Bond
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No Recess: The Importance of Post-Issuance Compliance Policies and Procedures for New York State School Districts

Overview

Tax-exempt bonds and notes, the interest on which is exempt from federal income taxation, are routinely issued by school districts across New York State to finance a wide variety of capital projects and to refinance existing tax-exempt debt. The central benefit to tax-exempt debt financing is that it provides greatly reduced borrowing costs to school districts. The Internal Revenue Code (the "Code") and regulations of the Treasury Department (the "Treasury Regulations") impose a number of requirements on issuers of tax-exempt debt in order to maintain the tax-exempt status of interest paid on tax-exempt bonds. Among others, these requirements include restrictions on the expenditure and investment of tax-exempt bond proceeds, the use of facilities financed with tax-exempt debt, changes in use of property financed with tax-exempt debt, and the sale or disposition of property financed with tax-exempt debt.

Post-Issuance Compliance

As part of the issuance of tax-exempt bonds, a school district typically covenants to comply with all requirements of the Code and the Treasury Regulations to maintain the tax-exempt status of interest payable on the school district's bonds. A failure to comply with these ongoing covenants could result in a time-consuming and expensive audit by the Internal Revenue Service (the "IRS"), substantial settlement costs or even jeopardize the tax-exempt status of outstanding bonds and notes.

Emphasis on Policies and Procedures by the IRS

The IRS has strongly encouraged issuers to adopt post-issuance compliance policies and procedures to better enable issuers to comply with the provisions of the Code and the Treasury Regulations that apply to tax-exempt bonds. As stated in IRS Publication 4079: Tax-Exempt Governmental Bonds (January 2016), the IRS "believes that issuers that establish and follow comprehensive written monitoring procedures to promote post-issuance compliance generally are less likely to violate the federal tax requirements related to its bonds, and are more likely to find any violations earlier, than those without procedures." Likewise, the IRS recently modified Form 8038-G – the information statement required to be filed by school districts in connection with a tax-exempt bond or note issue – to include questions as to whether the issuer has established procedures to monitor the requirements of the Code applicable to tax-exempt bonds and notes.

Additionally, the IRS provides school districts with a further incentive to adopt post-issuance compliance procedures under its Voluntary Closing Agreement Program ("VCAP"). This program was established to assist issuers in resolving violations of federal tax laws applicable to tax-exempt debt. A school district with established post-issuance compliance policies and procedures that submits to VCAP in connection with any non-compliance can generally expect to receive more favorable treatment from the IRS than it would otherwise receive under an audit examination by the IRS for the same non-compliance (i.e. if policies and procedures were not in place). This carrot versus stick approach provided by the IRS further illustrates the importance it places on post-issuance compliance.

Components

The key components of any post-issuance compliance policies and procedures for tax-exempt obligations should include provision for the following:

- Due diligence review at regular intervals;
- Identification of official or employee responsible for review;
- Training of responsible official or employee;
- Retention of adequate records to substantiate compliance;
- Procedures reasonably expected to timely identify non-compliance; and
- Procedures ensuring that issuer will take steps to timely correct non-compliance.

Tailored Solutions

Given the heightened awareness of the IRS on post-issuance compliance, school districts must be diligent in their compliance efforts – and the adoption of policies and procedures is an important component of that process. Bond's public finance attorneys regularly work with school districts throughout New York State with respect to the issuance of tax-exempt debt and post-issuance compliance matters. As part of this practice, we have assisted numerous school districts throughout the State in drafting post-issuance compliance policies and procedures. These policies and procedures allow a school district to identify potential areas of concern and to maximize the likelihood that post-issuance compliance requirements are met.

If you have any questions about post-issuance compliance procedures, please contact Christopher C. Canada, any of the attorneys in our Public Finance Practice, or the attorney in the firm with whom you are regularly in contact.