

IRS Bond Compliance: Post Closing Priorities

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Overview

- 1) **Priorities Post-Closing: What should be done first and what can wait?**
- 2) **Practical Pointers: 5 Steps to Success**

Priorities Post-Closing

- **First: Avoiding the cardinal sin**
 - Not knowing where your bond proceeds are spent
- **Second: Avoiding the lesser sins**
 - Not maintaining records
 - Not knowing what is going on in your buildings
 - Not monitoring arbitrage

Cardinal Sin: Not knowing where your bond proceeds are spent

- Where did all the money go?
- Identify projects funded with bond proceeds
 - Where to look
 - ✓ Requisitions
 - ✓ General ledger entries
 - ✓ Summaries of actual uses (versus projected expenditures)
 - ✓ Official statements, deal documents
- Refunded issues
- Determine the amount of equity or taxable proceeds used for project expenses

Lesser Sin: Not maintaining records

- What types of records must be kept?
 - Bond transcript
 - Swap documents
 - Expenditures of proceeds
 - Investments of proceeds
 - Use of bond-financed buildings
- How long?
 - The life of the bond issue *plus* 3 years (or if refunded, the life of the combined bond issues *plus* 3 years)

Not maintaining records (cont.)

- **Make a plan**
 - Designate a “Responsible Person”
 - Determine where records will be held
 - Decide whether hard copies or electronic copies will be held
 - Ensure that you can find them if there is an audit

Lesser sin: Not knowing what is going on inside your buildings

- Which buildings?
 - ✓ Facilities financed in whole or in part with bond proceeds
 - ✓ Facilities directly benefited from utility or infrastructure projects
- “Private use” of these buildings may jeopardize the tax-exempt status of the interest on your bonds

Not knowing what is going on inside your buildings (cont.)

- How much is too much?
 - Technically 5%; but includes costs of issuance separately capped at 2% of proceeds, so in practice limit is approximately 3% for post-1986 series
- Measurement usually based on square footage
 - For example, if 20% of bond proceeds are used to build a student center and 5% of the square footage of the student center is for private use, the student center uses up 1% of the private use cap
- Alternative measurements
 - Time based use of locations (e.g., theaters, athletic facilities, dorms rented out in summer)
 - Revenue based allocation (e.g., sponsored research)

Not knowing what is going on inside your buildings (cont.)

- What is private use?
 - Use of bond-financed property by any person or entity other than:
 - The borrower
 - A 501(c)(3) affiliate of the borrower
 - A state or local government entity
 - Use by the federal government and other non-profits may be considered private use

Not knowing what is going on inside your buildings (cont.)

- **Borrower beware:**
 - Transfer of ownership
 - Leases and short-term rentals
 - Management and service contracts
 - Research agreements
 - Unrelated business activities

Not knowing what is going on inside your buildings (cont.)

- Review private use in the most recent year
 - Look at each bond financed project
 - Review Facilities Questionnaires
 - Has any equity or taxable debt been applied?
 - Determine the private use from each project for each series of bonds
- Then, look back to prior years
 - How far back?
 - Since the date of issue of the outstanding bonds
 - Where to look
 - Past Facilities Questionnaires
 - Contracts
 - Consult tax office for unrelated business uses

Not knowing what is going on inside your buildings (cont.)

- If private use is above 3% there are options available
 - “Blend down”
 - Finer-tooth comb
 - Reallocation
 - “Private payment or security” test
 - Closing agreement (last resort)
- Consult counsel

Lesser sin: Not monitoring arbitrage

- Basic rule: proceeds of a bond issue may not be invested at a yield in excess of bond yield
- Exceptions to the rule
 - Project or construction fund spending exceptions
 - Bona fide debt service fund exceptions
 - If no exception, either yield restrict or pay rebate

Not monitoring arbitrage (cont.)

- Spending requirements (Project Fund, DSRF, Debt Service Fund)
- Sinking Funds
 - Endowments can inadvertently be established as a sinking funds
- Fundraising
 - When are donated funds treated as proceeds of a bond issue (and subject to arbitrage rule)?

Practical Pointers: 5 Steps to Success

- 1) Assemble a team
- 2) Agree on a strategy
- 3) Establish a responsible person system
- 4) Create deadlines and accountability expectations
- 5) Implement annual monitoring plan

Step #1: Assemble your Team

- **Members of your team**
 - Treasury
 - Facilities (both real estate and planning)
 - Research Administration
 - Office of the General Counsel
 - Tax Office

Step #2: Agree on a Strategy

- What is possible given records, resources, and time?
 - Current snap shot
 - Complete retrospective review
- Research agreements
- Facility uses
 - Who knows the uses? Centralized vs. school/program info
 - Where are documents kept; should they be centralized?
- Who has “clout” to make compliance happen?

Step #3: Implement a Responsible Person System

- Designate a single individual responsible for each compliance task
 - ✓ Provides accountability
 - ✓ Ensures the right person is doing each job
- Number of different individuals depends on size of organization

Responsible Person System (cont.)

- **Examples of different tasks**
 - Initial compliance review
 - Monitoring private use
 - Avoiding creation of sinking funds
 - Record retention

Responsible Person System (cont.)

- Appoint a compliance coordinator to oversee multiple responsible persons
 - ✓ Organize compliance effort
 - ✓ Ensure that deadlines are met

Step #4: Create Deadlines

- Set reporting time frames to higher governance authority
- Remind officer who signs 990 of importance
- Monitor and “publish” progress

Step #5: Annual Monitoring Plan

- Ongoing allocation of proceeds, equity and taxable debt
- Spend down
- Use of facilities (annual questionnaire)
- Monitoring arbitrage/rebate rules

Other IRS Compliance Issues

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IRS Compliance Questionnaire

In 2008-2009, the IRS launched a “*Colleges and Universities Compliance Project.*”

Several Key Governance Issues:

- Executive Compensation
- Dealings with related entities; including both 501(c)(3) and for-profit
- Conflicts of Interest Policies
- Investment Policies

Executive Compensation

- Overview
 - Private Inurement/ Private Benefit Concepts
 - IRS Intermediate Sanctions
 - “Rebuttable Presumption” Procedure
 - Have a written policy (no “catch-up” time allowed!)
 - Independent body review and approval
 - Board or Board Committee
 - Disinterest parties (No conflicts of interest)
 - Comparability data (who and how developed?)
 - Documenting decision process (how and when?)

Related Entities

- IRS concerns about UBI
- Related 501 (c) (3)
 - Document process for cost/income transfers
 - Reasonable basis (e.g. cost)
- Related for-profit (Especially academic medical centers)
 - Must be arm's length, fair market value transfers
 - Document process

Conflicts of Interest Investment Policies

- Written conflict of Interest policies required
 - Note: no “catch up” time allowed.
 - Time to review?
 - Policy for Board and “top management officials”?
 - Policy for “full time faculty”?
 - Emerging issue: institutional conflicts of interest
- Written investment policy required
 - Look to state law (model codes)

The End

Questions?