

JONES HALL,
A PROFESSIONAL LAW CORPORATION

REVENUE PROCEDURE 97-15
CLOSING AGREEMENTS FOR OUTSTANDING BONDS

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**REVENUE PROCEDURE 97-15
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I. INTRODUCTION. On January 16, 1997, the Department of the Treasury issued Revenue Procedure 97-15 providing a program under which issuers may request closing agreements to prevent interest on bonds from being included in gross income, or from being treated as a tax preference for purposes of the alternative minimum tax, by reason of post-issuance actions ("Subsequent Actions").¹ The program is not based upon audits,² does not preclude audits with respect to other matters,³ does not apply to bonds where the issuer has been notified that the issue has been selected for audit,⁴ and, because expeditious processing of requests is desired, negotiations on the basis of mitigating circumstances is not be permitted under the program.⁵

II. EFFECTIVE DATE. The program is effective for bonds issued on or after May 16, 1997, but an issuer may apply the program to any bonds issued before that date.⁶

III. APPLICATION

1. **Bond Period of Application.** The closing agreement will apply to the period between the issue date and the first date after the closing date on which bonds may be redeemed by their terms⁷ or, in the case of alternative minimum tax, between the date of Subsequent Action and the date specified in the closing agreement.⁸ (Thus, presumably, if there is compliance with the Revenue Procedure, interest due on the affected bonds during the covered period will not be included in gross income if the bonds are redeemed on the redemption date specified in the closing agreement (see below) and will not be treated as a preference item for purposes of the alternative minimum tax.)

2. **Covered Provisions.** The program applies to failures that are subject to the remedial action provisions of the private activity bond regulations where proceeds have been spent.⁹ These provisions relate to the following:

- (i) the private business use test (but not the private security or payment test),

* Except as otherwise specifically stated, § references are to sections of Rev. Proc. 97-15. The term "Regulations" refers to the final private activity bond regulations (TD 8712). The term "Code" refers to the Internal Revenue Code of 1986.

1 § 1.
2 § 3.04.
3 § 3.05.
4 § 4.02.
5 § 3.06.
6 § 8.
7 § 3.02.
8 § 3.03.
9 § 4.01.

- (ii) the unrelated or disproportionate use test,
- (iii) the test lowering the private business tests for certain output facilities,
- (iv) the test lowering the private business tests for certain large issues,
- (v) the private loan financing test,
- (vi) the requirements for exempt facility bonds (other than those for qualified residential rental facilities and those for local furnishing of electric energy or gas),
- (vii) the requirements for small issue bonds (other than the capital expenditure limitation and the \$40 million limit),
- (viii) the requirements for qualified redevelopment bonds,
- (ix) the requirements for qualified 501(c)(3) bonds (other than the \$150 million limit and the restrictions for such bonds for residential rental housing),
- (x) the land limit exclusion for land acquired for environmental purposes,
- (xi) the requirement for rehabilitation expenditures in the case of acquisition of existing facilities,
- (xii) the prohibition upon use of proceeds for skyboxes and other prohibited facilities, and
- (xiii) the public hearing and approval requirement.¹⁰

The program does not relate to the loss of interest deductions and similar provisions relating to changes of use for tax-exempt bonds.¹¹

IV. PROCEDURE

A. In General. If an issuer properly requests a closing agreement, enters into the closing agreement, pays the closing agreement amount (see below) and notifies the bondholders (see below), then the interest on the bonds will not be included in gross income, and will not be an item of tax preference for purposes of the alternative minimum tax, by reason of the Subsequent Action.¹²

B. Request for Closing Agreement

1. **Timing.** A closing agreement must be requested within 180 days of the Subsequent Action.¹³

2. **Information Required.** The issuer must include the following information in the request: (i) a copy of the filed and executed Form 8038, (ii) the final offering document (if any), (iii) a statement detailing the Subsequent Action, (iv) an explanation

¹⁰ § *Id.*

¹¹ § 4.02. Code sections 150(b) and (c).

¹² § 3.01.

¹³ § 5.01.

of the computation of the closing agreement amount (see below), and (v) the form of notice to bondholders (see below), which "may acknowledge that the issuer does not currently have funds on hand to redeem the nonqualified bonds."¹⁴

3. Remedial Action Conditions Precedent. The issuer must have satisfied the conditions precedent to remedial action contained in the private activity bond regulations as a condition to the execution by the Service of a closing agreement.¹⁵

a. Governmental and 501(c)(3) bonds. In the case of governmental bonds and qualified 501(c)(3) bonds, the conditions precedent to remedial action consist of satisfaction of the reasonable expectations test,¹⁶ compliance with the 120 percent maturity limit,¹⁷ receipt of fair market value consideration¹⁸ and treatment of disposition proceeds as gross proceeds for arbitrage purposes.¹⁹

b. Certain private activity bonds. In the case of exempt facility private activity bonds, small issue private activity bonds, qualified redevelopment bonds and the requirements listed above that are applicable to certain private activity bonds, the conditions precedent to remedial action consist only of the reasonable expectations test.²⁰

4. Execution. The request must be signed by an official of the issuer authorized to sign a Form 8038, who has personal knowledge (i) of the facts covered by the closing agreement, (ii) of the Subsequent Action and (iii) of the computation of the closing agreement amount.²¹ To sign the request, the issuer must first comply with the requirements of section 9.02(11) and (12) (relating to representatives authorized to appear before the IRS) of Revenue Procedure 97-4 (or successor procedure).²²

5. Declaration Under Penalty of Perjury. A specified declaration under penalty of perjury must accompany the request (and any factual information submitted after the request and any changed request) and must be signed by the issuer (and not the issuer's representative).²³

C. The Closing Agreement

1. Form and Content. The closing agreement is prepared by the Service and, generally, will be in substantially the form of the exhibit that is attached to Revenue Procedure 97-15.²⁴ Among other matters, the form recites that the IRS has not formally asserted claims against the issuer or sought to tax any bondholders on the interest income,²⁵ sets forth the first date on which the bonds may be redeemed under the terms of the bond documents²⁶ and states the following:

¹⁴ § 5.02.

¹⁵ § 5.04(1).

¹⁶ Regulations §§ 1.141-12(a)(1) and 1.145-2(a).

¹⁷ Regulations §§ 1.141-12(a)(2) and 1.145-2(a).

¹⁸ Regulations §§ 1.141-12(a)(3) and 1.145-2(a).

¹⁹ Regulations §§ 1.141-12(a)(4) and 1.145-2(a).

²⁰ Regulations §§ 1.142-2(b), 1.144-2 and 1.147-2.

²¹ § 5.05.

²² § 5.06.

²³ § 5.07.

²⁴ § 5.03.

²⁵ Exhibit recital C.

²⁶ Exhibit recital F.

- that the issuer shall pay the closing agreement amount (see below);²⁷
- that bondholders are not required to include interest on the bonds in their gross income or to treat interest as a preference item for alternative minimum tax for the period specified;²⁸
- that within 30 days after the agreement, the issuer will notify bondholders of redemption;²⁹
- that the issuer is required to redeem bonds on a specified date;³⁰
- that the IRS may take actions for other violations arising after the agreement;³¹
- that no income shall be recognized by a bondholder as a result of the agreement or payments made pursuant to the agreement;³²
- that no party "shall endeavor by litigation or other means to attack the validity" of the agreement;³³
- that the agreement may not be cited or relied upon in any other case;³⁴
- that the issuer, in certain cases, will consent to public disclosure of information regarding the agreement;³⁵
- that if the bonds are retired before redemption, no amount may be refunded;³⁶ and
- that the agreement is conclusive except that it may be reopened in the event of fraud or misrepresentation, is subject to Code sections that provide that effect be given to their provisions notwithstanding other laws (including any stated exception for Code section 7122 (regarding compromise of cases by the Treasury Department prior to reference to the Justice Department for prosecution or defense) and is subject to laws enacted after the agreement that applies to a tax period ending after the date of the agreement.³⁷

2. Disclosure Upon Failure to Redeem. For closing agreements relating to non-inclusion of interest in gross income, the issuer must execute a "§ 6103(c) disclosure consent" authorizing the Service to make public any returns and return information of the

27 Exhibit paragraph 1.
 28 Exhibit paragraph 2.
 29 Exhibit paragraph 3.
 30 Exhibit paragraph 4.
 31 Exhibit paragraph 5.
 32 Exhibit paragraph 7.
 33 Exhibit paragraph 8.
 34 Exhibit paragraph 9.
 35 Exhibit paragraph 10.
 36 Exhibit paragraph 11.
 37 Exhibit paragraph 12.

issuer relating to the closing agreement if the issuer fails to redeem the nonqualified bonds in accordance with the terms of the closing agreement.³⁸

3. **Execution.** The request must be signed by an official of the issuer authorized to sign a Form 8038 who has personal knowledge (i) of the facts covered by the closing agreement, (ii) of the Subsequent Action and (iii) of the computation of the closing agreement amount.³⁹

D. Closing Agreement Amount

1. **In General.** For relief from taxability, the closing agreement amount equals an estimate of the federal income tax liability that is not required to be paid with respect to interest accruing on the nonqualified bonds commencing on the date of the Subsequent Action.⁴⁰ For relief from alternative minimum tax, the closing agreement amount equals an estimate of the federal income tax liability not required to be paid by reason of the closing agreement commencing on the date of the Subsequent Action.⁴¹

2. **Computation.** For relief from taxability, the amount is computed by (i) determining interest accruing on the nonqualified bonds commencing on the Subsequent Action date and ending on the next redemption date, (ii) multiplying this amount for each calendar year by 0.29, (iii) present valuing those amounts (by assuming payment on April 15 of the following year), and (iv) determining the sum of the present value amounts for all calendar years.⁴² Present value is computed as of the date on which the payment is sent to the Service and determined on the basis of a discount rate equal to the taxable applicable federal rate, with semiannual compounding, determined as of the date of Subsequent Action.⁴³ For relief from alternative minimum tax, a similar procedure is followed except that the multiplier is 0.0014 (instead of 0.29).⁴⁴

3. **Time of Payment.** The closing agreement amount must be paid simultaneously with the execution of the closing agreement.⁴⁵

4. **Source of Payment.** The closing agreement amount may not be paid from the proceeds of tax-exempt bonds.⁴⁶

E. Notice to Bondholders

1. **Form of Notice.** For closing agreements requesting relief from taxability, the issuer must provide written notice to the bondholders that (a) the nonqualified bonds will be redeemed on the next redemption date, and (b) if the issuer fails to redeem the bonds in accordance with the closing agreement on that date, the bonds will be treated as private activity bonds that are not qualified bonds (*i.e.*, are not tax-exempt) as of that date.⁴⁷

38 § 5.04(4).

39 § 5.05.

40 § 6.01.

41 § 6.04.

42 § 6.01.

43 § 6.02.

44 § 6.04.

45 § 5.04(5).

46 §§ 5.04(2)(b) and 5.04(3).

47 §§ 5.02(5) and 5.04(2)(a).

2. Time of Notice. The bondholders must be notified in writing within 30 days after the date the closing agreement is executed by the Service.⁴⁸

January 20, 1997

⁴⁸ § 5.04(2)(a).