

## MEMORANDUM

**Date:** September 22, 2011

Staff Summary No. 7

**To:** Members, California School Finance Authority

**From:** Katrina M. Johantgen, Executive Director

**Subject:** Resolution No. 11-39, Post-Issuance Tax Compliance Procedures for Tax-Advantaged Bonds

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**Background:** The Internal Revenue Service (IRS) recently revised a key form (known as Form 8038) that the Authority executes whenever tax-advantaged bonds are issued. The IRS revisions to Form 8038 impose new post-issuance reporting and other responsibilities on issuers.

The IRS requires Form 8038 (Information Return for Tax-Exempt Private Activity Bond Issues) to be completed and executed by any bond issuer in connection with a new issue of tax-exempt bonds. The IRS revised the form in April 2011 which added five additional lines. The only changes directly affecting the Authority are lines 43 and 44. Line 43 states "Check the box if the issuer has established written procedures to ensure that all nonqualified bonds of this issue are remediated in accordance with the requirements of the Code and Regulations." Line 44 states "Check the box if the issuer has established written procedures to monitor the requirements of section 148." (Section 148 of the IRS code is the statute defining arbitrage and how borrowers must handle investments of bond proceeds. By definition, an arbitrage bond means "*any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly to acquire higher yielding investments or to replace funds which were used directly or indirectly to acquire higher yielding investments.*")

In consultation with Orrick, Herrington & Sutcliffe LLP, Authority staff submits the attached written procedures to comply with the new requirements prompted by the IRS revisions to Form 8038. The procedures address three major issues, which are:

- Arbitrage rebate and yield;
- Use of bond proceeds and bond-financed or refinanced assets (including remedial action, if necessary);
- Record keeping requirement;

If adopted by the Authority, these new procedures, and the responsibility for complying with each aspect of the procedures, will be memorialized in a signed agreement between the Authority and the Borrower. Specifically, the procedures will be documented in the Tax Certificate and Agreement (the "TCA"), a document which both the Authority and the Borrower currently sign in connection with a new issue of tax-advantaged bonds and which historically memorializes these types of activities and responsibilities for both the Authority and the Borrower. The TCA is one of many documents that need to be executed for a bond sale to close.

Resolution 11-39  
September 22, 2011

The Authority currently anticipates more bond closings in the future. Since the newly revised Form 8038 is a requirement of a bond issuance closing, staff submits the procedures attached herein to be adopted and in effect as soon as possible.

**Recommendation:** Staff recommends the Authority approve Resolution No. 11-39 Adopting Post-Issuance Tax Compliance Procedures for Tax-Advantaged Bonds.