Sailing the Uncharted Seas
Municipal Bond Enforcement

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Part One

This presentation is condensed from a presentation made by Chapman and Cutler LLP to the Illinois Government Finance Officers Association.
Federal Muni Enforcement

- IRS: Federal Tax Compliance Scrutiny
- SEC: Initial and Continuing Disclosure: Enforcement
- Dept. of Justice: Criminal bid rigging and price fixing
Why this talk now

- More federal enforcement is visible
  - 3 big actions in fall 2006: Decisions in SEC v. Weiss and San Diego; DOJ GIC probe in November
- Congress, Treasury and the IRS think of municipal bonds as Tax Shelters
- Accounting boards and the SEC are worried about the integrity of municipal balance sheets
  - Unfunded Pension and OPEB liabilities
Problems can progress and compound

- **Tax Problem:** Bonds sold as tax exempt when they are not – Fine to the IRS
- **SEC Problem:** tax error now becomes a disclosure omission in the OS under federal securities rules – SEC fine and injunction
- **Criminal Problem:** Could have criminal implications if sufficient intent and profit – Fines and/or jail time
Federal Tax Compliance

- At time of Issuance
- Post-issuance compliance
- IRS Bond Audits

IRS Bond audits protect the integrity of the tax system throughout the life of an issue
Odds of an IRS Audit?

- Most of the 400 – 500 IRS Audits are for issues of more than $5,000,000. In 2006, 4 in 35 of these issues were audited.

- 1 in 4 of every IRS Audit ends with a finding of “Taxability”.

- Small issues are not exempt. 50 – 100 issues are audited by mail each year.
Hot Federal Tax Issues

- Will you start spending your bond proceeds **NOW** and spend all within 3 years?
- Did you calculate and pay **arbitrage rebate** that you may owe?
- Have you kept **adequate records** of all disbursement and investments for possible tax questions?
- Do you understand **advance refundings**?
- Did you fully understand any **GIC, SWAP or hedge investment** included in any bond deal?
Arbitrage Rebate – Don’t forget

- What is the yield on my bonds?
- What has been the investment yield on the bond proceeds?
- Does my issue qualify for any particular exemption (small issuer, 2 year spend down, etc)?
- Keep good investment records.
More to come

- SEC Enforcement activity
- Depart of Justice probes