RECOVERY ACT

Initial Published Guidance for American Recovery and Reinvestment Act of 2009 Bonds Was Complete, Accurate, and Consistent

March 16, 2010

Reference Number: 2010-11-035

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Phone Number | 202-622-6500
Email Address | inquiries@tigta.treas.gov
Web Site | http://www.tigta.gov

INITIAL PUBLISHED GUIDANCE FOR AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 BONDS WAS COMPLETE, ACCURATE, AND CONSISTENT

Highlights

Final Report issued on March 16, 2010

Highlights of Report Number: 2010-11-035 to the Internal Revenue Service Chief Counsel and Commissioner for the Tax Exempt and Government Entities Division.

IMPACT ON TAXPAYERS

The American Recovery and Reinvestment Act of 2009 (Recovery Act) authorizes new and expanded bond financing subsidies of more than $57.8 billion. However, this figure could be much higher because one type of tax credit bond, known as Build America Bonds, was not given a limit. These financing subsidies enable State and local governments to borrow at lower costs for capital projects and also target programs for schools and energy projects. The Internal Revenue Service (IRS) quickly published guidance to help bond issuers understand how to issue tax-exempt and tax credit bonds intended to stimulate the economy by preserving and creating jobs.

WHY TIGTA DID THE AUDIT

The Recovery Act contains spending and tax provisions of $787 billion over 10 years and is intended to preserve and create jobs, reduce home foreclosures and college costs, provide health insurance and unemployment benefits, promote critical public infrastructure investment, and stabilize the budgets of State and local governments. The overall objective of this review was to determine whether IRS published guidance was complete, accurate, and consistent to allow issuance of tax-exempt and tax credit bonds in accordance with the Recovery Act.

WHAT TIGTA FOUND

The initial guidance published by the IRS in the form of notices was complete, accurate, and consistent with the tax-exempt and tax credit bond requirements of the Recovery Act. The notices provided information to help bond issuers understand how to issue tax-exempt and tax credit bonds as provided for by the Recovery Act.

In addition, IRS management plans to update expiring Recovery Act guidance and provide supplemental information in the form of published guidance by June 30, 2010.

WHAT TIGTA RECOMMENDED

There were no recommendations in this report. However, key IRS management officials reviewed it prior to issuance and agreed with the facts and conclusions presented.

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

March 16, 2010

MEMORANDUM FOR CHIEF COUNSEL
COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Initial Published Guidance for American Recovery and Reinvestment Act of 2009 Bonds Was Complete, Accurate, and Consistent (Audit # 200910131)

This report presents the results of our review of Internal Revenue Service (IRS) published guidance for American Recovery and Reinvestment Act of 2009 (Recovery Act)[1] tax-exempt and tax credit bonds. This review was conducted as part of the Treasury Inspector General for Tax Administration Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

The Recovery Act provides separate funding to the Treasury Inspector General for Tax Administration through September 30, 2013, to be used in oversight activities of IRS programs. This audit was conducted using Recovery Act funds.

We did not make any recommendations in this report. However, key IRS management officials reviewed it prior to issuance and agreed with the facts and conclusions presented.

Copies of this report are also being sent to the IRS managers affected by the report finding. Please contact me at (202) 622-6510 if you have questions or Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations), at (202) 622-8500.

[1] Pub. L. No. 111-5, 123 Stat. 115 (2009).

Table of Contents

Abbreviations

IRS	Internal Revenue Service
TEB	Tax Exempt Bonds

Background

The American Recovery and Reinvestment Act of 2009 (Recovery Act)[1] was enacted on February 17, 2009, as an emergency response to an economic crisis unlike any since the Great Depression. The Recovery Act contains spending and tax provisions of $787 billion over 10 years to preserve or create an estimated 3.5 million jobs by the end of September 2010, reduce home foreclosures and college costs, target programs for schools and energy projects, provide health insurance and unemployment benefits, and enable State and local governments to borrow at lower costs for capital projects to promote critical public infrastructure investment and stabilize their budgets.

The Recovery Act authorizes the issuance of tax-exempt and tax credit bonds which provide State and local governments fiscal relief needed to help stimulate the economy.

The Recovery Act contains multiple provisions that authorize the issuance of additional tax-exempt bonds and greatly expands the market for tax credit bonds.[2]

- **Tax-exempt bonds** are issued by State or local governments, where the interest income paid by the bond issuer to bond investors is not taxable by the Federal Government.
- **Tax credit bonds** differ from traditional tax-exempt bonds. If bonds are issued as tax credit bonds, investors must include the total interest income received in gross income and claim a Federal tax credit equal to a percentage of the interest income received or the bond's face value for a limited number of years.

In Calendar Year 2006, State and local governments issued $428.3 billion in tax-exempt bonds,[3] and tax credit bonds were a small part of the bond market. The Recovery Act increased tax-exempt bond financing by $17 billion. However, tax credit bonds were significantly increased by at least $28.4 billion. This figure could be much higher because one type of tax credit bond, known as Build America Bonds, was not limited in the total dollar amount that can be issued.

Prior to enactment of the Recovery Act, there had been no substantive legislative changes for tax-exempt and tax credit bonds in approximately 20 years. Therefore, it was important that the Internal Revenue Service (IRS) provide published guidance to help with the issuance of

[1] Pub. L. No. 111-5, 123 Stat. 115 (2009).
[2] See Appendix IV for detailed provisions of tax-exempt and tax credit bonds in the Recovery Act.
[3] This information was published by the Internal Revenue Service Statistics of Income Division and was the latest year available. Since the accuracy of this Internal Revenue Service-provided statistic did not affect the accomplishment of our audit objective, we did not verify its accuracy.

tax-exempt and tax credit bonds that comply with the Recovery Act provisions, which is critical to stimulating the economies of State and local governments.

The IRS Office of Chief Counsel has responsibility for management and operation of the published guidance program. This includes identifying when published guidance is needed, drafting the guidance to provide information for issuance of bonds that comply with the tax laws, and providing information that helps IRS personnel apply the tax laws correctly and uniformly.

The Tax Exempt Bonds (TEB) office within the Tax Exempt and Government Entities Division is responsible for administering Federal tax law applicable to tax-exempt and tax credit bonds. Although the Recovery Act bond provisions share some characteristics of previous tax-exempt or tax credit bonds, each new or modified bond also brings individual attributes such as volume cap amounts,[4] direct payments,[5] or credits to taxable income that present additional complexity for tax administration.

This review was performed at the Office of Chief Counsel Headquarters and the Tax Exempt and Government Entities Division TEB Headquarters Office in Washington, D.C., during the period September through December 2009. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

---

[4] A maximum dollar amount of bonds that can be issued during a specific time period.
[5] A payment to State or local government bond issuers in the form of a Federal subsidy for specific types of bonds.

Results of Review

Published Guidance Is Complete, Accurate, and Consistent With the Recovery Act's Bond Provisions

The initial guidance published by the IRS in the form of notices[6] was complete,[7] accurate, and consistent with the tax-exempt and tax credit bond requirements of the Recovery Act. The notices were issued quickly to help bond issuers understand how to issue tax-exempt and tax credit bonds intended to stimulate the economy by preserving and creating jobs.

The Office of Chief Counsel and other offices took action to develop Recovery Act bond guidance

IRS Office of Chief Counsel management began coordinating with the IRS TEB and Indian Tribal Governments offices; the Office of Tax Policy, Department of the Treasury; and the Bureau of Indian Affairs, Department of the Interior, approximately 1 month before enactment of the Recovery Act on February 17, 2009. Between April and July 2009, seven notices were developed, approved, and published as guidance for Recovery Act tax-exempt and tax credit bonds. The seven notices are also included in the applicable Internal Revenue Bulletin[8] and posted to the IRS Internet web site (IRS.gov) to make them easily available to the public.

Each of the seven notices included the following information 1) description of the bond and its purpose; 2) requirements to issue the bond; 3) the tax credit percentage, where applicable; 4) instructions to receive the tax credit or Federal direct payment; 5) volume cap amounts and allocation instructions, where applicable; 6) applications to apply for volume cap amount, where applicable; and 7) IRS reporting requirements.

Figure 1 identifies the notices, date of publication, and the respective tax-exempt and tax credit bonds.

---

[6] Notices are a public pronouncement by the IRS that contains guidance that involves substantive interpretations of the Internal Revenue Code or the law.

[7] The Treasury Inspector General for Tax Administration defines complete as addressing all Recovery Act bond provisions. This is not an indication that the current guidance is final and that additional guidance will not be issued. The IRS can issue additional guidance as issues arise or when interpretations of the law are needed. In addition, the Tribal Economic Development Bonds Notice did not contain the effective date of the Recovery Act provision. This notice was not considered to be incomplete because it is an interpretation of laws already in effect.

[8] The Internal Revenue Bulletin is the authoritative instrument of the IRS Commissioner for announcing official rulings and procedures.

Figure 1: IRS Notices Related to Tax-Exempt and Tax Credit Bonds

Notice	Date of Notice Publication	Bond
2009-26	April 2009	Build America Bond
2009-29	April 2009	Qualified Energy Conservation Bond
2009-30	April 2009	Qualified Zone Academy Bond
2009-33	April 2009	New Clean Renewable Energy Bond
2009-35	April 2009	Qualified School Construction Bond
2009-50	June 2009	Recovery Zone Economic Development Bond and Recovery Zone Facility Bond
2009-51	July 2009	Tribal Economic Development Bond

Source: Internal Revenue Bulletins dated April 20, 2009; April 27, 2009; June 29, 2009; and July 13, 2009.

To determine whether IRS management developed notices that were complete, accurate, and consistent with the tax-exempt and tax credit bond provisions included in the Recovery Act, we traced and compared[9] each provision with information provided in the notices and identified the following:

- All bond provisions in the Recovery Act were included in the respective notices. As a result, we determined the published guidance was complete.
- All bond provisions in the Recovery Act were correctly stated in the respective notices. As a result, we determined the published guidance was accurate.
- All bond provisions in the Recovery Act were free of contradiction in the respective notices. As a result, we determined the published guidance was consistent.

In addition, IRS management included information in the notices for the public to contact Office of the Chief Counsel staff with any questions, comments, or concerns about the Recovery Act tax-exempt and tax credit bond provisions. Each of the seven notices includes the names and telephone numbers of IRS Office of Chief Counsel staff members who prepared the notices. Also, one notice includes the name and telephone number of two TEB office staff members, and

[9] Provisions included in other public laws that created the existing tax credit bonds were also traced and compared to the respective notices.

one notice includes the name and telephone number of an official of the Bureau of Indian Affairs. Including contact information in notices is a standard IRS practice. Therefore, State, local, and tribal government officials as well as professional organizations communicated directly with knowledgeable IRS officials to ask specific questions pertaining to Recovery Act bonds.[10]

The Office of Chief Counsel plans to issue additional Recovery Act bond guidance

IRS Office of the Chief Counsel management stated the initial seven notices were successful in providing information to help bond issuers understand how to issue Recovery Act tax-exempt and tax credit bonds. After publishing the initial seven notices, IRS Office of Chief Counsel management also decided to update expiring Recovery Act guidance and provide supplemental information in the form of published guidance. By June 2010, the IRS plans to publish additional guidance for the following:

- General Guidance for Tax Credit Bonds – This will include an explanation of legal requirements for all tax credit bonds, including those in the Recovery Act.
- Qualified Zone Academy Bonds – Final regulations will be issued.
- Qualified School Construction Bonds – The volume cap allocation amounts expired on December 31, 2009, and will be updated.
- Build America Bonds – An explanation of IRS administrative requirements will be published.

This supplemental guidance is included in the IRS Office of the Chief Counsel Business Year 2009-2010 Priority Guidance Plan,[11] which addresses the most important taxpayer and tax administration issues needing clarification during the business year.

[10] It was not in the scope of this audit to review specific inquiries and associated responses.
[11] The Priority Guidance Plan is the business year plan for the published guidance program. The business year begins July 1 and ends June 30.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether IRS published guidance was complete,[1] accurate, and consistent to allow issuance of tax-exempt and tax credit bonds in accordance with the American Recovery and Reinvestment Act of 2009 (Recovery Act).[2] To accomplish our objective, we:

I. Identified Recovery Act tax-exempt and tax credit bond provisions.

   A. Reviewed the Recovery Act to identify the tax-exempt and tax credit bond provisions and related requirements (e.g., new bonds or modifications to existing bonds such as changes to volume cap amounts or allocations rules, etc.).

   B. Reviewed the Internal Revenue Code, other pertinent public laws, and the Office of Management and Budget Implementing Guidance for the Reports on Use of Funds Pursuant to the American Recovery and Reinvestment Act of 2009 (M-09-21, issued June 22, 2009) to identify the Recovery Act's impact on tax-exempt and tax credit bonds existing provisions and related requirements (e.g., new bonds or modifications to existing bonds such as changes to volume cap amounts or allocations rules, etc.).

II. Identified actions planned or taken by the TEB office or IRS management to develop and provide bond issuers with published guidance on tax-exempt and tax credit bond provisions included in the Recovery Act.

   A. Discussed with the TEB office and IRS management actions planned (e.g., providing additional guidance) or taken by their offices or other IRS offices to develop and provide published Recovery Act bond guidance.

   B. Obtained information (i.e., notices) developed by TEB office management or other IRS offices that provided published guidance.

   C. Identified the processes implemented to address stakeholders' (e.g., bond issuers) questions and concerns about Recovery Act bond provisions.

---

[1] The Treasury Inspector General for Tax Administration defines complete as addressing all Recovery Act bond provisions.
[2] Pub. L. No. 111-5, 123 Stat. 115 (2009).

III. Evaluated the Recovery Act bond published guidance developed by the TEB office and other IRS offices and determined if it was complete, accurate, and consistent with the bond provisions and requirements in the Recovery Act.

A. Reviewed and compared the Recovery Act bond guidance developed by the TEB office and IRS management with the applicable tax-exempt and tax credit provisions identified in the Recovery Act, Internal Revenue Code, and other public laws.

B. Determined whether the Recovery Act bond guidance developed by the TEB office and IRS management was complete, accurate, and consistent with bond provisions and related requirements included in the Recovery Act.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the Internal Revenue Code, the American Recovery and Reinvestment Act of 2009, and TEB and Chief Counsel office policies and procedures for developing and issuing published guidance. We evaluated these controls by interviewing management, reviewing applicable information, and comparing published guidance to the Recovery Act.

Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Troy D. Paterson, Director
Gerald T. Hawkins, Audit Manager
Deadra M. English, Lead Auditor
Cheryl J. Medina, Senior Auditor

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Associate Chief Counsel, Financial Institutions and Products CC:FIP
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Government Entities, Tax Exempt and Government Entities Division SE:T:GE
Director, Indian Tribal Governments, Tax Exempt and Government Entities Division SE:T:GE:ITG
Director, Tax Exempt Bonds, Tax Exempt and Government Entities Division SE:T:GE:TEB
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:

Chief Counsel CC
Director, Communications and Liaison, Tax Exempt and Government Entities Division SE:T:CL

Appendix IV

Tax-Exempt and Tax Credit Bonds Included in the Recovery Act

Figures 1 and 2 identify the tax-exempt and tax credit bonds included in the American Recovery and Reinvestment Act of 2009 (Recovery Act).[1]

Figure 1: Tax-Exempt Bonds Included in the Recovery Act

Tax-Exempt Bonds	Authorized Issuance Amount	Purpose of Bond
Recovery Zone Facility Bonds	$15 billion before January 1, 2011	A type of private activity bond[2] that can be used to finance certain kinds of business development activities in areas of significant economic distress.
Tribal Economic Development Bonds	$1 billion through December 31, 2010[3] $1 billion through December 31, 2011	A type of bond issued by tribal governments to finance any project on Indian reservations, except gaming activities. These bonds can be issued tax-exempt or direct payment.

Source: Treasury Inspector General for Tax Administration analysis of the Recovery Act bond provisions.

[1] Pub. L. No. 111-5, 123 Stat. 115 (2009).
[2] Private activity bonds are issued by or on behalf of State or local governments for the purpose of providing special financing benefits for qualified projects. The financing is most often for projects of a private user, but have some public benefit and the government generally does not pledge its credit.
[3] Tribal Economic Development Bonds are issued in two allocations. The first allocation ends December 31, 2010, and the second allocation ends December 31, 2011. Bonds not issued by those dates for either allocation are forfeited.

Figure 2: Tax Credit Bonds Included in the Recovery Act

Tax Credit Bonds	Authorized Issuance Amount	Purpose of Bond
Build America Bonds	Unlimited before January 1, 2011	There are two types of Build America Bonds; **tax credit** and **direct payment**. • Build America Tax Credit bonds can be issued to finance any governmental purpose for which tax-exempt governmental bonds (excluding private activity bonds) can be issued. Federal tax credits are provided to investors in an amount equal to 35 percent of the total coupon interest payable by the issuer. • Build America Direct Payment bonds are more limited in their use than are the credit option. Issuers receive a Federal subsidy in the amount of 35 percent of the interest payment.
Qualified School Construction Bonds	$11.2 billion for Calendar Year 2009[4] $11.2 billion for Calendar Year 2010 Unlimited after Calendar Year 2010	These bonds are issued to finance the construction, rehabilitation, or repair of public school facilities or acquire the land for such a facility. Bond investors receive a Federal tax credit of 70 percent of the face amount of the bonds purchased.
Recovery Zone Economic Development Bonds	$10 billion before January 1, 2011	These bonds are issued to finance economic development and activity in areas designated as recovery or empowerment zones. Bond investors receive a Federal tax credit of 45 percent of interest income received or bond issuers receive a direct Federal payment of 45 percent of the interest income paid.

[4] The $11.2 billion allocation for Qualified School Construction Bonds for Calendar Years 2009 and 2010 includes $200 million each year for schools funded by the Bureau of Indian Affairs.

Tax Credit Bonds	Authorized Issuance Amount	Purpose of Bond
New Clean Renewable Energy Bonds	Increased to $2.4 billion through December 31, 2009	These bonds are issued to finance renewable energy facilities, such as wind, geothermal, landfill gas, or solar energy, and must be owned by a public power provider, State, or local government body or cooperative electric company. Bond investors receive a Federal tax credit of 70 percent of the face amount of the bonds purchased.
Qualified Energy Conservation Bonds	Increased to $3.2 billion after October 3, 2008	These bonds are issued to finance energy conservation efforts such as reducing energy consumption in public buildings and mass transportation or implementing green communities programs. Bond investors receive a Federal tax credit of 70 percent of the face amount of the bonds purchased.
Qualified Zone Academy Bonds	$2.8 billion through December 31, 2010 Unlimited after Calendar Year 2010	These bonds are issued to finance public school programs designed in cooperation with business to enhance the academic curriculum, increase graduation and employment rates, and prepare students for college and the workforce. Bond investors receive a Federal tax credit of 70 percent of the face amount of the bonds purchased.

Source: Treasury Inspector General for Tax Administration analysis of the Recovery Act bond provisions.