGROUND

Since February 1, 2010, the MSRB has required public disclosure under Rule G-37 of contributions to bond ballot campaigns made by dealers, their MFPs, dealer-controlled PACs, and their non-MFP executive officers. Dealers are not required to disclose contributions made by MFPs and non-MFP executive officers to a bond ballot campaign for a ballot initiative with respect to which such person is entitled to vote if such contributions, in total, do not exceed $250 per ballot initiative. Rule G-37 also requires dealers to maintain records of certain reportable contributions to bond ballot campaigns pursuant to Rule G-8. The requirements resulted, in part, from industry concerns that certain contributions to bond ballot campaigns could assist dealers with obtaining municipal securities business, as well as the MSRB's concern about the lack of effective public transparency regarding information on bond ballot campaign contributions. The existing Rule G-37 prohibition on engaging in municipal securities business is not triggered by contributions that are made to bond ballot campaigns by dealers, MFPs or their PACs.

The approved amendments to Rule G-37 add greater specificity to the public disclosures relating to contributions made by dealers and dealer personnel to bond ballot campaigns, and any municipal securities business awarded as a result of the corresponding bond ballot measures. Further, access to such information in a centralized format on the MSRB's EMMA website (through Form G-37) will increase the amount of information available to market participants, furthering the goals of market transparency and market integrity. The revisions also will assist the MSRB in its on-going review of Rule G-37 and potential conflicts of interest or other practices that may present challenges to the integrity of the municipal securities market related to the political contributions by dealers and dealer personnel.

SUMMARY OF AMENDMENTS

Rule G-37(e)(i)(B)(2) is amended to provide that, in disclosing the contribution amount made to a bond ballot campaign, the dealer also must include, in the case of in-kind contributions, the value and nature of the goods or services provided, including any ancillary services provided to, on behalf of, or in furtherance of the bond ballot campaign. The amendments also require dealers to disclose the specific date on which such contributions to bond ballot campaigns were made.

Rule G-37(e)(i)(B) is amended to require dealers to disclose the full issuer name and full issue description of any primary offering resulting from voter approval of a bond ballot measure to which a contribution required to be disclosed has been made. Such information is required to be reported in the same calendar quarter in which the closing date for the issuance that was authorized by the bond ballot measure occurred.

The amendments also provide a look-back provision for bond ballot campaign contributions that are made by an MFP or a non-MFP executive officer during the two years prior to an individual becoming an MFP or a non-MFP executive officer of a dealer. The look-back provision limits the additional disclosures required under Rule G-37(e)(i)(B) to those items that would have been required to be disclosed if such individual had been an MFP or a non-MFP executive officer at the time of such contribution. Rule G-37(e)(i)(B) also requires dealers to disclose both the amount and source of any payments or reimbursements related to any bond ballot contribution received by a dealer or its MFPs from any third party.

Rule G-37(g) is amended to expand the definition of "contribution" and create a new term, the "reportable date of selection." The amendments to the definition of "contribution" distinguish between contributions made to an official of an issuer and contributions made to a bond ballot campaign. The term "reportable date of selection" means the specific date on which a dealer is selected, either in writing or orally, to engage in municipal securities business that must be reported on Form G-37.

Finally, conforming amendments to Rule G-8(a)(xvi)(H) and (I) require dealers to maintain records of the supplemental information related to bond ballot campaign contributions that are required to be disclosed on Form G-37 pursuant to the amendments.

The MSRB reminds dealers that the amendments apply only with respect to municipal securities offerings with a sale or issuance date on or after July 1, 2013, the effective date of the amendments. Thus, dealers will not be required to supplement bond ballot campaign disclosures made with respect to offerings that are prior to July 1, 2013. However, dealers must disclose the full issuer name and full issue description of any primary offering with a sale or issuance date on or after July 1, 2013 resulting from voter approval of a bond ballot measure to which a contribution required to be disclosed has been made, even if such contribution was made by the dealer, its MFPs, any dealer controlled PAC, or its non-MFP executive officers prior to July 1, 2013 but on or after February 1, 2010 (the date on which dealers were first required to record and disclose contributions to bond ballot campaigns). The additional disclosures required under the amendments must be submitted to the MSRB no later than the last day of the month following the end of each calendar quarter starting July 1, 2013. Hence, the additional disclosures must first be submitted to the MSRB no later October 31, 2013 for the quarter commencing on July 1, 2013 and ending on September 31, 2013.

Questions about the amendments may be directed to Leslie Carey, Associate General Counsel, at 703-797-6600.

Dealers Like MSRB Retail Order Proposals; MAs Warn Issuers Can Be Exploited.

Dealer groups said Tuesday that they support Municipal Securities Rulemaking Board proposed rule changes on retail order periods, but non-dealer financial advisors warn issuers can be exploited, with underwriters simply determining for them which “retail” investors can buy the bonds in offerings.

The reaction comes after the MSRB filed rule changes with the Securities and Exchange Commission Monday that are designed to ensure underwriters follow issuers’ orders that a certain amount of their bonds be offered to retail investors at the initial offering price.

“The proposed rule change addresses concerns related to retail order periods presented from issuers, dealers and municipal advisors,” the MSRB said in its filing. “Those concerns include the mischaracterization of orders as “retail” and the failure of syndicate managers to disseminate timely notice of the terms and conditions of a retail order period to all dealers, including selling group members.

The board also said that another concern is that pricing information was required but not delivered at all or in time to allow the requesting dealer’s retail customers to determine whether they would like to purchase the bonds.

“To address these concerns, the proposed rule change establishes specific obligations on the senior syndicate manager to disseminate to the syndicate and selling group members detailed information about the terms and conditions of any retail order period,” the board said. “The proposed rule change also requires dealers to capture certain additional information in connection with orders placed under a retail order period to ensure that such orders are from bona fide retail customers."

Bond Dealers of America president and chief executive officer Mike Nicholas said BDA is pleased the MSRB did not develop one definition of retail orders for all issuers because this would have proven costly and unnecessary.

"The BDA believes retail order periods can be beneficial both to the issuer and retail customer as long as issuers are permitted to proscribe how they want dealers to document their compliance with the retail order period, rather than establish a one-size-fits-all dealer mandate that does not provide additional issuer benefit but does add compliance costs by requiring the production of information that is, potentially, not necessary," Nicholas said.

David Cohen, managing editor and associate general counsel at the Securities Industry and Financial Markets Association, said his group had supported moving forward with existing MSRB guidance, such as the board's Rule G-17 on fair dealing.

"Now the MSRB has decided to reorganize some of its interpretive guidance associated with MSRB Rule G-17 into new or revised rules," Cohen said. "Consequently, we support the proposed rule changes to the extent they would protect dealers that follow issuers' instructions and require timely notice of retail order period terms and conditions to all syndicate and selling group members."

National Association of Independent Public Finance Advisors president Jeanine Rodgers Caruso said some issuers could be left vulnerable by the MSRB's proposal.

"Where issuers do not retain municipal advisors, they will likely place an undue amount of trust in their underwriter and will rely upon them to supply a definition of 'retail,' which may result in issuers receiving less favorable sales outcomes than they may otherwise have been able to achieve," said Rodgers Caruso, a muni advisor with Fiscal Advisors and Marketing, Inc.

The board punted on the controversial issue of whether to develop interpretative guidance to its Rules G-17 and R-30 on prices that would have addressed whether underwriters could offer munis at different prices to retail and institutional customers. Some market participants have complained that some underwriters set up two CUSIPs for the same bond, one to be sold to institutional investors at a lower price and one to retail investors at a higher price.

"The comments received on retail order periods and the board's study of such programs does not establish a basis for additional pricing guidance at this time," the MSRB told the SEC. "In particular, the MSRB is mindful that any guidance should be grounded in further study and analysis and should consider the extent to which pricing differentials may affect an issuer's willingness to use a retail order period."

Instead, the MSRB is asking the SEC to approve changes to its Rule G-8 on books and records, G-11 on primary offering practices and G-32.

The board is recommending a two-stage implementation process, with the changes to Rules G-8 and G-11 occurring six months after SEC approval and the changes to Rule G-32 implemented no later than March 31, 2014 or at a later announced date. This longer period would allow the MSRB to design an automated system for dealers to report to the EMMA system.

"These provisions will establish basic protections for issuers and customers and provide additional tools to assist with the administration and examinations of retail order periods," the MSRB said in the filing.

In the proposed changes to Rule G-11, the MSRB wants to define “retail order period” to mean when “going away orders” will be solicited from customers that meet the issuer’s designated eligibility criteria. A going away order means an order for which a customer is already conditionally committed.

The MSRB proposes the senior syndicate manager deliver to other members of the syndicate a written statement of all terms, conditions and pricing information required by the issuer and to obtain the issuer’s approval of the statement. An underwriter must provide the issuer’s information to each dealer with which it has an arrangement with to market the issuer’s securities.

Any dealer placing an order during a retail order period would have to provide certain information, possibly through an electronic order entry system, before the time of formal award of the bonds. This would include, among other things, whether the order met the issuer’s eligibility criteria, whether the order was a going away order and the par amount of the order.

Under the proposed changes to Rule G-8, the syndicate manager for each primary offering must maintain records that show various things such as: the description and aggregate par value of the securities; the name and percentage of participation of each syndicate member; the terms and conditions required by the issuer; all orders received for the purchase of the securities from the syndicate; the dates of the settlement with the issuer and the closing of the account; and a reconciliation of profits and expenses of the account. An underwriter must keep similar records, including for those instances in which it accorded equal or greater priority over other orders to orders for its own account or its related accounts and the specific reason for doing so.

The proposed changes to Rule G-32 requires underwriters to report to EMMA whether a primary offering included a retail order period and the period during which it was conducted.

by: LYNN HUME and KYLE GLAZIER

FINRA Fines Two Firms $62,500 for Muni Rule Violations.

Two broker dealers were fined a total of $62,500 for municipal bond fair pricing and trade reporting violations, while two individuals were fined $35,000 and suspended for violating other muni rules, the Financial Industry Regulatory Authority said Monday.

The sanctions were detailed in FINRA’s just-released monthly disciplinary actions.

RBC Capital Markets, LLC was fined $42,500 and ordered to pay customers $17,870.60 in restitution for violating the Municipal Securities Rulemaking Board’s Rules G-30 on prices and commissions, G-17 on fair-dealing, and G-34 on CUSIP numbers, new issue and market information requirements.

Morgan Stanley Smith Barney LLC was fined $20,000 for violating the MSRB’s Rule G-14 on trade reporting.

Both New York City-based firms neither admitted nor denied the findings but accepted the sanctions. RBC Capital could not be reached for comment. A spokesperson for Morgan Stanley declined to comment.

FINRA said RBC Capital Markets, in 15 transactions between its own account and customers during the second quarter of 2010 and the first quarter of 2011, either purchased or sold munis at aggregate prices that were not fair and reasonable "taking into consideration all relevant factors, including the best judgment of the broker … as to the fair market value of the securities at the time of the transaction," as well as expenses and the fact that the dealer is entitled to a profit.

In exhibits included in enforcement documents, FINRA found RBC owed a customer $3,570 for selling 100 of 2005 Metropolitan Transportation Authority revenue bonds at 104.958 in April 2010. It owed another customer $2,983.50 for buying 85 of Maryland Health and Higher Educational Facilities Authority's 1998 revenue bonds at 89.100. These were the highest amounts of restitution owed to customers.

FINRA also found that the firm, during the second quarter of 2011, failed to submit to the MSRB accurate interest rate reset dates for variable rate demand obligations in 462 instances. The firm also failed to provide information on the results of auctions for auction rate securities and information on interest rate resets within the required time frame in 94 instances.

FINRA fined Morgan Stanley $20,000 for failing to report correct trade information to the MSRB. The self-regulator said that, during the fourth quarter of 2010 the firm reported 44 trades, when they were interdealer deliveries of securities or "step outs" and not reportable interdealer trades. During the third quarter of 2011, the firm report 27 trades that were "step outs" and should not have been reported as interdealer trades, FINRA said.

FINRA fined Richard Lee Reno, Sr., who resides in Beaver Falls, Pa. and was the chief compliance officer of Fortune Financial, $30,000 and suspended him for a year for conducting business in Section 529 college savings plans without proper qualification and without a properly qualified principal, in violation of MSRB Rules G-2 and G-3 on standards and classifications. In addition, the firm failed to have a supervisory system for such municipal securities, in violation of Rule G-27, FINRA said.

These are college savings plans set up under Section 527 of the Internal Revenue Code to allow parents or others to invest on a tax-advantaged basis to save for the costs of college for a beneficiary. The sanctions are a "default decision" against Reno, FINRA said, because he never answered the self-regulator's complaint. Reno is not currently associated with any firm.

FINRA fined Joseph H. Johnson from Sayville, N.Y. $5,000 and suspended him for 30 days for engaging in unsuitable short-term trading and switching municipal bond closed-end funds in customers' joint brokerage account. According to FINRA, Johnson recommended a joint account purchase shares of closed-end muni bond funds with long-term, conservative objectives and then sold the shares in a relatively short period of time. The joint account suffered losses of about $25,000 and was charged about $14,000 in commissions.

by: LYNN HUME

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SEC to Seek Admissions in Some Settlements: White

(Reuters) – Securities regulators are going to try to extract admissions of wrongdoing from defendants in some of their settlements, a move that could ultimately force more cases to go to trial, Securities and Exchange Commission Chair Mary Jo White said Tuesday.

The announcement from White marks a departure from the typical practice at the SEC and many other civil federal regulatory agencies of allowing defendants to settle cases without admitting or denying the charges.

That practice has come under scrutiny following the financial crisis, leading some federal judges to challenge or strike down proposed settlements with defendants.

"I have reviewed the policy," White said at the annual "CFO Network" event hosted in Washington by the Wall Street Journal.

"We are going to in certain cases be seeking admissions going forward. I think … public accountability in particular kinds of cases can be quite important and if we don't get them, then we litigate them."

White's planned changes to settlement policy come as the SEC is awaiting a critical decision from a New York appeals court after U.S. District Judge Jed Rakoff declined to approve a proposed $285 million settlement with Citigroup Inc over whether the bank misled investors during the financial crisis.

White told reporters on the sidelines of the event that people should not interpret the change as a criticism of the settlement policy and in fact a "majority" of cases will still likely be settled with defendants neither admitting nor denying any wrongdoing.

"This is not a criticism of the past practice and having 'no admit, no deny' settlement protocols in your arsenal as a civil enforcement agency … (is) critically important to maintain," she said.

She added that cases will need to meet certain criteria in order for the SEC to seek admissions. Those include cases where there was "widespread harm to investors" or "egregious intentional misconduct," she said.

Rakoff, who has been arguably the most vocal about the SEC's settlement policy, declined to comment on the changes White announced.

NYT: S.E.C. Has a Message for Firms Not Used to Admitting Guilt.

The days of cop-out settlements in big securities cases may be waning.

In a departure from long-established practice, the recently confirmed chairwoman of the Securities and Exchange Commission, Mary Jo White, said this week that defendants would no longer be allowed to settle some cases while "neither admitting nor denying" wrongdoing.

"In the interest of public accountability, you need admissions" in some cases, Ms. White told me. "Defendants are going to have to own up to their conduct on the public record," she said. "This will help with deterrence, and it's a matter of strengthening our hand in terms of enforcement."

In a memo to the S.E.C. enforcement staff announcing the new policy on Monday, the agency's co-leaders of enforcement, Andrew Ceresney and George Canellos, said there might be cases that "justify requiring the defendant's admission of allegations in our complaint or other acknowledgment of the alleged misconduct as part of any settlement."

They added, "Should we determine that admissions or other acknowledgment of misconduct are critical, we would require such admissions or acknowledgment, or, if the defendants refuse, litigate the case."

Ms. White said that most cases would still be settled under the prevailing "neither admit nor deny" standard, which, she said, has been effective at encouraging defendants to settle and speeding relief to victims.

The policy change follows years of criticism that the S.E.C. has been too lenient, especially with the large institutions that were at the center of the financial crisis. Bank of America, Goldman Sachs, Citigroup and JPMorgan Chase were among the defendants that settled charges related to the financial crisis while neither admitting nor denying guilt, although Goldman was required to admit that its marketing materials were incomplete.

That this approach became such a heated public issue is in large part because of the provocative efforts of Judge Jed S. Rakoff of Federal District Court, who has twice threatened to derail settlements with large financial institutions that neither admitted nor denied the government's allegations.

In late 2011, he ruled that he couldn't assess the fairness of the agency's settlement with Citigroup in a complex mortgage case without knowing what, if anything, Citigroup had actually done. In his ruling, he said that settling with defendants who neither admit nor deny the allegations is a policy "hallowed by history but not by reason."

He described the settlement, which was for $285 million, as "pocket change" for a giant bank like Citigroup. Other judges have followed Judge Rakoff's lead, and an appeal of his Citigroup ruling is pending before the Court of Appeals for the Second Circuit.

The new policy would seem to vindicate Judge Rakoff, at least in spirit, but Ms. White said the decision was rooted in her experience as United States attorney in New York, where defendants in criminal cases are almost always required either to enter a guilty plea or go to trial.

"Judge Rakoff and other judges put this issue more in the public eye, but it wasn't his comments that precipitated the change," she said. "I've lived with this issue for a very long time, and I decided it was something that we should review, and that could strengthen the S.E.C.'s enforcement hand." (Judge Rakoff, who is presiding over a trial in Fresno, Calif., said he couldn't comment, citing the appeal of his Citigroup ruling.)

Those concerned that Ms. White, who before her confirmation as chairwoman of the S.E.C. was head of the litigation department at the prominent corporate law firm Debevoise & Plimpton, might be too cozy with the big banks and corporations that were formerly her clients, can breathe easier. Even some of the S.E.C.'s harshest critics were at least somewhat mollified.

"It's an important step in the right direction," said John Coffee, a professor at Columbia Law School and a vocal critic of S.E.C. settlements he deems too lenient. "There's clearly a public hunger for accountability. Mary Jo White has shown she is sensitive to this."

Ms. White agreed. "There's no question I share the desire for more accountability in cases where that is warranted," she said. "I do think there are situations where public accountability is particularly important, and that will be our focus. I don’t want to overstate this — no admit, no deny will still be the way most cases are resolved — but I think it’s an important change.”

There’s little doubt that extracting admissions of wrongdoing gives the S.E.C. enormous new leverage, and not just because defendants want to avoid the damage to their reputation that comes with admitting misconduct. Any admission is likely to be seized upon by private litigants in civil lawsuits, including class actions, with potentially devastating financial consequences.

“If they admit culpability to the S.E.C., plaintiffs will cite that in their cases, and that could mean hundred of millions or billions in damages,” Professor Coffee said. “It’s not just the stigma they’re worried about.”

Those concerned that the S.E.C. already has too much power, including many corporate defense lawyers, were critical.

“I don’t like this at all,” said Brad Karp, a litigator and chairman of Paul, Weiss, Rifkind, Wharton & Garrison who represented Citigroup in its settlement talks with the S.E.C. “It gives them enormous leverage. A financial institution cannot fight a primary regulator and win. They have you. They have complete leverage over you. Even if you fight and win over a year, the damage will outweigh any litigation result.”

But Ms. White’s emphasis on public accountability suggests that she sees admissions of guilt as far more than a bargaining chip to extract bigger settlements. In the type of prominent cases cited by the enforcement staff, the S.E.C. may be unwilling to negotiate over an admission of wrongdoing and will force defendants to go to trial.

That could cut two ways. Some corporate defendants have settled cases, even when they believed they were innocent, to avoid the cloud of litigation, and treated any fines simply as a cost of doing business. Now, if the S.E.C. takes a case to trial, it will be forced to prove its case.

“If they take a hard line where admissions are an inevitable cost of resolving the case, it will force defendants to trial,” Mr. Karp said. Defendants will “try to find every way possible to avoid that outcome. If they can negotiate around it, there will be early settlements. But if not, they’ll go to trial.”

Citigroup has said that if Judge Rakoff’s ruling is upheld and its settlement is overturned, it will go to trial rather than admit wrongdoing.

Ms. White said that “our aim is to apply this policy in appropriate cases, and we’ll do this in the public interest.” She continued: “Will this lead to more cases going to trial? It’s hard to say going in, but it might. We have to be prepared to go to trial, and we have to make people believe we’re prepared.”

That may be a tall order. Defense lawyers and judges have raised questions about the S.E.C.’s trial competence in complex cases. The S.E.C. responded that of its last 11 cases that went to trial, it prevailed in eight.

An important test of that litigation capacity is likely to come next month, when Fabrice Tourre, a former Goldman Sachs trader who is accused of misleading clients in a complex mortgage deal, is scheduled to go on trial.

Exactly which cases, and how many, will result in admissions of wrongdoing remain to be seen.

“It will be very interesting to see how this plays out in six months or a year,” Mr. Karp said.

The S.E.C. memo cites three criteria: “misconduct that harmed large numbers of investors or placed investors or the market at risk of potentially serious harm”; “egregious intentional misconduct”; or “when the defendant engaged in unlawful obstruction of the commission’s investigative processes.”

Relatively few of the financial crisis cases, including the big mortgage fraud cases settled by Citigroup, JPMorgan and Goldman Sachs, would seem to meet those criteria, because the purported misconduct wasn’t that egregious, the evidence in some cases was ambiguous and the victims were limited to a few sophisticated financial institutions rather than large numbers of the investing public.

Ms. White declined to comment on any specific cases, but said: “No one case precipitated this. From this point forward, we’ll be looking for appropriate cases in which to apply the policy. Most will still be resolved on a no admit, no deny basis. But we’ll be scrutinizing this.”

Professor Coffee said the agency should go even further, by identifying and holding more individuals responsible.

Still, he said, “You have to give Mary Jo credit: She has shown she is less tone deaf” to public demands for accountability. “The S.E.C. may have to bring fewer cases and pursue them harder,” he added. “But that could be a good thing.”

Reuters: FINRA Reviewing Brokerages' Use of Social Media.

Wall Street’s Financial Industry Regulatory Authority is looking at how brokerage firms supervise their use of communication outlets such as Facebook, Twitter and LinkedIn, the industry-funded regulator said.

FINRA, which conducts periodic “sweeps,” or targeted checks on Wall Street brokerages, sent out letters to firms earlier this month requesting information about their use and monitoring of social media communications for the companies and individual employees.

The letter, which FINRA posted to its website on Monday, included requests for information such as how firms monitor whether their use of social media complies with industry rules.

FINRA also asked for specific data such as the URLs for each social media site used by firms and the identity of all individuals who post or update content of those sites.

“Everyone is looking at social media these days,” said Francis Curran, a New York-based lawyer with McCormick & O’Brien LLP, adding that FINRA’s issuance of the letter is reflective of a broader industry interest in the use of social media.

Firms use social media for purposes such as marketing, communications and client outreach, but they have to be careful not to breach rules concerning advising and making recommendations for clients.

FINRA published an initial social media regulatory notice in January 2010, providing guidance on the industry’s use of blogs and social media networking sites, “so it makes sense to incorporate social media reviews into our routine surveillance,” FINRA spokesman George Smaragdis said.

In its letter, FINRA also requested a list of the firms' top 20 producing advisers who used social media for business purposes to interact with clients between Feb. 4 through May 4, including the dollar amount of sales made and commissions earned during that period.

The Wall Street watchdog regularly issues "targeted examination letters" to gather information about the industry's response to certain regulations. The number of firms included in the sweeps can vary from a handful to dozens.

FINRA did not disclose the number of firms to which the letters were sent.

"They want to be sure the representatives and firms are complying with various communications," Curran said. "You really have firms running the gamut, where they absolutely don't want registered representatives doing anything on Twitter versus other firms that are trying to embrace the communication without creating problems for FINRA or the SEC."

MSRB Releases "What to Expect" Videos for Municipal Bond Investors.

The Municipal Securities Rulemaking Board (MSRB) today released new educational videos for municipal securities investors about what they should expect from their brokers when investing in the municipal securities market. Designed to easily communicate important concepts, the videos focus on the key obligations of brokers when engaging in municipal securities transactions. The videos are a key addition to the MSRB's Investor Toolkit, an online resource to equip investors with basic information to successfully navigate the municipal securities market.

Investors should also always understand the costs and risks associated with investing in municipal securities. The Investor Toolkit also includes Evaluating a Municipal Bond's Interest Rate Risk, which addresses how a municipal bond's value can fluctuate due to changes in interest rates and What to Know When Selling a Municipal Bond Prior to Maturity which reminds investors what they should consider when selling their municipal securities.

"The MSRB is committed to continually providing investors with access to objective resources to help them understand how the municipal market works," said MSRB Executive Director Lynnette Kelly. "We hope the additions to the Investor Toolkit will provide investors with information that previously was difficult to obtain in one place."

Highlights of the MSRB's Investor Toolkit include:

- Getting started when investing in municipal securities
- Learning more about the municipal securities market
- Using the EMMA® website

http://www.msrb.org/Municipal-Bond-Market/Investor-Resources/Investor-Toolkit.aspx

http://www.msrb.org/msrb1/EMMA/pdfs/Evaluating-Interest-Rate-Risk.pdf

http://www.msrb.org/msrb1/EMMA/pdfs/Selling-Before-Maturity.pdf

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Adequate Written Procedures Needed for Post-Issuance Compliance With Bond Requirements.

Issuers of tax-exempt bonds should maintain adequate written procedures to ensure continued compliance with the tax rules after the bonds are issued, panelists at a program on post-issuance compliance said June 21.

Christopher Woodin, a senior tax law specialist in the IRS tax-exempt bonds unit, said issuers have a fiduciary responsibility to look after bondholders' best interests. "As an issuer . . . you have to make sure that those bonds remain in compliance with the tax-exempt bond rules," he said at the American Institute of Certified Public Accountants Not-for-Profit Industry Conference in Washington. One way to do that is to adopt and implement written procedures for meeting the requirements "long after the bonds have been issued," he said.

Edward J. Jennings, tax director at the University of Michigan, agreed. "The IRS is looking for a written tax policy as part of due diligence," he said. "They're looking for more information from you." He added that a tax certificate, despite its discussion of arbitrage, private business use, and other areas of concern to the IRS, is not sufficient.

Woodin said the IRS is working on language in the Internal Revenue Manual that will tell revenue agents what to look for when determining whether an issuer's written procedures are adequate. "That's not a safe harbor and won't necessarily ensure that we would consider the procedures that were prepared adequate," he explained. "But at least it gives you some level of guidance to know at least what our examiners are looking at and what they need to see to say that a written procedure is adequate."

It is much easier to resolve a post-issuance compliance problem through the IRS's voluntary closing agreement program (VCAP) than by having a problem uncovered during an examination, which could result in higher penalties and taxability of the bonds, Woodin said. "With the VCAP program we try to work with issuers to come to some resolution that will work for you but does recognize that there is a violation," he said.

Woodin also discussed the IRS's market segment examinations of exempt bonds, explaining that the agency wants to look at the segments every three years through examinations tailored to each segment. Some segments are advance refundings, section 501(c)(3) bonds, exempt facility bonds, student loan bonds, student construction bonds, and Build America Bonds.

Woodin also announced that Clifford Gannett, the longtime director of the tax-exempt bonds unit, is retiring. No replacement has been named.

by Fred Stokeld

Nonlegal Roles of IRS Attorneys May Waive Attorney-Client Privilege.

A federal district court recently held that a senior counsel within the IRS Large Business and International Division was not acting as a legal adviser and that some documentation therefore wasn't protected from discovery by the attorney-client privilege.

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wasn't protected from discovery by the attorney-client privilege.

A December 13, 2012, order in Kearney Partners Funds LLC v. United States, No. 153-10, by the U.S. District Court for the Middle District of Florida reviewed documents sent between an LB&I senior counsel and field agents. The taxpayer had asked the court to compel the IRS to produce the documents on the ground that the materials were not subject to the attorney-client privilege because the government attorney was "simply another IRS employee working on the case and not counsel."

Although noting that the IRS attorney was a counsel representative to the LB&I issue management team overseeing the alleged abusive transaction, the court rejected the government's argument that the privilege applied because the attorney was counsel of record in Tax Court cases involving the shelter issue and had worked on other cases involving the same taxpayers. After an in camera review of the documents, the district court held that the government "does not assert that the documents reveal protected mental impressions, trial strategy, or legal advice," and that consequently, it did not "find good cause to support a claim for the attorney client privilege."

A February 4 court order clarifying the previous order reiterated that documents written by the IRS attorney addressed "factual issues" in a case and were "not addressing specific legal advice." The court found that the documents at issue in a discovery challenge were "merely communications" and "not specified confidential legal advice" subject to the attorney-client privilege.

"Merely because [the senior counsel] is an attorney is not sufficient grounds to impose the attorney-client privilege on her communications," the court said in the additional order.

Robin L. Greenhouse of McDermott Will & Emery said the district court decision points out that the increasing integration of LB&I counsel into the exam process is expected to affect the application of the attorney-client privilege to claims of protection from discovery by the government. "Frequently, IRS attorneys have dual roles, providing both legal advice but also acting as an examiner in drafting information document requests, interviewing witnesses, and preparing the notice of proposed adjustments," she said. "As the court in Kearney Partners found, in those circumstances it is difficult to ascertain whether an attorney was acting as a lawyer or part of an exam team."

The district court's decision is important because LB&I counsel have been increasingly acting in this dual capacity, particularly in transfer pricing cases, said Greenhouse. Consequently, "the court's opinion confirms that LB&I's counsel staffing structure could adversely impact its ability to claim privilege for work they are doing," she said.

The normal presumption is that outside counsel are providing legal advice to a client, but there is no presumption for in-house counsel because in-house frequently has both legal and nonlegal responsibilities, Greenhouse said. "Here the role of IRS LB&I counsel makes it difficult to draw lines, and thus their communications should be closely scrutinized to determine if the attorney-client privilege protection applies," she said.

The litigation in Kearney Partners has covered several court venues and yielded interesting tidbits on how judges continue to evaluate privilege issues arising out of tax shelter transactions. Like in many other cases arising from transactions the IRS viewed as abusive, the government pursued a taxpayer who used partnership forms to artificially generate capital losses to offset significant gains. After the audit, the IRS made proposed adjustments disallowing the taxpayer's claimed loss, which the taxpayer challenged in federal district court. During the litigation, the IRS issued a subpoena to the taxpayer's law firm seeking the production of documents related to the investment structure used in the shelter.

The law firm objected to the production of some of the documents, claiming attorney-client, work product, and section 7525 tax practitioner privileges. In an action brought by the government to compel production, Kearney Partners Funds LLC v. United States, No. 11-4075, a magistrate judge for the U.S. District Court of the District of New Jersey held that the documents were protected by the attorney-client and work product privileges. The magistrate's rationale under the work product doctrine, if it is upheld on appeal, could expand the privilege's scope.

In construing the application of the attorney-client privilege, the magistrate found that the taxpayer's adviser was providing "legal and tax advice pertaining to the transactions undertaken" by the taxpayer, including "the possibility of litigation arising out of the transactions," and therefore that the privilege applied to the communications. The magistrate also held that the adviser hadn't waived the taxpayer's privilege.

Of substantial interest to tax practitioners are the magistrate judge's thoughts on work product. After an in camera review of the contested documents, the magistrate held that the legal evaluation of the taxpayer's proposed investment scheme qualified for work product protection because the documents were prepared in anticipation of possible litigation with the IRS.

"The motivating purpose behind the creation of the Communications was to aid in future litigation," the magistrate wrote, adding that "it is clear that the Communications were intended to inform [the taxpayer] about the complexity of the proposed investment that could lead to legal exposure because of its aggressive nature."

The government appealed the magistrate's opinion and order regarding the motion to compel, but only concerning the attorney-client privilege, leaving the work product portion unchallenged. The district court upheld the magistrate's decision.

Other courts have steadfastly resisted the notion of pre-litigation advice receiving work product protection. In Textron Inc. et al. v. United States, No. 09-750, the full First Circuit held that the work product privilege extends only to documents prepared for use in litigation, rather than documents created to comply with financial reporting rules. The en banc opinion reversed an original First Circuit panel that had upheld a federal district court's decision that the workpapers at issue were protected from disclosure because the documents had been prepared in anticipation of litigation.

However, in Regions Financial Corp. et al. v. United States, No. 2:06-CV-00895, the district court held that analyzing a listed transaction is much more closely connected to litigation than preparing a tax return, and thus the work product doctrine applies. The court stated that the "contested documents contain precisely the kind of legal analysis that the work product doctrine exists to protect." While the documents may have had some utility outside litigation, "they would not have been created were Regions not primarily concerned with litigating with the IRS" regarding the listed transaction, the court wrote.

The problem for taxpayers seems to be that while district courts have sometimes accepted the rationale that tax planning documents can be subject to the work product privilege, circuit courts have yet to uphold those conclusions. The Eleventh Circuit dismissed the government's appeal in Regions Financial after the IRS settled with the taxpayer, making the workpaper issue moot.

Most recently, in a May 22 order , the Florida district court addressed the added issue of judicial review of penalty assertions by the government in light of an IRS announcement offering penalty waiver for taxpayer disclosure of participation in the specified tax shelter. The taxpayer sought summary judgment on its claim that accuracy-related penalties should be waived for compliance with Announcement 2002-2, while the IRS argued that the court lacked subject matter jurisdiction on the issue. While the announcement established internal agency rules that lacked the force and effect of law, the court held that the IRS pronouncement was "an agency-wide directive designed to confer important benefits to taxpayers."

Because the announcement set forth a uniform rule of conduct by IRS personnel and was meant to induce taxpayers to disclose their involvement in tax shelters in exchange for the waiver of penalties, the court stated that the IRS "failed to observe self-imposed limits upon the exercise of its discretion which invited reliance upon such limitations." The use of "will" in the announcement's language regarding the waiver of penalties for properly disclosed taxpayer participation "indicates an intent to be bound," the court wrote. Consequently, it was proper under the Administrative Procedure Act for the court to review the taxpayer's disclosure for compliance with the announcement's terms.

However, the court rejected the taxpayer's argument that an LB&I directive on penalty imposition required IRS compliance in order to sustain a penalty. The IRS memo directed agents to obtain approval from the director of field operations in order to impose accuracy-related penalties, but in this case the decision to deny penalty relief to the taxpayer was made by chief counsel. The court held that the strictly internal procedure outlined in the memo was not subject to judicial review, but rather was a nonbinding rule that did not confer rights on taxpayers. That the IRS deviated from a "benign procedure for administering the disclosure process" did not deprive the taxpayers of a due process, the court wrote.

Thomas D. Sykes of Gould & Ratner LLP said the court's discussion of Announcement 2002-2 was "careful, balanced, and not obviously flawed," noting that public IRS pronouncements like announcements are often relied on by taxpayers.

Sykes said it was understandable that the government would, as a threshold matter, argue that a court lacks the jurisdiction or authority to review an IRS decision not to honor the terms of an IRS announcement. Jurisdictional analysis is highly formalistic, and the executive branch tends to try to protect its prerogatives from the other branches, although the role of the Administrative Procedure Act in the review of IRS actions is still being developed by the courts, he said.

An unanswered question is why the IRS sought to impose penalties despite the timely disclosure it had invited under Announcement 2002-2, Sykes said. It is one thing if there were extraordinary circumstances behind the IRS's refusal to waive penalties, but "if the IRS is backing away from its long-standing policy of honoring resolution arrangements that do not amount to a closing agreement, then that is a worrisome development," he said.

The IRS frequently relies on an agreement procedure to close cases that isn't technically binding upon the government, and yet it has an established policy of honoring those agreements, Sykes said. "For decades, Forms 870-AD have been used far more often than closing agreements to memorialize settlements reached between the IRS and a taxpayer, and yet that form is not technically binding upon the IRS because they are generally executed by IRS officials who lack the settlement authority that is required for a closing agreement — the exclusive means prescribed by the code for settling tax disputes," he said. "Nonetheless, the IRS will seek to enforce the terms of a Form 870-AD against a taxpayer, using an equitable estoppel theory."

Sykes said that when he worked for the Justice Department Tax Division, there was a policy that the government would honor the terms of Forms 870-AD "in the absence of fraud or mutual mistake, even though those forms were not technically binding upon the IRS and even though equitable estoppel is a legal doctrine that only rarely, if at all, can be applied against the government." Now that the government has lost the threshold jurisdictional argument over whether IRS decisions made under an announcement are reviewable, “one hopes that government attorneys will give the policy issues — similar to those involved in the deliberations back in the 1980s over the respect to be given to Forms 870-AD — careful consideration,” he said.

Miri Forster, the national leader for tax controversy at Rothstein Kass, said practitioners look to IRS internal guidelines for clarity and that taxpayers expect the IRS to adhere to those guidelines. “While the court makes a distinction between an announcement and an internal directive, the taxpayer’s expectation is that IRS communications are in sync and will be followed in the same manner,” she said. Although internal guidance is not authority, “why shouldn’t the IRS be held responsible when it does not follow its own internal rules? If the IRS isn’t going to follow its own guidelines, this may create confusion for those analyzing IRS guidance in connection with future initiatives,” she said.

by Jeremiah Coder

S. 952 Would Clarify Treatment of Church Pension Plans.

S. 952, the Church Plan Clarification Act of 2013, introduced by Senate Finance Committee member Benjamin L. Cardin, D-Md., would provide various clarifications regarding the treatment of church plans, including application of controlled group rules, contribution limits, automatic enrollment, transfers and mergers, and investments.

113TH CONGRESS

1ST SESSION

S. 952

To amend the Internal Revenue Code of 1986 to clarify the

treatment of church pension plans, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 14, 2013

Mr. CARDIN (for himself and Mr. PORTMAN) introduced the following

bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to clarify the treatment of church pension plans, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Church Plan Clarification Act of 2013”.

SEC. 2. CHURCH PLAN CLARIFICATION.

(a) APPLICATION OF CONTROLLED GROUP RULES TO CHURCH PLANS. —

(1) IN GENERAL. — Section 414(c) of the Internal Revenue Code of 1986 is amended —

(A) by striking “For purposes” and inserting the following:

“(1) IN GENERAL. — For purposes”, and

(B) by adding at the end the following new paragraph:

“(2) CHURCH PLANS. —

“(A) GENERAL RULE. — Except as provided in subparagraphs (B) and (C), for purposes of this subsection and subsection (m), an organization that is otherwise eligible to participate in a church plan as defined in subsection (e) shall not be aggregated with another such organization and treated as a single employer with such other organization unless —

“(i) one such organization provides directly or indirectly at least 80 percent of the operating funds for the other organization during the preceding tax year of the recipient organization, and

“(ii) there is a degree of common management or supervision between the organizations.

For purposes of this subparagraph, a degree of common management or supervision exists only if the organization providing the operating funds is directly involved in the day-to-day operations of the other organization.

“(B) NONQUALIFIED CHURCH-CONTROLLED ORGANIZATIONS. — Notwithstanding the provisions of subparagraph (A), for purposes of this subsection and subsection (m), an organization that is a nonqualified church-controlled organization shall be aggregated with one or more other nonqualified church-controlled organizations, or with an organization that is not exempt from tax under section 501, and treated as a single employer with such other organizations, if at least 80 percent of the directors or trustees of such organizations are either representatives of, or directly or indirectly controlled by, the first organization. For purposes of this subparagraph, a ‘nonqualified church controlled organization’ shall mean a church-controlled organization described in section 501(c)(3) that is not a qualified church-controlled organization described in section 3121(w)(3)(B).

“(C) PERMISSIVE AGGREGATION AMONG CHURCH-RELATED ORGANIZATIONS. — Organizations described in subparagraph (A) may elect to be treated as under common control for purposes of this subsection. Such election shall be made by the church or convention or association of churches with which such organizations are associated within the meaning of subsection (e)(3)(D), or by an organization determined by such church or convention or association of churches to be the appropriate organization for making such election.

“(D) PERMISSIVE DISAGGREGATION OF CHURCH-RELATED ORGANIZATIONS. — For purposes of subparagraph (A), in the case of a church plan (as defined in subsection (e)), any employer may permissively disaggregate those entities that are not churches (as defined in section 403(b)(12)(B)) separately from those entities that are churches, even if such entities maintain separate church plans.

“(E) ANTI-ABUSE RULE. — For purposes of subparagraphs (A) and (B), the anti-abuse rule in Treasury Regulation section 1.414(c)-5(f) shall apply.”.

(2) EFFECTIVE DATE. — The amendments made by this subsection shall apply to taxable years beginning before, on, or after the date of the enactment of this Act.

(b) APPLICATION OF CONTRIBUTION AND FUNDING LIMITATIONS TO 403(b) GRANDFATHERED DEFINED BENEFIT PLANS. —

(1) IN GENERAL. — Section 251(e)(5) of the Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248), is amended —

(A) by striking “403(b)(2)” and inserting “403(b)”, and

(B) by inserting before the period at the end the following: “, and shall be subject to the applicable limitations of section 415(b) of such Code as if it were a defined benefit plan under section 401(a) of such Code and not the limitations of section 415(c) of such Code (relating to limitation for defined contribution plans).”.

(2) EFFECTIVE DATE. — The amendments made by this subsection shall apply as if included in the enactment of the Tax Equity and Fiscal Responsibility Act of 1982.

(c) AUTOMATIC ENROLLMENT BY CHURCH PLANS. —

(1) IN GENERAL. — This subsection shall supersede any law of a State that relates to wage, salary, or payroll payment, collection, deduction, garnishment, assignment, or withholding which would directly or indirectly prohibit or restrict the inclusion in any church plan (as defined in this subsection) of an automatic contribution arrangement.

(2) DEFINITION OF AUTOMATIC CONTRIBUTION ARRANGEMENT. — For purposes of this subsection, the term “automatic contribution arrangement” means an arrangement —

(A) under which a participant may elect to have the plan sponsor make payments as contributions under the plan on behalf of the participant, or to the participant directly in cash, and

(B) under which a participant is treated as having elected to have the plan sponsor make such contributions in an amount equal to a uniform percentage of compensation provided under the plan until the participant specifically elects not to have such contributions made (or specifically elects to have such contributions made at a different percentage).

(3) NOTICE REQUIREMENTS. —

(A) IN GENERAL. — The plan administrator of an automatic contribution arrangement shall, within a reasonable period before such plan year, provide to each participant to whom the arrangement applies for such plan year notice of the participant’s rights and obligations under the arrangement which —

(i) is sufficiently accurate and comprehensive to apprise the participant of such rights and obligations, and

(ii) is written in a manner calculated to be understood by the average participant to whom the arrangement applies.

(B) ELECTION REQUIREMENTS. — A notice shall not be treated as meeting the requirements of subparagraph (A) with respect to a participant unless —

(i) the notice includes an explanation of the participant’s right under the arrangement not to have elective contributions made on the participant’s behalf (or to elect to have such contributions made at a different percentage),

(ii) the participant has a reasonable period of time, after receipt of the notice described in clause (i) and before the first elective contribution is made, to make such election, and

(iii) the notice explains how contributions made under the arrangement will be invested in the absence of any investment election by the participant.

(4) EFFECTIVE DATE. — This subsection shall take effect on the date of the enactment of this Act.

(d) ALLOW CERTAIN PLAN TRANSFERS AND MERGERS. —

(1) IN GENERAL. — Section 414 of the Internal Revenue Code of 1986 is amended by adding at the end the following new subsection:

“(y) CERTAIN PLAN TRANSFERS AND MERGERS. —

“(1) IN GENERAL. — Under rules prescribed by the Secretary, except as provided in paragraph (2), no amount shall be includible in gross income by reason of —

“(A) a transfer of all or a portion of the account balance of a participant or beneficiary, whether or not vested, from a plan described in section 401(a) or an annuity contract described in section 403(b), which is a church plan described in subsection (e) to an annuity contract described in section 403(b), if such plan and annuity contract are both maintained by the same church or convention or association of churches,

“(B) a transfer of all or a portion of the account balance of a participant or beneficiary, whether or not vested, from an annuity contract described in section 403(b) to a plan described in section 401(a) or an annuity contract described in section 403(b), which is a church plan described in subsection (e), if such plan and annuity contract are both maintained by the same church or convention or association of churches, or

“(C) a merger of a plan described in section 401(a), or an annuity contract described in section 403(b), which is a church plan described in subsection (e) with an annuity contract described in section 403(b), if such plan and annuity contract are both maintained by the same church or convention or association of churches.

“(2) LIMITATION. — Paragraph (1) shall not apply to a transfer or merger unless the participant’s or beneficiary’s benefit immediately after the transfer or merger is equal to or greater than the participant’s or beneficiary’s benefit immediately before the transfer or merger.

“(3) QUALIFICATION. — A plan or annuity contract shall not fail to be considered to be described in sections 401(a) or 403(b) merely because such plan or account engages in a transfer or merger described in this subsection.

“(4) DEFINITIONS. — For purposes of this subsection:

“(A) CHURCH. — The term ‘church’ includes an organization described in subparagraph (A) or (B)(ii) of subsection (e)(3).

“(B) ANNUITY CONTRACT. — The term ‘annuity contract’ includes a custodial account described in section 403(b)(7) and a retirement income account described in section 403(b)(9).”.

(2) EFFECTIVE DATE. — The amendment made by this subsection shall apply to transfers or mergers occurring after the date of the enactment of this Act.

(e) INVESTMENTS BY CHURCH PLANS IN COLLECTIVE TRUSTS. —

(1) IN GENERAL. — In the case of —

(A) a church plan (as defined in section 414(e) of the Internal Revenue Code of 1986), including a plan described in section 401(a) of such Code and a retirement income account described in section 403(b)(9) of such Code, and

(B) an organization described in section 414(e)(3)(A) of such Code the principal purpose or function of which is the administration of such a plan or account,

the assets of such plan, account, or organization (including any assets otherwise permitted to be commingled for investment purposes with the assets of such a plan, account, or organization) may be invested in a group trust otherwise described in Internal Revenue Service Revenue Ruling 81-100 (as modified by Internal Revenue Service Revenue Rulings 2004-67 and 2011-1), or any subsequent revenue ruling that supersedes or modifies such revenue ruling, without adversely affecting the tax status of the group trust, such plan, account, or organization, or any other plan or trust that invests in the group trust.

(2) EFFECTIVE DATE. — This subsection shall apply to investments made after the date of the enactment of this Act.

LTR: IRS Denies Exempt Status to Jewish Orthodox Synagogue.

The IRS denied tax-exempt status under section 501(c)(3) to a Jewish Orthodox synagogue because it failed to establish that it was organized and operated exclusively for exempt purposes and not for the private benefit of its creators, and because it lacked control and discretion of its funds.

Citations: LTR 201325017

Contact Person: * * *

Identification Number: * * *

Contact Number: * * *

UIL Code: 501.00-00, 501.03-00, 501.03-20, 503.00-00

Release Date: 6/21/2013

Date: March 28, 2013

Employer Identification Number: * * *

Form Required To Be Filed: * * *

Tax Years: * * *

Dear * * *:

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, Notice of Intention to Disclose, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

Enclosure

Notice 437

Redacted Proposed Adverse Determination Letter

Redacted Final Adverse Determination Letter

* * * * *

Contact Person: * * *

Identification Number: * * *

Contact Number: * * *

FAX Number: * * *

UIL Numbers: 501.00-00, 501.03-00, 501.03-20, 503.00-00

Date: January 25, 2013

Employer Identification Number: * * *

LEGEND:

B = individual

C = individual

D = individual

E = couple

F = individual

G = organization

H = business

J = individual

k = dollar amount

L = individual

W = state

X = date

Dear * * *:

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below. This letter supersedes our letter dated July 9, 2012.

ISSUES

1. Do the available facts show you have failed to pass the operational test, therefore disqualifying you from exemption under Section 501(c)(3) of the IRC? Yes, for the reasons described below.

2. Does the fact that you allow a non-board member to have signatory authority on your checking account demonstrate a lack of control and discretion of your funds, causing you to fail the operational test, therefore disqualifying you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.

3. Have your transactions resulted in private benefit, therefore precluding you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.

4. Do the capital improvements you made constitute a substantial non-exempt purpose, therefore disqualifying you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.

FACTS

You were formed by Articles of Incorporation on X by Trustees B, C and D. Article seven of your Articles states you were formed, in part:

To establish, maintain and conduct services for divine worship and religious observances in accordance with the customs and traditions of the Orthodox Jewish Religion; to establish, maintain and conduct synagogue for religious worship and prayer in accordance with the customs and traditions of the Orthodox Jewish Religion; to establish, maintain and conduct classes in Talmud and religious education; to purchase and lease such property as may be necessary for or incidental to the conduct and welfare of the corporation and the fulfillment of its religious objectives and purposes; and to solicit contributions form the general public in order to sustain said religious corporation.

Your Bylaws state you were formed to maintain a synagogue to conduct religious worship and services in accordance with the tenants of Jewish Orthodox faith. Article eight of your Bylaws states the following:

The Treasurer shall have the care and custodies of the monies belonging to the Organization and shall be responsible for such monies and securities of the Organization. He shall cause to be deposited in a regular business bank or trust company all sums of the Organization. He or one of the other offices [sic] must be one of the persons who shall sign checks or drafts of the organization. No special fund may be set aside that shall make it unnecessary for the Treasurer to sign the checks issued upon it.

You state in your attachments to Form 1023 that “our organization (you) is controlled by the board of directors. They make all decisions about the organizations (your) activities, and decide how funds are to be spent.”

You submitted a Conflict of Interest Policy, which has a purpose of protecting your interest when contemplating entering into a transaction, or arrangement that might benefit the private interest of an officer or director of the organization or might result in a possible excess benefit transaction. However, no one had signed the Conflict of Interest Policy.

You describe your activities as that of a congregation, with services held each weekday morning in accordance with Jewish tradition, as “described in prayer books available at any bookstore.” Per your application, you have * * * members. However, you submitted a list of your members of which there were only * * *. Only one of your Trustees was included in your membership listing. You attract new members through “word of mouth, we have no website.”

When we asked how you came into existence you said “adherents and former students of B decided to form a congregation to foster community feeling [sic] among former students and appreciative community members.”

Your rabbi is B. You said, “We have no written contract with the rabbi. The rabbi does not receive a salary from the congregation. He is otherwise employed.” G, a school located within your facility, employs B. B works at least 25 hours per week for them. He works at least 10 hours per week for you, and does not conduct services for any other organization. D and C are the father and father-i--law of B, respectively. You said volunteers conduct all activities. You later revised your board, adding L with B resigning.

You said your schedule is as follows:

Sunday thru Thursday,

9:00AM – 1:00PM — tractate Brachot (blessings)

3:00PM – 6:00PM — tractate Shabbos, and

8:00PM – 9:15PM — code of Jewish law

Friday, 9:30AM – 11:30PM — Brachot (Blessings)

The following is the schedule for G's shared use of your facility:

Sunday thru Thursday, 8:00AM – 9:30PM

Friday, 8:00AM – 1:00PM

Despite your statement that services are held "every day," it is noted, per your schedule, you do not offer services on the Sabbath (Saturday).

Regarding your membership, you stated you were a membership organization, "a Sabbath-observing Jew who pays dues may become a member of congregation." Members have the right to vote at annual membership meetings and to elect directors. You further asserted "a member may belong to another Orthodox Jewish congregation."

We asked for a list of the governing body members of G and you responded by saying "unavailable we do not maintain the records of the" school. However, B is an employee of G. We asked again for this information and you said "most business entities limit the information allowed to employees to the extent necessary to carry out their functions. Accordingly teaching employees are not usually privy to broader organization information since it does not impact on their pedagogical function."

You are distinguishable from G as "they are a religious school for the religious instruction of young teens. We are a congregation for young and old alike." The students of the school are not your congregants. You share physical space with the school. Specifically, you share the synagogue space. Although B is a teacher at the school, when we asked approximately how many students attend G, which operates in your physical space, you said "we are not the party to properly address the . . ." school's enrollment. You conduct religious classes. The instructors for these classes are four men, one of which is B. The other three instructors are Rabbis for other congregations.

You provided a list of your donors. When asked for the Employer Identification Number (EIN) for those donors that were not individuals, you responded, "It is very difficult in our identity theft conscious society to collect specific personal identifying information. This is information not readily shared and just inquiries arouse suspicion and may jeopardize collection efforts especially for a not-for-profit."

You submitted budgets which showed revenue in the form of gifts, grants and contributions of approximately $* * * annually, with membership fees accounting for approximately $* * * annually, for a three year period. Your expenses consisted of occupancy, professional fees, and other — with other being the majority.

We asked if you had a bank account. You responded you did not yet have a bank account. However, several days after we received correspondence indicating you did not yet have a bank account, you mailed us copies of your bank statements. Regarding this discrepancy you said:

It was erroneously understood to refer to an operating account which we do not have. The Congregation had at one point an active account solely set aside for the purpose of making renovations to the site for use as a congregation. Once the congregation realized their error of their own volition they set the records straight by submitting the statements.

The bank account showed that you had already had tens of thousands of dollars flow through your account before you even submitted your application for exemption, in contradiction to the proposed budgets you provided. B, C, D and F all have signatory authority on your checking account. As evidenced by canceled checks you submitted, F had, in fact, signed checks on your behalf. We asked why F, who is not one of your board members, has signatory authority on your account. You said “in the event board members are not available, and to offer an element of oversight.” However, we asked if F was related to any of the board members and you responded that she is the daughter of C, daughter-in-law of D and wife of B. You later stated, when asked about payment of expenses from your accounts, that various members pay for out of pocket expenses keeping you afloat.

You occupy a two story, 40 by 100 sq. ft. building. You indicated, “The first floor is a synagogue, furnished with tables, chairs, bookcases, a stand for reading the Torah scroll, an ark for storage of the Torah scroll and prayer books.” On the second floor, “there are classrooms, a dining room and offices for the congregation.” You “occupy the space free of rent” and you “have no lease.” Per our request, as you did not have a lease agreement, you submitted a statement signed by the individuals who own the facility where you conduct your activities. The statement is as follows:

I acknowledge the use of the building at address H by the congregation. I allow it to be used indefinitely (although not contractual) provided the congregation maintains the cleanliness of the building and agrees not to exceed fire department allowable maximum occupancy.

We asked if you had made any improvements to the facility and you responded simply “yes.” We further inquired and you said the “improvements were basically to retrofit the building from a business commercial use to a congregation house of worship use. This involved plastering and installing sheetrock for the walls and installing a drop ceiling, as well as tiles covering a cement floor. It also involved setting up walls to define rooms.” We asked for you to provide the total cost of the project, which you omitted. We again asked and you said the total cost was k dollars. We asked how you are ensured continued use of the facility you have improved, as you have no lease agreement. You responded as follows:

We are assured in a number of ways. Firstly, we have a very good relationship with the owner who is excited about our future growth. Secondly, if our stay is terminated abruptly we would be made whole by the landlord being that at that point he would be the beneficial recipient of the improvements. The cost would be collectable both in a legal proceeding as we’ll [sic] as in a rabbinical tribunal.

G did not pay for any of the renovations. The name of the contractor for the renovation projects is H. We asked for a copy of the contract with the contractor, how the terms were negotiated, the name of the owner of the company, and a description of the renovations planned. To these inquires you responded:

The work was done on a step-by-step project-by-project basis. Each project was priced with various contractors and craftsmen. Work was awarded by project to the one we felt best suited to fill our needs. As we gained confidence in H we felt we are best off using him exclusively. We cannot vouch for ownership, but our contact at H is J. No more renovations planned."

Regarding our request for copies of the written contracts, you said there is "no overall contract, as construction [sic] done per project basis as opposed to master construction project." We asked for copies of all of the bids you received for your projects. Rather than provide same, you simply provided a sheet that contained the total of all of the bids received.

You later provided a list of the actual construction costs totaling k dollars and including skeleton and sheet rocking, security, plumbing, air conditioning, electric, carding, furniture and fixtures, floors, ceiling, professional and misc.

You submitted internal and external photographs of your facility. The internal photographs showed two large rooms with numerous desks. One of the rooms had windows at the top of the walls near the ceiling. The other interior photographs include rooms with very large windows. The windows in both rooms were different in location and size than the windows shown in the exterior photographs of the facility. You said "the room (you use) is not in the basement but on the first floor and the windows are at the top of the walls. It seems that in the older commercial buildings that's how the architecture was that windows were placed on top of the room. The other pictures are from the interior of the second floor. The exterior pictures are the entrances of the front side of the building and these rooms face the back of the building." You provided no other photographs to confirm your assertions.

We sent you an internet article which stated F is the director of a religious camp, which has a very similar name to you and to the school with whom you share a facility. We asked if the camp was one of your proposed activities and you said "no."

We sent you a print from the internet which shows an organization with your exact same name operating a high school out of a different street address, but the same city, as you. You said they are an "unrelated entity which just coincidently has the same name."

You submitted minutes from your board meetings for each of the three annual meetings you held, and two additional meetings after those. Each indicates a meeting of the trustees was held. The minutes each state that one of your Trustees acted as chairman of the meeting and each year he ". . . nominated three Trustees . . ." and each year he nominated himself and the other two governing body members as Trustees, who are all related (B, C and D). Each year the meeting minutes also document the appointment of B, C and D as Officers. In comparison, the most recent two meetings for which you provided documentation indicate a meeting of the membership was held, not of the trustees, although the same people were present.

LAW

Section 501(c)(3) of the Code describes corporations organized and operated exclusively for charitable purposes no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Rev. Proc. 2012-9, superseding Rev. Proc. 90-27, 1990-1 C.B. 514, Section 4.01, provides the Internal Revenue Service will recognize the tax-exempt status of an organization only if its application and supporting documents establish that it meets the particular requirements of the section under which exemption from federal income tax is claimed. Section 4.02 states that a determination letter or ruling on exempt status is issued based solely upon the facts and representations contained in the administrative record. It further states:

(1) The applicant is responsible for the accuracy of any factual representations contained in the application.

(2) Any oral representation of additional facts or modification of facts as represented or alleged in the application must be reduced to writing over the signature of an officer or director of the taxpayer under a penalties of perjury statement.

(3) The failure to disclose a material fact or misrepresentation of a material fact on the application may adversely affect the reliance that would otherwise be obtained through issuance by the Service of a favorable determination letter or ruling.

Section 4.03 states that the organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.

In United States v. Wells Fargo Bank, 485 U.S. 351, 108 S. Ct. 1179, 99 L. Ed. 2d 368 (1900), the Supreme Court held that an organization must prove unambiguously that it qualifies for a tax exemption.

In American Guidance Foundation v. U.S., 490 F. Supp. 304 (D.D.C. 1980), the court said that, at a minimum, a church must include a body of believers that assemble regularly in order to worship. It must also be reasonably available to the public in the conduct of worship, in its educational instruction, and in its promulgation of doctrine. In addition, it was held that when the assets of an organization are used to pay for the living expenses of an individual(s) denial of exemption is appropriate. Generally, there are fourteen criteria used in determining whether or not an organization qualifies as a church. These criteria are as follows:

a. A distinct legal existence

b. A recognized creed and form of worship

c. A definite and distinct ecclesiastical government

d. A formal code of doctrine and discipline

e. A distinct religious history

f. A membership not associated with any other church or denomination

g. Ordained ministers ministering to its congregation

h. Ordained ministers selected after completing prescribed studies

i. Literature of its own

j. Established place of worship

k. Regular congregation

I. Regular religious services

m. Sunday schools for religious instruction of the young

n. Schools for the preparation of ministers

The court stated that courts in cases where church status has been litigated have more heavily weighted certain criteria. It considered the following factors to be especially important:

A membership not associated with any other church or Denomination

Established places of worship

Regular religious services.

In Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 531 (1980), in an action for declaratory judgment pursuant to section 7428(a), the Tax Court considered an adverse ruling by the IRS on an application for exempt status as a church. The applicant had declined to furnish some information, and made answers to other inquiries that were vague and uninformative. On the basis of the record, the Court held that the applicant had not shown that no part of its net earnings inure to the benefit of the family or that petitioner was not operated for the private benefit.

In Western Catholic Church v. Commissioner, 73 T.C. 196 (1980), the petitioner's only activities were some individual counseling and distribution of a few grants to needy individuals. The petitioner's failure to keep adequate records and its manner of operation made it impossible to trace the money completely, but the court found it clear that money passed back and forth between petitioner and its director and his for-profit businesses. The Court Held that petitioner had not shown it was operated exclusively for exempt purposes or the no part of its earnings inured to the benefit of its officer.

In Basic Unit Ministry of Alma Karl Schurig v. Commissioner, 511 F. Supp. 166 (D.D.C. 1981), aff'd, 670 F.2d 1210 (D.C. Cir. 1982), the court upheld IRS's denial of exempt status as a religious organization in a declaratory judgment action. The court held that in factual situations where there is evident potential for abuse of the exemption provision, a petitioner must openly disclose all facts bearing on the operation and finances of its organization. Here Plaintiff did not proffer sufficiently detailed evidence of its charitable disbursements, or the extent of its support of its members. Rather, plaintiff continually responded that it had already provided the data, or could not furnish anything further. Therefore, the court found that the applicant did not meet its burden to positively demonstrate that it qualifies for the exemption. The Court of Appeals for the District of Columbia Circuit, in affirming that the organization had not met its burden of establishing that no part of its net earnings inured to any private individual, observed:

"taxpayer confuses a criminal prosecution, in which the government carries the burden of establishing the defendant's guilt, with a suit seeking a declaratory judgment that plaintiff is entitled to tax-exempt status, in which the taxpayer, whether a church or an enterprise of another character, bears the burden of establishing that it qualifies for exemption."

In National Association of American Churches v. Commissioner, 82 T.C. 18 (1984), the court denied a petition for declaratory judgment that the organization qualified for exempt status as a church. In addition to evidence of a pattern of tax-avoidance in its operations, the court noted that the organization had failed to respond completely and candidly to IRS during administrative processing of its application for exemption. An organization may not declare what information or questions are relevant in a determination process. It cited a number of declaratory relief actions that upheld adverse rulings by the Service because of the failure of the applicants to provide full and complete information on which the Service could make an informed decision.

In Peoples Prize v. Commissioner, T.C. Memo 2004-12 (2004), the court upheld the Service's determination that an organization failed to establish exemption when the organization failed to provide requested information. The court stated "[Applicant] has, for the most part, provided only generalizations in response to repeated requests by [the Service] for more detail on prospective activities. . . . Such generalizations do not satisfy us that [applicant] qualifies for the exemption."

In New Dynamics Foundation v. United States, 70 Fed. Cl. 782 (2006), the petitioner brought to challenge the denial of its application for exempt status. The court found that the administrative record supported the Service's denial on the basis that the organization operated for the private benefit of its founder, who had a history of promoting dubious schemes. The organization's petition claimed that the founder had resigned and it had changed. However, there was little evidence of change other than replacement of the founder with an acquaintance who had no apparent qualifications. The court resolved these questions against the petitioner, who had the burden of establishing it was qualified for exemption. If the petitioner had evidence that contradicted these findings, it should have submitted it as part of the administrative process. "It is well-accepted that, in initial qualification cases such as this, gaps in the administrative record are resolved against the applicant".

APPLICATION OF LAW

Section 501(a) of the Internal Revenue Code provides for exemption for organizations operated exclusively for religious, charitable, and educational purposes. Section 1.501(c)(3)-1(a)(1) of the regulations states that if an organization fails to meet either the organizational test or the operational test, it is not exempt. We cannot determine and you are unable to substantiate that your programs are furthering exclusively 501(c)(3) purposes; therefore you are not described in section 501(c)(3) of the Code. Because you are not described in section 501(c)(3) you fail the operational test and are not exempt.

To be exempt an organization must serve public rather than private interests, as described in 1.501(c)(3)-1(d)(1)(ii) of the regulations. Despite having one board member resign, two of the three are still related. Further, the trustee that resigned is still employed in a position of power as your rabbi. You also allow a non-board member, who is related to the other board members, to write checks. You have executed capital improvements on a facility that is privately owned. You have been unable to fully substantiate these improvements, as there was no contract for the work, no documentation on a bid process nor any documentation on your selection process for the contractor. You have only provided that no one on your governing body is related to the contractor. You have been unable to substantiate that the owner of the facility will not benefit from your improvements, as there is no documentation on what would occur in the event you had to vacate the facility, nor is there any documented agreement on the terms of your use of the facility. You have expended most of your revenue for capital improvements for a facility you do not own, and for which do not have a lease agreement. Further, you have provided little details regarding the school, G, that is also sharing this facility. It is unclear if this is a privately owned school, who might own it, or who from that school is benefitting from the improvements you have made to the facility. As you have been unable to document the public benefit of the improvements done to this facility, you have not proven your assets will not inure to insiders or be used to privately benefit certain individuals.

As required by Rev. Proc. 2011-9 you have not established that you are organized and operated exclusively for exempt purposes and not for the private benefit of your creators. Section 4.02(3) of this Rev. Proc. states that the failure to disclose a material fact or misrepresentation of a material fact on the application may adversely affect the reliance that would otherwise be obtained through issuance by the Service of a favorable determination letter or ruling. You indicate control by your board of directors, and that they make all decisions about your activities and how funds are spent. Yet you have stated in correspondence that members are paying expenses out of pocket to keep you afloat, while also stating that members are appraised of issues regarding your finances. It is unclear who has financial control of your operations. We initially asked about bank accounts, to which you replied you had none, only to submit months worth of bank statements indicating much larger actual income than you had submitted as projected budgets. You have a non board member with signatory authority on you account, which was not disclosed, and was discovered only on submission of cancelled checks. Given the information provided regarding your financial data, it is unclear what your sources of income and expenses will be, or how you intend on maintaining control over your accounts. As a result, we cannot consider the administrative record complete and subsequently your failure to disclose material facts does not demonstrate that your operations further exempt purposes.

As in the above-cited cases of Basic Unit Ministry of Alma Karl Schurig and Peoples Prize, you have the burden of showing you come squarely within the terms of the law conferring the benefit sought, and whether you have satisfied the operational test is a question of fact. You did not respond openly or candidly to our questions as evidenced by the repeat requests for documentation of your facility. In fact, we asked the same questions multiple times and continually received little or no details regarding your operations, or responses contradicted information previously given. You did not provide details regarding your donors or the school with which you share a facility. You were also unable to produce copies of bids for the renovations you performed. An applicant seeking exempt status must provide sufficient information for the Service to make an informed decision, as indicated in National Association of American Churches. You must respond completely and candidly. You have given answers to our inquires that were vague and occasionally contradictory. You have not proven unambiguously that you qualify for a tax exemption, as in United States v. Wells Fargo Bank.

As in the case of Western Catholic Church v. Commissioner, your lack of sufficient records and lack of control over an funds fails to establish an exempt purpose consistent with Section 1.501(c)(3) of the regulations. You permit a non board member, F, to write checks on your behalf, which is in direct contrast with Article Eight of your Bylaws. You delegated your authority, responsibility, and operations to individuals outside of your internal operating control. You allow an unauthorized individual access to your bank account. This, together with your statement that members are paying expenses out of pocket, demonstrates a lack of financial control. Given the contradictory responses provided regarding your financial data it is unclear who may or may not benefit from transactions, what your sources of income and expenses will be, or how you intend on maintaining control over your accounts. Because we cannot determine how you will use or control income or what you may expense we cannot conclude who benefits from these transactions. As it is unclear who will benefit you have not proven your assets will not inure to insiders or be used to privately benefit certain individuals.

As in Bubbling Well Church of Universal Love, you are in a position to perpetuate control of the organization’s operations indefinitely, prepare its budget, have complete control of the organization’s finances and make all decisions on how the funds were spent. The close control held by a few individuals, without a system for public oversight, creates an environment for potential abuse and insider benefit as there are no defined roles or responsibilities for your board or policies setting forth their duties and the handling of your finances. Despite your statements that you are a membership entity, your board meeting minutes confirm the tightly held control of the organization. Therefore, the undue control of the organization by a related board causes the organization to serve private interests and thus fail the operational test.

American Guidance Foundation provides, at a minimum, a church must include a body of believers that assemble regularly in order to worship in an established location, must be reasonably available to the public in the conduct of worship, in its educational instruction, and in its promulgation of doctrine:

It is unclear from your responses if you are conducting regular religious services. While you provided a daily schedule of activities, despite your statement that you act in accordance with traditions, you hold no Sabbath services. G operates from the same facility and you do not conduct service on the Sabbath, although you require your members to observe the Sabbath.

We are unable to conclude you have an established facility for religious services. You are sharing both space and at least one employee with G. You were unable or unwilling to provide any information regarding G. As a result, there is a lack of clarity regarding where you are operating inside of the facility. While you have stated you use the first floor of the building, the pictures you have submitted lend one to think otherwise. The descriptions given in combination with the pictures provided call into question your presence and use of the facility, your establishment in the facility, and your regular use of the facility. It is also unclear how many students G has, making it impossible for us to determine how much space they would occupy in your facility, or to what extent they are using your facility. We are unable to determine who has access to your facility, or when. You have no materials or literature advertising your services to the public, relying instead on word of mouth. It is unclear from your responses that you have an established, regular location for religious services reasonably available to the general public.

We are unable to conclude you have an established congregation that regularly assembles for worship services. You initially stated you have 50 members, but later said you only have 25 members. Only one of your trustees is a congregant. You have provided varied numbers of attendees and have had no increase in attendance in over three years, which calls into question whether you have an established body of believers. Further, it would seem that if you require your congregants to be Sabbath-observing, they must attend services at a different location on the Sabbath as you do not offer services that day. Based on these facts it is unclear that you have an established and regular body of worshipers.

While you meet some of the 14 points as listed in American Guidance, your lack of, or inconsistency of, information has not conclusively demonstrated the existence of the basic tenets required for obtaining status as a church — regular worship services conducted at a regular location with a regular congregation.

An organization that is unable to demonstrate they have now or will have in the future sufficient records to show operations exclusively further exempt purposes will not be found to meet the operational test under Section 501(c)(3) of the Code. You were unable to provide a copy of the contract, or bids, for the construction work on your facility. You have been unable to provide financial data, citing members handling your expenses, despite a grant that was proposed by B. As in the above-cited case of New Dynamics Foundation v. United States, you have not demonstrated that your operations exclusively further exempt purposes and it is your burden to revolve gaps in the administrative record.

APPLICANT'S POSITION

You said it is standard business practice in your state to engage in leasehold improvements, and most properties have to be retro fitted to the specifics of the entity using the property. Leasehold improvements are treated as an asset and depreciate over the life of the asset. It is not considered a benefit to the landlord since the asset is owned and depreciated by the lease holder. You further asserted that the "sum of the total renovations was less than $* * * which is considered a modest sum" by State W standards for construction cost. "Although the written bids were not located the entity maintained the bid tally sheet" which in State W the government agencies consider it sufficient documentation of bids.

Regarding your allowance of a non-board member to write checks, you stated the IRS doesn't mandate any specific management policy. You further stated:

The fact that a small organization which affords the board with tight oversight of fiscal transactions suffices to exercise control of funds. A board is generally not intended to be involved in detail micro managing of daily operations. Accordingly check signing which is typical of daily management is delegated to persons more readily available outside of the board. This is standard practice in State W to the extent that banks in State W have sample board resolutions designating persons outside the board as signatories."

You also cited some laws from State W as well as a trade manual for non-profits discussing internal controls. These indicate delegating is an effective means of management and supervision is a control activity.

You indicated you are willing to adopt policies we suggest in order to satisfy the operational test. In fact, you submitted board meeting minutes from a recent meeting whereby you nominated an additional, unrelated member of the board. You said the new board member's credential of business acumen and being an unrelated party establishes a well-rounded, totally unrelated board. You said this should aid the approval process. You further asserted the unrelated board mitigates and minimizes the possibility of conflict of interest at the governance level. You said this has public benefit as well as a compliance enhancement and logically should expedite the tax-exempt application process.

Most recently you have requested expedite status of your application for exemption. Your expedite request indicates that an individual with the same surname of B and D (you did not provide the first name) has ". . . committed to our congregation a grant . . ." of a specific amount for the purpose of purchasing a Torah scroll to memorialize his ancestry." This is conditional on our being approved as a 501(c)(3) organization by . . ." a certain date, in time for a specific Jewish holiday. You further stated, "Loss of the grant would severely impact our operations as a Torah Scroll is a necessity."

SERVICE'S RESPONSE TO APPLICANT'S POSITION

You indicated you spent over $* * * for renovations. Based on your documented income, this was * * *% of your revenue to provide renovations to a building not owed by you and for which you do not have a lease. In fact, you said you had a bank account "solely set aside for the purpose of making renovations to the site for use as a congregation." You said the building is an asset owned and depreciated by the leaseholder; however, you do not have a lease. You are operated for the substantial non-exempt purpose of providing renovations to a building, thus providing substantial private benefit to the owner.

Although you state you qualify for exemption under Section 501(c)(3) of the Code as a church under

Sections 509(a)(1) and 170(b)(1)(A)(i), you are operating in a manner which contradicts your Bylaws. We are unable to conclude which operational procedures you adhere to and which ones you disregard. You suggest you are willing to adopt policies and procedures in order to satisfy the operational test; however, your written policies and procedures (Bylaws) already in place do not appear to have been followed. Therefore, the adoption of policies to which you may not adhere is insufficient to establish exemption

Your addition of a fourth, unrelated board member does not eliminate the control of the board by the majority-related board. Likewise, the commitment of a grant from a related party does not sufficiently establish qualification of exempt status.

PROTEST

You submitted additional photographs of your facility. You also submitted a lease agreement prepared by the landlord’s attorney. Rent was calculated by evenly dividing the amount of capital improvements done to the facility, k dollars, by the lease term, 60 months. You said this satisfies the private benefit issue. The lease you submitted is back-dated four years and permits your occupancy rent free for one more year. After that time you will have to pay rent.

SERVICE’S RESPONSE TO APPLICANT’S PROTEST

Although you now have a retroactive lease agreement, you did not substantiate how the rent amount was determined and whether it is reasonable. You simply divided the amount of money spent on the renovations over a five year period with you receiving a credit against the amount due. You have not indicated what happens after the five year period expires. The lease also does not alleviate the benefit derived to the other tenants of the building. Although your new lease agreement may reduce some concern over the private benefit to the owners of the facility regarding the renovations you performed, you still have not substantiated the actual improvements made, the process by which they were done and their public benefit.

CONCLUSION

Based on the above facts and law, we conclude that you do not qualify for exemption under section 501(c)(3) of the IRC. More specifically you fail the operational test and lack control and discretion of your funds. Each of these non-exempt purposes causes you to be disqualified from exemption under Section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, Exempt Organization Appeal Procedures for Unagreed Issues.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, Power of Attorney and Declaration of Representative, if you have not already done so. You can find more information about representation in Publication 947, Practice Before the IRS and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service

EO Determinations Quality Assurance

Room 7-008

P.O. Box 2508

Cincinnati, OH 45201

Deliver to:

Internal Revenue Service

EO Determinations Quality Assurance

550 Main Street, Room 7-008

Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

Enclosure:

Publication 892

IRS Phone Forum: "Charities and their Volunteers" - July 17

Many charities use all-volunteer labor to accomplish their work. Even those fortunate enough to have paid staff often rely heavily on volunteers to enhance their efforts.

This phone forum will help charity leaders and tax practitioners understand the tax rules that can come into play with volunteers. We'll discuss what charities and their volunteers need to do to avoid any unintended tax consequences for the organization or the volunteer.

Topics include:

- Out-of-pocket expenses
- Which expenses are deductible
- Travel expenses
- Vehicle expenses
- Recordkeeping
- Reimbursing the volunteer

Click here to register for this event:

http://ems.intellor.com/index.cgi?p=204706&t=71&do=register&s=&rID=417&edID=305

IRS Phone Forum: "Veterans Organizations - Complying with IRS Rules" — July 30.

Veterans organizations occupy a special place in the world of exempt organizations. Not only are most veterans organizations exempt from tax, but contributions to them may be deductible, and some are permitted to set aside amounts that are used to provide insurance benefits to members.

This combination — tax-exempt status, deductibility of contributions and the ability to pay benefits to members — is relatively rare and is evidence of Congress's intent to provide special tax treatment for veterans organizations. This phone forum provides information to help them stay tax exempt.

Topics include:

- Requirements for exemption
- Recordkeeping
- Filing and reporting
- Unrelated business income tax
- Exempt activities
- Bona fide guests

Click here to register for this event:

http://ems.intellor.com/index.cgi?p=204705&t=71&do=register&s=&rID=417&edID=305

[GASB Issues Proposals on Concepts for Measurement of Assets and Liabilities and on the Measurement and Application of Fair Value.]

The Governmental Accounting Standards Board (GASB) today issued for public comment a proposed Concepts Statement that would guide the GASB when establishing standards regarding the measurement of assets and liabilities for U.S. state and local governments. The GASB also issued its Preliminary Views regarding the measurement of fair value and the application of fair value, including note disclosures. Finally, the GASB issued a Plain-Language Supplement that addresses both proposals and is intended to solicit feedback on the proposals from non-accountant financial statement users.

“The proposed Concepts Statement would establish concepts for both measurement approaches and measurement attributes,” said GASB Chairman Robert H. Attmore. “Measurement is a necessary component of a complete GASB conceptual framework, which will enhance consistency in future standards setting for state and local governments.”

Regarding the Preliminary Views on fair value, Mr. Attmore said, “In conjunction with the proposed Concepts Statement, the proposed changes to GASB’s fair value standards are intended to increase consistency and comparability in governments’ fair value measurements and related disclosures. The goal is to enhance financial statement users’ ability to assess a government’s financial health and accountability.”

Measurement Concepts

The Exposure Draft, Measurement of Elements of Financial Statements, proposes concepts that will inform the GASB’s decisions when establishing future standards for how state and local governments would determine the dollar amount at which to report assets and liabilities.

The GASB is proposing two approaches to measuring assets and liabilities—initial amounts and remeasured amounts. Initial amounts are determined at the time an asset is acquired or a liability is incurred. Remeasured amounts are determined anew as of the date of each year’s financial statements.

The GASB also is proposing four measurement attributes (the characteristic of an asset or liability that is being measured):

Historical cost is the price paid to acquire to acquire an asset or the amount received when a liability is incurred in an actual transaction.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Replacement cost is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the measurement date.

Settlement amount is the amount at which an asset could be realized or a liability could be liquidated with the counterparty, other than in an active market.

Fair Value Measurement and Application

The Preliminary Views, Fair Value Measurement and Application, describes how fair value should be defined and measured, what assets and liabilities should be measured at fair value, and what information about fair value should be disclosed in the notes to the financial statements.

It is the GASB's preliminary view that investments generally should be measured at fair value. An investment would be defined as a security or other asset that a government holds primarily for the purpose of income or profit and the present service capacity of which is based solely on its ability to generate cash, to be sold to generate cash, or to procure services for the citizenry.

Certain investments would be excluded from measurement at fair value and should continue to be measured according to existing GASB standards, such as investments in money market instruments with remaining maturity at time of purchase of one year or less.

Under current accounting standards, state and local governments are required to disclose how they arrived at their measures of fair value if they are not based on quoted market prices. In the Preliminary Views document, the GASB proposes expanding those disclosures to include the levels of inputs a government uses to measure fair value and the judgments made to arrive at those inputs.

Providing Feedback

Both proposals and the Plain-Language Supplement are available on the GASB website, www.gasb.org. Stakeholders are encouraged to review the proposals and provide comment by September 30, 2013. The GASB also is planning to host a public hearing on both proposals in Flushing, New York, on November 1, 2013, at 8:30 a.m. EST.

For the Preliminary Views on Fair Value Measurement and Application, the GASB will be conducting a field test (in which governments go through the hypothetical process of applying the proposed standards) and is seeking state and local governments to participate. Governments interested in participating should contact GASB Project Manager Randy Finden at rjfinden@gasb.org.

The Exposure Draft is available at:

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175827186082&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

Preliminary Views are available at:

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175827186112&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

Plain Language Supplement available at:

http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175827186097&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

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Internet Seminar on the GFOA's New Program for Small Governments that Prepare Modified Cash Basis Financial Reports.

Sign up to participate in GFOA's complimentary one-hour Internet training seminar, The GFOA's New Program for Small Governments that Prepare Modified Cash Basis Financial Reports. This course is designed for the accounting or auditor professional interested in modified cash basis financial reporting and the new award program recently announced by the GFOA. The interactive training will offer guidance on the practical application of the modified cash basis for financial reporting as well as the format and contents of a small government annual financial report (SGAFR).

Click on individual dates to register: July 11, 2013; September 18, 2013; or download the Registration form. Earn 1 CPE credit with your participation.

July 11, 2013:

http://gfoa.org/index.php?option=com_content&task=view&id=2670

September 18, 2013:

http://gfoa.org/index.php?option=com_content&task=view&id=2671

Download the registration form at:

http://gfoa.org/downloads/GFOATrainingCertificateofConformance.pdf

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SIFMA: Derivatives 101 – July 17, 2013 – NYC.

What exactly is a SWAP? This half-day program will focus on the fundamentals of derivatives regulation, answering even the most basic questions. In the aftermath of Dodd-Frank, many securities and commodities professionals are now responsible for derivatives – often without much background in these products.

This program is designed to give both seasoned and newly appointed legal and compliance professionals a comprehensive overview of derivatives including product types, market structure, regulatory framework, and the impact of Dodd-Frank on derivatives regulation.

Register at:

https://mbrservices.net/ConferenceRegistration/MeetingRegistration.aspx?meetingid=1149

SIFMA: Fatal Flaws in Markup Research Paper.

A research paper released last week suggests that widespread violations of MSRB fair pricing rules are rampant in the municipal market. Scratching just below the surface, however, reveals serious flaws in the methodology and assumptions underlying the authors' conclusions.

First, the paper does not provide any indication as to how the authors determined markups on municipal bond transactions. The authors indicate that they use data collected by the MSRB under their Real-Time Transaction Reporting System. However, RTRS data does not separate out markups, which need to be inferred from trade price information. Without knowing how the authors used trade price data to determine markups, it is nearly impossible to replicate their calculations or determine their validity.

Second, the authors pay virtually no attention to the Financial Industry Regulatory Authority's robust examination and enforcement system for detecting unfair pricing activity and sanctioning violators. Rooting out fair pricing violations is a key element of virtually all FINRA municipal examinations.

Third, the authors state that "the MSRB instructs members to calculate markups on municipal bond trades as the difference between the prices charged to the customer and the prevailing market price and to calculate markdowns as the difference between the prices paid to investors and the prevailing market price. The broker-dealers' contemporaneous cost of acquiring…the bonds through inter-dealer trades or offsetting trades with investors establishes a presumption of the prevailing market price." In fact, MSRB rules do not include any such instruction. The citation provided by the authors refers to draft MSRB interpretive guidance which was never adopted. Rather, MSRB Rule G-30 requires dealers to buy or sell securities "at an aggregate price (including any mark-down or mark-up) that is fair and reasonable." The MSRB's fair pricing rule does not directly set guidelines or standards for markups and does not use the concept of contemporaneous cost.

Fourth, in their discussion of markups, the authors take no account of fundamental issues such as costs to dealers of financing and hedging inventories and servicing customer accounts and for market movements that could account for differences in the prices at which dealers purchase and sell securities. One of the examples cited by the authors involves an inventory position which, according to the authors, a dealer acquired then sold off in a series of customer trades over a four-week period. Without analyzing those specific bonds, generally the authors fail to address questions such as how market benchmarks performed over that period and what the dealer's cost of financing and hedging that inventory over four weeks was.

Moreover, a key issue the authors neglect throughout the paper relates to the cost of servicing customer accounts. The markup earned by a dealer on a single sale must often cover the cost of servicing that customer position, including periodic valuations and statements, possibly for decades.

Fifth, the authors overstate the portion of outstanding municipal securities held by individuals. Citing SIFMA data, the authors state that "one half of the $3.7 trillion in municipal bonds outstanding at the end of 2012 was directly held by individual investors." Our data on holdings of municipal securities come from the Federal Reserve Board's "Flow of Funds" publication, which tracks holdings of "households," not individuals. Moreover, "households" are a residual category, meaning that household holdings really reflects the holdings of any category of investors not otherwise accounted for, including individuals but also including others. In addition, a growing portion of the municipal market held by individuals is owned through separately managed accounts, which are professionally managed and generally buy and sell bonds in block-size transactions.

Sixth, the authors make no distinction between trades involving fee-based accounts and traditional brokerage accounts. This distinction is important because with a fee-based account, because a dealer earns periodic fee revenue based on the size of the account, markups on transactions can be smaller. With traditional brokerage accounts, all the dealer's revenue is derived from markups on customer sales, so markups must be larger to account for dealer costs of servicing accounts. Including markups on trades involving fee-based accounts makes the average and median markups smaller than they would be on trades involving only traditional brokerage accounts. For an "apples-to-apples" comparison, the authors should have analyzed markups on fee-based and traditional accounts separately.

Seventh, the authors' proposals for addressing perceived shortcomings in municipal securities pricing rules are deeply flawed. They suggest a municipal securities pricing rule based on “dealers’ contemporaneous cost,” an elusive concept in a market like ours where most bonds trade very infrequently. When a dealer buys a bond that remains in inventory for weeks, the dealer’s “cost” relative to current market pricing is often almost impossible to determine. That is the reason the MSRB has successfully administered a rule based on fair pricing rather than markup regulation for decades.

Finally, Misters Deng and McCann are not independent academics but rather professional witnesses closely affiliated with plaintiffs and claimants in securities litigation and arbitration cases against broker dealers. It should come as no surprise that their conclusions suggest significant numbers of pricing violations against investors, potentially leading to actions in which the authors would have a financial interest.

Enforcing fair pricing standards in a thinly traded market like that for municipal securities is difficult and complex. Determining fair prices is often subject to interpretation, and intelligent and informed market professionals can and often do disagree about the value of a bond at particular time. While it is appropriate for regulators to periodically review pricing rules to ensure customers’ prices are fair, and academic research can help inform that process, there is no systemic mispricing of customer transactions as the authors claim.

by: Michael Decker

Michael Decker is a managing director and co-head

of the municipal securities group at SIFMA.

Moody's: Detroit Default, Plan, Break Ground in Muni Market.

Detroit’s default and debt-restructuring plan are precedent-setting in the U.S. municipal market, Moody’s Investors Service said on Monday, because the city is looking to bondholders, as well as labor unions and pensioners, to share the pain.

The city on Friday defaulted on a $39.7 million payment on certificates of participation and presented a plan to restructure its finances.

“The restructuring plan is unconventional and precedent-setting in the municipal market. It builds a strong case for insolvency, girding the city for a tough fight with creditors of all types,” Moody’s said in a statement.

The proposal by Emergency Manager Kevyn Orr calls for unsecured creditors to take a pro rata share of $2 billion of new limited recourse participation notes, which would be issued to replace approximately $11 billion of unsecured obligations.

“The substantial reduction offered to unsecured creditors, the extent of the city’s financial stress and the complexity of the city’s debt add to the uncertainty of many classes of debt ultimately recovering their investment,” the rating agency added.

On Thursday, before the city’s announcement, Moody’s downgraded several classes of Detroit debt to Caa2 with a negative outlook.

Moody’s also said the plan is unusual as it proposes similar treatment of various debt security types.

It noted that Orr did not propose a plan for creditors who are considered secured, such as the debt of the city’s water and sewer enterprises or the city’s general obligation debt, which is enhanced by state aid and claims relative to interest rate swaps. However, the latter are subject to negotiations.

“The plan appears to treat the general obligation and pension obligation certificates similarly, which would be a break from tradition,” Moody’s said.

Standard & Poor’s, which on Friday downgraded the city to CC from CCC minus, said it was sure to cut the rating further.

Detroit's Orr: Investors in Bonds Headed for Haircut Should Have Known.

If you bought Detroit debt without making sure it came with support from credit enhancement or a revenue lien, you will now pay the price, Detroit emergency manager Kevyn Orr says.

“If you lent money to an insolvent city that has been going insolvent as openly and notoriously as possible since 2000, and you don’t have a security interest, then you are an unsecured creditor,” Orr told The Bond Buyer in a telephone interview Tuesday. “This has been building for decades and decades. They understood the risk.”

Orr’s comments come days after he unveiled a comprehensive but controversial restructuring plan that relies on slashing the city’s unsecured debt. Orr wants to issue $2 billion of notes to pay off holders of $11.4 billion of unsecured debt on a pro rata basis.

He said he should know within 30 days whether he will file a Chapter 9 bankruptcy.

The plan puts $650 million of the city’s unlimited- and limited-tax general obligation bonds on par with $5.7 billion of retiree health care, $1.5 billion of pension certificates, and a newly assessed $3.5 billion unfunded pension liability. Orr, a corporate bankruptcy attorney who worked on the Chrysler restructuring, said his decision to lump GO bonds in with debt like unfunded retirement liabilities and POCs reflects “traditional categories.”

“For those that were apparently unsecured, they were all treated equally,” he said. “We’ve been saying since the beginning that our thinking, our methodology, is to treat all claimants equally within their class.”

The restructuring plan was not vetted by the state and came solely from his office, said Orr. It does not reflect a formal position by the state on the classifications of a local government’s debt.

“We have not talked to the state about this, and the state has no obligation to us on this proposal. This is our proposal,” he said.

The treatment of $650 million of the city’s GOs — out of a total of $1.1 billion of GOs — as unsecured surprised many in the municipal market, who note that unlimited-tax GOs are typically considered among the safest products in the market.

Orr countered that assessment, saying UTGOs are no more than “the safest unsecured debt” in reality.

“I know the whole moral argument,” he said. “But unsecured claimants always say, ‘It’s not me’.”

The banks that are counterparties on the city’s eight interest-rate swaps hedging $1.4 billion of pension certificates, for example, were savvy enough to demand a lien on casino revenues in 2009 when it became clear Detroit would have a hard time making the payments, he said.

“The factors that have gone into underwriting since 2000 reflect the acute deterioration,” said Orr.

As part of the restructuring plan, Orr announced an immediate moratorium on repayment of all unsecured debt, starting with a $39.7 million payment due Friday on the pension COPs.

Holders of the COPs have the ability to sue the city in state court over the default. If they win, the court would order a judgment levy forcing the city to raise taxes to generate new money to cover the debt payments.

But Orr cautioned that a lawsuit could push the city closer to a Chapter 9 filing.

“We expect to have intense negotiations that would forestall any lawsuit,” he said. “Any lawsuit would cause us to reassess our plan to try to pursue an out-of-court settlement. If I were the parties, I would not run to the courthouse.”

Detroit will continue to default on unsecured debt, including its GOs, that comes due during negotiations, Orr said. It will also continue to make payments on the debt it considers secured, while negotiating with creditors on a restructuring or refinancing aimed at providing the city relief on its annual debt service burden.

Secured debt totals about $7 billion, including $5.9 billion of water and sewer revenue bonds and $480 million of GOs. Nearly all the debt carries bond insurance.

Orr said he expects to meet with bondholders later this week and next, with some meetings in person and some on the telephone. It should become clear within the next 30 days whether the city will file for Chapter 9 bankruptcy.

“That doesn’t necessarily mean we’re going to file in 30 days,” he said. “If we’re making progress, we’ll continue to negotiate.”

The emergency manager said he’s not focused on the impact the default or proposed haircut may have on other Michigan issuers or the broader municipal market.

“Frankly, my focus is on the obligation I have for the city of Detroit,” he said. “I cannot really take into account the potential impact it may have [on the municipal market].”

He added that he doubts the city’s default or a bankruptcy would stain other local governments or the state itself.

“Detroit is such a unique situation,” he said. “Detroit is so clearly insolvent that for anybody to impute anything on another municipality because of Detroit is wrong.”

Orr said he’s not worried about future access to the markets when the city may badly need borrowed money.

“My experience is once you get a debtor in a position with better cash flows and lower debt, that they’re more credit worthy,” he said.

The restructuring plan included a new assessment of the city's pension liability that boosts the unfunded figure to $3.5 billion from about $640 million. Orr has a meeting set with labor to discuss cuts on Thursday, and would not go into detail ahead of the meeting on the new pension figures, which are based on more conservative investment and amortization assumptions.

"There's no mysteries here," he said, "It's straightforward math."

He also declined to comment on the notion that the restructuring plan favors unions and employees over bondholders, saying only that labor feels as strongly as bondholders that they are facing unfair sacrifices.

"If you ask unions, this is yet another Wall Street bailout," Orr said.

"I can't be governed by perception — only by the reality of where we are," he added. "I understand different people are going to be upset, but at the end of the day we tried to adhere to the benefits of the bargain they cut."

Orr said he is negotiating with creditors on a class-by-class basis. The city may enter into separate — confidential — agreements with creditors of the same class, he noted.

"There may be times when different people want to cull themselves from the herd, and we may enter into confidential settlements with those folks," he said. "We reserve that right."

As to whether the city can expect help from the state or the federal government, directly or indirectly, Orr said it's unlikely.

"Let me put it this way: It's been made clear to me that we are on our own," he said. "The cavalry is not coming."

by: CAITLIN DEVITT

CUSIP Global Services Projects Continued Growth in Bond Issuance.

"The dual trend of low interest rates and a slowly improving economy is creating a perfect storm for new debt issuance," said Richard Peterson, Director, Global Markets Intelligence, S&P Capital IQ. "The jury is still out on how long that environment will last, but for now, all signs are pointing to increases in issuance over the next several weeks."

The full press release is available at:

http://img.en25.com/Web/StandardandPoors/CUSIP%20Issuance%20Trends%20May%202013_PR.pdf

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National League of Cities Comments on Proposed Regs on Health Insurance Provider Fee.

Clarence Anthony of the National League of Cities has commented on proposed regulations (REG-118315-12) on the annual health insurance provider fee under the Affordable Care Act, seeking clarification that governmental employers who self-fund their benefit plans on a pooled basis, and the pools in which they participate, fall under the self-insured employer exclusion and, thus, aren't covered entities subject to the fee.

June 3, 2013

The Honorable Daniel Werfel

Acting Commissioner

Internal Revenue Service

CC:PA:LPD:PR (REG-118315-12)

P.O. Box 7604

Ben Franklin Station

Washington, DC 20044

RE: Health Insurance Providers Fee Notice of Proposed Rulemaking — Comments and Request to Testify

Dear Acting Commissioner Werfel:

The National League of Cities ("NLC") on behalf of cities and towns throughout the country appreciates the opportunity to provide comments to Treasury and the Internal Revenue Service ("Treasury") on the Notice of Proposed Rulemaking ("Proposed Rule"), Health Insurance Providers Fee, as published in the Federal Register on March 4, 2013 (78 Fed. Reg. 14034), and subsequently corrected on March 22, 2013 (78 Fed. Reg. 17612). Many of these cities and towns have joined together to form public entity health care pools to provide health care insurance coverage to their employees. Without the benefit of these pools, many of these entities would not be large enough to self-insure and all would face either larger or more unpredictable costs to provide these essential benefits.

Section 9010 imposes an annual fee on covered entities engaged in the business of providing health insurance for any U.S. health risk. ACA §§ 9010(a)(1) and (c)(1). Generally, section 9010 provides that the term "covered entity" does not include: (1) any employer to the extent the employer self-insures its employees' health risks; (2) any governmental entity; (3) certain nonprofit entities that do not engage in certain political activities and receive more than 80-percent of revenues from Medicaid, Medicare, and SCHIP; and (4) non-employer established VEBAs.

While the Proposed Rule defines the term "governmental entity" to include political subdivisions of a state, it does not include instrumentalities of a governmental entity. 78 Fed. Reg. at 14042.

The preamble notes that instrumentalities that provide health insurance may qualify for other exclusions under section 9010, such as the exclusion for employers that self-insure their employees' health risks. 78 Fed. Reg. at 14037. Treasury invites comments on the types of instrumentalities, if any, that would be covered entities under the general definition and the extent to which they would qualify for exclusions consistent with the statute. Our detailed comments are below.

We also request an opportunity to testify at the public hearing on June 21, 2013.

I. Background

NLC is the country's largest and oldest national organization serving over 19,000 cities and towns throughout the country and 49 state municipal leagues. Founded in 1924, NLC helps city leaders build better communities through federal advocacy, research, and information sharing between and among cities and towns and state municipal leagues.

State municipal leagues are intergovernmental organizations comprised of member cities and towns within a state. They were formed and operate to improve the operations of their municipal government members and promote the welfare of citizens of those municipalities by faciliating and coordinating research and programs that (i) advance the efficient and effective operations of member municipalities, (ii) promote governmental efficiency and effective governance, and (iii) coordinate and effect advocacy and communications with the legislative, administrative and judicial branches of state and federal governments on issues affecting member municipalities.

Many governmental entities are authorized under state law to join together to self-insure health benefits for their employees through risk-sharing pools, trusts or other group arrangements (collectively, "Pools"). These entities are operated exclusively for the benefit of the municipal employers. An NLC affiliate, the NLC Risk Information Sharing Consoritum ("NLC-RISC") is an association of state municipal league intergovernmental risk-sharing Pools in thirty-four states. NLC-RISC member Pools offer property, liability, workers' compensation, unemployment, and/or employee benefit programs to their combined 16,000+ member cities, towns, counties and other local government entities.

NLC-RISC member Pools are universally exempt from tax under Code § 115 or as VEBAs under Code § 501(c)(9). Many have private letter rulings recognizing that they perform an essential government function on behalf of their municipal participants with all of a Pool's income accruing solely for the benefit of their participating public employers and not for private interests.

Those Pools that provide health benefits to local government employees and their families are all comprised of governmental entities that would be excluded from the fee were they to provide health benefits through their own separate health plan, under both the governmental entity exclusion and the self-insured employer exclusion. In many cases, cities and towns are too small to effectively self-insure some or all health benefits for their own employees. Thus, when cities and towns join together to provide health coverage through a Pool, they enjoy economies of scale, which helps to lower the cost of the coverage for both the municipalities and their employees. They also enjoy enhanced stability by having a larger risk pool.

On behalf of cities and towns throughout the country who have joined together to form public entity health Pools, we submit this comment letter to request an express exclusion for these Pools in the final rule. Although we believe Pools fit within the self-insured employer exclusion (or VEBA exclusion for those Pools that are VEBAs), they are instrumentalities of governments and thus are not included in the governmental entity exclusion under the Proposed Rule. We are concerned that without an express inclusion in the definition of governmental entities not subject to the fee or an express exclusion from the fee as self-insured employers, the Pools or the municipal employers covered under a pooled arrangement could be interpreted as being covered entities subject to the fee.1

We believe that the overarching intent of Congress is to exclude governmental entities that self-insure their employees' health benefits from the health insurer fee. This is evident by the existence of both the governmental entity exception and the self-insured employer exception. These exceptions should apply whether the governmental entity provides the self-insurance alone or does so jointly with other governmental entities through a Pool.

II. Recommendations

We recommend that Treasury define governmental entity in the final rule to expressly include a Pool through which political subdivisions jointly self-insure their employees' health benefits. Alternatively, we recommend that Treasury specifically include Pools, and the governmental entities that self-insure their employees' health risks through Pools, in the self-insured employer exclusion.

1. Governmental Entity Exclusion

Treasury should expressly include Pools in the definition of governmental entity. ACA § 9010(c)(2)(B) broadly excludes any governmental entity from the definition of covered entity. However, the Proposed Rule narrows the definition of governmental entity to not include instrumentalities of states or local political subdivisions. 78 FR at 14042.

In the discussion of instrumentalities in the preamble to the Proposed Rule, Treasury refers to instrumentalities within the meaning of Rev. Rul. 57-128. That revenue ruling confirmed the tax-exempt status for federal employment tax purposes of an interstate association of several state insurance departments. In the ruling, the IRS applied a six factor test in determining whether the association was an "instrumentality of one or more states or political subdivisions." All Pools satisfy this six factor test, and therefore are either instrumentalities of their public entity participants or are intergovernmental agencies in their own right under state law. Thus, it appears that Pools may not be exempted from the definition of covered entity as "governmental entities" under the Proposed Rule.

Pools are comprised of counties, municipalities, school districts, authorities and other local political subdivisions and are established under state intergovernmental cooperation laws. Their sole purpose is to provide health benefits to the employees and employees' dependents of their municipality participants. As a result, they have been recognized by the IRS as performing an essential government function on behalf of their participants — with all of their income accruing solely to their participating governmental employers — and are therefore exempt from taxation under Code § 115(1), in accordance with Rev. Ruling 90-74, 1990-2 C.B. 34.

Not excluding Pools from the definition of covered entity because they may also be deemed governmental instrumentalities is inconsistent with the rationale for their Code § 115 tax exemption, as expressed in Rev. Ruling 90-74, which states in pertinent part that:

Political subdivisions insure against casualty risks and other risks arising from employee negligence, workers' compensation statutes, and employee health obligations. Insuring against these risks satisfies governmental obligations. Any private benefit to employees from insuring against these various risks is incidental to the public benefit.

* * *

[T]he income of an organization formed, operated, and funded by one or more political subdivisions (or by a state or one or more political subdivisions) to pool their risks in lieu of purchasing insurance to cover their public liability, workers' compensation, or employees' health obligations is also excluded under section 115(1) if private interests do not, except for incidental benefits to employees of the participating states or political subdivisions, participate in or benefit from the organization.

(Emphasis added). See Rev. Rul. 90-74, 1990-2 C.B. 34. Based on this published ruling, the Service has issued numerous section 115 private letter rulings to state or municipal health insurance funds for active and/or retiree health benefits.

Thus, as governmental instrumentalities or agencies that perform an essential government function, Pools should not be treated any differently under ACA § 9010 than the governmental entities that use them to provide health benefits to the governmental entities' employees. Pools are funded solely by local taxpayers and governed by public officials on a tax-exempt, non-profit basis. Like the governmental entities that use them, Pools should not be subject to the health insurer fee. We therefore respectfully request that the final rule expressly include this type of governmental "instrumentalities" in the definition of governmental entity.

We note that this approach would be consistent with the definition of government entity in the Code § 4980H employer shared responsibility proposed rule, which defines government entity as expressly including any "agency or instrumentality" of "a state or political subdivision thereof." See 78 Fed. Reg. 241. We see no reason why the health insurer fee should depart from the commonly used definition of government entity.

2. Self-Insured Employer Exclusion

We strongly support Treasury expressly including Pools in the definition of governmental entity excluded from the health insurer fee. Alternatively, Treasury should expressly include governmental entities that use Pools, and the Pools themselves, in the definition of self-insured employer.

Section 9010 and the Proposed Rule provide that the term "covered entity" does not include any employer to the extent that the employer self-insures its employees' health risks. ACA § 9010(c)(2)(A); 78 Fed. Reg. at 14042. The Proposed Rule defines self-insured employer as an employer that sponsors a self-insured medical reimbursement plan within the meaning of Treas. Reg. § 1.105-11(b)(1)(i), including plans that do not involve shifting risk to an unrelated third party, as described in Treas. Reg. § 1.105-11(b)(1)(ii). 78 Fed. Reg. at 14042.

The local governments that comprise a governmental risk-sharing Pool jointly fund their employees' health benefits plans on a pooled basis in which they share the risk and do not shift the risk to a licensed health insurer or other unrelated third party. The government participants are inextricably bound to the Pool and each other by the intergovernmental obligations they assume for the establishment and funding of the Pool itself. With ultimate governing authority and financial accountability for each Pool vested in its public entity participants, those Pools are not unrelated third parties (or health insurers).

As explained earlier, the way Pools operate and how they are funded make their participating governmental employers "self-insured employers" within the meaning of Treas. Reg. § 1.105-11. For that reason, we respectfully request that the final rule clearly provide that governmental employers who self-fund their benefit plans on a pooled basis, and the Pools in which they participate, both fall within the self-insured employer exclusion and thus are not covered entities subject to the health insurance fee.

* * *

We appreciate the opportunity to comment on the Proposed Rule. If you have any questions, please contact Carolyn Coleman, Director, Federal Relations, 202.626.3023, coleman@nlc.org or Erin Rian, NLC-RISC Program Manager, 202.626.3122, erian@nlcmutual.com.

Sincerely,

Clarence E. Anthony

Executive Director

National League of Cities

Washington, DC

FOOTNOTE

1 We note that as governmental entities, Pools are not MEWAs under ERISA § 3(40) and thus, should not be included within the definition of “covered entity” as MEWAs.

More Issuers Contemplate BAB Redemptions.

More issuers are lining up to redeem Build America Bonds early after interest subsidy payments were reduced as a result of across the board spending cuts by Congress.

A review of event notices by The Bond Buyer showed eight issuers have indicated in the last month that they are likely to take advantage of extraordinary redemption provisions to refund BABs, half of them school districts located in Ohio. In May the state’s capital city, Columbus, said it planned to refinance approximately $368.7 million of BABs issued in 2009 and 2010, making it one of the first issuers to make such a redemption of BABs because of the so-called sequestration cuts.

Issuers Begin Calling BABs Due to Sequestration

In March, $85 billion of the federal budget cuts went into effect and cut the 35% interest subsidy rate the Treasury Department had promised to pay issuers by 8.7%. In April, issuers began announcing their intent to redeem BABs, cutting off a stream of interest income to investors.

Market analysts have said they expect issuers to continue to examine whether the options to refinance their BABs are economically beneficial and produce a savings.

“There was an enormous variation in the way call language was written in these deals,” said Chris Mier, managing director of analytical services at Loop Capital Markets. “But the ones with the par call language are being called.”

Mier said there has been some investor frustration with these calls. While it is the right of the issuer to decide about the cuts, most “investors feel they got sandbagged by the Treasury Department because of the risk of sequestration or the cut was clearly not properly disclosed by the federal government,” he said. “The federal government acted like this was never going to happen and here it has happened.”

The Board of Education of the Brunswick City School District in Ohio notified bond holders on the Municipal Securities Rulemaking Board’s EMMA system May 29 that they had the option to authorize the provision on $15.46 million of BABs but had not chosen to do so yet.

The district said it received a notice from the Internal Revenue Service on May 13 about the reduced interest payment on the bonds. The district said that it had already received a reduced payment from the Treasury consistent with the sequestration cut but that it would not affect its ability to pay the interest payment due on June 1.

The BABs were used to renovate and construct school and transportation facilities at eight different schools within the district, according to the official statement. Peck Shaffer & Williams LLP was bond counsel. Stifel Nicolaus was underwriter.

The Austintown Local School District in Youngstown, Ohio adopted the extraordinary redemption provision on May 29 but has not determined whether it will proceed to sell, issue and deliver the refunding bonds to all or any part of the $12.655 million in BABs. Those bonds were used to pay the local share of school construction under the state of Ohio Classroom Facilities Assistance Program, the official statement said.

RBC Capital Markets was underwriter. Squire, Sanders & Dempsey LLP was bond counsel.

The Keystone Local School District in Lagrange, Ohio also notified bond holders on June 4 about the possibility to refinance $5.8 million of Series 2010B BABs. On June 3, the Board of Education of the School District adopted a resolution acknowledging the reduced interest subsidy payment and its option to redeem the bonds. The district also has not determined if it will proceed to refinance the bonds. Squire, Sanders & Dempsey LLP was bond counsel. Robert W. Baird & Co. Inc. was underwriter.

The Eaton Community City School District in Preble, Ohio announced its intent to authorize the redemption of $3.77 million of BABs on May 29 to its bond holders. RBC Capital Markets was underwriter. Peck, Shaffer & Williams LLP was bond counsel.

Separately, the Washington County Housing and Redevelopment Authority in Woodbury, Minnesota announced its intent to refund $7.7 million of recovery zone economic development bonds issued in 2010.

The city of Manhattan, Kan., said it was contemplating exercising its extraordinary optional right to redeem $33.14 million of Series 2009-2 BABs.

The Independent School District in South Washington County, Minn., announced to bond holders on June 3 that the extraordinary redemption provision had been triggered on $4.365 million of qualified zone academy bonds.

And finally, the Rock Island County Metropolitan Mass Transit District announced that the Board of Trustee met on June 18 to consider redemption of $10.29 million of Series 2010B BABs.

BABs expired at the end of 2010. Almost $188 billion of BABs were issued since they were created in 2009 as part of the American Recovery and Reinvestment Act.

by: JENNIFER DEPAUL

WSJ: Jefferson County Debt Plan Is Costly.

Escaping the largest U.S. municipal failure could leave Jefferson County, Ala., in an even deeper hole.

The county’s plan to emerge from bankruptcy protection hinges in part on the sale of $1.9 billion of new debt this fall to refinance debt tied to its troubled sewer system. But some observers call terms of the new debt onerous.

Jefferson County, Ala., taxpayers stand to repay nearly $6.9 billion over the term of a debt deal.

The proposal for the refinancing, which has been approved by a majority of county commissioners, includes a set of bonds that schedule larger debt payments in the later years of the financing. About $474 million are a type of debt called capital-appreciation bonds. Such bonds have been derided by California's treasurer as "terrible" for their backloaded payments, and Michigan has banned their sale by municipalities.

All told, Jefferson County taxpayers would stand to repay nearly $6.9 billion over the four-decade term of the financing, more than three times the amount the county initially plans to borrow. That is perhaps billions more than they would pay under a plan whose payments would be more evenly distributed, said a potential investor.

Municipal bonds sold to fund water and sewage projects often cost the issuer no more than two times the initial amount borrowed after about 30 years. At current interest rates, a home buyer with good credit can expect to pay less than double the cost of a home over the life of a 30-year mortgage.

But, more-traditional financing for Jefferson County's sewer system "would have required higher initial sewer rate increases," said Jefferson County Commission President David Carrington. "Our rates need to be reasonable."

Jefferson County plans to pay for the new debt with sewer revenues, which will come from rate increases for its sewer-system customers. Sewer bills are expected to increase about 7% annually for the first four years under the deal, according to the county's agreement with debtholders.

Some observers wonder if the county will be able to meet the obligations stacked up in later years. "It's future taxpayers that bear the risk of the higher payments down the road," said Richard Ciccarone of McDonnell Investment Management, whose firm purchases municipal bonds and oversees an $8 billion portfolio of them.

The new debt is needed to complete an agreement signed this spring between Jefferson County officials and investors holding $3.1 billion of debt linked to the sewage-system upgrade. The deal, which helps the Alabama county put behind it the largest municipal bankruptcy in terms of debt outstanding in U.S. history, came after hedge funds and other creditors forgave $1.2 billion of sewer debt. The new bonds would refinance much of the remaining debt. The county filed for Chapter 9 bankruptcy protection in November 2011.

The county's proposal to sell the debt could be formally approved by a judge as early as November. If the plan is allowed to proceed, the debt is likely to be sold to investors as early as then. In addition to the capital-appreciation debt, the $1.9 billion package includes $1.42 billion of bonds that pay interest periodically, according to county documents. Jefferson County has the option to buy back some of the bonds after 10 years.

With capital-appreciation bonds, buyers agree to forgo regular interest payments in favor of receiving accreted payments near the end of the bond's maturity. The bonds were designed to help rapidly growing areas in states such as Texas and Florida where school districts need to borrow money fast to expand their campuses, but they want to make sure future residents share in the cost burden.

Because the bonds push payments to future taxpayers, California Treasurer Bill Lockyer called capital-appreciation bonds "terrible deals" that are the "equivalent of payday loans." He proposed a statewide moratorium this year. Some California school districts using capital-appreciation bonds will repay 10 times or more than the original amount they borrowed, the treasurer said.

The Jefferson County proposed repayment ratio is higher than a typical muni sewer bond. The Detroit water and sewer department sold about $660 million in debt last year but will only pay about two times that amount back to bondholders over the 26-year life of its debt, Mr. Ciccarone said. That ratio was similar for some 30-year debt sold by the Birmingham, Ala., waterworks board earlier this year.

Robert Brooks, a finance professor at University of Alabama, said he found Jefferson County's proposed refinancing deal troubling because the projected sewer revenue growth rate it assumes to pay for the bonds—which for many years is at least 3%—seems ambitious, because the sewer system has only had declining revenue in recent years.

"Those numbers certainly couldn't be based on history," he said. "Three percent seems unreasonably high."

By KELLY NOLAN and KATY STECH

- *In re Allstate Life Ins. Co. Litigation*, in which the district court found that underwriters' counsel spent enough time reviewing and editing the POS in a bond sale that a trier of fact could find that it had actual knowledge of the misstatements contained in the POS, thus giving rise to a duty to disclose, given their substantial role in the transaction.
- GFOA: Building a Better Budget Document, Second Edition.
- MSRB Files with the SEC Amendments to MSRB Rules on Retail Order Periods.
- MSRB Reminds Investors, Market Professionals to Assess Terms of Build America Bonds and other Direct-Pay Bonds in Light of Federal Sequester.
- Study Claims Billions of Dollars of Excessive Muni Markups.
- A series of interesting articles concerning the situation in Detroit, including: In Embattled Detroit, No Talk of Sharing Pain; Detroit Restructuring Plan Includes Bond Default; and Detroit Default Shines A Light on Bond Insurers.
- A Wall Street Journal piece, Intelligent Investor: What's Eating Munis? and the follow-up, How to Buy Muni Bonds.

BANKRUPTCY - CALIFORNIA

In re City of Stockton, Cal.

United States Bankruptcy Court, E.D. California - June 12, 2013 - B.R. - 2013 WL 2629129

"Chapter 9 is unique among voluntary Bankruptcy Code cases in that a municipality must litigate its way to the order for relief before restructuring its debt. Capital markets creditors of the City of Stockton have required the City to prove its eligibility for chapter 9 relief under 11 U.S.C. §§ 109(c) and 921(c). Such a proceeding is like a qualifying round in a competition; success leads only to the main event—the process of achieving a viable plan of adjustment. Without a confirmed plan, a municipality lacks constitutional authority to compel impairment of contracts."

"This opinion addresses chapter 9 eligibility issues that arose during the three-day trial on the question whether to order relief and the post-trial motion to alter or amend the findings regarding the strategy adopted by certain creditors. The focus is on pre-filing obligations of the municipality in dealing with creditors and stakeholders. Concluding that the City carried its burden to establish the elements required for an order for relief and concluding that the objectors inappropriately used an issue relating to plan confirmation, but that is irrelevant to eligibility, as a pretext to decline to negotiate in good faith and to force a trial that should not have been necessary, relief will be ordered."

BONDS - ARIZONA

In re Allstate Life Ins. Co. Litigation

United States District Court, D. Arizona - June 10, 2013 - Not Reported in F.Supp.2d - 2013 WL 2474508

At issue in this lawsuit was the offering and sale of $35 million in revenue bonds (the "Bonds") used to finance the construction of an Event Center in the Town of Prescott Valley, Arizona. Plaintiffs in this case were entities and individuals who purchased in the Bond offering in November 2005 (the "Bondholders"). They include Allstate Life Insurance Company and a number of individual plaintiffs whose interests were represented by the Indenture Trustee of the Bonds, Wells Fargo.

The defendants in this case were numerous. They included the underwriters for the bonds, attorneys for the underwriters, and the various entities that received the proceeds for the bonds and built the Event Center. For the purposes of this motion, the relevant defendant was the law firm Stinson Morrison Hecker's ("Stinson"), who served as underwriters' counsel for the offering. Stinson initially represented only the underwriter Stern, but later represented all the underwriters participating in the offering.

This action was based on a number of misstatements purportedly made by all defendants. These misstatements were allegedly made in the Preliminary Official Statement and the Official Statement. The OS provided two sources for paying debt service on the Bonds: (1) the net operating income from the Event Center and (2) Transaction Privilege Tax Revenues ("TPT Revenues"), allegedly pledged by the Town of Prescott Valley, consisting of sales taxes generated by the Event Center and certain areas near the Event Center. The alleged misstatements pertained to: (1) the annual attendance and profitability of the Event Center; and (2) the existence of a lien or other security device on the TPT Revenues for the benefit of the Bondholders.

Plaintiffs alleged that the defendants failed to disclose the existence of two feasibility reports, and that the OS stated that no feasibility reports had been prepared on its projections at all. Since its opening, the Event Center failed to recognize profit at the level of the projections set forth in the OS.

Plaintiffs also asserted claims based on alleged drafting errors in the bond documents. Plaintiffs claimed that the OS falsely stated that the debt service on the Bonds would be "secured" by a first lien on the TPT Revenues. They allege that due to defective drafting in certain Bond documents, no such lien exists. Plaintiffs allege that, because of these drafting errors, the Town of Prescott Valley has refused to deliver TPT Revenues for debt servicing on the Bonds, thus harming the Bondholders.

Stinson brought a Motion for Summary Judgment. The burden thus fell on Plaintiffs to raise a material issue of fact that Stinson made the misleading statements or was so involved in drafting the OS that it had actual knowledge of misleading facts, giving rise to a duty to disclose.

The court concluded that reasonable juror could find, based on the above evidence, that Stinson substantially participated in the drafting, preparing, and reviewing of the POS, which was part of the OS containing the misleading statements alleged by Plaintiffs to constitute an unlawful sale of securities under A.R.S. § 44–1991. Moreover, a finder of fact could determine, based on the evidence set forth by Plaintiffs, that Stinson spent enough time reviewing and editing the POS that it had actual knowledge of the misstatements contained in the POS, thus giving rise to a duty to disclose, given their substantial role in the transaction. Stinson's Motion for Summary Judgment was therefore denied on Plaintiffs' § 44–1991 claim.

Plaintiffs provided evidence of Stinson's substantial assistance in reviewing and proposing changes to the POS and issuing a clean 10b–5 opinion that was a condition precedent to the underwriters' purchase of the bonds. These were all steps along the process which culminated in the fraudulent sale of the bonds to Plaintiffs, the primary violation. Based on this evidence, a reasonable fact-finder could conclude that Stinson's actions, in the aggregate, constitute "more than a little aid." Wells Fargo, 38 P.3d at 26. Stinson's Motion for Summary Judgment on the aiding and abetting claim was therefore denied.

However, Plaintiffs have to overcome Stinson's showing that there was no material issue of fact that Stinson did not supply any information to the Plaintiffs. As such, Stinson's Motion for Summary Judgment was granted on Plaintiffs' claim of negligent misrepresentation.

ZONING - DELAWARE

Murray v. Town of Dewey Beach

Supreme Court of Delaware - June 10, 2013 - A.3d - 2013 WL 2474684

Property owners brought action challenging town's authority to enter into settlement agreement with a commercial developer.

The Supreme Court of Delaware held that action challenging town's settlement agreement with commercial developer permitting violations of zoning restrictions was subject to limitation period in statute governing zoning challenges, where the effect of the settlement agreement was to amend zoning restrictions to allow construction of a commercial development. 10 Del.C. § 8126.

FIRST AMENDMENT - FLORIDA

City of Fort Lauderdale v. Chuanwen Wang

District Court of Appeal of Florida, Fourth District - June 12, 2013 - So.3d - 2013 WL 2493972

Artist who sold his art on sidewalks sought declaratory judgment that three content-neutral city ordinances that operated to bar him from selling his artwork on sidewalks in beach area violated his First Amendment rights.

The district court of appeal held that zoning map submitted by artist did not establish that ordinances violated First Amendment by purportedly failing to provide alternative channels of communication.

In a public forum, a governing entity may establish time, place, or manner restrictions upon an activity which is otherwise fully protected by the First Amendment if the restrictions (1) are content-neutral, (2) are narrowly tailored to serve a significant government interest, and (3) leave open ample alternative channels of communication; the government holds the burden of demonstrating each prong of this test.

Zoning map did not establish that three content-neutral city ordinances that operated to bar artist from selling his artwork on sidewalks in beach area violated artist's First Amendment rights by purportedly failing to provide alternative channels of communication. The map itself did not demonstrate how much tourist activity was in any particular zoning district.

SCHOOLS - FLORIDA

Gabriele v. School Bd. of Manatee County

District Court of Appeal of Florida, Second District - June 7, 2013 - So.3d - 2013 WL 2451349

Teacher sought review of final order of county school board, suspending her employment for fifteen days without pay and returning her from a professional service contract to an annual contract.

The district court of appeal, held that Florida K–20 Education Code does not grant school boards the authority to return an employee under a professional service contract to an annual contract.

A professional service contract under the Florida K–20 Education Code is a continuous contract which renews automatically, and can only be terminated for just cause or based upon uncorrected performance deficiencies.

NEGLIGENCE - GEORGIA

Clark v. City of Atlanta

Court of Appeals of Georgia - June 7, 2013 - S.E.2d - 2013 WL 2450871

Pedestrian filed suit against city and other defendants for injuries sustained when she tripped and fell on uneven sidewalk pavers.

The court of appeals held that fact issue remained whether city had constructive notice of uneven sidewalk pavers, thus precluding summary judgment.

Constructive notice of a defect in the public roads or sidewalks, as a prerequisite to imposing liability on the city for any injuries resulting therefrom, may be imputed through the knowledge of the city's employees or agents, or may be shown by testimony as to how long the defect existed prior to the injury, objective evidence that the defect existed over time, or evidence that others were injured as a result of the same condition over a period of years.

The question of the city's constructive notice of a defect in a sidewalk or public road ordinarily is for the jury, except in the absence of any evidence of constructive notice that could create a fact question, and in such an instance, the issue of negligence is a matter of law.

The length of time a defect in a public road or sidewalk must exist in order for an inference of constructive notice of the defect to arise, as a prerequisite to holding the city liable for any injuries resulting therefrom, is ordinarily a jury question.

OPEN MEETINGS ACT - IOWA

City of Postville v. Upper Explorerland Regional Planning Com'n

Supreme Court of Iowa - June 7, 2013 - N.W.2d - 2013 WL 2450154

City and resident-taxpayer brought action against state regional planning commission and its members, alleging violation of the Open Meetings Act, and sought damages.

The Supreme Court of Iowa held that:

- Volunteer members of commission could not be held personally liable for Open Meetings Act violation;
- Issue of fact existed as to whether commission violated reasonable notice requirements for government meetings pursuant to Open Meetings Act;
- Commission complied with statute requiring publication in newspaper of general circulation of names and gross salaries of members regularly employed.

There was no evidence that volunteer members of State regional planning commission engaged in intentional misconduct or a knowing violation of Open Meetings Act in taking secret ballot vote approving contract to purchase property, as required to hold members personally liable for Open Meetings Act violations.

For purposes of provision in statute granting any volunteer serving on any council of governments immunity from claim based upon an act or omission of the person performed in discharge of the person’s duties, except for acts or omissions which involve intentional misconduct or knowing violation of the law, “intentional misconduct” requires more than a reckless disregard for the law, and a “knowing violation” requires a deliberate or conscious act.

Genuine issue of material fact, as to whether public had reasonable access to bulletin board in hallway of State regional planning commission’s office, when commission posted public notice of its meeting, precluded summary judgment in action against commission asserting that it violated reasonable notice requirements for government meetings pursuant to Open Meetings Act.

TORT CLAIMS ACT - MASSACHUSETTS

Moore v. Town of Billerica

Appeals Court of Massachusetts - June 7, 2013 - N.E.2d - 83 Mass.App.Ct. 729

Mother of child hit by baseball in town park brought action against town under Massachusetts Tort Claims Act (MCTA).

The appeals court held that:

- Town had governmental immunity, and
- Town had immunity under recreational use statute.

Town’s failure to erect signs or barriers between park and baseball field to prevent injury to users of park was not “negligent maintenance,” and thus town had tort immunity, under section of MCTA providing immunity for a governmental unit’s failure to prevent or diminish the harmful consequences of a condition not originally caused by governmental unit.

PUBLIC UTILITIES - MINNESOTA

In re Xcel Energy's Application for a Route Permit for CapX 2020 Hampton-Rochester-La Crosse High Voltage Transmission Line

Court of Appeals of Minnesota - June 10, 2013 - Not Reported in N.W.2d - 2013 WL 2460343

Consolidated certiorari appeals challenged a high-voltage-transmission-line (HVTL) route permit issued by Minnesota Public Utilities Commission (MPUC) to Northern States Power Company, doing business as Xcel Energy (Xcel).

The appeal of a church and landowners concerned the first segment of the permitted route. The church and landowners argued that the MPUC erred by designating Xcel's preferred route for that segment because: (1) Xcel improperly modified its proposed route late in the application process, which violated statutory notice and environmental-review requirements; (2) the route violated Minnesota's nonproliferation policy; and (3) the MPUC relied on extrarecord information in designating the route.

On certiorari review, the court of appeals will affirm the MPUC's decision to issue an HVTL route permit unless the decision is arbitrary or capricious, exceeds the agency's jurisdiction or statutory authority, is made upon unlawful procedure, reflects an error of law, or is unsupported by substantial evidence in view of the entire record. The court concluded that none of these elements existed, affirming the MPUC's decision.

EMINENT DOMAIN - MISSOURI

State ex rel. Jackson v. Dolan

Supreme Court of Missouri, En Banc - May 28, 2013 - S.W.3d - 2013 WL 2459994

Landowners petitioned for writ of prohibition, contending that order condemning their land at request of port authority was unauthorized.

The Supreme Court of Missouri held that:

- Condemnation by port authority of landowner's land through eminent domain satisfied the public use requirement, but
- Taking violated statute that prohibited port authority from acquiring private property through eminent domain for solely economic development purposes.

"Economic development" is defined in statute that prohibits condemning authority from acquiring private property through the process of eminent domain for solely economic development purposes as an increase in all four of the factors listed in the definition, that is, an increase in the tax base, tax revenues, employment, and general economic health.

Port authority's taking of landowner's land was solely for economic development purposes and, thus, violated statute that prohibited port authority from acquiring private property through eminent domain for solely economic development purposes. Although taking would have facilitated construction of a loop track to handle trains and improved river commerce, taking was included in the port authority's economic development plan, and the only manner in which the taking would have improved river commerce was by drawing more economic development into the area, as opposed to making such commerce easier to conduct.

SCHOOLS - MISSOURI

Breitenfeld v. School Dist. of Clayton

Supreme Court of Missouri, En Banc - June 11, 2013 - S.W.3d - 2013 WL 2631061

Parents of students enrolled in accredited public school district brought action against that district and the transitional school district in which students resided, which had lost accreditation, for declaratory judgment that transitional district was required under “Unaccredited District Tuition Statute” to pay for students’ tuition in accredited district. The circuit court granted summary judgment to districts. Parents appealed. The Supreme Court of Missouri reversed and remanded.

On remand, taxpayers from districts were allowed to intervene to argue that statute violated constitutional amendment’s prohibition against unfunded mandates, and taxpayers named state as a defendant. The circuit court determined that statute was unconstitutional as applied to defendant districts and entered judgment in favor of accredited district on its counterclaim against one parent for tuition owed. That parent and the state appealed. The Supreme Court, on its own motion, transferred case from the court of appeals.

The Supreme Court of Missouri held that:

- An increased cost of performing an existing activity or service cannot itself result in an unfunded mandate in violation of constitutional amendment, abrogating School District of Kansas City v. State, 317 S.W.3d 599;
- Tuition-payment provision of statute at issue did not impose a “new” or “increased” activity or service on either unaccredited district or accredited district, as necessary to create an unfunded mandate;
- Tuition-payment provision did not shift a state tax burden to a local entity so as to create unfunded mandate;
- Record did not support a finding that provision imposing new mandate on an unaccredited district to provide transportation to resident pupils who attended an accredited school in another district increased costs to taxpayers of unaccredited district, as necessary to constitute an unfunded mandate;
- Defense of impossibility did not apply with respect to one parent’s claim seeking payment of tuition for two students; and
- Trial court did not abuse its discretion in permitting taxpayers to intervene on remand.

OPEN PUBLIC RECORDS ACT - NEW JERSEY

Paff v. New Jersey State Firemen's Ass'n

Superior Court of New Jersey, Appellate Division - June 13, 2013 - A.3d - 2013 WL 2629978

Member of State Firemen’s Association brought action against Association alleging violations of the Open Public Records Act (OPRA).

The appeals court held that Association, as an independent State instrumentality, was a public agency whose records were subject to inspection under the OPRA.

Association's financial activities implicated OPRA's aim to shed light on the fiscal affairs of government, and to combat waste, misconduct and corruption. The Association was the direct recipient of substantial revenues generated from specific taxes imposed on insurance premiums, it was delegated authority to assure those funds were spent in accord with statutory strictures, and it disbursed funds directly in the form of burial benefits, and both regulated and oversaw the disbursement of relief benefits by local associations to which it distributed funds.

MUNICIPAL ORDINANCE - NEW JERSEY

Mile Square Towing, LLC v. City of Hoboken

Superior Court of New Jersey, Appellate Division - June 13, 2013 - Not Reported in A.3d - 2013 WL 2631202

Mile Square Towing, LLC appealed the denial of its challenges to the validity of an ordinance adopted by the City of Hoboken. The ordinance – City of Hoboken's Ordinance No. Z-131, codified as Chapter 184 of the General Code of the City of Hoboken – provides for licensing and regulation of businesses that remove and store motor vehicles.

Because the ordinance does not exceed Hoboken's authorization to license and regulate towing services provided in N.J.S.A. 40:48–2.49, or impermissibly delegate authority to the director of Hoboken's Department of Parking and Transportation to administer and enforce Chapter 184, the court affirmed.

EMINENT DOMAIN - NEW YORK

Commissioner of Transp. v. Sunny Lumber Supply NY, Inc.

Civil Court, City of New York, Kings County - May 30, 2013 - N.Y.S.2d - 2013 N.Y. Slip Op. 23177

Commissioner of Transportation, as condemnor, commenced holdover proceeding to evict occupant, as condemnee, and seeking judgment of possession of property taken for public bridge project, under Eminent Domain Law.

The Civil Court, City of New York, held that:

- Subject matter jurisdiction was not lacking over eviction proceeding, and
- Condemnor satisfied requirements of Eminent Domain Law.

Condemnor's holdover proceeding to evict condemnee and seeking judgment of possession of property taken for public bridge project, pursuant to Eminent Domain Law, was within jurisdiction of civil court, under Real Property Actions and Proceedings Law, authorizing court of civil jurisdiction to hold special proceeding to recover real property.

AGE DISCRIMINATION IN EMPLOYMENT ACT - NEW YORK

Abramson v. Board of Educ. of Middle Country School Dist. No. 11

United States Court of Appeals, Second Circuit - June 7, 2013 - Fed.Appx. - 2013 WL

2450579

“These cases are controlled by Auerbach v. Board of Education of the Harborfields Central School District, 136 F.3d 104, 107 (2d Cir.1998), which interpreted the Age Discrimination in Employment Act’s (“ADEA’s”) safe harbor provision for retirement incentives. The Court held that a retirement incentive plan is consistent with the ADEA if it ‘(1) is truly voluntary, (2) is made available for a reasonable period of time, and (3) does not arbitrarily discriminate on the basis of age.'”

“The School District’s retirement incentive plan is almost identical to the one at issue in Auerbach, and easily passes its three-part test. The incentive was plainly voluntary; all three of the employees here independently chose not to accept. It was available for a reasonable amount of time; the employees had until February 1 in their final year of service to make their retirement election—a full month more than the teachers had in Auerbach. Finally, the provision does not enable arbitrary discrimination. Every employee who had worked the minimum number of years required under the plan was given the opportunity to accept the incentive, and employees who chose to decline (like the plaintiffs) were able to ‘continue to work as valued employees in the School District without any corresponding loss of benefits or job status.'”

ZONING - PENNSYLVANIA

Bernotas v. Zoning Hearing Bd. of City of Bethlehem

Commonwealth Court of Pennsylvania.June 7, 2013 - A.3d - 2013 WL 2450160

Adjacent landowners sought review of decision of zoning hearing board granting variances to applicant to expand grocery store, a nonconforming use of property.

The Commonwealth Court upheld the granting of the variances, finding that:

- Dimensional variance standard, rather than nonconforming use standard, applied to application for variances;
- Substantial evidence supported finding that hardship resulted from unique physical conditions of property;
- Substantial evidence supported finding that requested expansion was necessary for reasonable use of the property;
- Substantial evidence supported finding that proposed expansion would not adversely impact neighborhood; and
- Applicant was required to obtain a variance, not special exception.

In general, an applicant can establish unnecessary hardship required for a variance by demonstrating either that physical characteristics of the property are such that the property cannot be used for the permitted purpose or can only be conformed to such purpose at a prohibitive expense, or that the property has either no value or only a distress value for any permitted purpose.

In considering a dimensional variance request, multiple factors may be considered, including the economic detriment to the applicant if the variance was denied, the financial hardship created by any work necessary to bring the building into strict compliance with the zoning requirements and the characteristics of the surrounding neighborhood.

Dimensional variance standard, rather than nonconforming use standard, applied to application for variances to add loading dock, ramp, and warehouse for grocery store, a nonconforming use of the property; additions would increase nonconforming use without creating a new use on the lot, and proposed new structures were incidental and secondary to principle nonconforming use of the property and would improve and modernize existing structures devoted to nonconforming use.

WORKERS' COMP - TEXAS

City of Bellaire v. Johnson

Supreme Court of Texas - June 7, 2013 - S.W.3d - 2013 WL 2450151

Contract worker brought negligence action against city and city garbage truck driver for injuries sustained when he fell into garbage truck hopper. Ooops.

The Supreme Court of Texas held that worker’s claim was subject to workers’ compensation’s exclusive remedy bar.

An employee cannot avoid the workers’ compensation exclusive remedy bar by arguing that he was not covered under the specific terms of his employer’s workers’ compensation insurance policy. Rather, the employee is covered as a matter of law, and any dispute by the carrier over whether it agreed to provide such coverage under the policy’s terms is with the employer.

Contract worker furnished to city by staffing services company was city’s employee, rather than an independent contractor, where city controlled the details of worker’s work, notwithstanding worker’s claims that he was not a “paid employee” of the city within the meaning of self-insured city’s interlocal agreement, and was not paid by the city or by the hour. The city provided worker with workers’ compensation coverage as a matter of law, and worker was paid by the city through staffing company and on the basis of the hours he reported to the city.

MSRB to Co-Host Boston Education and Outreach Seminar.

The Municipal Securities Rulemaking Board (MSRB) and the Boston Women in Public Finance will co-host an education and outreach event for municipal market professionals on July 23, 2013 in Boston, MA. The event will provide an opportunity for industry professionals to learn about the MSRB’s priorities, its rulemaking efforts for municipal advisors and dealers, and current issues facing the municipal securities market.

The seminar will be held on Tuesday, July 23, 2013 from 2:00 p.m. – 5:00 p.m. ET at the Millennium Bostonian Hotel, 26 North Street, Boston, MA 02109. Representatives from the MSRB will discuss its recent rulemaking and transparency initiatives in support of its mission to protect investors and municipal entities. MSRB staff will also discuss municipal market structure issues. Commonwealth of Massachusetts Assistant State Treasurer for Debt Management Colin MacNaught will join MSRB Chair Jay Goldstone for a discussion on considerations for defining issuer protection.

View the seminar agenda at:

http://msrb.org/msrb1/pdfs/BostonOutreachAgenda_July-23-2013.pdf

The seminar is open to all members of the municipal securities community. There is no cost to attend; however, pre-registration is required. The deadline to register is July 16, 2013.

Register for the Boston event at:

http://a3.acteva.com/orderbooking/loadEventRegistration.action?skuId=32134AFA013A6A29C4623B196A08B65D&catalogId=3211253B01310611E91018F70051E987&catalogGoWord=&emailAttendeeId=

For those unable to attend the outreach event in person, the MSRB will webcast the Boston event to expand accessibility to all industry professionals.

Register for the webcast at:

http://psav.mediasite.com/Mediasite/Login/Register?ReturnUrl=%2Fmediasite%2FPlay%2F8442bf2a4ccd48c58a32c29f28174fc41d

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NYT: In Embattled Detroit, No Talk of Sharing Pain; A bankruptcy in Detroit would have no precedent, despite an unusual flurry of municipal bankruptcies after the financial crisis.

When New York City threatened to declare bankruptcy in 1975, the idea so terrified everyone that it forced the city, its workers and its recalcitrant bankers to sit down and find ways to share the pain.

Now another large city, Detroit, appears to be on the brink of filing for bankruptcy, but there is little talk of sharing the pain. Instead, the fiscal crisis in Michigan is setting up as a gigantic clash between bondholders and city retiree.

The city's proposals, which could give some bondholders as little as 10 cents on the dollar, are making some creditors think they would be better off in bankruptcy. They see the specter of a federal judge imposing involuntary losses as less ominous than it was for New York.

"The haircut is so severe," said Matt Fabian, a managing director of Municipal Market Advisors, "I think it's scaring them into bankruptcy, rather than away from bankruptcy."

But city retirees, facing the prospect of sharply reduced benefits whether in bankruptcy or under Detroit's restructuring proposal, think they stand squarely on the moral high ground because despite the poverty of many current and retired members, they have already offered big concessions.

"It's not the employees that are costing the city money," said Edward L. McNeil, an official with the American Federation of State, County and Municipal Employees who is leading a coalition of 33 unions that will be affected by any restructuring of Detroit's debts, which total roughly $17 billion. Just last year, he said, those unions offered concessions that could have saved the city hundreds of millions of dollars a year. But Detroit "botched the implementation," he said.

And Michael VanOverbeke, interim general counsel for the general workers' retirement plan, said bondholders were investors hoping for returns, who should expect "a certain amount of risk."

"Planning for retirement and working for employers was not an investment into the market," he added. "These are people who are on a fixed income at this point in their life. They can't go back to work and start all over again." He said it was unthinkable to cut retirees' pensions outside of bankruptcy.

A bankruptcy in Detroit would have no precedent, despite an unusual flurry of municipal bankruptcies after the financial crisis. Rhode Island hurriedly passed a law giving municipal bondhholders priority over other creditors, including retirees, just before the small city of Central Falls filed for bankruptcy. That helped Central Falls resolve its bankruptcy quickly, but no one thinks Michigan could pass such a law. In Jefferson County, Ala., a large majority of the financial trouble grew out of debt issued to rebuild a sewer system, not pensions or other employee benefits. The rights of public workers and bondholders are in conflict in the bankruptcy of Stockton, Calif., but that case is not yet far enough along to be of any guidance to Detroit.

With talks on labor issues scheduled for Thursday, municipal bond market participants say one of their main concerns is that the city’s proposal would flatten the traditional hierarchy of creditors, putting say, a retired librarian on par with an investor holding a general obligation bond. That does not square with the laws and conventions of the municipal bond market, where for decades small investors have been told that such bonds are among the safest investments and that for “general obligation” bonds cities could even be compelled to raise taxes, if that’s what it took to make good. The “full faith and credit” pledge was supposed to make such bonds stronger than the other main type of muni — revenue bonds, which promised to pay investors out of project revenue.

Public finance experts have warned that broad societal problems could follow a loss of faith in municipalities’ commitments to honor their pledges. In a major report on the state of the muni market last year, the Securities and Exchange Commission warned that communities would find it increasingly costly to raise money, throwing into question the time-honored practices of building and financing public works at the local level.

Detroit’s proposal shows how much things have changed since the days when the municipal bond market consisted of two types of debt and little else. The emergency manager, Kevyn D. Orr, issued a complicated list of debts with a wide range of gradations, with general obligation bonds now inferior to revenue bonds.

Mr. Orr classified Detroit’s general obligation bonds into two groups — secured and unsecured — with the secured ones backed by outside sources of money, like state aid or federal block grants. The unsecured bonds are those that rely only on Detroit’s “full faith and credit” pledge. As a practical matter, much of Detroit’s bond debt is insured, so bondholders will feel no immediate pain as the city moves forward with its planned defaults. But the bond insurers have the right to do battle in the bondholders’ place, and other market interests are likely to join them.

Mr. Fabian said bondholders knew perfectly well that Detroit was broke and could not raise taxes and fees enough to cover all its bonds, but were still shocked by the proposed treatment.

“It’s not that people just want to get more money out of Detroit,” he said. “It’s the violence that’s being done to the city’s capital structure. It creates a new paradigm for investing in Michigan bonds.”

In the past, he said, the ratings agencies included the various debt structures in their evaluations of municipal bonds. An “unlimited-tax general obligation bond,” for instance, might be rated one or two notches higher than a “limited tax” version of the same bond. Investors would look at the rating, know what they were getting and pay more for the safer debt.

“Michigan is saying all that will go out the window,” Mr. Fabian said. “In effect, they’re saying that structure only matters when you don’t need it” — when everything is normal and the debt is being repaid.

“And when you need to rely on those legal differences, then they don’t matter,” he added. “It’s distressing.”

Municipal market participants are also rattled by a big, sudden increase in Mr. Orr’s measurement of Detroit’s pension shortfall, which he is also classifying as unsecured, leaving workers and bondholders to compete for whatever pool of money is left over. As of June 30, 2011, the city’s most recent actuarial snapshot showed that its two big pension funds were in pretty good shape — short by just $644 million, because the city had issued securities called “certificates of participation” in 2005 and 2006, and put the proceeds into the pension funds.

But Mr. Orr’s report said that estimated shortfall had been “substantially understated” through aggressive assumptions and other distortions. After correcting those, the two funds’ shortfall was closer to $3.5 billion.

And as for those certificates of participation, issued to produce money for pensions, they turn out to be among Detroit’s shakiest debts. The city already skipped a payment due last Friday, and Mr. Orr said the city had found “certain issues related to the validity and/or enforceability” of the debt. His report did not specify what the issues were, but said further investigation might be warranted.

The report said that to some extent, the trustees who sit on Detroit’s pension boards had worsened the pension trouble by promising workers “ad hoc sweeteners” and diverting investment income to other uses. As state-appointed emergency manager, Mr. Orr has authority to remove pension trustees.

But Mr. VanOverbeke said the trustees were not going anywhere. In fact, they have already set aside $5 million for a legal challenge in case Mr. Orr puts them “in a position that they would not have the resources necessary” to protect the pensioners, Mr. VanOverbeke said.

“It wasn’t put aside to do battle,” he said. “They were set aside so that as fiduciaries they can make the appropriate decisions and take the necessary actions as it is deemed appropriate.”

GFOA: Building a Better Budget Document, Second Edition.

In Building a Better Budget Document (second edition), the GFOA has assembled more than 250 exemplary budgetary examples taken directly from budget documents submitted to GFOA’s Distinguished Budget Presentation Awards Program. The book’s aim is for governments to use this information to continue improving their budget documents through more effective policy, financial, operations, and communication components.

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GFOA: An Elected Official's Guide: The New Pension Accounting.

Recently, the Governmental Accounting Standards Board (GASB) issued a new standard that fundamentally changes how state and local governments account for the cost of pension benefits in their financial statements. The GFOA's new publication An Elected Official's Guide: The New Pension Accounting uses a simple question-and-answer format to explain the "new pension accounting" in a way that is designed to be easily understandable even for those with little, if any, experience or background in accounting and financial reporting for pensions.

Order Form:

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