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CLIENT ALERT

ORGANIZATIONS WITH TAX EXEMPT BOND FINANCING

DO YOU HAVE A POST-ISSUANCE COMPLIANCE PLAN IN PLACE?

The Internal Revenue Services ("IRS") continues to scrutinize the policies and procedures put into place by borrowers of 501(c)(3) tax exempt bond financings. Recently, the IRS released a report on tax-exempt bond post-issuance compliance policies and procedures. This report was based on a series of questionnaires sent in 2008 to non-profit borrowers to evaluate whether they understood post-issuance compliance and record retention requirements. Overall, the IRS's report found significant gaps in understanding and implementation, with only 16% of the surveyed organizations having adopted written compliance procedures. As a result of these findings, the IRS now strongly encourages borrowers of 501(c)(3) bond financings to adopt formal procedures and practices to improve the likelihood of post-issuance compliance.

The IRS focus on post-issuance compliance plans is timely given that Schedule K of the revised IRS Form 990 ("Schedule K") is now in full force and effect. Schedule K requires 501(c)(3) organizations with tax exempt bond financing to confirm each year that their bond issuances comply with private business use limitations. This means that organizations must evaluate the use of the bond proceeds and bond financed property on an annual basis.

The best way for a 501(c)(3) organization to complete Schedule K and ensure that its bond financing does not lose its tax exempt status is to adopt and implement a written compliance plan which:

- appoints a compliance coordinator from within the organization, and
- includes three checkpoints:
    - an initial review of the bond issuance;
    - a screening arrangements for the use of the bond financed property; and
    - an annual review.

In undertaking these reviews, the organization should focus on the following:

- **Initial Review:** Schedule K requires each bond issuance to be reviewed separately to assure that at least 95% of the net proceeds is used for charitable purposes. To do this, the organization should

  - identify each bond-financed project and the expenditures from the bond proceeds; and
  - identify and calculate the percentage of any private business use associated with the bond issuance.

Organizations should work with counsel to identify any issues. The bond issuance's tax certificate is a good starting point.

- **Screening New Arrangements:** Because private business use of a bond-financed facility may threaten the tax exempt status of the bonds, it is imperative that the 501(c)(3) organization develop systematic policies and procedures to monitor the use of bond-financed facilities and any contracts related to the use of such facilities. Schedule K requires disclosure of how the organization monitors the private business use of its bond-financed facilities. Several common contracts, such as leases and management and other contracts with third party providers, can constitute private business use. These leases and contracts must be carefully drafted in order to fit within a safe harbor or other exception. In addition to new contracts, existing arrangements with third parties should be reviewed by counsel to assure compliance.

- **Annual Review:** Schedule K requires detailed disclosures about the investment and expenditure of bond proceeds. Many organizations will need to develop or further refine their procedures for tracking these proceeds. The procedures should be integrated into existing accounting systems, so that issues can be addressed in a timely manner.

The IRS has also emphasized that record retention policies are an important part of the framework for ensuring post-issuance compliance. As a result, 501(c)(3) organizations with tax exempt bond financing should consider formalizing their record retention policies, including bond transcript and expenditure records.

For additional information or assistance with crafting written policies and procedures, please contact Attorney Elka Sachs at esachs@kb-law.com or (617)482-7211.

Links to Schedule K and related instructions can be found at:
http://www.irs.gov/charities/article/0,,id=185561,00.html