



CREATING AN EFFECTIVE POST- BOND ISSUANCE TAX COMPLIANCE PROGRAM

A Web Conference Series hosted by
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Welcome & Introductions



Michael G. Bailey



Dana M. Lach

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REMINDER: Upcoming Sessions

- Mark your calendar and plan to join us for the remaining sessions of the Creating an Effective Post-Bond Issuance Tax Compliance Program Web conference series.
 - **Thursday, May 31, 2007**
Session II: Selecting Assets to Finance With Tax-Exempt Bonds and Other Compliance Strategies
 - **Thursday, June 7, 2007**
Session III: Conducting an Internal Audit of Tax-Exempt Bond Compliance

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Web Conference Details

- Call **866.493.2825** for technology assistance
- Dial ***0** (star/zero) for audio assistance
- Ample time for live Q & A will be allotted at the end of the formal presentation
- We encourage you to Maximize the PowerPoint to Full Screen Usage:
 - Hit F5 on your keyboard; or
 - Select “View” from the toolbar menu and click “Full Screen”

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SESSION I: ESTABLISHING A TAX-EXEMPT BOND COMPLIANCE PROGRAM

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IRS Focus on Compliance Policies

- Major IRS initiative will check on nonprofit tax-exempt bond compliance procedures
- IRS letters will go to thousands of nonprofit organizations
- Letters will be modeled after similar compliance checks (executive compensation and community benefit)
- Particular focus on recordkeeping

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Reasons for the IRS Initiative

- Follows earlier initiative directed at 501(c)(3) bonds
- IRS appears to believe nonprofit compliance procedures are generally deficient
- IRS wants nonprofits to adopt procedures

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Reasons to Establish a Compliance Policy

- Reduce risk of IRS bond audit
- If audited, IRS may be more sympathetic
- Negotiating power with IRS in audits is limited
- Avoid missing deadlines or making other mistakes
- Take best advantage of favorable rules
- In long-term, more cost-effective for future financings, change of use, and other actions
- Clarify roles and responsibilities

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Historical Perspective: from “snapshot” to feature film

- Before 1986, most tax-exempt bond rules were thought to be based on a date-of-issuance “snapshot”
- Tax Reform Act of 1986 and subsequent rules greatly increase post-issuance requirements
- A bond document “time warp” is common
- New rules require a new framework to put compliance into practice

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Assign Responsibilities

- Compliance requires a blend of tasks — legal review, information gathering, computation and recordkeeping
- Policy needs to identify specific tasks and assign them to specific employees or functions
- Define legal and treasury responsibilities
- A “compliance committee” may be helpful for some organizations

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Basic Unit of Compliance: the Bond “Issue”

- Rules apply separately to each bond “issue”
- First step: identify each “issue”
- What is bond “issue” for tax purposes may not be the same as for state law or securities law purposes
- Special considerations may apply to refundings and special “separate issue” elections

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Recordkeeping: “books and records”

- Rules refer to maintenance of “books and records”
- Not limited to date-of-issuance “snapshot”
- For each issue, establish a “books and records” file system on date of issuance
- Take into account any special separate issue treatment

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Recordkeeping: establishing “books and records” files

- Bond transcript
- Bond trustee requisitions and other information showing how proceeds are spent
- Project completion certificate and other post-issuance allocations and elections
- Records of investments (including bond trustee statements)
- Financed property use contracts and records
- Remedial action and other change-of-use records
- Amendments and other changes (including interest rate conversions and defeasance)
- Letters of credit and other guarantees
- Interest rate swaps and other derivatives

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Recordkeeping policies and procedures

- Cross-reference records not physically maintained in the files
- Establish a consistent retention period: e.g., 3 years after the April 15 of the year after the last bond is retired
- Coordinate with general record retention policy
- Special requirements for electronic records

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Recordkeeping: how strict is the burden?

- Three considerations: Internal Revenue Code requirements, bond document requirements, IRS expectations
- IRS expectations are rigorous, and appear to exceed Code and bond document requirements
- IRS Notice 2006-63 requested comments on the recordkeeping burden
- Limited recordkeeping relief is possible, but not likely for retention periods

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Recordkeeping: Special Considerations for Outstanding Bond Issues

- May 16, 1997 — final private use regulations became effective
- IRS position is stricter for bonds issued on or after May 16, 1997
- New refunding regulations require review of private use of refunded bonds issued on or after May 16, 1997
- For refunded bonds issued before May 16, 1997, private use on and after December 19, 2005 must be reviewed

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Establish a Deadline Reminder System

- List responsibilities and dates on the date of issuance in a deadline reminder sheet
- Rebate dates (commencement of computations, completion and payment)
- Project completion review (commencement and completion)
- Yield restriction
- Other special deadlines

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Establish a Project Completion Review Procedure

- May determine how bond proceeds are spent up to 18 months after the placed-in-service date of a "project."
- Time-limited chance to correct mistakes
- Opportunity for rebate benefits (e.g., meet spending exceptions)
- Opportunity to manage private use issues
- Must document equity contributions
- Establish a record for future private use compliance and refundings
- Strongly recommend use of a formal process, established on the date of issuance
- Coordinate with any completion certificates required in bond documents

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Establish Rebate and Yield Restriction Compliance Procedures

- Assign responsibility to obtain rebate computations, make rebate payments and comply with yield restriction requirements (commonly a Treasury function)
- Recommend retaining a rebate service provider on the date of issuance
- Recommend preparing a summary schedule of funds and accounts subject to rebate and yield restriction
- Establish “fair market value” procedures for purchase and sale of investment, including use of bidding safe harbors for investment contracts
- Consider a policy regarding when to invest in SLGs

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Establish a Procedure to Monitor and Measure Private Use

- Assign responsibility to track private use (in addition to reviewing contracts to determine whether they result in private use)
- Given right framework, this is a computational and informational gathering task
- Identify the bond “issue” and the applicable private use limit (e.g., 5%, 25%, \$15 million)
- Establish a consistent approach for creating a monitoring spreadsheet, or “private use log”, for each bond issue

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Monitoring and Measuring Private Use: Initial Contents of a Private Use Log

- Applicable private use limit
- Reasonably expected denominator:
 - Sale proceeds
 - Less proceeds applied to reserve fund
 - Less proceeds applied to qualified guarantees
 - Plus project period investment earnings
- Reasonably expected private use arrangements
- Update in connection with project completion review and as additional private use arises

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Monitoring and Measuring Private Use: Importance of Simplifying Conventions and Approaches

- Use of simplifying conventions can reduce the administrative burden
- Private use rules can be complex (e.g., a private use log needs to track different economic life “measurement periods” for different assets)
- Consider a general policy to meet private use limits on an annual basis, even though the averaging “measurement period” rule is more liberal
- Consider a policy to take compliance burdens into account in selecting which assets to finance
- Many tax agreements use simplifying conventions but don’t say so (e.g., limiting private even if private payments or security do not exceed the applicable limit)

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Determining the Amount of Private Use Resulting from an Arrangement

- Tasks may span legal, as well as a computational and information gathering
- May require more coordination among different functions
- Different tracing approaches may apply for buildings, building renovations, and equipment
- Method for common areas and other property used in common
- Special rules for uses of the same asset at different times or simultaneously
- Zero-limit for private ownership

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Review of Physician and Other Service Contracts

- Commonly treated as a legal function
- Assign responsibility for review and maintenance of a list for all service contracts, using a consistent template
- Obtain from counsel a detailed service contract checklist (for example, providing standards and clarification for applying Rev. Proc. 97-13)
- Use service contract checklist to screen, not to resolve all interpretive questions

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Review of Other Contracts

- Adopt similar review and list maintenance procedures for research agreements and clinical trial agreements
- Adopt similar list maintenance procedures for leases
- Leases to for-profits should be presumed to result in private use
- Adopt procedures to review sales of property
- Adopt a list of contracts not subject to review — employment, janitorial, office equipment repair, hospital billing and any other “solely incidental” contracts

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Review of Contracts with Other 501(c)(3) Organizations

- Private use review should extend to these contracts
- May need to review the qualification of the other organization and whether the contract furthers the exempt purpose of each organization

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Review of Unrelated Trade or Business Activities

- Assign responsibility for review of potential unrelated trade or business activity
- Coordinate with UBI tax reporting, but do not rely on Form 990-T reporting
- UBI tax reporting may not be at the high confidence level required for tax-exempt bonds and may rely upon exceptions that do not apply for tax-exempt bond purposes
- Require special review of types of facilities at a higher risk for unrelated trade or business activity (for example, parking garages and pharmacies)

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Procedures for Changes of Use of Bond-Financed Property and Remedial Actions

- Generally require consultation with counsel as contract is negotiated
- Generally require a supplemental tax certificate and opinion for each remedial action
- Seek consistency in approach and documentation
- Highlight advantages of sales that are “exclusively cash”

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Special Procedures for Refunding Bonds

- Require cross-reference in books and records of refunded bonds
- Require bond counsel to clearly identify the property financed (e.g., any “multipurpose” elections)
- Determine whether “combined issue” rule applies

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Additional Areas for Compliance Procedures

- \$150 million limit on nonhospital bonds, if a practical concern
- Letters of credit, bond insurance and other guarantees
- Interest rate swaps and other derivative contracts
- Amendments and other changes to bonds or bond documents
- Retirement of bond issues

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Planning Procedures

- Reimbursement declarations of intent: at least annually review need for a declaration of intent, preferably in connection with annual budget
- Establish procedures for reviewing restricted donations

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Develop an Implementation Plan

- Plan for outstanding bond issues may be less complete than for new bond issues
- Establish formal books and records files for each outstanding bond issue
- Complete a deadline reminder schedule for each outstanding bond issue
- Do a project completion review for each outstanding bond issue, if timely
- Select outstanding bond issues for further priority implementation

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DEADLINE REMINDER SCHEDULE TEMPLATE

Name of Bond Issue	
Closing Date	
Principal Amount	
Final Maturity	
Reasonably Expected Project Completion Date	
Commencement Date of Project Completion Review	
Completion Date of Project Completion Review	
Commencement Dates of Rebate Installment Computations	
Commencement Date of Final Rebate Computation	
Completion Dates of Rebate Installment Computations	
Due Dates for Rebate Installment Payments	
Due Date for Rebate Final Payment	
Commencement Date for Project Fund Yield Restriction	
Other Actions	

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BOOKS AND RECORDS TEMPLATE
(BOND ISSUE FILING SYSTEM)

Name of Bond Issue	
Date of Issuance	
<i>File</i>	<i>File Location</i>
1. Bond Transcript	
2. Bond Trustee Requisitions	
3. Detailed Information Showing Establishing How Bond Proceeds Are Spent	
4. Project Completion Certificate and Other Post-Issuance Allocations and Elections	
5. Records of Investments (including Bond Trustee Statements)	
6. Financed Property Use Contracts and Records	
7. Remedial Action and Other Change of Use Records	
8. Letters of Credit and Other Guarantees (including Extensions and Replacements)	
9. Interest Rate Swaps and Other Derivative Contracts	
10. Amendments and Other Changes (including Interest Rate Conversions and Defeasance)	

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SERVICE CONTRACT SCHEDULE TEMPLATE

Name of Service Provider	
Type of Service or Practice	
Effective Date	
Term	
Location of Space Used	
Term of First Date of Optional Termination without Penalty or Cause	
Does the Contract Clearly Meet a Safe Harbor under Rev. Proc. 97-13 or Other Approved Arrangement?	
If not, name of counsel approving the contract and date of approval	
If treated as noncompliant, list of bond issues financing the space used	

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Questions & Answers

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