



**COUNTY OF LOS ANGELES  
TREASURER AND TAX COLLECTOR**



**MARK J. SALADINO**  
TREASURER AND TAX COLLECTOR

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December 8, 2011

TO: John Naimo  
Assistant Auditor-Controller  
Auditor-Controller

Jan Takata  
Senior Manager  
Chief Executive Office

FROM: Glenn Byers *G.B.*  
Assistant Treasurer and Tax Collector

SUBJECT: **TAX COMPLIANCE PROCEDURES**

The Treasurer and Tax Collector has adopted the attached procedures with respect to post-issuance compliance for tax-exempt bonds. The procedures are required as a result of the new and expanded Form 8038-G published by the Internal Revenue Service. The Public Finance Division of the Treasurer and Tax Collector will work with each of your respective offices to implement the new procedures and to make any necessary changes that will further said implementation.

If you have any questions regarding the attached post-issuance compliance procedures, please contact Doug Baron at 974-8359.

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Pb/db/form8038

Attachments

c: Connie Yee, Accounting Division

**ARBITRAGE COMPLIANCE PROCEDURES**  
**(Governmental Use Bonds)**

- 1.1 Note the yield of the issue, as shown on the Internal Revenue Service (IRS) Form 8038-G.
- 1.2 Review the tax certificate to determine the Temporary Periods, i.e., the periods during which the federal tax rules relating to arbitrage yield restriction permit certain Gross Proceeds of an issue to be invested at a yield that is materially higher than the yield for the issue.
- 1.3 During Temporary Periods various categories of Gross Proceed, any sale proceeds, investment proceeds, replacement proceeds, transferred proceeds of an issue, may be invested in Higher Yielding Investments, i.e., investment property within the meaning of Sections 148(b)(2) and 148(b)(3) of IRS Code (Code) that produces a yield that (a) in the case of investment property allocable to replacement proceeds of an issue and investment property in a refunding escrow, is more than one thousandth of one percentage point (.00001) higher than the yield on the applicable issue, and (b) for all other purposes is more than one-eighth of one percentage point (.00125) higher than the yield on the issue.
- 1.4 Do not invest Gross Proceeds in Higher Yielding Investments following the end of the applicable Temporary Period identified in 1.2 unless yield reduction payments may be made.
- 1.5 Monitor expenditures of proceeds, including investment proceeds, against issuance date expectations for satisfaction of the three-year or five-year Temporary Period from yield restriction on investment of proceeds and to avoid “hedge bond” status.
- 1.6 Ensure that investments acquired with Gross Proceeds satisfy IRS regulatory safe harbors for establishing fair market value (e.g., through the use of bidding procedures), and maintain records to demonstrate satisfaction of those safe harbors.
- 1.7 Consult with bond counsel before engaging in credit enhancement or hedging transactions in respect of the issue, and before creating separate funds that are reasonably expected to be used to pay debt service on the issue.
- 1.8 Maintain copies of all contracts and certificates relating to credit enhancement and hedging transactions relating to the issue.
- 1.9 Whenever applicable, ensure that the debt service fund meets the requirements of a Bona Fide Debt Service Fund, i.e., a fund used primarily to achieve a proper matching of revenues with debt service that is depleted at least once each bond year, except for a reasonable carryover amount not to exceed the greater of: (i) the earnings on the fund for the immediately preceding bond year; or (ii) one-twelfth of the debt service on the issue for the immediately preceding bond year. *To the extent that the bond fund qualifies as a*

*Bona Fide Debt Service Fund for a given bond year, the amounts held in that fund may be invested in Higher Yielding Investments.*

- 1.10 Ensure that amounts held in any reasonably required debt service reserve fund that are invested in Higher Yielding Investments do not exceed the least of: (i) 10% of the stated principal amount of the issue (or 10% of the sale proceeds of the issue if the issue has original issue discount or original issue premium that exceeds 2% of the stated principal amount of the issue plus, in the case of premium, reasonable underwriter's compensation); (ii) maximum annual debt service on the Issue; or (iii) 125% of average annual debt service on the issue.
- 1.11 *Subject to the possible exceptions, including those mentioned below, earnings on proceeds, to the extent invested at a yield in excess of the bond yield (i.e., positive arbitrage), generally must be rebated to the U.S. Treasury, even if a Temporary Period exception from yield restriction allowed the earning of that positive arbitrage.*
  - 1.11.1. Ensure that rebate calculations will be timely performed and payment of Rebate Amounts, if any, will be timely made; such payments are generally due 60 days after the fifth anniversary of the issuance date, and then in succeeding installments every five years; the final rebate payment for the issue is due 60 days after retirement of the last bond of the issue. Rebate Amounts are defined as the excess of the future value, as of any date, of all receipts on any investment property that is acquired with Gross Proceeds as an investment and not in carrying out any governmental purpose of an issue over the future value, as of that date, of all payments on those investments, computed in accordance with Section 148(f) of Code and Tax Regulations §1.148-3
  - 1.11.3. If the 6-month, 18-month, or 24-month spending exception from the rebate requirement may apply to the issue, ensure that the spending of proceeds is monitored prior to the semi-annual spending dates for the applicable exception.
  - 1.11.4. *Timely make rebate and yield reduction payments and file IRS Form 8038-T.*
  - 1.11.5. Even after all other proceeds of the issue have been spent, ensure compliance with rebate requirements for any debt service reserve fund and any debt service fund that is not exempt from the rebate requirement.
- 1.12 The foregoing items shall be monitored at least annually as long as there are unspent Gross Proceeds.
- 1.13. Maintain records of investments and expenditures of proceeds, rebate exception analyses, rebate calculations, IRS Forms 8038-T, and rebate and yield reduction payments, and any other records relevant to compliance with the arbitrage restrictions.
- 1.14 With the exception of items 1.6, 1.7, and 1.8 (to be monitored by the Public Finance Division of the Treasurer and Tax Collector), the following division shall be responsible for monitoring compliance with the arbitrage rebate requirements of Section 148 of the

Code, as set forth in these procedures:

**Accounting Division of the County Auditor-Controller**

- 1.15 The division responsible for monitoring compliance with the arbitrage rebate requirements of Section 148 of the Code shall receive appropriate training regarding the issuer's accounting systems and their application to the investment and expenditure of Gross Proceeds. This training shall occur when a new individual assumes the responsibilities described in this checklist.
- 1.16 The records required to be kept under this checklist shall be maintained in paper or electronic format until the date three (3) years after the last bond of the applicable issue has been retired; if any portion of such issue is refunded by a refunding issue, such records shall be maintained until the later of the date three (3) years after the last bond of the issue has been retired or the date three (3) years after the last bond of the refunding issue has been retired.

**USE OF PROCEEDS PROCEDURES AND  
REMEDIAL ACTION INSTRUCTIONS FOR NONQUALIFIED BONDS  
(Governmental Use Bonds)**

**1. Use of Proceeds**

- 1.1 Ensure there exists a clearly established accounting procedure for tracking investment and expenditures of proceeds, including investment proceeds.
- 1.2 At or shortly after issuance of the bond issue, allocate proceeds to reimbursement of prior expenditures, as appropriate.
- 1.3 Ensure that a final allocation of proceeds (including investment proceeds) to qualifying expenditures is made if proceeds are to be allocated to project expenditures on a basis other than “direct tracing” (direct tracing means treating the proceeds as spent as shown in the accounting records for proceeds draws and project expenditures). An allocation other than on the basis of “direct tracing” is often made to reduce the Private Business Use (see Section 2 below) of proceeds that would otherwise result from “direct tracing” of proceeds to project expenditures. This allocation must be made within 18 months after the later of the date the expenditure was made or the date the project was placed in service, but not later than five years and 60 days after the issuance date or 60 days after the issue is retired. Bond counsel can assist with the final allocation of proceeds to project costs.
- 1.4 Maintain careful records of all bond-financed facilities and other costs (e.g., issuance costs, credit enhancement and capitalized interest) and uses (e.g., deposit to reserve fund) for which proceeds were spent or used. These records should be maintained separately for each issue of tax-exempt obligations.
- 1.5 On at least an annual basis, identify all current and contemplated uses of bond-financed facilities and confer as necessary with counsel to ensure that the use of the bond-financed facilities complies with the covenants and restrictions set forth in the tax certificate.

**2. Monitoring Private Loan Limits and Private Business Use**

- 2.1 Before considering any loan to a private person (i.e., an individual or business), engage counsel to review the agreements to determine whether they might exceed the Private Loan Limit (defined below).
- 2.2 Before entering into any new management, service, or research agreements described in 2.4.3 and 2.4.4 below, engage counsel to review the agreements to determine whether they result in Private Business Use, i.e., any use in a trade or business (either directly or indirectly) carried on by any private person.
- 2.3 Analyze at least annually any Private Business Use of bond-financed facilities to determine whether the 5% or 10% limitation, as applicable, on Private Business Use of proceeds is exceeded (the lesser 5% limitation is generally applicable to private business use that does not have any direct or indirect relation to governmental operations). Contact bond counsel if either limit is exceeded.

- 2.4 Maintain copies of all of the following contracts or arrangements (or, if no written contract exists, maintain detailed records of the following contracts or arrangements) with a private person:
- 2.4.1 Sales of bond-financed facilities.
  - 2.4.2 Leases of bond-financed facilities.
  - 2.4.3 Management or service contracts relating to bond-financed facilities.
  - 2.4.4 Research contracts under which a private person sponsors research in bond-financed facilities.
  - 2.4.5 Any other contracts involving “special legal entitlements” (such as naming rights or exclusive provider arrangements) granted to a private person with respect to bond-financed facilities.

Each of the foregoing contracts or arrangements may result in Private Business Use of the bond-financed facilities. Consult with bond counsel to undertake any necessary remedial actions, discussed below, with respect to the “nonqualified bonds” that result from a private use determination. If a remedial action is not available, consult with bond counsel regarding the potential application of the voluntary closing agreement program maintained by the Internal Revenue Service.

- 2.5 Remedial Actions may be required if a “Deliberate Action” has been taken by the issuer with respect to Private Business Use or Private Loan Limits. A Deliberate Action is any action taken after the issuance date by the issuer that is within the issuer’s control and that causes:
- 2.5.1 more than 5% or 10%, as applicable, of the proceeds to be used for a Private Business Use (the “Private Business Use Limit”), and more than 5% or 10%, as applicable, of either the principal of or interest on the issue to be secured by or derived, directly or indirectly, from private security or payments (collectively with the Private Business Use Limit, the “Private Business Limits”); or
  - 2.5.2 the amount of proceeds that are to be used to make or finance loans to any private person, in the aggregate, to exceed the lesser of 5% of such proceeds or \$5,000,000 (“Private Loan Limit”).

An action by the issuer is not a Deliberate Action if the action was (i) the result of an involuntary conversion of all or a portion of the project, or (ii) an action that was taken in response to a regulatory directive made by the federal government (see Regulations §1.141-2(d)(3)(ii)).

### 3. Remedial Actions

- 3.1 A Deliberate Action can be cured if the issuer reallocates the proceeds that had been allocated to the project or portion thereof as to which the Deliberate Action occurred to other permitted uses not later than 18 months after the later of (i) the date of the expenditure to which the proceeds were originally allocated or (ii) the placed in service date of the project or portion thereof to which such proceeds

were originally allocated, but not later than 60 days after the fifth anniversary of the issuance date or the retirement of the issue, if earlier (see Regulations §§1.141-6(a) and 1.148-6(d)(1)(iii)).

3.2 If a Deliberate Action cannot be cured through the timely reallocation of proceeds (as described in 3.1), the following remedial actions may resolve the inappropriate use of proceeds that caused the Private Business Use limit or Private Loan Limit to be exceeded:

3.2.1 *Redemption of Non-Qualified Bonds.* The “non-qualified bonds” are the portion of the issue allocable to the Deliberate Action that causes the issue to exceed the Private Business Limits or the Private Loan Limit. In general, within 90 days after the Deliberate Action, either the non-qualified bonds must be redeemed or an escrow that defeases the non-qualified bonds to their earliest redemption date must be established. A defeasance escrow may not be used, however, if the period between the issuance date and the earliest redemption date of the non-qualified bonds is more than 10.5 years; in such case, a closing agreement with the Internal Revenue Service (“IRS”) may be necessary. If a defeasance escrow is established, the issuer must notify the IRS within 90 days of its establishment. Notwithstanding the general requirement stated above that all non-qualified bonds must be redeemed or defeased, if the disposition proceeds consist exclusively of cash, it is sufficient that the disposition proceeds be used to redeem or defease a pro rata portion of the non-qualified bonds.

3.2.2 *Alternative Use of Disposition Proceeds.* The issue satisfies the requirements of this remedial action if:

- 3.2.2.1. all disposition proceeds consist exclusively of cash;
- 3.2.2.2. the issuer reasonably expects to spend the disposition proceeds within two years after the date of the Deliberate Action;
- 3.2.2.3. the disposition proceeds are treated as proceeds for purposes of the Private Business Limits and the Private Loan Limit, the use of the disposition proceeds does not cause the issue to exceed these limits, and the issuer does not take a subsequent Deliberate Action that causes either of these limits to be exceeded;
- 3.2.2.4. any unspent disposition proceeds must be used to redeem all or a portion of the issue; and
- 3.2.2.5. if the disposition proceeds are to be used by a 501(c)(3) organization, from the date of the Deliberate Action, the non-qualified bonds must constitute Qualified 501(c)(3) Bonds and be treated as reissued for that purpose.

3.2.3 *Alternative Use of Project.* The issuer satisfies the requirements of this remedial action if:

- 3.2.3.1. the portion of the project that is transferred or disposed of could have been financed by another type of tax-exempt bond;
- 3.2.3.2. the Deliberate Action taken by the issuer did not involve a purchase financed by another issue of tax-exempt bonds; and
- 3.2.3.3. any disposition proceeds resulting from the Deliberate Action (other than those related to the provision of services) are used to pay debt service on the issue on the next available payment date or, within 90 days of receipt, are deposited into a yield-restricted escrow to be used to pay debt service on the next available payment date.

Under these circumstances, the non-qualified bonds are treated as re-issued as of the date of the Deliberate Action, and must remain qualifying tax-exempt bonds throughout their term.

- 3.3 To determine which Remedial Action to use, the issuer should consult directly with bond counsel. The ability to use one of the above Remedial Actions is also governed by the following five conditions:
  - 3.3.1 On the issuance date, the issuer did not reasonably expect either the Private Business Limits or the Private Loan Limit to be exceeded at any time while any portion of the issue was outstanding.
  - 3.3.2 On the issuance date, the weighted average maturity of the issue did not exceed 120% of the weighted average of the reasonably expected economic lives of the assets comprising the project.
  - 3.3.3 Unless the project is being used for an alternative use (as described in 3.2.3 above), the new user of all or any portion of the project must have paid fair market value therefor.
  - 3.3.4 The issuer must treat any “disposition proceeds,” which are all proceeds received from the sale, transfer or other disposition of all or a portion of the project, as gross proceeds for arbitrage (Section 148) purposes.
  - 3.3.5 Prior to the Deliberate Action, the proceeds were used for a governmental purpose unless the remedial action to be taken is described in 3.2.1.

#### **4. Responsible Person, Training and Record Retention**

- 4.1 The following office shall be responsible for monitoring the use of proceeds and the existence of any private business use of bond-financed facilities, as set forth in these procedures:

##### **Chief Executive Office – Capital Projects Division**

- 4.2 The individuals responsible for monitoring the use of proceeds and the existence of any private business use of bond-financed facilities shall receive appropriate training regarding the issuer’s accounting systems (including entries for the expenditure of proceeds on bond-financed facilities), contract intake system,

facilities management and other systems that track the expenditure and use of proceeds.

- 4.3 This training shall occur when a new individual assumes the responsibilities described in these procedures.
- 4.4 Training shall be available to ensure current knowledge of the issuer's existing accounting, contract, facilities management and other systems that involve tax-exempt obligations and exposure to any pertinent additional systems that are subsequently implemented by the issuer.
- 4.5 The records required to be kept under these procedures shall be maintained in paper or electronic format until the date three (3) years after the last bond of the applicable issue has been retired; if any portion of such issue is refunded by a refunding issue, such records shall be maintained until the later of the date three (3) years after the last bond of the issue has been retired or the date three (3) years after the last bond of the refunding issue has been retired.