ADVISORY COMMITTEE ON
TAX EXEMPT AND GOVERNMENT ENTITIES
(Act)

RECORD RETENTION REQUIREMENTS FOR
TAX-EXEMPT BONDS AND TAX CREDIT BONDS:
A SPECIFIC PROPOSAL FOR PUBLISHED GUIDANCE

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EXECUTIVE SUMMARY

This project makes a specific proposal for published guidance addressing the record retention requirements for tax-exempt bonds and tax credit bonds. The project recommends publication of a revenue procedure that establishes safe harbors for certain record retention practices. The report makes a specific recommendation for bonds and tax credit bonds that are issued for the benefit of state and local governments and 501(c)(3) organizations (that is “governmental” bonds that are not private activity bonds under section 141 of the Code, qualified 501(c)(3) bonds issued under section 145 of the Code, and tax credit bonds that have similar qualification requirements, including Build America Bonds issued under section 54AA of the Code). The project contemplates, however, that the same approach should be extended to different types of tax-exempt bonds and tax credit bonds, using the basic framework set forth, but adding additional modules to set forth the specific additional qualification requirements for different types of tax-exempt bonds and tax credit bonds.

The administrative burden of record retention relating to tax-exempt bonds and tax credit bonds is unusually great for a number of reasons. First, many of the qualification requirements for tax-exempt bonds and tax credit bonds apply for the entire term of a bond issue. Because tax-exempt bond and tax credit bond issues commonly have a term of 30 years or more, and are commonly refinanced for even longer terms, an issuer may be required to maintain records to demonstrate tax compliance over a very long period. In addition, a number of detailed and complex qualification rules apply, so that multiple different types of records are necessary to demonstrate compliance.

The special record retention problems in this area have been discussed in prior ACT reports, in public comments in response to Notice 2006-63, and in numerous other less formal stakeholder communications with the Service. Specific approaches to provide record retention guidance and relief have proved to be difficult to develop.

The project recommends that the key to developing practical safe harbor guidance is to link safe harbor record retention relief to the adoption and implementation of reasonable post-issuance tax compliance procedures. Accordingly, the project sets forth both a proposal for specific types of record retention safe harbors and a description of the core elements of post-issuance compliance procedures and practices that are required to qualify for those safe harbors.

The project does not recommend that the published guidance define the substantive standards that may apply to issuers of tax-exempt bonds and tax credit bonds under section 6001 of the Code. Regardless of the technical application of section 6001, it has become increasingly commonplace for issuers of tax-exempt bonds and tax credit bonds to enter into contractual covenants to maintain records.
necessary to demonstrate tax compliance. In addition, application of the substantive standards may be different for different types of bonds and records and presents difficult interpretive issues, and likely could require a much longer period to develop. The development of record retention safe harbors can instead be more quickly developed to meet the immediate practical need for guidance.
METHODOLOGY

The team approached this project by first considering the recommendations of prior ACT reports relating to record retention as a whole, reviewing public comments in response to Notice 2006-63, and reviewing the status of the Tax Exempt Bond program in developing responses to those reports and public comments. The team conducted several interviews with officials of TEB to discuss concerns and issues regarding record retention that have arisen in the context of administration of the requirements for tax-exempt bonds, including in examinations, compliance checks, and voluntary closing agreements.

After the development of proposed specific recommendations, the team then sought informal input from a variety of affected stakeholders, including certain members and staff of the Government Finance Officers Association, the National Association of Higher Educational Facilities Authorities, the National Council of Health Facilities Finance Authorities, the National Association of Bond Lawyers, and the Section of Taxation of the American Bar Association. The final project reflects certain input made by these stakeholders.
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DISCUSSION

Prior ACT Reports on the Record Retention Burden for Tax-Exempt Bonds

Prior ACT reports have discussed in some detail the record retention burden faced by issuers of tax-exempt bonds, in particular the 2005 and 2008 ACT reports.

The 2005 ACT Report entitled “Tax Exempt Bonds: Record Retention Burden” emphasized that practical guidance is needed on record retention requirements for tax-exempt bonds, particularly because, in many instances, maintenance of records relevant to tax-exempt bond compliance may be required for periods in excess of 30 years. The 2005 ACT Report made the following specific recommendations:

- The Service should develop a revenue procedure providing guidance on the types of records that issuers of tax-exempt bonds should retain and the related time period for retention of those records.
- The Service should establish a special exception for governmental and qualified 501(c)(3) bond issuers that will ease the burden of recordkeeping for the arbitrage rebate requirements.
- The Service should evaluate the merits of a 2002 proposal on voluntary certification of bond-related records that will allow destruction of certain records prior the general requirements of the Code and regulations.
- The Service should consider establishing a Recordkeeping Agreement Pilot Program similar to the one established by Notice 2004-11 related to the research credit. A similar program could be established for use with complex areas of bond compliance, such as those associated with private use.

The 2008 ACT Report entitled “After the Bonds are Issued: Then What?” emphasized the need for adoption and implementation of post-issuance bond compliance practices and procedures. The 2008 Act Report specifically discussed the importance of record retention as an element of post-issuance compliance practices and procedures.

This report builds on the many of the recommendations of those prior ACT reports.

Actions Taken by the Service relating to Record Retention for Tax-Exempt Bonds

The Service has not published any comprehensive guidance addressing the application of record retention requirements to tax-exempt bonds or tax credit bonds. The applicable regulations do contain scattered record retention
requirements for a number of specific provisions. Most of these record retention provisions refer to the requirement to maintain certain elections or allocations in the books and records of an issue. The most detailed record retention provision for tax-exempt bonds set forth in regulations concerns the safe harbor to establish whether guaranteed investment contracts and investments for yield restriction defeasance escrows are acquired at fair market value. See Treas. Reg. §1.148-5(d)(6)(iii).

In 2003, the Service posted on the webpage for its Tax Exempt Bond program “Tax Exempt FAQs regarding Record Retention Requirements” (the “FAQs”). The FAQs have been modified over time but remain posted on the Tax Exempt Bond webpage. The FAQs note that, during the course of an examination, the Service’s Tax Exempt Bond agents will request all material records and information to support an issue’s compliance with section 103 of the Code. The FAQs set forth a detailed discussion of the records that agents may request, but also indicates that the FAQs are not to be cited as an authoritative source on record retention requirements.

The FAQs state that the requirements of section 6001 of the Code and Treas. Reg. §1.6001-1(a) apply to issuers, conduit borrowers, and bondholders and may apply to other parties to a tax-exempt bond transaction. The FAQs indicate that material records should generally be retained for as long as bonds of an issue are outstanding, plus three years after the final redemption date of the bonds.

Although the FAQs are not formal published guidance, the posting of the FAQs prompted significant reaction among state and local government issuers and bond counsel. In particular, it appears that the posting of the FAQs has resulted in a prevailing practice of including more specific record retention covenants in tax-exempt bond documents.

In Notice 2006-63, the Service requested public comments for developing record retention standards, including recordkeeping limitations programs, for tax-exempt bond issues. The Service in particular asked for public comments on managing any burdens potentially associated with the record retention requirements that apply to issuers and other parties in tax-exempt bond transactions.

In response to Notice 2006-63, the Service received 11 public comments. Most of the comments relate to the special record retention considerations of issuers of bonds for single family and multi-family housing. Public comments addressing the application of record retention requirements to governmental bonds and qualified 501(c)(3) bonds were submitted by the National Association of Bond Lawyers (the “NABL Public Comments”) and the National Association of Higher Educational Facilities Authorities and the National Council of Health Facilities Finance Authorities (the “NAHEFA/NCHFFA Public Comments”).

This report takes into account the public comments made in response to Notice 2006-63.
Tax Compliance Checklists Submitted by the National Association of Bond Lawyers and the Government Finance Officers Association

In light of the Service’s increased emphasis of the need for post-issuance compliance relating to tax-exempt bond eligibility requirements, the National Association of Bond Lawyers and the Government Finance Officers Association jointly submitted to the Service and the Treasury form Tax Compliance Checklists (the “NABL/GFOA Checklists”), most recently by a letter dated August 16, 2007. The ACT believes that the NABL/GFOA Checklists represent an important step in the development of industry guidelines for tax-exempt bond compliance, although the NABL/GFOA Checklists do not necessarily correspond in every detailed respect with the recommendations set forth in this report.

The ACT recommends that a guidance project relating to record retention should consider the NABL/GFOA Checklists as a possible model approach for reasonable post-issuance compliance procedures.

IRS Tax-Exempt Bond Compliance Check Questionnaires

In a number of administrative actions since the release of Notice 2006-63, the Service further indicated a view that record retention and other aspects of post-issuance compliance are strongly interrelated.

In 2007, the Service initiated a soft-contact compliance check program to evaluate the post-issuance compliance and record retention practices within the tax-exempt bond industry. In 2007, the Service sent its “Tax-Exempt Bond Financings Compliance Check Questionnaire” (Form 13907) to 207 section 501(c)(3) organizations that are borrowers of tax-exempt bond proceeds. In 2009, the Service sent its “Governmental Bond Financings Compliance Check Questionnaire” (Form 14002) to approximately 200 state and local government issuers of tax-exempt bonds.

Both compliance check questionnaires begin with a Part I that asks questions related to general post-issuance compliance, focusing in particular on whether the issuer or borrower has written procedures to ensure compliance and whether the issuer or borrower has assigned responsibility for identified compliance tasks to specific officials, departments, or functions. The majority of the remainder of each questionnaire asks questions relating to recordkeeping, which include general recordkeeping practices (Part II) and recordkeeping practices relating to investments and arbitrage compliance (Part III), expenditures and assets (Part IV), and private business use.

On September 11, 2008, the Service released its “Interim Report on Charitable Financings: A Summary of Reported Data & Analysis” on its Tax-Exempt Bonds Compliance Check Initiative for charitable financings. This 2008 interim report discusses in detail the responses to the charitable financings compliance check questionnaire and also contains a significant discussion of the Service’s views
relating to post-issuance compliance and record retention relating to tax-exempt bonds. Notably, the 2008 interim report emphasizes that the Service "encourages issuers and beneficiaries of tax-exempt bonds to implement procedures that will adequately enable them to safeguard against post-issuance violations that result in loss of the tax-exempt status of their bonds." The 2008 interim report also specifically references recommendations in the 2005 ACT Report and 2007 ACT Report relating to post-issuance compliance and record retention.

The ACT recommends that a guidance project relating to tax-exempt bond record retention should take into account responses and reactions to these compliance check questionnaires.

**New Tax-Exempt Bond Reporting Requirements in Form 990**

Substantial new reporting requirements in the redesigned Form 990 even more strongly indicate that the Service has an expectation that 501(c)(3) organization borrowers of tax-exempt bond proceeds will adopt record retention and post-issuance compliance procedures. The new reporting requirements are primarily set forth in the new Form 990 Schedule K. Schedule K requirements identification of bond issues benefiting the organization (Part I), detailed information recording how proceeds are spent (Part II), detailed information regarding private business use of bond-financed property (Part III), and certain information regarding arbitrage compliance (Part IV). Perhaps most notably, Schedule K asks whether the organization has “adopted management practices and procedures to ensure the post-issuance compliance of its tax-exempt bond liabilities”. Because Schedule K requires annual reporting, it implies that at least in the case of qualified 501(c)(3) bonds, the borrower has an obligation to monitor tax compliance on an annual basis.

Accordingly, any published guidance project relating to record retention for qualified 501(c)(3) bonds should take into account the new Form 990 reporting requirements and be sufficient for borrowers to meet those requirements. The ACT recommends, however, that the specific wording and approach of Schedule K should be reexamined in the context of such a publication project. For example, it might be appropriate for a revised Schedule K to reference the record retention safe harbors that are set forth in such published guidance.

**Recent Increased Importance of Tax Credit Bonds**

The American Recovery and Reinvestment Act has greatly increased the importance of tax credit bonds issued under sections 54, 54A and 54AA of the Code. In particular, for any bonds issued after February 17, 2009, through 2010, a state or local government may elect to issue its bonds for governmental purposes either as traditional tax-exempt bonds under section 103 of the Code or as Build America Bonds under section 54AA of the Code. In the case of bonds issued for new capital projects during that period, a state or local government may also elect to issue its bonds as Qualified Build America Bonds, which entitles the issuer to
receive tax subsidy payments equal to 35 percent of interest that is payable on the bonds.

The enactment of the new authorization for Qualified Build America Bonds in particular makes more urgent the need for record retention guidance, because this new type of bond establishes a new administrative relationship of state and local governments to the Service and this relationship raises new and difficult record retention issues. The procedures established for filing for credit payments for Build America Bonds under initial published guidance also imply that the need for record retention guidance is urgent. For example, the initial procedures require an issuer of fixed rate bonds to file a Form 8038-CP with the Service not less than 45 days and not more than 90 days before each interest payment date. This requirement of periodic filing throughout the term of a bond issue further highlights the need for clear safe harbor guidance on record retention and post-issuance compliance procedures, particularly because issuers may have concerns about the level of compliance review that is appropriate to make such periodic filings.

Other types of new tax credit bonds which are authorized to be issued for governmental purposes include Recovery Zone Economic Development Bonds.

The qualification requirements for the new types of tax credit bonds for governmental purposes are in general similar to the requirements for traditional tax-exempt bonds, with certain additional requirements. In particular, Build America Bonds must in general meet all of the eligibility requirements for traditional tax-exempt bonds.

Because of the new importance of tax credit bonds, this report makes recommendations that apply both to traditional tax-exempt bonds and to the new types of tax credit bonds that can be issued for governmental purposes, including in particular Build America Bonds.

**Interpretive Issues under Section 6001 and Other Provisions of the Code**

Prior ACT reports and public comments in response to Notice 2006-63 generally recommend that the Service publish practical safe harbor guidance on record retention requirements for tax-exempt bonds. This report continues to recommend publication of safe harbor guidance rather than substantive interpretation of how the record retention requirements of the Code apply to tax-exempt bond issuers and borrowers.

The technical interpretation of how record retention requirements may apply in this context likely would require the resolution of a number of difficult interpretive issues that do not need to be definitively resolved to provide helpful guidance. The technical application of record retention requirements may be different for the following types of stakeholders: (1) state and local governments as issuers of tax-exempt bonds; (2) state and local governments as issuers of Qualified Build
America Bonds; (3) conduit borrowers of tax-exempt bonds; and (4) holders of tax-exempt bonds.

In the case of state or local government issuers of tax-exempt bonds, it is uncertain whether the record retention requirements of section 6001 of the Code apply at all, because state and local governments are not liable for income tax. Arguably, the requirement to file the Form 8038 information returns for tax-exempt bonds may result in certain record retention requirements. Even if so, however, the records relevant to those returns only concerns a limited set of the requirements for a bond issue to qualify as tax-exempt. For example, the Form 8038-G concerns only date of issuance information and the Form 8038-T only concerns information relating to “rebate” of certain investment profits when required to be made. In other words, a focus on any record retention requirements derived from information returns is not likely to be helpful in providing an overall framework for bond compliance record retention.

In the case of issuers of Qualified Build America Bonds, a state or local government issuer is placed in an administrative relationship to the Service that is the same as, or very similar to, a taxpayer, because the issuer will receive payments that are treated as tax refunds. A technical interpretation of all of the new record retention implications this new relationship could be difficult.

Conduit borrowers of tax-exempt bonds may be treated as taxpayers subject to income tax relating to tax-exempt bond compliance only in the case of qualified private activity bonds (such as bonds issued for the benefit of 501(c)(3) organizations) that are subject to the “change-of-use penalties” set forth in section 150(b) of the Code. In the case of qualified 501(c)(3) bonds, if an issue is non-compliant with use-of-proceeds restrictions, section 150(b) imputes unrelated business income and denies an interest deduction to the conduit borrower. Because section 150(b) concerns only requirements relating to use of bond-financed property, focus on the possible income tax liability of conduit borrowers is not likely to be helpful in providing an overall framework for bond compliance record retention.

In the case of bondholders (unlike issuers and conduit borrowers), all of the applicable eligibility requirements are material, because in general a bondholder is subject to additional income tax if the bond is noncompliant for any reason. Bondholders, however, rarely have direct control of, or even ready access to, the records necessary to establish compliance.

In addition, a meaningful and complete interpretation of substantive record retention requirements would need to address issues relating to burden of proof, particularly in light of the burden-shifting provisions of section 7491 of the Code. Such guidance would need to address how burden of proof standards may apply differently to different participants in a bond transaction. For example, the burden of proof standards that apply to a bondholder that purchases a bond in good faith
reliance on covenants and representations of an issuer may not necessarily be the same as an issuer that is directly responsible for tax compliance.

The Need for a Practical Safe Harbor Approach

As a practical matter, most issuers are expressly or implicitly contractually obligated to maintain records to establish bond compliance, regardless of the manner in which section 6001 and other record retention provisions of the Code may apply to them. It is commonplace for issuers to broadly covenant in bond documents for the benefit of bondholders not to take any action that would cause the bonds to fail to qualify under the applicable eligibility requirements for tax-exempt bonds or tax credit bonds. In addition, particularly after the posting of the FAQs by the Service in 2003, it has become commonplace for many bond documents to include express record retention covenants. Prompt guidance setting forth reasonable record retention safe harbor guidance is needed to inform issuers on ways to comply with such contractual covenants, even if for no other reason.

The thesis of this report is that the best and most practical approach is to establish flexible record retention safe harbors that are conditioned on the adoption and implementation of reasonable bond compliance procedures. This approach recognizes that record retention is best viewed in the context of overall tax compliance. The ACT believes that this approach can address the administrative goals of the Service to ensure and encourage tax compliance, while at the same time permitting more record retention relief for issuers.

This approach requires both the description of “reasonable bond compliance procedures” and the description of specific record retention safe harbors. The ACT believes that this framework approach could be implemented in a number of different ways. In order to further advance the dialogue with a goal towards moving forward to published guidance, this report sets forth an issues memorandum and draft revenue procedure making a specific proposal for how this framework approach could be implemented.

Description of the Proposed Revenue Procedure

The proposed revenue procedure identifies the core elements of reasonable bond compliance procedures that must be adopted and implemented to qualify for favorable record retention safe harbors. These core elements are identified as (1) reasonable procedures for assignment of compliance responsibilities; (2) reasonable procedures for the establishment and maintenance of books and records; (3) reasonable procedures for compliant investment of gross proceeds; (4) reasonable procedures for the review and allocation of bond proceeds; (5) reasonable procedures for periodic monitoring of use of financed property; and (6) reasonable susceptibility to audit. The proposed revenue procedure acknowledges by specific examples and otherwise that, in light of the great variety of bond issuers and borrowers, a "one size fits all" approach is not workable, and that issuers should have considerable flexibility to meet these core elements.
The proposed revenue procedure then sets forth specific record retention safe harbors for the following types of records: (1) investment requirements; (2) expenditure requirements; and (3) qualified use of bond proceeds and bond-financed property.

A general theme of the record retention safe harbors is that detailed records are required to be maintained only for a minimum period of six years (but not longer than three years after the bonds are retired), provided that summary records are maintained for a general record retention period.

Additional Public Comment

The approach set forth in the proposed guidance project is in certain respects novel and publication of a guidance project using this approach can be expected to have significant impact on the procedures of state and local governments. In that light, although the ACT recommends that the guidance project be set forth in a revenue procedure, the ACT also recommends that the Service and Treasury consider publication of a proposed revenue procedure subject to further public comment.

Recommendations for Regulatory Revisions to Provide Additional Record Retention Relief

The ACT believes that publication of safe harbor guidance on record retention for tax-exempt bonds and tax credit bonds should also be an occasion for the Service and Treasury to consider revisions to regulations to provide additional relief from record retention burden.

Certain provisions of the existing regulations were expressly adopted in order to reduce administrative burden on issuers. The final private activity bond regulations published on January 16, 1997, for the first time set forth an express rule that compliance with the private activity bond requirements for governmental bonds must take into account “deliberate actions” as well as date of issuance reasonable expectations. At the time of promulgation of these regulations, however, neither issuers nor the Service fully understood the large administrative burden imposed by the “deliberate action” rule. The ACT believes that the Service should revisit the scope of exceptions in light of administrative burdens relating to record retention and post-issuance compliance.

In recognition of this administrative burden, Treas. Reg. §1.141-2(d)(5) provides a special rule for general obligation bond programs that finance a large number of different purposes. Under that rule, an issuer can establish compliance with the private activity bond tests based solely on date of issuance reasonable expectations (without taking into account subsequent deliberate actions) provided that a number of conditions are met. The detailed requirements of this special rule, however, make the provision unavailable for many issuers. For example, one condition of the rule is that the issuer must reasonably expect to expend all net proceeds of the bond issue within 6 months of the date of issuance and must
reasonably expect to expend all net proceeds of the bond issuer before expending proceeds of similar general obligation bonds. The preamble to the final regulation adopting this special rule expressly indicates that it was adopted to minimize administrative burden on issuers:

The proposed regulations provide a special exception to the definition of disposition proceeds that is intended to minimize the burden of tracing the use of proceeds of general obligation bonds that finance a large number of projects. Commentators suggested that this exception should be available for other types of bonds and that fewer conditions should apply to the exception.

The final regulations provide a similar rule that is broadly stated as an exception to the rule that a deliberate action after the issue date can cause an issue to fail to meet the private activity bond tests. The exception is intended to provide relief for “cash flow” general obligation bond programs, where issuers use the proceeds of an issue for a large number of projects and spend proceeds promptly. These programs merit special treatment because they further the purposes of the arbitrage rules.

TD 8712, 62 F.R. 2276 (January 16, 1997).

Another example of a regulatory exception that is far too narrowly crafted is the special rule for dispositions of personal property in the ordinary course of business of an established governmental program set forth in Treas. Reg. §1.141-2(d)(4).

Examples of possible revisions to the regulations that could significantly reduce administrative burden include the following: (a) expansion of the special rule for general obligation bonds that finance a large number of separate purposes to make it more widely available to general obligation bond issues that finance capital projects; (b) consideration of other exceptions to the “deliberate action” rule that requires monitoring of use of bond-financed property after the date of issuance, including exceptions for small issuers, (c) expansion of the rule for dispositions of personal property in the ordinary course of an established governmental program so that it applies to qualified 501(c)(3) bonds; and (d) adoption of a regulatory de minimis rule to the requirement for qualified 501(c)(3) bonds that all property must be owned by a 501(c)(3) organization or a state or local government.

A Renewed Call for Simplification

Finally, the ACT recommends that a published guidance project dealing with record retention and post-issuance compliance should be accompanied by a renewed commitment to regulatory simplification to ease the compliance burden on issuers.
and borrowers. To a certain extent, the complexity of the tax-exempt bond and tax credit bond requirements is inherent in the detailed provisions of the Code, but the complexity of implementing regulations and published guidance in many cases makes the compliance burden on issuers and borrowers unnecessarily burdensome.

A prime example is the rule for “yield reduction payments” set forth in the arbitrage regulations under section 148 of the Code. These regulations permit an issuer to make payments to the Treasury to reduce investment yield on investments, but only in certain cases which are specified in an unduly complex rule. In cases where yield reduction payments are not permitted, an issuer may be required to achieve compliance by means of complicated investment strategies or a costly voluntary closing agreement. There appears to be no compelling reason why yield reduction payments should not be permitted in all cases.

In 1992, the Service announced a major commitment to simplification of regulatory guidance under section 148 of the Code. See 57 FR 20971. That commitment was followed up with the publication of final regulations in 1993 that took significant steps towards simplification and that identified simplification as a primary objective. Since that time, the Service’s emphasis on tax-exempt bond simplification has largely faded. Now is the occasion for a renewed litmus test for the reexamination and adoption of tax-exempt bond and tax credit bond regulations and other interpretive guidance: are the interpretive rules readily understandable by issuers and readily susceptible to implementation in reasonable post-issuance compliance procedures.
APPENDIX C

PROPOSED FORM OF REVENUE PROCEDURE

Rev. Proc. 2009-__

Records Establishing Compliance with Certain Requirements of Sections 103, 141 through 150, 54AA, 54F and 1400U-2

Section 1. Purpose

The purpose of this revenue procedure is to set forth conditions under which certain factual and other matters material to the requirements of §§ 103, 141 through 150, 54AA, 54(f) and 1400U-2 of the Internal Revenue Code of 1986 (the Code) will be considered by the Service to be established. This revenue procedure does not set forth substantive standards for recordkeeping requirements under § 6001. This revenue procedure is intended to provide administrative relief to issuers and conduit borrowers of tax-advantaged bonds. The failure of an issuer or conduit borrower to adopt the safe harbors set forth in this revenue procedure will not establish any presumption adverse to an issuer or conduit borrower in an examination.

Section 2. Background

.01 Requirements for state and local obligations under §§103 and 141 through 150 of the Code

(1) Under section 103(a) of the Code, gross income does not include interest on any State or local bond. Under § 103(b)(1), § 103(a) does not apply to a private activity bond, unless it is a qualified bond under § 141(e). Under § 141(e), a private activity bond is a qualified bond only if it meets the applicable requirements of §§ 142 through 147. Under § 103(b)(2), § 103 does not apply to any arbitrage bond within the meaning of § 148. Under § 103(b)(3), §103(a) does not apply to any bond unless such bond meets the requirements of § 149.

(2) Many of the requirements of §§ 103 and 141 through 150 apply to an issue on the date of issuance and after the date of issuance throughout the term of the issue. In most instances, failure to comply with such requirements results in interest on the obligations becoming includible in gross income from the date of issuance. In part because obligations issued under § 103 commonly may have maturities in excess of 30 years and may finance a large number of different projects, record retention requirements relating to such requirements may be unusually burdensome.

(3) The issuer (or conduit borrower) of obligations issued under § 103 may covenant to the holders of the obligations to meet the applicable requirements
under §§103 and 141 through 150, and will customarily have control of records relating to compliance.

02 Requirements for Build America Bonds under §54AA of the Code

(1) Under §54AA(a) of the Code if a taxpayer holds a Build America Bonds on one or more interest payment dates during any taxable year, there shall be allowed as a credit against income tax for the taxable year an amount equal to the sum of the credits determined under §54AA(b) with respect to such dates. The amount of the credit determined under §54AA(b) with respect to any interest payment date for a Build America Bond is 35 percent of the interest payable by the issuer with respect to such date. Under §54AA(d) of the Code, for purposes of §54AA, the term “Build America Bond” generally means any obligation (other than a private activity bond) if the interest on such obligation would (but for §54AA) be excludable from gross income under §103, such obligation is issued before the date designated therein, and the issuer makes an irrevocable election to have §54AA apply.

(2) Under §6431, in the case of any Qualified Build America Bond issued under §54AA(g) before January 1, 2011, the issuer shall be allowed a credit with respect to each interest payment under such bond in an amount equal to 35 percent of the interest payable under such bond. Under §54AA(g), the term “Qualified Build America Bond” generally means any Build America Bond if 100 percent of the available project proceeds are to be used for capital expenditures and the issuer makes an irrevocable election to have §54AA(g) apply.

03 Requirements for Economic Development Recovery Zone Bonds under §1400U-2 of the Code

(1) Under §1400U-2 of the Code, a Recovery Zone Economic Development Bond is treated as a Build America Bond and a Qualified Build America Bond, provided that a tax credit amount of 45 percent of interest payable applies rather than a 35 percent tax credit. The term “Recovery Zone Economic Development Bonds” generally means a bond 100 percent of the available project proceeds of which are used for the purposes of promoting development or other economic activity in a recovery zone.

04 Application of recordkeeping requirements

(1) Section 6001 provides that every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules as the Secretary may from time to time prescribe. Whenever necessary, the Secretary may require any person, by notice served upon that person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not that person is liable for tax.
(2) Section 1.6001-1(a) generally provides that persons subject to income tax, or required to file a return of information with respect to income, must keep such books or records as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by that person in any return of such tax information.

(3) Section 1.6001-1(e) provides that the books or records required by § 6001 must be kept available at all times for inspection by authorized internal revenue officers or employees, and must be retained as the contents thereof may become material in the administration of any internal revenue law.

Section 3. Safe harbor bond compliance procedures

01. Safe harbor bond compliance procedures mean reasonable procedures adopted and implemented by an issuer that are intended to ensure compliance with the applicable requirements of §§ 103, 141 though 150, 54, 54A, and 54AA and that include at least all of the following elements—

(1) Reasonable procedures to assign compliance responsibilities to appropriate departments, employees, or other functions;

(2) Reasonable procedures for the establishment and maintenance of books and records files for each issue;

(3) Reasonable procedures for compliant investment of gross proceeds for each bond issue;

(4) Reasonable procedures for the review and allocation of expenditures of bond proceeds for each issue;

(5) Reasonable procedures for periodic monitoring of use of proceeds and financed property; and

(6) Susceptibility to audit to verify adherence to the procedures.

02. Reasonable procedures for assignment of compliance responsibilities mean procedures that identify and assign responsibility for each of the Bond Requirements that apply to each Category of Bond Issue. The specific manner in which the assignment is made may take into account the size and organizational structure of the issuer, the size and complexity of the issues of tax-exempt bonds and tax credit bonds that are issued by the issuer, the nature of the Bond Requirements that are applicable, and other relevant facts and circumstances that apply to the issuer and its obligations.

The following are examples of reasonable procedures for assignment of compliance responsibilities.
Example 1. City A seeks to adopt and implement safe harbor bond compliance procedures for its general obligation bonds. Under the City A’s charter, the chief financial officer generally has responsibility for financial matters, the city attorney has responsibility for legal interpretation, and the city treasurer has responsibility for investment of funds. City A adopts tax-exempt bond compliance policies that assign to these officers specific compliance tasks. For example, in general, the chief financial officer is assigned responsibility to review how bond proceeds are spent, to maintain records relating to expenditures, and to compute the amount of any private business use of bond proceeds. The city attorney is assigned responsibility to review any contractual arrangements for use of bond-financed property and to maintain records relating to any such arrangements. The treasurer is assigned responsibility to ensure that all investments purchased with tax-exempt bonds are purchased and sold at fair market value, that reports relating to the rebate requirement of § 148 are obtained on a timely basis, that any required rebate payments are made to the United States on a timely basis, and that records relating to such investments are retained. Such an approach, if implemented for each specific material requirement, may meet the requirement for reasonable procedures for assignment of compliance responsibilities.

Example 2. Health Care Organization H is an organization described in § 501(c)(3) that owns and operates five hospitals. The general counsel of H also serves as the assistant treasurer. H seeks to adopt safe harbor bond compliance procedures for its hospital revenue bonds. H determines to appoint the general counsel/assistant treasurer as “bond compliance officer” and to assign all tax-exempt bond compliance responsibilities to the bond compliance officer, with the exception of record retention requirements relating to expenditures of bond proceeds, which are to be maintained at the hospital level. Such an approach, if implemented for each specific material requirement, may meet the requirement for reasonable procedures for assignment of compliance responsibilities.

03. **Reasonable procedures for the establishment and maintenance of books and records files** mean procedures that identify different categories of material records of each issue that may be created both on or before the date of issuance and throughout the term of the issue, that identify the location where each category of records will be retained and that identify the department, employees or function responsible for maintaining each category of material records. In most cases, procedures for the establishment of books and records files will not be reasonable if the books and records files consist only of records available as of the date of issuance (for example, only the bond transcript). Procedures for the maintenance of books and files are reasonable only if all elections required or permitted under the Code or Income Tax Regulations for an issue are maintained for the General Record Retention Period. An important factor in determining whether books and records files are reasonable is whether the files are designated in a manner that identifies and takes into account treatment of bonds as different issues for purposes of the Bond Requirements (which may be different than the identification of bonds as different issues for state law or bond document requirements.)
In the context of record retention requirements for tax-exempt bonds and tax credit bonds, a specific proposal for published guidance is discussed. An example is given where City A seeks to adopt safe harbor compliance procedures for its general obligation bonds. City A adopts compliance procedures that identify the following files of books and records for each of its general obligation bond issues, that specify the location of each such file and that identify a department responsible for maintaining each file:

1. The bond transcript.
2. Requisitions to the bond trustee.
3. Other information showing how the bond proceeds are spent, which may include invoices and checks or other verifiable information.
4. Records showing actual payments of debt service on the issue.
5. The bond proceeds expenditure certificate and other post-issuance tax allocations and elections, if any.
6. Records of all investments of bond proceeds and any other “gross proceeds” of the bonds, including rebate reports and evidence of rebate payments.
7. Records establishing the use of all property financed with proceeds of the bond issue, including service contracts and leases.
8. Records, certifications, and opinions relating to any “change of use” of bond-financed property, including remedial action certificates and opinions.
9. Records relating to extensions or replacements of guarantees of bonds of the issue, such as letters of credit, and records showing the dates and amounts of any payments for guarantees.
10. Records relating to interest rate swaps or other derivatives relating to the bonds entered into after the date of issuance, if any, and records showing the dates and amounts of any payments and receipts with respect to each derivative contract.
11. Records relating to any modifications of the bonds or the bond documents of the bond issue, including amendments to bond documents and interest rate mode conversions.

These different categories of records will be maintained at varying different locations by a number of different responsible officials or departments. City A has adopted reasonable procedures establishing books and records files for its general obligation bonds.
04. *Reasonable procedures for compliant investment of gross proceeds* means reasonable procedures that are intended to ensure that the investment of gross proceeds meets the arbitrage requirements of § 148 and the federal guarantee requirements of § 149(b) including at least the following elements –

   (1) Procedures to ensure that all such investments are purchased and sold at fair market value in bona fide, arm’s-length transactions;

   (2) Procedures to ensure that all such investments that are guaranteed investment contracts or investments for a yield restricted defeasance escrow are purchased and sold pursuant to the “three-bid” safe harbor set forth in § 1.148-5(d)(6)(iii), unless application of that safe harbor is determined to be not reasonably practicable. For example, application of the safe harbor may be determined not to be reasonably practicable because of limited interest of potential providers of the investment;

   (3) Procedures to ensure that bond proceeds are not intentionally held uninvested and are not actually held uninvested for a period of longer than 3 days;

   (4) Procedures to ensure that any required rebate payments are made to the Service on a timely basis;

   (5) Procedures to ensure that any funds or accounts that are subject to yield restriction are specifically identified and that yield restriction requirements are met for such funds or accounts, either by means of investment or yield reduction payments;

   (6) Procedures to ensure that rebate and yield restriction computations and payments are determined in a manner consistent with the final allocation of proceeds to expenditures;

   (7) Procedures to ensure that any funds or accounts that are treated as containing gross proceeds of the issue, but which are not directly funded with proceeds of the issue (for example, any “sinking funds” or “pledged funds” that are treated as “replacement proceeds”), are specifically identified for review for compliance with investment restrictions.

05. *Reasonable procedures for the review and allocation of expenditures of bond proceeds.*

   (1) *In general.* Reasonable procedures for the review and allocation of expenditures of bond proceeds mean reasonable procedures that are intended to ensure that bond proceeds are used for qualifying expenditures including at least the following elements--

      (a) Review to confirm that each amount treated as an expenditure was a cash outlay to an unrelated party to the issuer;
(b) Review to confirm that each amount for a working capital expenditure is permitted under applicable restrictions of the Code and regulations (for example, is permitted under the “proceeds-spent-last” rule for working capital expenditures in § 1.148-6(d) or the limitation on financing working capital expenditures with available project proceeds of §§ 54AA);

(c) Review to confirm that each amount treated as an expenditure did not involve a noncustomary prepayment (that is, a prepayment that would give rise to investment property because it is noncustomary);

(d) Review to confirm that the final determination of how bond proceeds are spent is consistent with the qualified use requirements that apply to the issue, including any applicable restrictions on financing issuance costs;

(e) In the case of qualified 501(c)(3) bonds, review to confirm that the final determination of how bond proceeds are spent is consistent with the public approval of the issue;

(f) Review to confirm that the final determination of how bond proceeds are spent is consistent with any restrictions on the minimum weighted average maturity of the capital expenditure property financed with proceeds of the bonds set forth in the Code or applicable federal income tax regulations; and

(g) Review to confirm that the method for allocating proceeds to expenditures, if different than a specific tracing method, is stated.

(2) Procedure for execution of a final proceeds expenditure allocation certificate. Under §§ 1.141-6 and 1.145-2 allocations to expenditures generally may be made using any reasonable, consistently applied accounting method. The adoption and implementation of a procedure requiring the execution of a final proceeds expenditure allocation certificate within the time period required by applicable regulations is a strong factor in establishing that procedures for the final review and allocation of bond proceeds is reasonable. In general, issuers may allocate proceeds to expenditures for a period ending 18 months after the financed project is placed in service, as further set forth in § 1.148-6(d).

06. Reasonable procedures for periodic monitoring of use of financed property.

(1) Reasonable procedures for periodic monitoring of use of financed property mean reasonable procedures that are intended to ensure that use of bond-financed property meets the applicable use-of-proceeds requirements including at least the following elements –

(a) Procedures to ensure that each contract for use of bond-financed property is reviewed for compliance with the applicable qualified use requirements by an employee knowledgeable the applicable legal standards (for example, the legal standards for service contracts set forth in Rev. Proc. 97-13, as amended), before the contract is entered into or renewed;
(b) Procedures to monitor and measure the actual percentage amount of nonqualified use during the period bonds of an issue are outstanding;

(c) Procedures requiring the implementation of a remedial action permitted under applicable regulations, or the submission of a voluntary closing agreement request to the Service, promptly after noncompliance with the applicable qualified use requirements is identified, including policies devoting sufficient resources to implementing remedial actions or making voluntary closing agreement requests, as may be required; and

(d) Procedures for periodic training of employees responsible for periodic monitoring in the types of actions that can result in nonqualified use of bond-financed property, in the availability of remedial actions and voluntary closing agreement requests to correct nonqualified use, and in the applicable legal standards for determining whether a contract for use of bond-financed property results in qualified use or nonqualified use.

(2) Examples. The following are examples of reasonable procedures relating to the periodic monitoring of use of financed property.

Example 1. State C seeks to adopt reasonable procedures for the periodic monitoring of use of financed property of its general obligation bonds. In order to simplify the administrative burden of compliance review and record retention, State C adopts the following conservative conventions. State C’s procedures generally require that the amount private business use of proceeds of any bond issue will not be permitted to exceed the lesser of 5 percent or $15,000,000, even though a 10 percent limitation applies in most cases under § 141, except in the case of unrelated or disproportionate private business use. In the case of bond issues to which this conservative procedure is applied, State C does not retain any books and records sufficient to determine whether any private business use is unrelated or disproportionate. State C’s procedures also provide, however, that the amount of private business use of a bond issue may be permitted to exceed 5 percent, provided that the attorney within the Attorney General’s office knowledgeable in the applicable private activity bond rules makes a special review of any private use arrangements to determine whether they result in unrelated or disproportionate use, and State C maintains records sufficient to establish whether any private use is treated as unrelated or disproportionate. This is a reasonable procedure relating to the periodic monitoring of financed property.

Example 2. District D seeks to adopt reasonable procedures for the periodic monitoring of use of financed property of its water revenue bonds. In order to simplify the administrative burden of compliance review and record retention, District D adopts the following conservative conventions. District D’s procedures generally require that the amount of private business use of proceeds will not be permitted to exceed the lesser of 10 percent or $15,000,000 determined on an annual basis, even though measuring private business use on an average basis over a measurement term which may be as long as the term of a bond issue is
generally permitted. Because of the nature of the projects financed by District D (for example, water plants), District D is able to determine with a high degree of confidence for each issue that no use of financed property that results in private business use would be treated as unrelated or disproportionate use. District D's procedures require that its finance director must monitor private business use of the property financed by each issue on an annual basis to determine with a high degree of confidence that that amount does not exceed the permitted limit, but do not require a computation of the exact amount of private business use. For purposes of determining the amount of private business use in prior years during the term of an issue, District D conservatively assumes that the amount of private business use was the maximum permitted amount, so that District D does not benefit from the rule that permits private business use to be determined on an average basis over a measurement term. This is a reasonable procedure relating to the periodic monitoring of financed property.

07. *Reasonable susceptibility to audit* means that procedures are set forth in written form in a manner that is reasonably susceptible to either internal or external audit to determine whether the employees, departments, or functions of the issuer that are identified as responsible for specific compliance task responsibilities have met those responsibilities on a timely basis. The requirement of reasonable susceptibility to audit does not require that compliance with the procedures be actually audited by an internal or external auditor at any specific intervals.

**Section 4. Other Definitions**

01. *Bond* means an obligation of a State or local government that is intended to be an obligation the interest on which is excludable from gross income under § 103, a qualified tax credit bond under § 54A(d), a Build American Bond under § 54AA, or a Recovery Zone Economic Development Bond under § 1400U-2.

02. *Bond Requirements* means the requirements of §§ 103, 141 through 150, 54, 54A, 54AA, and 1400U-2 that apply to an issue.

03. *Category of Bonds* generally means a type of Bonds subject to substantially the same requirements under the Code. For example, each of the following is a different Category of Bonds: qualified 501(c)(3) bonds issued under § 145; qualified mortgage revenue bonds issued under § 143; and each different type of exempt facility bond issued under § 142. Bonds are not treated as different Categories, however, merely because they may be subject to different regulations or other published guidance or are subject to different amended versions of the same subsection of the Code.

In the case of Governmental Bonds, an issuer may in addition chose to treat different types of obligations issued under substantially different State law authority as different Categories of Bonds. For example, an issuer may determine to treat each of general obligation bonds, water and sewer revenue bonds, and tax increment bonds as a different Category of Bonds.
04. **Conduit Borrower** is defined in § 1.150-1(b) and generally means the obligor on a purpose investment.

05. **Conduit Financing Issue** is defined in § 1.150-1(b) and generally means an issue the proceeds of which are used or are reasonably expected to be used to finance at least one purpose investment representing at least one conduit loan to one Conduit Borrower.

06. **Conduit Financing Issuer** means the actual issuer of a Conduit Financing Issue.

07. **Detailed Records of Expenditures** generally mean detailed records of all expenditures of proceeds of an issue including at least the following information: (1) the amount of each expenditure; (2) information sufficient to identify the separate project or purpose of each expenditure; (3) identification of the specific unrelated party (for example, the vendor or contractor) receiving the payment; (4) the date of the expenditure on which the expenditure was made; (5) except as provided by this section, the reasonably expected weighted average maturity of each separate project or purpose; and (6) the placed in service date of each separate project or purpose that is a capital expenditure. In general, detailed records of expenditures include invoices and checks. Detailed Records of Expenditures may include records relating to equity contributions to projects financed with proceeds.

In the case of proceeds used for working capital purposes subject to the “proceeds-spent-last” rule in § 1.148-6(d)(3), Detailed Records of Expenditures include cash flow statements, financial statements and other records reasonably sufficient to establish the amount of the deficit amount material to determining whether proceeds are treated as expended.

08. **Detailed Records of Investments** means detailed records all investments of gross proceeds of an issue generally including the following information: (a) purchase price (including the amount of accrued interest stated separately); (b) nominal rate of interest; (c) par or face amount; (d) purchase date; (e) maturity date; (f) amount or original discount or premium (if any); (g) general type of investment; (h) frequency of periodic payments (and actual dates and amounts of receipts); (i) period of compounding; (j) date of disposition; (k) amount realized on disposition (including the amount of accrued interest stated separately); (l) in the case of guaranteed investment contracts and yield restricted defeasance escrow investments, transaction costs (e.g., commissions) incurred in acquiring, carrying, or disposing of the investments; and (m) if an investment is not traded on an established securities market, such as a guaranteed investment contract, or in a yield restricted escrow, market price data sufficient to establish that the purchase price (or disposition price) was not greater than (or less than) the arm’s-length fair market value on the date of acquisition (or disposition) or, if earlier, on the date of a binding contract to acquire (or dispose of) the investment.
09. **Detailed Records of Use Arrangements** means detailed records of all arrangements for use of proceeds and property financed by an issue, including copies of all contracts for use of bond-financed property that may result in nonqualified use. In the case of a governmental bond, Detailed Records of Use Arrangements do not need to include records of arrangements that are general public use or of contracts for services that are solely incidental to the primary governmental function of the bond-financed property. In the case of a qualified 501(c)(3) bond, Detailed Records of Use Arrangements need to include records sufficient to determine whether the bond-financed property is used for an unrelated trade or business, regardless of the term of an arrangement.

**Example.** County E issues general obligation bonds to finance a parking garage, which are intended to be tax-exempt governmental bonds. County E enters into the following types of contracts for use of the parking garage: (a) a service contract for management of the parking facility; (b) a janitorial contract for the parking garage office; and (c) monthly contracts for use of parking spaces, which are offered to the general public on the basis of rates that are generally applicable and uniformly applied. In connection with the issuance of the bonds, County E was advised by bond counsel that contracts of the nature of the janitorial contract was incidental to the primary governmental function of the parking garage and that arrangements of the nature of the monthly parking contracts were general public use arrangements. The Detailed Records of Use Arrangements for this issue of bonds are required to include the management contract for operation of the parking garage, but not the janitorial contract or the monthly parking contracts.

10. **General Record Retention Period** generally means the period ending on the date that is three years after the last bond of an issue is retired.

11. **Governmental Bond** means an obligation issued under § 103 of the Code that is not a private activity bond under § 141, a Build America Bond issued under § 54AA, and a Recovery Zone Economic Development Bond issued under § 1400U-2.

12. **Issuer** generally means the entity that actually issues an issue and, unless the context or a provision clearly requires otherwise, each conduit borrower for the issue.

13. **Minimum Detailed Record Retention Period** means a period that is the shorter of (1) six years after the relevant action or event to which a record relates and (2) the General Record Retention Period. In the case of records relating to investments, the Minimum Detailed Record Retention Period generally begins on the date of the applicable payment or receipt. In the case of records relating to expenditures of proceeds, the Minimum Detailed Record Retention Period generally begins not earlier than the date on which proceeds are actually treated as paid to an unrelated person. In the case of records relating to qualified use of bond proceeds or bond-financed property, the Minimum Detailed Record Retention Period generally begins not earlier than the last date on which an arrangement for
use of proceeds or financed property terminates. In the case of records relating to elections required or permitted to be made under the Code or Income Tax Regulations, the Minimum Detailed Record Retention Period is the same as the General Record Retention Period.

14. *Project* means a project as defined for purposes of the allocation and accounting rules under § 141 of the Code, as set forth under § 1.141-6(a). In general, the term project means one or more facilities or capital projects, or other property that meets each of the following requirements: (1) the facilities or capital projects are functionally related or integrated and are located on the same site or reasonably adjacent sites and (2) the facilities or capital projects are reasonably expected to be placed in service within the same 12-month period.

15. *Qualified Use Compliance Certificate* means a certificate executed by a responsible officer for each issue containing the following information for the period covered by the certificate: (1) a list of all contractual arrangements for use of the proceeds or property financed by the issue, including identification of any contractual arrangements resulting in nonqualified use; (2) a certification that all such arrangements have been reviewed to determine whether they result in nonqualified use, and (3) a certification of the total amount of nonqualified use of bond-financed property (as a percentage of proceeds or net proceeds) for the period. In general, for this purpose a responsible officer must be an officer or employee of the issuer with authority to make certifications under state or local law who either is knowledgeable in the types of actions that can result in nonqualified use of bond-financed property, in the availability of remedial actions and voluntary closing agreements to correct nonqualified use, and in the applicable legal standards for determining whether a contract for use of bond-financed property results in qualified use or nonqualified use or has consulted with a person who is knowledgeable in such matters in connection with execution of a Qualified Use Compliance Certificate. For example, a responsible officer may consult with an independent bond counsel or other professional in connection with execution of a Qualified Use Compliance Certificate, but is not required to do so.

A Qualified Use Compliance Certificate may be in any reasonable form, and may be in the form of more than one certificate, provided that all of the required information is set forth. For example, a properly completed Schedule K to Form 990 will meet the requirement for certifications to the effect that all arrangements have been reviewed to determine whether they result in nonqualified use and regarding the amount of nonqualified use of bond-financed property. Accordingly, a Qualified Use Compliance Certificate may consist of a properly completed Schedule K together with a separately maintained list of all contractual arrangements for use of the proceeds of the bond-financed property including an identification of any contractual arrangements resulting in nonqualified use.

In the case of Governmental Bonds, a Qualified Use Compliance Certificate must be completed on a basis not less frequently than the period rebate is or would be due to be paid to the United States under § 148 (for example, not less frequently
than a period 5 years if no special election is made and is all bonds of the issue are not retired during that period).

In the case of Qualified 501(c)(3) Bonds, a Qualified Use Compliance Certificate must be completed on an annual basis and must also include a list of all unrelated trade or business use activities or arrangements resulting in nonqualified use of the bond-financed property.

16. **Refunding Issue** is defined in § 1.150-1(d) and generally means an issue of obligations the proceeds of which are used to pay principal, interest or redemption price on another issue (a prior issue).

17. **Summary Record of Expenditures** means a statement or statements summarizing all expenditures of proceeds of an issue including at least the following information: (1) the amount of expenditure for each separate project or purpose; (2) a description of each separate project or purpose; (3) date of the expenditure or reasonable date range during which the expenditure was made; (4) except as provided by this section, the reasonably expected weighted average maturity of each separate project or purpose; and (5) the placed in service date of each separate project or purpose that is a capital expenditure or reasonable placed in service date range. A Summary Record of Expenditures may include records relating to equity contributions to projects financed with proceeds.

For this purpose, the “project or purpose” of an expenditure must be sufficiently detailed to be the basis of determining whether the issue meets the applicable qualified use of proceeds and bond-financed property restrictions. For example, all capital expenditures for a new building generally may be treated as a single project or purpose if the entire building may be treated as a single project for purposes of the private activity bond restrictions of § 141. In the case of qualified 501(c)(3) bonds, the description of project or purpose of an expenditure must include information sufficient to establish that the project or purpose is within the scope of expenditures permitted under the public approval of the issue. Expenditures for Issuance Costs must be stated as a separate project or purpose. Expenditures for working capital purposes must be stated as a separate project or purpose or separate projects or purposes, as appropriate. Expenditures for qualified guarantee fees must be separately stated.

18. **Summary Records of Investments** means a statement or statements summarizing all investments of gross proceeds of an issue including at least the following information: (1) the amount paid for each investment; (2) the date the payment for each investment is made; (3) the amount each receipt from each investment is made; and (4) the date each receipt is received. A rebate report summarizing investment activity for a period, regardless of whether the rebate report uses the “investment method” showing all reinvestments or the “disbursement method” showing only payments for investments and payments for expenditures is an acceptable Summary Record of Investments.
Section 5. Scope

This revenue procedure applies to obligations of a State or local government that are intended to be an obligations the interest on which is excludable from gross income under § 103 and which are not a private activity bonds under § 141, obligations that are intended to qualify as qualified 501(c)(3) bonds under § 145, obligations that are intended to qualify as Build American Bonds under § 54AA, and obligations that are intended to qualify as a Recovery Zone Economic Development Bonds under § 1400U-2.

Section 6. Operating Guidelines for Safe Harbor Bond Compliance Procedures

01. In general. An issuer that has adopted and in good faith implemented all of the safe harbor bond compliance procedures set forth in section 3 of this revenue procedure with respect to any Category of Bonds may conclusively establish the factual and other matters material to compliance with the applicable Bond Requirements described in this section. In general, an issuer may conclusively establish only factual matters under this revenue procedure, except that an issuer may also establish whether prior use of financed property was qualified use as a legal matter by means of a Qualified Use Compliance Certificate. For example, records relating to investments maintained under this revenue procedure will not conclusively establish whether, in the case of a refunding issue, an issuer’s determination of transferred proceeds used a method permitted under the applicable regulations.

02. Service review of qualification. The general requirement that safe harbor bond compliance procedures must be reasonable is intended to provide issuers with flexibility to meet the substantive requirements of the safe harbor using any reasonable method, taking into account the issuer’s particular facts and circumstances. If an issuer in good faith adopts and implements bond compliance procedures that are intended to meet all of the requirements of section 3 of this revenue procedure, the Service ordinarily will not challenge in an examination the conclusive effect of records retained before the date the examination is commenced (in a manner taking into account records required to be maintained during the applicable Minimum Detailed Record Retention Period). The Service may determine in an examination of a bond issue, however, that the bond compliance procedures of an issuer do not meet all of the requirements of section 3 of this revenue procedure and that new records retained after the date of any such determination will not have conclusive effect on a prospective basis, even if an issuer has in good faith adopted and implemented bond compliance procedures.

03. Investment requirements. An issuer may conclusively establish the amounts paid and received on investments of gross proceeds of an issue by maintaining a Summary Record of Investments for the issue, provided that the issuer also maintains Detailed Records of Investments of gross proceeds of the issue for at least the Minimum Detailed Record Retention Period. A Summary Record of
Investments will not, however, conclusively establish that investments that are
guaranteed investment contracts or yield restricted defeasance escrows were
acquired or sold at fair market value.

04.  Bond proceeds expenditure requirements.

(1)  In general. An issuer may conclusively establish the expenditure of
proceeds of an issue by maintaining a Summary Record of Expenditures for the
issue, provided that the issuer also maintains a Detailed Record of Expenditures for
the Minimum Detailed Record Retention Period.

(2)  Equity contributions. An issuer may conclusively establish the amount of
equity contributions to a project financed with proceeds in the same manner as the
expenditure of proceeds may be established under this revenue procedure.

(3)  De minimis rule. An issuer may conclusively establish that an amount of
proceeds of an issue not exceeding 5 percent of the proceeds of the issue and not
exceeding $250,000 for any project or purpose are expended for a qualified use,
provided that the issuer otherwise has adopted and implemented safe harbor bond
compliance procedures for the issue and in good faith reasonably believes that the
proceeds were expended for a qualified use. Multiple projects or purposes may be
eligible for this $250,000 exception, provided that, in the aggregate, the projects or
purposes qualifying for the exception do not exceed 5 percent of the proceeds of
the issue.

(4)  Special rule for working capital expenditures. An issuer may conclusively
establish that proceeds of an issue are spent on working capital expenditures that
are directly related to capital expenditures financed by the issue to the extent
permitted by § 1.148-6(d)(3)(ii)(A)(5) (that is, in general in an amount not exceeding
5 percent of the sale proceeds of the issue) if (a) the issuer reasonably expected on
the date of issuance that the amount of working capital expenditures that are so
directly related would at least equal the amount treated as expended; and (b) the
issuer does not treat the working capital expenditures as made sooner than on a
pro rata basis relative to the capital expenditures to which the working capital
expenditures are directly related.

05.  Requirements for qualified use of proceeds and financed property.

(1)  In general. An issuer may conclusively establish whether the proceeds and
property financed by an issue are used for qualified use by maintaining a Qualified
Use Compliance Certificate for each relevant period, provided that the issuer also
maintains a Detailed Record of Use Arrangements for the applicable Minimum
Detailed Record Retention Period. A Qualified Use Compliance Certificate will not,
however, conclusively establish whether proceeds and property financed by an
issue are used for qualified use with respect to any arrangement if the Service
commences an examination of the issue during the Minimum Detailed Record
Retention Period for that arrangement. A Qualified Use Compliance Certificate
may be used by an issuer, for example, to determine the average amount of nonqualified use over the applicable measurement period under § 1.141-3(g).

(2) De minimis rule. An issuer may conclusively establish that property financed with amount of proceeds of an issue not exceeding 5 percent of the proceeds of the issue and not exceeding $250,000 for any project or purpose is used for a qualified use, provided that the issuer otherwise has adopted and implemented safe harbor bond compliance procedures for the issue and in good faith reasonably believes that the proceeds were used for a qualified use. Multiple projects or purposes may be eligible for this $250,000 exception, provided that, in the aggregate, the projects or purposes qualifying for the exception do not exceed 5 percent of the proceeds of the issue.

Section 7. Application to Refunding Issues

01. In general. This section sets forth the treatment of records for Refunding Issues under this revenue procedure. Refunding Issues may consist of all of an issue or a portion of a multipurpose issue that refunds all or a portion of a prior issue.

02. Investment records. Records relating to investments of gross proceeds of a prior issue are material to compliance of a Refunding Issue only to the extent that those investments become gross proceeds of the Refunding Issue (either as transferred proceeds or as replacement proceeds).

03. Expenditure records. Records relating to expenditures of proceeds of a prior issue are material to compliance of a Refunding Issue.

04. Records of use of bond-financed property. Records relating to use of property financed with a prior issue are material to compliance of a Refunding Issue to the extent that such prior use is material for determining whether the combined issue rule set forth in § 1.141-13(b) applies to the Refunding Issue and the prior issue. Accordingly, in general records relating to use of financed property on and after December 19, 2005 and records relating use of financed property after the issue date of prior bonds issued on or after May 16, 1997 are material to compliance of the Refunding Issue.

Section 8. Application to Conduit Financing Issues

01. In general. In the case of a conduit financing issue, the different elements of safe harbor bond compliance procedures may be adopted and implemented either by the Conduit Borrower or the Conduit Financing Issuer, provided that the assignment of responsibility is set forth in the books and records for the issue. For example, this requirement is met if the bond documents assign all post-issuance compliance responsibilities to the Conduit Borrower, so that the Conduit Financing Issuer has no record retention obligations. In another example, a Conduit Financing Issuer may assume responsibility for compliant investment of gross proceeds (including compliance with yield restriction and rebate requirements) and
books and records relating to such investments, but not responsibility for other bond compliance procedures. Safe harbor bond compliance procedures may be implemented in this manner provided that the assignment of responsibility is set forth in the books and records for the issue.

02. **Requirement of Conduit Borrower to make certifications to Conduit Financing Issuer regarding adoption and implementation of safe harbor bond compliance procedures.** In the case of a Conduit Financing Issue, a Conduit Borrower will be treated as having adopted and implemented safe harbor bond compliance procedures (or elements of such procedures) only if (1) the Conduit Borrower provides a certification to the Conduit Financing Issuer which are maintained in the books and records for the issue that it has adopted and implemented reasonable bond compliance procedures that are intended to meet the requirements of section 3 of this revenue procedure, and (2) the Conduit Borrower provides periodic certifications to the Conduit Financing Issuer which are maintained in the books and records for the issue to the effect that it has in fact implemented reasonable bond compliance procedures that are intended to meet the requirements of section 3 of this revenue procedure. For this purpose a periodic certification may be provided in intervals of not greater than 5 years and may be in the form of a general bond covenant compliance certificate provided to the Conduit Financing Issuer.

03. **Special requirements for Pooled Financing Bonds.** In the case of Pooled Financing Bonds, a Conduit Financing Issuer must also adopt and implement reasonable procedures that are intended to ensure compliance with the applicable provisions of the Code and the regulations that apply to Pooled Financing Bonds (for example, the requirements of § 149(f)) in order to meet the requirements of section 3 of this revenue procedure.

**Section 9. Effect on Other Documents**

01. The period permitted for allocating proceeds to expenditures under Treas. Reg. § 1.148-6(d) is extended for certain issues as set forth in section 10 of this revenue procedure. Guidelines published by the Service for maintenance of records under an electronic storage system and maintenance of records with an automated data processing system apply to records maintained under this revenue procedure. See Rev. Proc. 97-22 and Rev. Proc. 98-25.

**Section 10. Effective Date and Transition Rules**

01. **General effective date.** This revenue procedure generally applies to bonds issued after [the date of publication of this revenue procedure in the Internal Revenue Bulletin.]

02. **Elective retroactive application to particular bond issues.** An issuer may apply this revenue procedure to any bonds issued on or before [the date of publication of this revenue procedure in the Internal Revenue Bulletin], provided
that the issuer must consistently apply this revenue procedure at least to all issues
of the same Category of Bonds that are issued after December 31, 2002 and
before [the date of publication of this revenue procedure in the Internal Revenue
Bulletin] and that are not refunding bonds. In the case of a Conduit Financing
Issues, the provisions of this section 10.2 apply separately to the same Category of
Bonds issued for the benefit of the same Conduit Borrower.

.03 Special transitional relief for period to determine how bond proceeds are
spent. If an issuer chooses to consistently apply this revenue procedure to all
issues of the same Category of Bonds that are issued after December 31, 2002
and before [the date of publication of this revenue procedure in the Internal
Revenue Bulletin], the period for making a final allocation of proceeds to
expenditures set forth in §§1.141-6(a), 1.148-6(d) and 1.145-2(a) is extended for
those issues for a period of one year after [the date of publication of this revenue
procedure in the Internal Revenue Bulletin]. In the case of Conduit Financing
Issues, the provisions of this section 10.3 apply separately to the same Category of
Bonds issued for the benefit of the same Conduit Borrower.

04. Special transitional rule for Review of Qualified Use and Completion of
Qualified Use Compliance Certificates. If an issuer chooses to apply this revenue
procedure as permitted by this section 10 to bonds issued on or before [the date of
publication of this revenue procedure in the Internal Revenue Bulletin], the issuer
may complete a Qualified Use Compliance Certificate to conclusively establish
whether the proceeds and property financed by an issue are used for qualified use
in the manner described in section 6.04 of this revenue procedure. The period of
time for completing a Qualified Use Compliance Certificate described in section
4.15 of this revenue procedure does not apply to a Qualified Use Compliance
Certificate that is completed not later than [date that is one year after the date of
publication of this revenue procedure in the Internal Revenue Bulletin], so that the
period for completing Qualified Use Compliance Certificates is extended.