



Basic Arbitrage Compliance Requirements

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Goal of IRS Arbitrage Rules

Arbitrage Rules designed to eliminate any arbitrage incentive to:

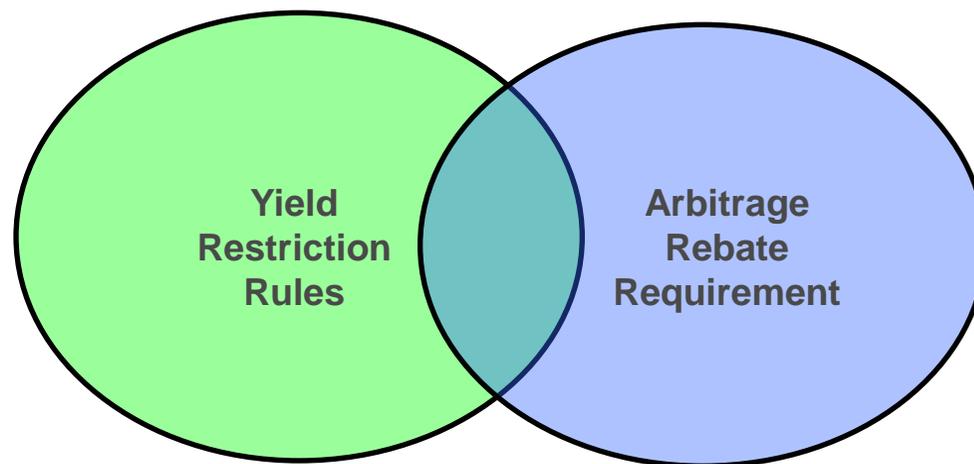
- Issue more bonds than needed,
- Issue bonds earlier than needed, and
- Leave bonds outstanding longer than needed

to accomplish the governmental purpose of the bond issue.

Two Separate Rules

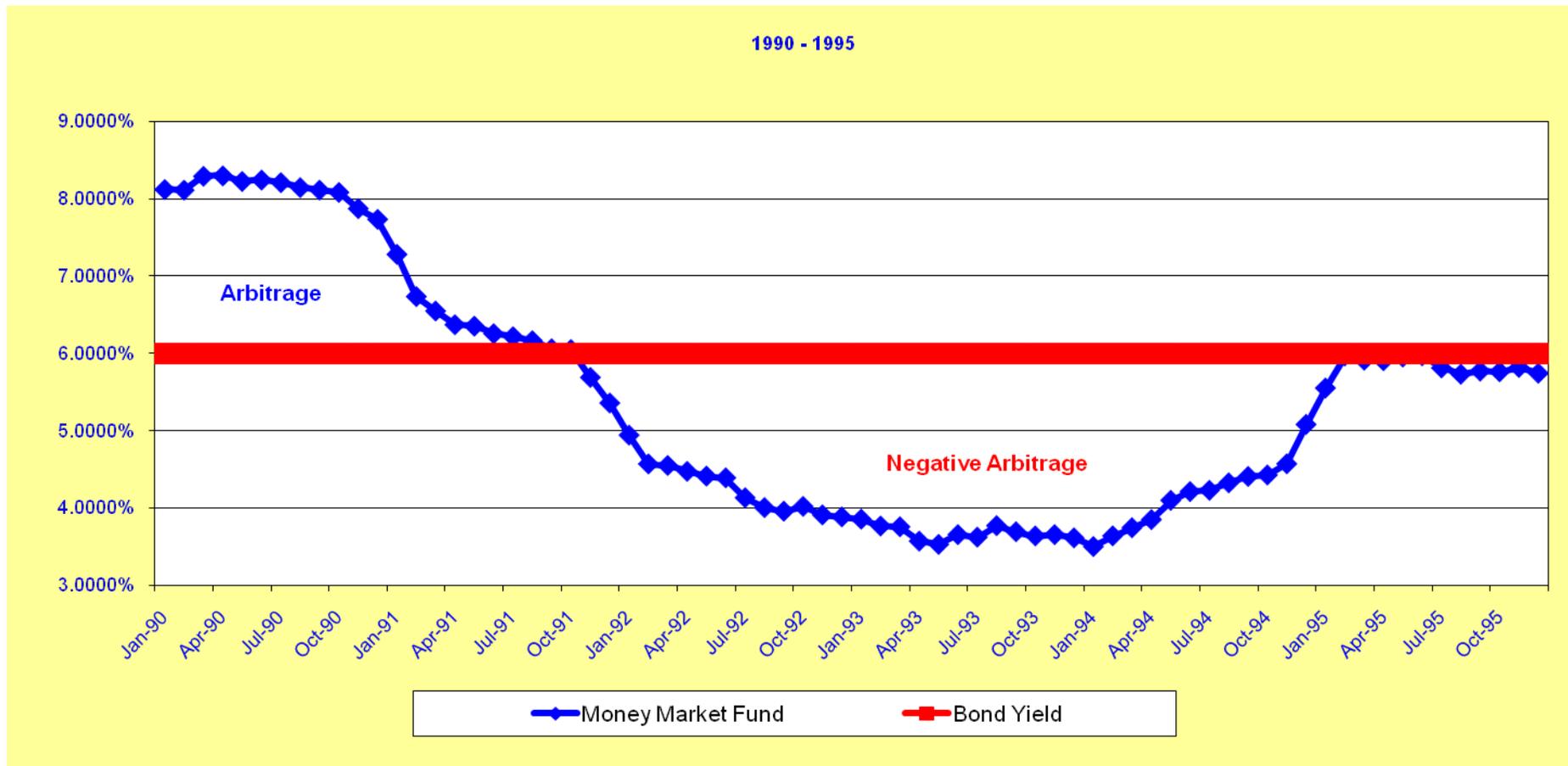
Yield Restriction – IRC Section 148(a): Governs when you may legally earn arbitrage from investing bond proceeds.

Arbitrage Rebate - IRC Section 148(f): Mandates when you must rebate arbitrage earned to the federal government.



Prior to 1986, only yield restriction applied. After 1986, both rules apply to a bond issue.

Arbitrage Rebate from 1990-1995



Proceeds Subject to Rebate or Yield Restriction



Sales proceeds

– Received from the sale of the bonds.



Investment proceeds

- Interest earnings on proceeds of an issue.



Transferred proceeds

– Unexpended proceeds of a refunded issue.



Replacement proceeds

– Non-proceeds treated as proceeds (e.g., debt service).

Yield Restriction Rules

History of the Arbitrage Laws

First major arbitrage laws passed as part of the Tax Reform Act of 1969.

- > Imposed limited time periods (“temporary periods”) for earning arbitrage.

First arbitrage regulations issued in 1979.

- > Most of those restrictions still apply today.

Arbitrage Rebate requirement first imposed to issuers in the 1980’s.

General Yield Restriction Rule

- In general, “gross proceeds” of an issue may never be invested at a yield that is materially higher than the yield on the bonds.

Materially higher defined as:

Above Bond Yield

- | | |
|---------------------------------|----------------------|
| ➤ General restriction | 1/8th of 1% (0.125%) |
| ➤ Advance refunding escrows | 1/1000th of 1% |
| ➤ Program investments (housing) | 1.5% on loans |
| ➤ Student loans | 2.0% on loans |
- Certain exceptions to this rule are available during “temporary periods”

Temporary Periods

- Temporary periods are time periods in which investing proceeds at a materially higher yield will not cause the bonds to become “arbitrage” bonds.
- Yield restriction is determined over time, not by investment.
- When determining compliance with yield restriction, all yield restricted (same “class”) are blended together.
- Lowest available materially higher yield is used for two types of restricted money.
- Sample: Construction fund (after 3 years) and escrow fund, use 1/1000th of 1% limit.

Three-Year Capital Projects Temporary Period

➤ Reasonable Expectations:

- **Expenditure Test** – 85% of proceeds are expected to be spent within 3 years.
 - **Time Test** – Issuer will enter into a contract for at least 5% of net sales proceeds within 6 months.
 - **Due Diligence Test** – Must proceed with due diligence to complete the projects.
- Temporary Period may be extended to 5-years if engineer or architect certifies project cannot be completed in 3 years.

After the Temporary Period

- Yield restrict remaining proceeds; or
- Make a Yield Reduction Payment may be permitted under 1993 Regulations

- Yield Reduction Payments:
 - 1993 regulations administrative solution to yield restriction.
 - Yield Reduction Payments (YRPs) are payments made to the IRS on yield restricted funds.
 - Paid at same time and manner as a rebate payment.

Yield Reduction Payment Sample # 1

		Arbitrage Earned
Years 1-3	(Unrestricted)	100,000
Years 4-5	(Restricted)	50,000
Arbitrage Rebate Payment		100,000
Yield Reduction Payment		50,000

Yield Reduction Payment Sample # 2

		Arbitrage Earned
Years 1-3	(Unrestricted)	80,000
Years 4-5	(Restricted)	<20,000>
		<hr/>
Arbitrage Rebate Payment		60,000
Yield Reduction Payment		-0-

Yield Reduction Payment Sample # 3

		Arbitrage Earned
Years 1-3	(Unrestricted)	<90,000>
Years 4-5	(Restricted)	70,000
		<hr/>
Arbitrage Rebate Payment		-0-
Yield Reduction Payment		70,000

Arbitrage Rebate Rules

Required Calculation Dates

Installment Calculation Dates (Every 5 Years)

- Installments must be paid at least every 5th bond year.
- Bond year is each one-year period ending on the date selected by the Issuer.
- If no date is selected by the Issuer, bond year ends on each anniversary date of the issue.
- Installment payable within 60 days.
- Installment of at least 90% of cumulative rebate is due.

Final Calculation Date:

- Date all bonds of an issue have been retired
- Cash defeasance or refunding may accelerate final computation date.
- Final payment due within 60 days.
- 100% of remaining arbitrage rebate amount is due.

Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate

▶ Under Sections 143(g)(3) and 148(f)
and Section 103(c)(6)(D) of the Internal Revenue Code of 1954

Part I Reporting Authority

Check box if Amended Return

1 Issuer's name		2 Issuer's employer identification number (EIN)	
3 Number and street (or P.O. box no. if mail is not delivered to street address) Room/suite		4 Report number (For IRS Use Only)	
5 City, town, or post office, state, and ZIP code		6 Date of Issue	
7 Name of Issue		8 CUSIP number	
9 Name and title of officer of the issuer or other person whom the IRS may call for more information		10 Telephone number of officer or other person	
11 Type of issue ▶		Issue price ▶	11

Part II Arbitrage Rebate and Yield Reduction Payments

Amount

12 Computation date to which this payment relates (MM/DD/YYYY)		Amount
13 Arbitrage rebate payment (see instructions) <input type="checkbox"/> check box if less than 100% of rebate amount	13	
14 Yield reduction payment (see instructions) <input type="checkbox"/> check box if less than 100% of yield reduction amount	14	
15 Rebate payment from Qualified Zone Academy Bond (QZAB) defeasance escrow (see instructions)	15	

Part III Penalty in Lieu of Arbitrage Rebate

16 Number of months since date of issue: <input type="checkbox"/> 6 mos <input type="checkbox"/> 12 mos <input type="checkbox"/> 18 mos <input type="checkbox"/> 24 mos <input type="checkbox"/> Other. No. of mos ▶		Amount
17 Penalty in lieu of rebate	17	
18 Date of termination election (MM/DD/YYYY)		
19 Penalty upon termination	19	

Part IV Late Payments

20 Does failure to pay timely qualify for waiver of penalty (see instructions) Yes <input type="checkbox"/> No <input type="checkbox"/>		Amount
21 Penalty for failure to pay on time (see instructions)	21	
22 Interest on underpayment (see instructions)	22	

Part V Total Payment

23 Total payment. Add lines 13, 14, 15, 17, 19, 21, and 22. Enter total here		23
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18	Date of termination election (MM/DD/YYYY)		
19	Penalty upon termination	19	

Part IV Late Payments

20	Does failure to pay timely qualify for waiver of penalty (see instructions)	Yes <input type="checkbox"/>	No <input type="checkbox"/>	
21	Penalty for failure to pay on time (see instructions)			21
22	Interest on underpayment (see instructions)			22

Part V Total Payment

23	Total payment. Add lines 13, 14, 15, 17, 19, 21, and 22. Enter total here	23	
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Part VI Miscellaneous

24	Unspent proceeds as of this computation date	24	
25	Proceeds used to redeem bonds	25	
26	Gross proceeds used for qualified administrative costs for guaranteed investment contracts (GICs) and defeasance escrows	26	
27	Fees paid for a qualified guarantee	27	
28	Is the issue a variable rate issue?	28	Yes <input type="checkbox"/> No <input type="checkbox"/>
29	Did the issuer enter into a hedge? Name of provider	29	Yes <input type="checkbox"/> No <input type="checkbox"/>
	Term of hedge		
30	Were gross proceeds invested in a GIC? Name of provider	30	Yes <input type="checkbox"/> No <input type="checkbox"/>
	Term of GIC		
31	Were any gross proceeds invested beyond an available temporary period?	31	Yes <input type="checkbox"/> No <input type="checkbox"/>
32	Calculations for filing of this form prepared by: <input type="checkbox"/> Issuer <input type="checkbox"/> Preparer:		

Signature and Consent

Under penalties of perjury, I declare that I have examined this return, and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. I further declare that I consent to the IRS's disclosure of the issuer's return information, as necessary to process this return, to the person that I have authorized above.

Signature of Issuer's authorized representative _____ Date _____ Type or print name and title _____

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
Firm's name	Firm's EIN		Phone no.	
Firm's address				

For Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11545Y

Form **8038-T** (Rev. 4-2011)

Exceptions to the Rebate Requirements

➤ Small Issuer Exception

- \$5 million or less in total T/E debt sold in calendar year
- Up to \$15 million for construction of public school facilities

➤ Debt Service Fund Exclusion

- Balance Test – less than 1/12th of debt service as a low balance
- Earnings Test – less than \$100,000 per bond year

➤ Spending Exceptions:

- 6-Month Exception
- 18-Month Exception
- 24-Month Exception

18-Month Spending Exception

Period	Cumulative Expenditures
6 months	15 %
12 months	60 %
18 months	100 %

Exception fails if any semi-annual period is missed.

24-Month Spending Exception

Period	Cumulative Expenditures
6 months	10 %
12 months	45 %
18 months	75 %
24 months	100 %

Exception fails if any semi-annual period is missed.

FAILURE TO COMPLY

- Possible loss of tax-exempt status – “Big Stick”
- If failure was not due to willful neglect
 - Pay penalty on rebate amount
 - Interest on underpayment
- Waiver of penalty allowed under certain circumstances
- Bonds will be declared taxable unless the:
 - failure was not due to willful neglect; and
 - issuer pays a penalty to the United States.

Penalty Assessment Rates

- Penalty equal to:
 - 50 percent for governmental bonds; or
 - 100 percent for private activity bonds, excluding qualified 501(c)(3) bonds.
- Interest also payable on correction amount (IRC section 6621).
 - IRS announced that interest rates will remain unchanged for the calendar quarter beginning October 1, 2012
 - The underpayment rate will be 3.00% (10/1/12 – 12/31/12)

Automatic Waiver of Penalty 1993 Regs

- Failure was not due to willful neglect (not intentional),
 - Issue is not under examination, and
 - Pay Rebate Amount plus interest within 180 days after discovery.
-
- Question - When does 180 days start running?

For additional information regarding Tax Exempt Bonds and IRS Enforcement visit the IRS website at: **www.irs.gov/Tax-Exempt-Bonds**

Tax Exempt Bonds

[Bond Professionals](#)[Bond Holders](#)[Conduit Borrowers](#)[Issuers](#)

Tax Exempt Bond Topics

- [About TEB](#)
- [TEB Forms/Pubs](#)
- [IRM](#)
- [FY 2012 Workplan](#)
- [TEB State Newsletter](#)
- [VCAP](#)
- [TEB Tax Stats](#)
- [Tax Exempt Bond Home](#)

Information for the Tax Exempt Bond Community



[Sale of Assets Financed with Tax-Exempt Bonds by State and Local Governments and 501\(c\)\(3\) Organizations](#)

Often, in their need to raise funds, state and local governments and 501(c)(3) organizations may sell property financed with tax-exempt bonds. These sales could cause the bond issue to become taxable. This article provides basic information concerning remedial actions needed, if necessary, to preserve the tax-exempt status of the bond issue.

[Reallocation Process Announced for Tribal Economic Development Bonds](#)

The IRS has announced a process for reallocation of available amounts of volume cap for Tribal Economic Development Bonds.

[TEGE ACT 11th Report](#)

The eleventh report of recommendations of the Advisory Committee on Tax Exempt and Government Entities (ACT).

[TEB Post-Issuance Compliance](#)

Provides basic post-issuance information for issuers of tax-advantaged bonds.



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