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TAX LINES

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The past quarter brought guidance from both the Chief Counsel side and the Tax Exempt Bond group (TEB) on the audit side of the Internal Revenue Service (the “Service”). On the Chief Counsel side, the Service released the final solid waste regulations, supplemental guidance on the issue date of draw-down bonds with respect to volume cap allocations, and private letter rulings. The Advisory Committee for Tax Exempt & Governmental Entities (“ACT”) released its annual report, expanding on a series of post-issuance compliance reports over the past several years. Congress managed to increase the debt limit, opening up the purchase of US Treasury Securities – State and Local Government Series (SLGS), but passed the buck to a new 12-member, bi-partisan committee, quickly dubbed the “Super Committee,” to figure out the important questions of how to cut at least \$1.5 trillion from the federal budget.

Supplemental Draw-down Bond Issue Date Guidance

On August 3, 2011, the Service released Notice 2011-63 (the “Notice”), 2011-34 IRB 172 (August 19, 2011), which brings relief from the stringent issue date rules for draw-down bonds. The Notice deals solely with the volume cap limitations on private activity bonds under Section 146 and “other bond volume cap and limitations under Federal law.” The guidance in the Notice supplements Notice 2010-81, 2010-50 IRB 825, released on November 23, 2010, which generally treated the date of issue of a bond that is part of a draw-down issue as the date of the draw as contrasted to the issue date of the “issue” under Treas. Reg. § 1.150-1(b) (the “2010 Notice”).

The 2010 Notice had raised a great number of administrative issues with respect to the private activity bond volume cap under Section 146, particularly in the absence of an effective date for what was viewed by issuers and practitioners as a reversal of a longstanding provision. The 2010 Notice would have required a carryover of private activity bond volume cap for draws that could not be made by end of the calendar year in the case of a current calendar year allocation, or in the case of carryover allocation, would have required that all draws be made before the carryforward expired. Allocating agencies and issuers had pointed out the difficulty of tracking allocation and draws in light of the requirement of Section 146(e)(3)(B), which requires carryforwards to be used in the order of the calendar year in which they arise. Implementing the 2010 Notice going forward would be challenging enough, but going back for an undetermined time to figure out if bonds still had the appropriate allocation could prove impossible. Further, issuers and conduit borrowers were often unable to provide purchasers of the draw-down bonds with enough comfort that volume cap would be available for all of the project costs if the draws spanned a calendar year and required a request for additional volume cap in a future calendar year.

The Notice provides that, solely for volume cap purposes, an issuer may treat a bond as issued either (1) on the issue date of the bond under the general rule of the 2010 Notice or (2) in the alternative, on the issue date of issue if the issuer issues the bonds by the later of (A) the

statutory deadline for issuing the bonds or (B) the end of the maximum carryforward period for unused volume cap under the applicable statute. The first prong deals with concerns Treasury and the Service may have had about extending the stimulus provisions past statutory deadlines via draw-down bonds

The Notice, both in the text and in the example, states that the maximum carryforward period during which bonds of an issue may be issued is applied by treating all of the unused volume cap for the issue as volume cap arising in the year in which the issue date of the issue occurs. In other words, if volume cap under Section 146 can be carried forward three years, the issuer has three years to make draws covered by the carryover volume cap from the year of the issue date of the issue regardless of whether the volume cap is current year or a carryforward allocation. Volume cap for Qualified Zone Academy Bonds under Section 54E can be carried forward only two years. The Notice points out that volume cap for small issue bonds under Section 144(a) cannot be carried forward at all, which essentially leaves small issue manufacturing bonds previously issued without guidance as to the status of draws made after the end of a calendar year for volume cap purposes or for purposes of the statutory changes with respect to 25% ancillary activities limit and manufacturing of intangibles that expired on December 31, 2010.

Thus, as a general matter, the Notice dovetails nicely with Treas. Reg. § 1.149(e)-1(d)(2)(ii) (B), which provides a more complete definition of draw-down bonds and states that bonds issued during different calendar years may be treated as part of the same issue for purposes of the Form 8038 filing if all amounts to be advanced pursuant to the draw-down loan are reasonably expected to be advanced within three years of the date of issue of the first bond.

The Notice does not use the term “elect” in the context of using the alternate option, but provides that issuers using the alternative option must write or type at the top of the information return, “Filed in Accordance with Notice 2011-63 State and Local Bonds: Volume Cap and Timing of Issuing Bonds.” Given the length of the title, that may take some creative manipulation of the fill-in form. The Form 8038 filing for bonds after the date of the Notice would appear to be evidence of applying the alternate option. The Notice states that if the issuer treats the bonds as issued on the issue date of the issue, it may not retroactively alter such treatment.

If an issuer had filed a Form 8038 for a pre-2010 Notice for the maximum amount permitted to be drawn under contemporaneous interpretations of Treas. Reg. §§ 1.150-1 and 1.149(e)-1, that filing would presumably be evidence of “treating” the issue date of the bonds as the issue date of the issue. Bonds issued between the 2010 Notice and the Notice may need to be reviewed to determine how they were “treated.” The Notice makes clear that the Service does not require an amended Form 8038 for bonds issued under the Notice for bonds treated as issued before August 3, 2011.

Final Solid Waste Disposal Facility Regulations

On August 18, 2011, the Service released final regulations governing the definition of solid waste disposal facilities (the “Final Regulations”), discarding the concept of “no value” test that

had been adopted in regulations finalized in 1972 but became the source of controversy in audits beginning in the late 1990s. To illustrate the difficulty in achieving final resolution, the progeny of the final regulations included Notice 2002-51 (soliciting comments on solid waste disposal facilities as part of an undertaking to provide guidance under the 2002-2003 Priority Guidance Plan), proposed regulations published on May 10, 2004, withdrawal of the 2004 proposals and a notice of new proposed rulemaking published on September 16, 2009 (the “2009 Proposed Regulations”), a public hearing held on January 5, 2010, and appearance of the regulation project year after year on the Priority Guidance Plan. The Service is probably just as relieved to have this project finalized as practitioners are to have final guidance upon which they can rely.

Definition of Solid Waste. Overall, the final regulations represent a markedly different framework for analysis than the framework adopted in 1972, but generally the Service adopts the concepts put forth in the 2009 Proposed Regulations. Therefore, a solid waste disposal facility is defined to mean a facility that processes solid waste in a qualified solid waste disposal process, performs a preliminary function, or is a functionally related and subordinate facility. The term solid waste is defined generally to mean garbage, refuse, and other solid material derived from any agricultural, commercial, consumer, governmental, or industrial operation or activity if the material is either “used material” or “residual material.”

With respect to the general meaning of solid waste, the Final Regulations add language that clarifies that a material is solid if it is solid at ambient temperature and pressure, language that had appeared in previous private letter rulings. The Final Regulations also acknowledge that solid waste can arise from governmental operations or activities.

The Final Regulations expand the definition of “used material” to include animal wastes produced in a biological process. Animal waste is a serious source of environmental concern, and entrepreneurs have come up with many innovation processes for disposal. This addition, however, is also likely to result in humorous shorthand references to these bond transactions. In a more subtle change, the language refers to solid waste as involving “operations and activities,” rather than solely to “products,” which commentators had viewed as limiting the potential materials that would qualify as solid waste.

Changes to the “residual material” definition were a little more significant in the Final Regulations. First, the Final Regulations add language to the effect that, in the case of multiple processes constituting an integrated manufacturing or industrial process, the material must result from or remain after the completion of the integrated process. In the preamble to the Final Regulations, the Service notes that commentators had recommended that in the case of multiple production processes at the same site, the regulations should permit a separate evaluation of each process to determine if residual material was generated. The preamble indicates that the comment was rejected “based on reasons associated with scope and administrability.” The preamble goes on to say that the definition of residual material is intended to cover only residual material that remains at the end of the integrated processes that are fundamentally interconnected or interdependent, based on all the facts and circumstances. For those commentators who asked for a clarification that a facility could have more than one residual material, the framework

adopted in the Final Regulations may be a rule that has the opposite result if the residual material is treated as an interim step in an “integrated process” such that no “residual material” would remain at the end of such process. The facts and circumstances language is likely to generate substantial discussion as to whether this opens the door or closes it with respect to this issue.

In another major change, the Final Regulations entirely eliminate the provision in the 2009 Proposed Regulations that had provided that residual material could not exceed 5% of the material entering the solid waste disposal process. The Service indicates in the preamble that the 5% test was dropped in response to comments pointing out that this limitation unduly restricted the scope of the residual material test and treated residual materials from different industries in a manner that was arbitrary.

The Final Regulations clarify the time for making the determination as to whether the material has a fair market value that is reasonably expected to be lower than the value of all of the products made in the production process or lower than the value of the service that produces such residual material is the date of issue of the bonds financing the facility. The nature of the determination of fair market value and the date of issue determination has the ring of the previous “no value” test, but this controversy, one hopes, is history.

As under the 2009 Proposed Regulations, the Final Regulations provide that material is not “used material” or “residual material” unless the person who generates, purchases, or otherwise acquires the material reasonably expects the material to be introduced into a “qualified solid waste disposal process” within a reasonable time after its production, acquisition, or purchase. The old phrase, one person’s trash is another person’s treasure, seems applicable here, so long as the process for turning it into treasure occurs within a reasonable time.

The Final Regulations generally take the approach of the 2009 Proposed Regulations, excluding from the definition of solid waste (1) virgin material, (2) solid or dissolved material in domestic sewage or other significant pollutant in water resources, (3) certain specified precious metals, (4) hazardous material, and (5) radioactive material. Of note, the Final Regulations address the concern raised by some commentators in that the definition of solid waste is modified to allow the introduction of virgin materials and precious metals into a final disposal process. The Service again rejected the recommendation that hazardous waste and radioactive waste that otherwise met the definition of solid waste (e.g., material that otherwise would constitute used material or residual material) be treated as solid waste, stating that the Service continues to believe that Congress intended to exclude those materials from the definition. In what may be a small concession, the Service provided that only hazardous and radioactive materials required to be disposed of or processed in specially licensed radioactive waste or hazardous waste facilities would be excluded.

Qualified Solid Waste Disposal Process. Like the 2009 Proposed Regulations, the Final Regulations designate three types of solid waste disposal processes: (1) a final disposal process (e.g., a landfill), (2) an energy conversion process (e.g., a municipal trash-to-energy facility), and (3) a recycling process (e.g., a tire recycling facility). The Final Regulations contain some minor

technical “clarifications” to the 2009 Proposed Regulations. The definition of final disposal process has been modified to include “spreading of solid waste in an environmentally compliant and safe manner.” The Final Regulations also provide that the issuer must have a reasonable expectation as of the date of issue that the containment will continue indefinitely and that the solid waste has no current or future beneficial use. Again, shades of the “no value” test?

The “first useful product” principle is revised to explain when the energy conversion process begins in addition to when it ends. Thus, the energy conversion process begins when a thermal, chemical, or other process is applied to solid waste and ends when the useful energy is first created, captured, or incorporated into the form of synthesis gas, heat, hot water, or other useful energy, and before any distribution of such energy. The Final Regulations eliminate the idea that the process ends at the point at which the useful energy is first created, captured, or incorporated into a first useful product. Under the Final Regulations, it ends before any transfer or distribution, regardless of whether such energy constitutes a “first useful product.”

Preliminary Function. The Final Regulations make a rather significant change from the Proposed Regulations with respect to a “preliminary function” that does not itself directly constitute a waste disposal process by dropping the requirement that solid waste constitute at least 50 percent of the input to a solid waste disposal facility. The Final Regulations drop Example 11 of the 2009 Proposed Regulations, which described a bottle sorting process in which at least 50% of the bottles by weight and volume each year were to be recycled. Thus, a function to collect, separate, sort, treat, process, disassemble, or handle solid waste that is preliminary to and directly related to a qualified solid waste disposal process will qualify, and if the preliminary process is part of a mixed-use facility, it will qualify to the extent that is related to the qualifying portion.

Recycling Process and First Useful Product. The Final Regulations retain the definition of a recycling process as meaning reconstituting, transforming, or otherwise processing solid waste into a useful product, but revise the definition of first useful product to clarify the extent to which certain “operational constraints” can be taken into account when determining the point at which a product can be extracted or isolated and sold independently. The Final Regulations state that the costs of extracting, isolating, storing, and transporting the product to a market may only be taken into account as operational constraints if the product is not used as part of an integrated manufacturing or industrial process in the “same location” as that in which the product is produced. Example 8 of the Final Regulations breaks out an example in the 2009 Proposed Regulations dealing with extraction of pulp from a paper recycling process. In the first part of the example, the Service finds under the facts that the process ends upon the sale of cleaned paper pulp at the company’s dock for a price that exceeds its costs of extracting the pulp. In the second variant of the example, the Service determines that if the company could only sell the pulp in a distant market, the costs of storing and transporting the pulp to the actual market may be taken into account in determining whether the pulp is the first useful product.

Mixed-use Facilities. The Final Regulations, as did both the existing “temporary” regulations from 1975 and the 2009 Proposed Regulations, have rules for assessing the qualified costs of so-called mixed use or dual use facilities that perform both a qualified solid waste disposal

function and some other non-qualified process. Mixed use facilities could be facilities used to dispose of both solid waste material and other material (e.g., an incinerator that burns both solid waste and liquid waste) or recycling or energy conversion facilities that require both waste material and virgin material to produce a usable product or usable energy. The general rule, which has been retained from the existing rules, continues to be that the qualified cost of the facility is determined by allocating the costs of the facility between the qualifying and non-qualifying functions on a basis that “reasonably reflects” a separation of the costs of the two functions, although the basis for the allocation where there is a mixed input is spelled out more directly in the Final Regulations.

The 65% Test. In particular, the Final Regulations provide more detail with respect to the so-called “65% Test” of the existing regulations. This test had acknowledged the need in many solid waste disposal processes for the introduction of materials that might otherwise not meet the definition of solid waste and provided that the entire facility could qualify if at least 65% of the input to a recycling facility, determined on either a weight or volume basis, consisted of solid waste. The 2009 Proposed Regulations retained the 65% Test but clarified that the test is to be applied on an annual basis, with failure in any year to be treated as a disqualifying change in use requiring remediation. In response to comments about the “cliff edge” approach to measurement of the 65% test, the Final Regulations provide a method for curing a shortfall in any year by taking into account the “excess” waste (i.e., the amounts in excess of 65%) introduced into the facility in the next two years. This 3-year average applies only if the failure to meet the 65% Test was a result of extraordinary events outside the control of the operator, such as natural disasters, strikes, major utility disruptions, or governmental interventions. While helpful, the Final Regulations did not give commentators what they wanted: the ability to average over the life of the bonds.

The Final Regulations further revised the 2009 Proposed Regulations to state that the annual testing period does not commence until the facility is “placed in service” within the meaning of Treas. Reg. § 1.150-2(b); that is, it is in operation “at substantially the level for which it was designed.” The Final Regulations also eliminated another cliff edge rule by clarifying that if a facility did not meet the 65% Test, bond proceeds could still be used to finance the portion of the mixed use facility based on the amount of material processed that did otherwise meet the regulations. The Final Regulations also preserve the rule of the 2009 Proposed Regulations that make the 65% Test applicable to solid waste disposal facilities in general, not just recycling facilities.

Examples. The Final Regulations generally modified the examples contained in the 2009 Proposed Regulations only to the extent necessary to reflect the substantive changes made, but they drop Example 2 of the 2009 Proposed Regulations. The preamble to the Final Regulations states that Example 2 was eliminated because some commentators said it was confusing. For those practitioners in the trenches, however, the example was very relevant and they had taken comfort from it appearing in the regulations. While the preamble states that there is no substantive inference to be drawn from the removal, this will likely be troubling to some.

Transition Rule and Effective Date. The Final Regulations apply to private activity bonds that are sold on or after October 18, 2011, the date 60 days after the date of publication of Final

Regulations in the Federal Register, but issuers may elect to apply the Final Regulations in whole to outstanding bonds sold before the October 18 date. The transition rules provide that the Final Regulations need not apply to bonds that are a current refunding of bonds to which the Final Regulations do not apply if the weighted average maturity of the refundings bonds does not exceed the weighted average maturity of the refunded bonds.

Post-Issuance Compliance

Several items released by TEB over the past quarter confirm that, in the modern municipal bond world, issuers and/or conduit borrowers simply must adopt and implement written post-issuance compliance procedures. TEB has used the analysis of the its compliance check questionnaires sent to 501(c)(3) and governmental entities to develop a sense of what is out there in the form of written procedures, together with the reports over the years from the Advisory Committee on Tax Exempt and Governmental Entities, to provide more detail on what might constitute written procedures for post-issuance compliance in revisions to the Internal Revenue Manual (the “IRM”).

This process has already started, and we are circling the wagons. The TEB pieces on post-issuance compliance come as the Super Committee begins its public meetings to discuss ways to reduce the deficit, including reducing tax expenditures. The President has lobbied in his volley with the American Jobs Act of 2011, introduced by Senate Majority Leader Harry Reid on September 13, 2011 (S. 1549), which would reduce the interest that could be excluded for taxpayers at a tax bracket higher than 28%. Perhaps one lesson the municipal bond community can take from this, if we believe the legislative process is a rationale one, is that we must demonstrate that we are good stewards of the public infusion of funds represented by tax-exempt interest, tax credits, and direct subsidy payments. While we make the case to the Super Committee and Congress for the continuance of tax exemption, we must also demonstrate that we are prepared and able to provide the ongoing due diligence paperwork and procedures deemed necessary to remain in compliance with the tax rules. While TEB acknowledges that no one size written procedure fits all, it has told us repeatedly over the past several years that the requirement for written post-issuance compliance procedures is a one size fits all requirement.

Final Report on Governmental and Charitable Compliance Check Questionnaires

TEB released its final report, dated July 1, 2011, on findings from the 501(c)(3) and governmental compliance check questionnaires it had sent out in 2007 and 2008 (the “Final Report”). TEB released an interim report with respect to the 501(c)(3) financings in September 2008, but that report acknowledged the limitations on drawing conclusions because of lack of clarity of some of the questions, particularly those that did not have a “not applicable” category for responses. The governmental questionnaire sent out several months later had revised the questions to remedy these issues.

The 501(c)(3) compliance check questionnaire was the first publication of the Service to pick up on the “written policies and procedures” language that had been included in the ACT Report of 2007. As discussed further in this article, this idea of having written procedures has taken on

a life of its own, now appearing as a question in some form on each of the Form 8038 filings and as a carrot for VCAP resolution.

Part II of the Final Report is labeled “Post-Issuance Compliance for Tax-Exempt Bonds” and essentially goes through the general rules for maintaining tax-exempt status on governmental and 501(c)(3) bonds. Part II cites to Section 6001 of the Code for the requirement that a taxpayer must maintain records sufficient to establish the amounts shown on a return. In this Part II, TEB ties the Section 6001 requirement to the idea that issuers and conduit borrowers should retain sufficient records to show that all tax-exempt bond related returns submitted to the Service are correct, and reiterates its view that each Form 8038-CP filing for a direct subsidy payment for tax credit bonds constitutes an issuer certification that as of the date the form is submitted, all the applicable requirements have been met for the payment of the refundable tax credit. Schedule K to Form 990 is also cited as a return requiring information reporting on continued compliance. Selected quotes from the ACT Reports of 2005, 2007 and 2009 are also included to bolster the argument for post-issuance compliance and voluntary reporting of violations.

Part III of the Final Report articulates the two objectives of the compliance check questionnaires. First, the questionnaire was expected to identify trends of comprehensive and/or inadequate post-issuance debt management procedures that could be shared with various stakeholders to enable issuers and borrowers to better understand their responsibilities and increase overall compliance with applicable tax requirements. Second, the projects were expected to identify noncompliance trends and information items for use in developing new compliance programs within TEB to increase overall compliance. The Final Report cites as an example that TEB could create new examination training programs and audit tools to assist revenue agents in identifying and resolving potential record retention deficiencies. This latter example touches a bit of a raw nerve because it would seem that with information in the responses to Notice 2006-63, the ACT recommendations made in the 2009 report for flexible record retention safe harbors, and the results from these compliance checks, the Service would have a good base from which to provide guidance on record retention. Past history demonstrates that it is generally more efficient and effective to provide clear guidance on record retention before developing an audit program. In the conclusion of the Final Report, TEB again states that it is looking at comments from stakeholders and anticipates continued joint efforts with stakeholders in the future to address these record retention burdens.

The Final Report summarizes the responses to the compliance check questionnaires in percentages. Of particular interest is its general review of the responses regarding written procedures (emphasis added in the Final Report). In addition to underlining the word “written” the Final Report describes what appears to be a hierarchy of responses:

- (1) Respondent provided a copy of the procedures or indicated conclusively in its narrative that it had written procedures.
- (2) Respondent indicated in its narrative that it had procedures (and described these in sufficient detail) but did not indicate that it had written procedures (labeled in the Final Report as “ad hoc” procedures).
- (3) Respondent indicated that it had written procedures but provided no detail.
- (4) Respondents said it contracted out responsibilities.
- (5) Respondent indicated in its narrative that it relied upon requirements in the bond documents for guidance on post-issuance compliance.

- (6) Respondent provided a narrative that restated the content of the question.
- (7) Non-responsive statements and no response.

The Final Report generally concludes that the respondents to both questionnaires had a good degree of recognition of the importance of post-issuance compliance and recordkeeping. It went on to say, however, that (1) with respect to 501(c)(3) organizations, the overall “effectiveness” of the implementation of such programs was questionable and (2) with respect to governmental issuers, TEB questions whether adequate resources are being applied to implement compliance programs. The Final Report states that lack of written procedures is consistent with TEB examination experience where it has noted significant pockets of industry inattention to post-issuance compliance, particularly with respect to maintenance of records throughout the life of the bonds. TEB states that without written procedures, record retention policies might be inadequate to promote post-issuance compliance and inability to document compliance in an audit. This takes us back to the same raw nerve about guidance on record retention.

The Final Report concludes that it is important for governmental issuers and 501(c)(3) organizations to have clearly defined procedures and to implement and review those procedures over time to ensure that the current person or persons responsible for post-issuance compliance will fulfill their duties, that monitoring of post-issuance compliance and recordkeeping should be integrated with existing accounting systems, and to recognize that appropriate procedures may vary substantially depending on the complexities of the bond issue, the project or projects financed, and the type and size of the issuer or conduit borrower.

The Final Report also discusses the future of compliance check questionnaires, listing efforts with respect to Build America Bonds and advance refundings. It would seem that this “soft contact” approach is here to stay.

Modifications to Voluntary Closing Agreement Program (VCAP)

TEB took up some of the recommendations of the ACT Reports of 2008 and 2010 by revising the IRM to include VCAP procedures for direct pay bonds and to clarify the consideration that TEB would give in determining the settlement amount for issuers with written post-issuance compliance procedures. TEB made the revisions public on its website in an August 11, 2011 announcement, accompanied by information entitled *TEB Post-Issuance Compliance: Some Basic Concepts* (the “Basic Concepts”). TEB provided further information in a teleconference held on September 8, 2011, with the accompanying slide show now on its website.

The Basic Concepts article provides perhaps the most clarity so far as to what TEB considers a written post-issuance compliance procedure. The Basic Concepts article identifies six “key characteristics” of written procedures. These are:

- Due diligence review at regular intervals.
- Identifying the official or employee responsible for review.
- Training of the responsible official/employee.
- Retention of adequate records to substantiate compliance (e.g., records relating to expenditure of proceeds).
- Procedures reasonably expected to timely identify noncompliance.
- Procedures ensuring that the issuer will take steps to timely correct noncompliance.

These key characteristics are an elaboration of the “4Ps” of the 2007 ACT Report (people, process, procedures, population), and explain in large part why TEB refers to post-issuance compliance based solely on informal unwritten procedures (“ad hoc” procedures) and tax certificates and bond documents as wanting in their review of the 501(c)(3) organization and governmental issuer compliance questionnaire responses in the Final Report as discussed above.

In the Basic Concepts article, TEB adds a paragraph dealing with the potential ramifications if diligence is not exercised at the time of issuance with respect to issuance-related requirements. The example used, as might be expected, is the establishment of issue price. The post-issuance compliance is focused on use of proceeds and arbitrage, and monitoring of the costs of issuance limitation, but does not specifically mention other potential VCAP post-issuance “identified violations” such as violation of the 120% maturity limitation.

The Basic Concepts summary sends the clear message that active monitoring of compliance will significantly improve the issuer’s ability to identify noncompliance, prevent violations of compliance from occurring, and resolve noncompliance in VCAP on more favorable terms. Under the revisions to VCAP, the party requesting VCAP must now include with the request an affirmative or negative statement as to whether it has adopted comprehensive written procedures intended to promote post-issuance compliance with, and to prevent violations of, the provisions of the Code related to tax-advantaged bonds. The issuer must also include a detailed description of the portion of such comprehensive procedures that relate to the violation that is the subject of the VCAP request. The issuer also should identify the authorized person(s) who adopted the procedures, the officer(s) with responsibility for monitoring compliance, the frequency of compliance check activities, the nature of the compliance check activities undertaken, and the date such procedures were originally adopted and subsequently updated (if applicable). The IRM goes on to state that the extent to which an issuer has appropriate written compliance procedures will be an equitable factor that will receive consideration in determining appropriate resolution terms with respect to VCAP requests.

The effect of adoption and implementation of written procedures is quantified in Section 7.2.3.4.4 of the IRM in the form of reducing the period for calculating a settlement amount if the issuer had, prior to the date of the violation, adopted written post-issuance compliance procedures, or if procedures have not been adopted before the violation, the issuer does implement procedures, timely identifies a violation, and submits a VCAP request within 90 days of the violation. In general, the settlement amount is calculated from the period commencing with the date of the deliberate action causing noncompliance. Under the new language added to the IRM, the settlement amount will be calculated from the earlier of the date the issuer discovered the violation or the date the issuer should have discovered the violation if the written procedures have been implemented.

This reduction in the settlement amount could significantly reduce the amount required to be paid with respect to a VCAP request, depending on the interest rate on the bonds, the amount of nonqualified bonds, and the time when the violation should have been discovered. Under TEB’s guidelines on written post-issuance compliance procedures, an issuer must conduct due diligence at “regular intervals,” and generally have procedures expected to “timely” identify

noncompliance. If the interval selected is every five years to coincide with rebate calculations, would that result in timely identification or discovery of violations, or must the due diligence be performed at least annually (as with Schedule K) or quarterly in order to fit within the general 100% settlement amount offered if a request is made within six months of a violation? Issuers will want to review their policies with this potential reduction in mind.

In the streamlined VCAP program for “identified violations” the TEB has adopted a minimum \$1,000 payment. Thus, if the settlement amount is less than \$1,000, the issuer will still have to pay \$1,000 to resolve the matter. The list of identified violations for tax-exempt bonds is supplemented by two items: (1) a violation of the requirement under Section 145 that all property financed with bond proceeds be owned by a 501(c)(3) organization and (2) the failure to have debt at all upon extinguishment of debt when a tax-exempt bond is purchased by the issuer or a related party. The latter addition puts the settlement procedures of Announcement 2011-19 into the body of the IRM.

The other important point of the IRM revisions is the addition of streamlined resolutions standards for perceived common violations involving direct pay tax-credit bonds. The ACT Report of 2010 had addressed these issues. As with the identified violations for tax-exempt bonds, the minimum settlement amount is \$1,000, the settlement amount is increased by 10% for VCAP requests submitted more than six months after the violation, the streamlined approach is not permitted for VCAP requests submitted more than one year after the violation, and a standard settlement amount is offered. The settlement amount is not based on taxpayer exposure, as is the case for tax-exempt bonds, but is based on the “credit maintenance amount” equal to the present value of credit amounts.

The identified violations for direct pay bonds are as follows:

(1) Bonds Become Private Activity Bonds—A violation occurs when an issuer takes a deliberate action that causes its BABs or recovery zone economic development bonds to be private activity bonds. An issuer may resolve this violation by paying the “credit maintenance amount” calculated on the nonqualified bonds. The issuer must reduce the principal payment schedule of the nonqualified bonds from the date of the violation to the final maturity date of the bonds on a pro rata basis (taking into account scheduled sinking fund payments). Principal reductions on the modified schedule must be pro rata.

(2) Final Allocation of Proceeds to an Impermissible Use—A violation occurs when an issuer makes a final allocation of proceeds to an impermissible use, such as excessive costs of issuance. To resolve the violation, the issuer must pay a “credit maintenance amount” on the nonqualified bonds. This is similar to the private activity bond standard mentioned above, except that nonqualified bonds must be treated as nonqualified from date of issuance because TEB views this as a serious violation given the 100% requirement for use of available proceeds.

(3) Issue Price Premium Above De Minimis Amount—A violation occurs when the issue price of BABs, recovery zone economic development bond, and tax credit bonds eligible for direct subsidy payments under Section 6431(f), such as Qualified School Construction Bonds,

is greater than the principal amount of each bond plus a de minimis amount of premium over the stated principal amount of each bond. If the issuer submits a VCAP request no later than 6 months after the issue date or February 1, 2012, with respect to a bond treated as extinguished for federal tax purposes and subsequently sold by the issuer to the public (the “Subsequent Sale”), the issuer must prepare a debt service schedule that adjusts the stated interest rate for each bond sold with more than the permissible premium to an interest rate that corresponds to the yield of the maturity assuming that the maturity was sold for the maximum permissible price. The settlement amount is equal to 100% of the credit maintenance amount on the bond maturity calculated assuming that the bond maturity accrued or will accrue interest at an interest rate equal to the difference between the original interest rate on the bond and the adjusted rate. In calculating the credit maintenance amount, the violation is treated as occurring on the issue date, but may be shortened when the issuer and TEB agree to modify the debt service schedule to treat the nonqualified bonds as no longer outstanding for purposes of requesting the subsidy. The debt service schedule for payments to the bondholders remains the same as when the bonds were sold. If the VCAP request is made more than 6 months after the issue date but within the later of one calendar year or August 1, 2012, the settlement payment is equal to 110% of the credit maintenance amount and nonqualified bonds for purposes of shortening the credit maintenance period calculation must be equal to 110% of the nonqualified bonds. The issuer may use VCAP if it relied on underwriter’s issue price certificate.

(4) Extinguishment/Merger—A violation occurs when an issuer claims a refundable credit on an extinguished bond. The issuer must pay the “credit maintenance amount” on the bonds acquired by the issuer or a related party (the “Initial Acquisition”), calculated over the period beginning with the date of the Initial Acquisition and ending on the first interest payment date on the bonds after the date of the closing agreement. If the Initial Acquisition occurred during the primary offering of the direct pay bonds, the settlement amount must also include an amount equal to all profits (if any) realized by the issuer or any governmental unit, agency, instrumentality, or other related party of the issuer from the Subsequent Sale. The effect of the closing agreement is that (1) the Initial Acquisition will not have resulted in an extinguishment prior to the effective date of the closing agreement for federal tax purposes (except for purposes of receiving direct payments) and (2) the Service will treat the bonds as having not been extinguished as a result of Initial Acquisition or reissued as a result of the Subsequent Sale.

Defeasance of direct pay bonds is not required for a remedial action as is generally true for settlement of many of the tax-exempt bond violations. TEB has taken the position that a defeasance of taxable bonds would be treated as a reissuance under the 1001 regulations, and under current law, the direct pay bonds cannot be refunded. The IRM encourages issuers to submit alternate ways to remedy violations, including the defeasance of direct pay bonds with traditional taxable debt that would not constitute a direct pay refunding bond.

Several new items are required to be addressed in a VCAP request. The party requesting VCAP must “fess up” to whether any previous or contemporaneous VCAP requests, including anonymous requests, have been submitted by the issuer with respect to that bond issue or pertaining to a violation that is the same as the request within the past five years. The entity must

include a statement describing any explanation that the issuer's representatives or other professionals have made to the issuer regarding conflicts of interest relating to the bonds that might exist under Circular 230. Further, the issuer must state whether the identified violation has been disclosed on EMMA or to any state or local government that grants tax-advantaged treatment to the bonds. If disclosed, the request must describe the disclosure and how it was made; if not disclosed, a statement to that effect must be made.

The IRM states that if an issuer wants to assert that the violation was caused by another party and requests consideration of that fact in VCAP resolution, the issuer must provide a description of the circumstances surrounding the violation and any information the issuer has regarding the acts or omissions, including identification of the party responsible for the acts or omissions.

Other miscellaneous changes to VCAP include the ability to resolve Form 8328 issues relating to carryforwards of volume cap that cannot be resolved under Revenue Procedure 2005-30. The IRM provides that a VCAP request can be submitted in advance of action resulting in a violation, but the closing agreement will not be executed until after the violation has occurred.

Revisions to Schedule K, Form 990

The Service published a draft of Schedule K to the 2011 Form 990, which also adds more questions on written procedures. In Part III (Private Business Use) Line 8 has been rewritten to ask if the organization has "established" (changed from "adopted" in the 2010 Form) "written procedures" (changed from "management practices and procedures") to ensure that all nonqualified bonds of the issue are remediated in accordance with the requirements under Regulations sections 1.141-12 and 1.145-2. Under Part IV (Arbitrage), the Service has squeezed in a new Line 7, which asks if the organization has established written procedures to monitor the requirements of Section 148. To cap it off, an entirely new Part V entitled "Procedures to Undertake Corrective Action" has been added with a single question asking if the organization has established written procedures to ensure that violations of federal tax requirements are timely identified and corrected through the voluntary closing agreement program if self-remediation is not available under applicable regulations. With this last addition, the Service was required to reduce the space available under Part VI Supplemental Information. No instructions have been released, but we can hope that many of the items that were unclear in the 2010 version will be corrected so that 501(c)(3) organization will not need to supplement as many items.

Report of Treasury Inspector General for Tax Administration on BABs Compliance Check Questionnaire

The Treasury Inspector General for Tax Administration ("TIGTA") released a report entitled *The Direct Pay Build America Bond Compliance Check Program Has Yet to Result in Wide-Scale Examinations* (Reference Number: 2011-11-052) on June 3, 2011 (the "TIGTA Report"), evaluating the use by TEB of a compliance check questionnaire for issuers of Build America Bonds ("BABs"). TEB's announcement at the NABL Tax and Securities Institute that TEB expected to audit each BAB issuance caused considerable concern, and Cliff Gannett later submitted a Letter to the Editor of *The Bond Buyer*, dated July 2, 2010, stating that concern that TEB would audit an

extraordinarily high number of BAB issuances was unfounded, that fewer than 10 issuers were under audit at that point, and that while the number might rise, the ultimate number would in no way reach the reported rates. Concern arose primarily because of the perceived need for additional guidance to clarify many of the issues that arose after Notice 2009-33, particularly the compliance check questionnaire questions related to whether issuers had written procedures in place to provide a check on the underwriter's certification as to issue price. These questions suggested that the issuer should hire an independent advisor or use bond counsel to check EMMA and question the underwriter if the information varied from the issue price certification.

The major recommendation of the TIGTA Report is for TEB to develop formal written procedures for developing and conducting compliance checks in order to ensure that any compliance check programs are within its statutory authority, that information gathered is useful for assessing risk, and that such programs do not create an increased burden on issuers by requesting information that is unnecessary and not useful if results are not properly anticipated. The TIGTA Report and the attached Management Response from Joseph H. Grant, Acting Commissioner of Tax Exempt & Government Entities, note that TEB developed the BABs questionnaire following formal administrative guidelines prepared by the Exempt Organizations section of TE/GE, previous TEB questionnaires, and Treasury processes developed to assess risk of ARRA programs. There is a certain amount of irony in TIGTA's conclusion that TEB did not have adequate written procedures, given TEB's continued push for written procedures from issuers of tax-exempt bonds. In its response, TEB states that it expects to amend the IRM by March 2012 to provide written procedures for compliance check questionnaires.

TIGTA selected a "judgmental" sample of 30 responses to the BABs questionnaire to aid in its evaluation of whether the questions were appropriate for identifying indications of a high risk of potential noncompliance for BABs. A "judgmental sample" is not a random sample that would allow TEB or TIGTA to generalize responses, and there is no indication as to what factors were considered in selecting the 30 responses. The TIGTA Report summarizes the results of only four broad categories of questions, with issuers reporting 100% on only the category of maintaining bond records on either paper or electronic media. TIGTA concluded that the questions were appropriate to the task and that the responses were not being used to conduct audits at this point. The TIGTA Report states that audits had been initiated based on filings for the direct subsidy payment that raised certain issues.

Advisory Committee on Tax Exempt and Government Entities ("ACT")

The 2011 ACT Report, released on June 15, 2011, contains two reports related to tax-exempt bonds. Three 103 lawyers (Michael Bailey, David Cholst, and George Magnatta) prepared the first report, focusing on the role of conduit issuers in tax compliance. The second report dealt with an update on issues related to use of Tribal Economic Development Bonds ("TEDBs") added by the American Recovery and Reinvestment Act of 2009 ("ARRA").

The section entitled *Tax-Exempt Bonds: The Role of Conduit Issuers in Tax Compliance* begins with a scholarly history of the development of conduit issuers, beginning with Revenue Ruling 57-187 and the enactment of industrial development bond provisions in the Revenue and Expenditure and Control Act of 1968 through the court discussion of the conduit issuer's role

in the *Harbor Bancorp v. Commissioner* case in 1995 and the IRS Restructuring and Reform Act of 1998, which gave issuers a role in enforcement proceedings and access to the IRS Office of Appeals.

Perhaps taking cues from TEB, ACT members sent out a survey to state and local governments to gather firsthand information on existing procedures and experiences in acting as a conduit issuer. Most of the respondents were members of the National Association of Health and Educational Facilities Financing Authorities and the National Council of State Housing Agencies. The instructions to the survey were careful to state that ACT was not acting on behalf of the Service and would not be sharing individual responses with the Service. The report does not state how many issuers responded, but describes the majority of the respondents as being operating entities with fulltime staff that were large issuers, mainly of 501(c)(3) bonds.

The survey questions are reproduced in Appendix A to the ACT Report and dealt with staff, procedures and documentation, recordkeeping, investment control, IRS examination and voluntary compliance programs, fees, and the conduit issuer role in “extraterritorial” bond issues (“host jurisdiction” situations). Responses are summarized for each category of questions, generally concluding that conduit issuers had a role that was relatively passive, with the conduit borrower expected to have the main responsibility for tax compliance.

The ACT Report views the conduit issuer as part of a broader “federalism” scheme, that is, the state or local government entity provides increased public transparency and a second level of government review and monitoring of tax compliance. This is an interesting perspective, and it is unfortunate that the survey did not ask an “open-ended” philosophical question of conduit issuers as to what they saw as their role in overall tax compliance. A change in the role of conduit issuers could result in issuer fee increases at a time when borrowers are “forum shopping” in part based on issuer fees as part of their determination of whether to issue tax-exempt bonds.

ACT recommends that the Service develop a more comprehensive framework for defining the role of the conduit issuer, but cautions that the Service should require full participation of conduit issuers only if a significant tax administration benefit is served. For example, ACT recommends that TEB drop the requirement that the issuer be the party to submit a VCAP request and that it modify its procedural stance that only a conduit issuer is a “taxpayer” under Section 6103 for audit purposes in tax-exempt bond and tax credit matters. The ACT Report states that the basis for treating a conduit borrower as the “taxpayer” would appear to be at least as sound as treating the conduit issuer as the taxpayer. The ACT Report does not recommend treating only the conduit borrower as the taxpayer, but urges that the Service adopt a more flexible approach to simplify administrative procedures and focus more on substantial tax compliance purposes.

The ACT Report also tackles reissuance and modifications of conduit financing terms. Revenue Ruling 81-281 is cited as illustrating the issue, for in that case the Service concluded that changes in the terms of bonds and security agreed to by the conduit borrower and the bondholder without action by the governmental issuer caused the bonds to be taxable. The Service

concluded that a conduit issuer had to at least nominally participate in approving changes to the terms of its previously issued bonds. Treas. Reg. § 1.1001-3(f)(6)(i) states that changes made by the bondholder and conduit borrower are indirect modifications of the tax-exempt bond. The ACT Report suggests that the Service clarify the extent of participation required by the conduit issuer in the case of modifications such as those described in Revenue Ruling 81-218, urging that the timely filing of a Form 8038 in the case of a modification that results in a reissuance should be sufficient.

In general, the ACT Report lays out several decision points for conduit issuers to consider in developing conduit issuer written post-issuance procedures. As with other recent reports of ACT in the tax-exempt bond area, the ACT Report contains “shovel ready” documents, including a model brochure that TEB could make available to conduit issuers, similar to its existing materials for governmental and 501(c)(3) borrowers on tax compliance.

The second article in the ACT Report of interest to the municipal bond community is entitled *Indian Tribal Governments: Supplemental Report on the Implementation of Tribal Economic Development Bonds under the American Recovery and Reinvestment Act of 2009*. This article is a follow up on the ACT Report of 2010 on Tribal Economic Development Bonds (“TEDBs”). Tribal bonds are another ongoing saga that arose from audits. ARRA provided tribal entities with broader ability to issue tax-exempt bonds in the form of TEDBs, similar to the types of issuance permitted for state and local governments, albeit within a volume cap that was to be awarded based on a method determined by the US Department of Interior.

After summarizing the highlights of the ACT Report, released in 2010, the ACT Report updates implementation of TEDBs under ARRA in several areas. First, the ACT Report provides an update on the status of the Secretary of Treasury’s report to Congress required by Section 1402(b) of ARRA to be delivered not later than one year after the date of enactment of ARRA. In response to a solicitation from Treasury, dated July 12, 2010, Treasury received 27 comment letters from tribes. The tribes generally recommended that the “essential governmental function” test be eliminated because it had proven difficult to develop administrative standards related to functions “customarily performed” by state and local governments, leading to many audit disputes. The request by the Service for comments to an Advance Notice of Proposed Rulemaking (Announcement 2006-59, 2006-36 IRB 388 (September 5, 2006)) had yet to result in guidance. The ACT Report states that several tribes reported applying for TEDB volume cap to avoid the uncertainties of the interpretations of essential governmental functions.

Commentators recommended use of the private activity bond tests available to state and local governments to help meet the need to access lower cost financing mechanisms to finance the backlog of infrastructure needs. While requesting the same treatment as other state and local governments, the commentators also requested that the tax rules accommodate the different governmental structures that exist among the tribes. In particular, they requested that “Section 17” corporations, wholly owned entities formed under Section 17 of the Indian Reorganization Act, be permitted to issue tax-exempt bonds on the theory that they are an integral part of tribal governments and perform an essential governmental function.

With respect to the payment side of the private activity bond test, the commentators had requested relief on the source of revenues that could be treated as governmental revenues. The suggestion was made that gaming revenues be viewed in the same manner as state lottery revenues and revenues from other commercial, industrial, and recreational facilities such as sports venues, convention centers, ports, and campgrounds. A broader approach, it was suggested, would respect the need of tribal governments to tap a wide variety of revenues to meet their debt service obligations and access the market.

The second major recommendation summarized by the ACT Report is to permit Indian tribes to issue private activity bonds. The ACT Report goes on to summarize arguments for expanding the categories of permitted private activity bonds to address unique tribal needs and for eliminating or at least modifying the volume cap rules applicable generally to states issuing private activity bonds.

The ACT Report discusses modifications to the TEDB provisions. The major themes include the following:

(1) Elimination of the requirement that financed facilities be located “on reservation.” The primary concern expressed with the limitation that projects be “on reservation” is that reservations are often scattered and remote and have an inadequate land base for economic development. The ACT Report states that use of TEDBs has been delayed as tribes await confirmation from the federal government as to the trust status of land and as certain Alaskan tribes seek confirmation as to whether they are tribes eligible at all because they have no reservation or trust lands. The ACT Report recommends that tribes be permitted to finance projects outside the reservation if the tribe can articulate a substantial connection or nexus to an area not on the reservation.

(2) Relief with respect to the limit on financing gaming activity. The ACT Report focuses on the importance of gaming activities to tribal governments and points out that the current restrictions imposed by the Indian Gaming Regulatory Act (“IGRA”) should eliminate concerns because IGRA already requires that revenues be applied to essential governmental functions, economic development, donations to charitable activities, or support of governmental operations. Tribes have also pointed out that the safe harbor of Notice 2009-51 for determining whether a proposed project is part of the same building with gaming activity needs to be clarified to confirm that independent buildings that are physically connected would still be eligible for financing with TEDBs.

(3) Permit federal guarantees of TEDBs. The argument is that an exception to the prohibition on federal guarantees is warranted by the lack of revenues to secure debt and the lack of access to meaningful collateral to secure debt.

(4) Repeal the requirement for bonds to be registered. The ACT Report points out that tribes must either bear the registration costs or find more costly private placements because tribal governments are not exempted from the registration and disclosure rules of the Securities Act of 1933 in the same manner as state and local governments.

The ACT Report acknowledges that there is little information on the successful use of TEDBs. The access to expanded financing came at the same time that the municipal market was struggling and coincided with defaults on four tribal debt issuances. The size limits on TEDBs were also cited as hindering access to the market, both in terms of the maximum amount al-

located to any tribe (\$22.5 million) and the fact that tribes that did not receive the full amount requested because of the size limit had to find additional sources of funding in the midst of a troubled market to complete the project.

The ACT Report concludes that legislative action is needed to modify the TEDB program to deal with the roadblocks described in the ACT Report so that it provides the intended benefit to tribes. Further, the ACT Report concludes that the allocation process for TEDBs has been unworkable and that the tribes should be consulted to develop a more qualitative approach to allocating to viable projects. On the administrative side, the ACT Report cites NABL's recommendations for technical corrections to ARRA, including the ability to refund TEDBs. The ACT Report also suggests that the Service conduct outreach and education to understand the issues related to TEDBs and to tribal financings under Section 7871 more generally. Finally, the ACT Report notes that the regulatory effort has stalled since the 2006 Advance Notice and that in the absence of clear guidance, tribal governments are reluctant to enter into the market and purchasers are reluctant to buy tribal bonds.

Follow up note: In a letter dated July 27, 2011, Emily McMahon, the Acting Assistant Secretary for Tax Policy, stated that the Treasury was continuing to actively work on the study required by ARRA, and was continuing to review the 27 letters submitted on the topic. The letter, however, gave no expected date of release of the study.

Form 8703 Update

The Service released a revised version of Form 8703, *Annual Certification of a Residential Rental Project*, filed with respect to multifamily housing projects financed with bonds issued under Section 142(d) of the Code. The form was last revised in 1998.

Form 8703 was revised to include the low-income asset-aside percentages permitted for Gulf Opportunity Zone, Midwestern disaster areas, and Hurricane Ike disaster areas, all of which permit a set-aside of either 20% of the units at 60% of area median income or 40% of the units at 70% area medium income.

Instructions to the form state that the form was updated to include changes made by the Housing and Economic Recovery Act of 2008 ("HERA"). Section 3010(a) of HERA eliminated the requirement of 142(d) for an annual income determination of residents with respect to any project for any year in which no residential units in the project were occupied by a new resident whose income exceeded the applicable income limit. The form interprets this to mean that the project owner report only the number of residential units in the project, the total number of units vacated, number of units vacated and reoccupied by residents who were low-income residents at the time of occupancy, and the number of low-income vacated units being held available for low-income residents. This provision will reduce the compliance burden of annually measuring income each year for projects with a stable tenant base.

The form has an entirely new section Part III to report the bond issue to which the form relates. The project owner/operator is required to pull information from the Form 8038 filed with respect to the bonds, including the name and EIN of the issuer, the name of the bond issue, issue date, issue price, CUSIP, and final maturity date. Form 8703 now also includes a Paid Preparer section. This section is likely to be left blank, as this post-issuance compliance form

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Interestingly, the estimates of the average time for recordkeeping, learning about the law, and preparing and sending the form doubled since the last revision.

Private Letter Rulings

The Service released two private letter rulings on municipal bond issues over the past three months.

Mixed-Use Allocation of Output Facility. The Service released a private letter ruling dealing with a mixed-use output facility. In PLR 201128010 (dated March 31, 2011 and released July 15, 2011), the issuer, a political subdivision, requested a ruling as to what portion of a facility owned by the issuer and managed by a nongovernmental electric cooperative under a management contract with the issuer could be financed with tax-exempt governmental bonds. Under the facts of the ruling, the issuer had entered into a power sales contract with the coop for a certain amount of the net rated capacity of the facility and the issuer retained the right to reserve a certain amount of the net rated capacity of the facility for its own use. Net rated capacity is defined as the nameplate capacity minus the auxiliary power needed to run the facility.

Under the power sales contract, for each year the issuer has the right to schedule or take the portion of the power generated by the facility equal to the percentage of the facilities net rated capacity reserved by the issuer for that year. If the issuer does not schedule or take all of its reserved portion, it must offer the unused output to the coop before offering to third parties. In addition, under the operating agreement with the coop, the issuer reimburses the coop for the issuer's share of the actual and direct expenditures incurred by the coop in the operation and maintenance of the facility. The issuer's share of expenses is determined by its reserved percentage share of the facility's net rated capacity.

The issuer expects to finance improvements to the facility and represents that any tax-exempt governmental bonds would be limited to its share of the costs. The issuer represents that throughout the term of the bonds it (1) will maintain its reserved net rated capacity and, (2) of the total energy generated at the facility, will take a sufficient amount so that no more than 10% of the facility's improvements that are to be financed with proceeds of the bonds will be used for private business use.

Although the regulations under Section 141 are cited by the Service for its analysis, the conclusion that tax-exempt bonds can be used in this case relies on an analysis of Advance Notice of Proposed Rulemaking (the "Advance Notice"), published on September 23, 2002 (67 Fed Reg 59767). When the private activity bond regulations under Section 141 were finalized in 1997, has typically been prepared by the operator, manager, or compliance consultant.

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Although the regulations under Section 141 are cited by the Service for its analysis, the conclusion that tax-exempt bonds can be used in this case relies on an analysis of Advance Notice of Proposed Rulemaking (the "Advance Notice"), published on September 23, 2002 (67 Fed Reg 59767). When the private activity bond regulations under Section 141 were finalized in 1997, the allocation and accounting rules for mixed-use facilities were reserved. The Advance Notice laid out several principles for determining the portion of a mixed-use facility, particularly with respect to output facilities, in anticipation of the publication of final allocation and accounting regulations. The Advance Notice permitted an issuer to rely on the provisions for bonds sold before the date of publication of final regulations. The Service published proposed regulations under Treas. Reg. § 1.141-6 on September 26, 2006, but final regulations have not been released and were not included in the Priority Guidance Plan for 2010-2011 (which technically ended June 30, 2011). The Advance Notice allowed an allocation of costs based on the percent-

age of nameplate capacity. In the private letter ruling, the Service concludes that the allocation of output under the power sales contract based upon reserved net rate capacity is equivalent to nameplate capacity. The Service concludes that the issuer can finance its reserve portion plus any costs attributable to the de minimis private business use permitted under Section 141.

The Service further concludes that the facility is public utility property and that the terms of the operating agreement with the coop fall within the arrangements not treated as private business use under Treas. Reg. § 1.141-3(b)(4)(iii)(C).

Student Loan Corporation. In PLR 201126020 (dated March 21, 2011 and released on July 1, 2011), the Service delved into the specialty area of student loan corporations and student loan bonds. Given the turmoil in the student loan area as the federal government attempts to move more activity to direct loans by colleges and universities, it is perhaps not surprising that the Service was asked to rule on an issuer's proposed actions to cease status as a qualified scholarship funding corporation under Section 150(d)(2) of the Code. Section 150(d)(3) was added to the Code in 1996, during another period of change in the student loan world, to provide the circumstances under which the tax exempt status of bonds issued by certain qualified scholarship funding corporations would continue even though the corporation would cease to meet the qualifications under Section 150(d) and would transfer assets to a taxable subsidiary. The facts of this particular ruling are rather unusual in that the 150(d) entity had determined to expand its charitable mission beyond the acquisition of student loan notes incurred under the Higher Education Act of 1965. In anticipation of amending its articles of incorporation, it used cash from the sale of some student loans and a line of credit from the issuer's parent and sole member to fully redeem its tax-exempt bonds. It certified to the Service that it would not issue any tax-exempt bonds in the future. While the Service describes the requirements of Section 150(d)(3) in the ruling, it notes that these provisions do not apply because the issuer had redeemed all of its tax-exempt bonds. In what appears to be a comfort ruling request by the issuer, the Service determines that regardless, because the issuer was a qualified scholarship funding corporation throughout the term of the bonds, the issuer's proposed actions would not cause interest on the bonds previously issued to fail to be excludable from gross income under Section 103 of the Code.

2011-2012 Priority Guidance Plan

The Service and Treasury were able to release the 2011-2012 Priority Guidance Plan on September 2, 2011 (the "Plan"), noting that the Plan (1) represents projects they intend to work on actively throughout the year but (2) does not place a deadline on completion of the projects. The Plan, which covers the period from July 1, 2011 through June 30, 2012, includes six items. Two of the items had been completed by the time of publication of the Plan: final solid waste regulations and clarification of the issue date for draw-down bonds. The remaining four items were left over from the 2010-2011 Priority Guidance Plan, including regulations on public approval requirements, arbitrage investment restrictions, and bond reissuance and guidance on the direct pay tax credit bonds pursuant to Section 6431(f).

This should prove to be another interesting year. Given the high likelihood that Congress will be presented with various tax proposals from the Super Committee, the President and Congress' own members, the Service and Treasury could find their plate filled with very different, and very pressing, requests for guidance.

Federal Securities Law

Paul S. Maco, Vinson Elkins LLP



Summer Activity

The Securities and Exchange Commission

In terms of municipal market regulatory activity, the SEC spent summer in the doldrums. The third, and apparently the final, SEC Field Hearing on the State of the Municipal Securities Market took place in Birmingham, Alabama on July 29, 2011. In her opening remarks, Commissioner Elisse Walter indicated what will follow: “As we draw to the close of the ‘information gathering stage’ of our initiative, Commission staff will begin to prepare a report concerning what we have learned, including their recommendations for further action that we should pursue. These may include recommendations for changes in legislation, regulations, and industry practice.”¹

The SEC’s work on a final rule for registration of municipal advisors remains a work in progress as well. On July 21, 2011, Chairman Schapiro told the Senate Banking Committee: “We have received approximately 1,000 comment letters on the proposal, including many expressing concerns regarding the treatment of appointed officials and traditional banking products and services. We will give all of these comments careful consideration before adopting a final rule.”²

The current Interim Final Temporary Rule expires at 11:59 p.m., Eastern Time, December 31, 2011. The SEC website post “Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act” under the captions “Upcoming Activity” lists “adoption of permanent rules for the registration of municipal advisors” under the time heading “August – December (planned).” At the time of this writing, the SEC has about three-and-a-half months to complete the task and publish the final rule. As observed in last quarter’s column, the proposed final rules potentially would include a broad selection of actors in the municipal market, many of whom might be surprised at finding their activities regulated. If a reasonable amount of time is to be provided to allow those deemed municipal advisors to register, whether surprised or not by their inclusion, the remaining rulemaking timeframe is even narrower.

The Municipal Securities Rulemaking Board

The Municipal Securities Rulemaking Board was hard at work this summer.

On September 12, 2011, the Board announced it had withdrawn five of its proposed rules regarding municipal advisor activity submitted earlier in the summer, stating it plans to resubmit the proposals “upon the SEC’s adoption of a permanent definition of the term ‘municipal

1 Statement at SEC Field Hearing on the State of the Municipal Market (July 29, 2011), available at <http://www.sec.gov/news/speech/2011/spch072911ebw.htm>.

2 Testimony on “Enhanced Oversight After the Financial Crisis: The Wall Street Reform Act at One Year,” Chairman Mary L. Schapiro before the United States Senate Committee on Banking, Housing and Urban Affairs (July 21, 2011), available at <http://www.sec.gov/news/testimony/2011/ts072111mls.htm>.

advisor' under the Securities Exchange Act of 1934.³ The withdrawn notices represent a substantial part, but not all, of the Board's regulatory output for Summer 2011, and include:

- SR-MSRB-2011-08 (July 26, 2011) (Proposed New Rule A-11, on Municipal Advisor Assessments, and New Form A-11-Interim).
- SR-MSRB-2011-10 (August 16, 2011) (Proposed Rule Change Consisting of Amendments to Rule G-20, on Gifts and Gratuities, Rule G-8, on Books and Records, and Rule G-9, on Preservation of Records, and to Clarify that Certain Interpretations by FINRA and NASD Would Be Applicable to Municipal Advisors).
- SR-MSRB-2011-12 (August 19, 2011) (Proposed Rule Change Consisting of Proposed New Rule G-42, on Political Contributions and Prohibitions on Municipal Advisory Activities; Proposed Amendments to Rules G-8, on Books and Records, G-9, on Preservation of Records, and G-37, on Political Contributions and Prohibitions on Municipal Securities Business; Proposed Form G-37/G-42 and Form G-37x/G-42x; and a Proposed Restatement of a Rule G-37 Interpretive Notice).
- SR-MSRB-2011-14 (August 23, 2011) (Proposed Rule Change Consisting of Proposed Rule G-36, on Fiduciary Duty of Municipal Advisors, and a Proposed Interpretive Notice Concerning the Application of Proposed Rule G-36 to Municipal Advisors).
- SR-MSRB-2011-15 (August 24, 2011) (Proposed Interpretive Notice Concerning the Application of Rule G-17, on Conduct of Municipal Securities and Municipal Advisory Activities, to Municipal Advisors).⁴

Among the MSRB rulemaking actions that remain pending before the SEC, two of the most noteworthy may be MSRB Notice 2011-36 (August 2, 2011),⁵ Interpretive Guidance Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities, and MSRB Notice 2011-52 Potential Applicability of MSRB Rules to Certain "Direct Purchases" and "Bank Loans" (September 12, 2011).⁶

MSRB Notice 2011-36 interprets the application of Rule G-17 to underwriter dealings with issuers. Among other requirements, the proposed interpretation provides:

- All representations made by underwriters to issuers of municipal securities in connection with municipal securities underwritings (e.g., issue price certificates and responses to requests for proposals), whether written or oral, must be truthful and accurate and may not misrepresent or omit material facts.

³ MSRB Notice 2011-51 (September 12, 2011), available at: <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-51.aspx?n=1>.

⁴ Id.

⁵ Available at: <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-36.aspx?n=1>.

⁶ Available at: <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-52.aspx?n=1>.

- An underwriter of a negotiated issue that recommends a complex municipal securities financing (*e.g.*, a variable rate demand obligation with a swap) to an issuer has an obligation under Rule G-17 to disclose all material risks, characteristics, incentives, and conflicts of interest (*e.g.*, payments received from a swap provider) regarding the complex municipal securities financing. Such disclosure would be required to be sufficient to allow the issuer to assess the magnitude of its potential exposure as a result of the complex municipal securities financing. In the case of routine financing structures, underwriters would be required to disclose the material aspects of the structures if the issuers did not otherwise have knowledge or experience with respect to such structures.
- A dealer's duty to have a reasonable basis for the representations it makes, and other material information it provides, to an issuer and to ensure that such representations and information are accurate and not misleading, as described above, extends to representations and information provided by the underwriter in connection with the preparation by the issuer of its disclosure documents (*e.g.*, cash flows).
- The duty of fair dealing under Rule G-17 includes an implied representation that the price an underwriter pays to an issuer is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the underwriter as to the fair market value of the issue at the time it is priced. The Notice distinguishes the fair pricing duties of competitive underwriters (submission of *bona fide* bid based on dealer's best judgment of fair market value of securities) and negotiated underwriters (duty to negotiate in good faith).
- In certain cases and depending upon the specific facts and circumstances of the offering, the underwriter's compensation for the new issue (including both direct compensation paid by the issuer and other separate payments or credits received by the underwriter from the issuer or any other party in connection with the underwriting) may be so disproportionate to the nature of the underwriting and related services performed, as to constitute an unfair practice that is a violation of Rule G-17.
- An underwriter should disclose potential conflicts of interest, including third-party payments, values, or credits made or received, profit-sharing arrangements with investors, and the issuance or purchase of credit default swaps for which the underlying reference is the issuer whose securities the dealer is underwriting or an obligation of that issuer.

MSRB Notice 2011-52 on Bank Loans is characterized as an "advisory" that the "MSRB has not filed it with the SEC for approval," and cautions that "no inference should be drawn that the SEC or its staff has approved its publication."⁷ As the Notice explains, "the MSRB intends to make dealers and municipal advisors aware that some financing instruments might be municipal securities. While the MSRB's intent is to draw attention to the factors to consider in determining whether an instrument is a security, the MSRB draws no legal conclusions regarding any individual instrument. Dealers and municipal advisors should consult with their legal counsel about the analysis of whether an individual instrument is a security."⁸

7 Id.

8 Id.

The Notice first warns: “if a broker-dealer serves as a placement agent for a ‘direct purchase’ by a bank of municipal securities or as a placement agent for a ‘bank loan’ that is, in fact, a municipal security, the broker-dealer is subject to all MSRB rules, as well as other federal securities laws.”⁹ The Notice then lists numerous MSRB Rule provisions that might apply.

The Notice then observes “municipal securities that are purchased by banks and subsequently restructured do not lose their character as municipal securities. However, when banks make ‘loans’ to state and local governments, even if only to provide a source of funds for those governments to purchase their own securities, whether such ‘loans’ will be considered securities can be a difficult question.” There then follows a discussion of *Reves v. Ernst & Young*,¹⁰ the 1990 Supreme Court case on whether demand notes issued by the Farmers Cooperative of Arkansas and Oklahoma are securities within the meaning of § 3(a)(10) of the Exchange Act.

The MSRB had given a “heads-up” that Notice 2011-52 was on its way in an earlier advisory notice, MSRB Notice 2011-37 (August 3, 2011), Financial Advisors, Private Placements, and Bank Loans.¹¹ As the MSRB explained, it wished “to bring an important issue to the attention of all financial advisors, both those that are not currently registered” with the SEC as brokers under the Securities Exchange Act of 1934 and those that are so registered. The MSRB then noted:

Under principles described by the SEC in no-action letters, if financial advisors engage in certain activities with respect to placements of municipal securities by issuers, they may be considered to be acting as a “broker” and, depending on the nature of such activities, could be viewed as placement agents. Activities of particular concern are introductions of potential investors to an issuer or negotiation with potential investors, in either case coupled with the receipt of transaction-based compensation. If a financial advisor, by virtue of its activities, would be viewed as a placement agent for a new issue of municipal securities, its activities in connection with such placement would be subject to all MSRB rules normally applicable in connection with private placements.¹²

In other words, an independent financial advisor acting as placement agent for an issue of municipal securities may need to register as a broker under the Exchange Act. As the MSRB then points out, “financial advisors that have not traditionally viewed themselves as brokers could unintentionally become subject to MSRB Rule G-23, which, effective November 27, 2011, generally precludes financial advisors that are broker-dealers from becoming underwriters or placement agents for issues of municipal securities for which they have been serving as financial advisors.”¹³

9 Id.

10 494 U.S. 56 (1990).

11 Available at: <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-37.aspx?n=1>.

12 Id.

13 Id.

Federal Courts

This summer, the United States Court of Appeals for the District of Columbia Circuit returned once again to the question of adequacy in SEC rulemaking, on this occasion in the case *Business Roundtable v. SEC*.¹⁴

As Judge Ginsburg, writing for the Court, explains: “The Business Roundtable and the Chamber of Commerce of the United States, each of which has corporate members that issue publicly traded securities, petition for review of Exchange Act Rule 14a-11. The rule requires public companies to provide shareholders with information about, and their ability to vote for, shareholder-nominated candidates for the board of directors. The petitioners argue the Securities and Exchange Commission promulgated the rule in violation of the Administrative Procedure Act, 5 U.S.C. § 551 *et seq.*, because, among other reasons, the Commission failed adequately to consider the rule’s effect upon efficiency, competition, and capital formation, as required by Section 3(f) of the Exchange Act and Section 2(c) of the Investment Company Act of 1940, codified at 15 U.S.C. §§ 78c(f) and 80a-2(c), respectively.”¹⁵

The Court “for these reasons [described above] and more,” granted the petition and vacated the rule.¹⁶

This column has previously noted the problems SEC rulemaking have encountered in withstanding challenge and resulting rejection by the D.C. Circuit.¹⁷ This most recent ruling adds to the list. It is worth noting that several weeks before *Business Roundtable*, the SEC’s Inspector General released its Report of Review of Economic Analysis Performed by the Securities and Exchange Commission in Connection with Dodd-Frank Rulemakings, June 13, 2011.¹⁸ The IG’s report was prepared in response to the request of several members of the Senate Banking Committee and covers, among other rulemakings, Registration of Municipal Advisors.¹⁹ Municipal market participants – and potential municipal advisors – may find the Conclusion of the IG’s report interesting. It notes: “we noted particularly in connection with the requirement that municipal advisors register with the Commission, the lack of an assessment of the impact of the proposed rule on a quantitative level.”²⁰ As pointed out above, the SEC has not issued the final rule under this rulemaking.

14 2011 U.S. App. LEXIS 14988 (DC Cir. July 22, 2011).

15 Id.

16 Id.

17 *See*, The Bond Lawyer (Fall 2009), at 20.

18 Available at: http://www.sec-oig.gov/Reports/AuditsInspections/2011/Report_6_13_11.pdf.

19 76 Fed. Reg. 824 (Jan. 6, 2011).

20 I.G. Report at 43.

Patent Law for Bond Lawyers – Almost A Requiem?

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The following updates two articles by the author on patent law for bond lawyers. The first, “Patent Law for Bond Lawyers – Watch Out for Now,” appeared in the March 1, 2008 edition of The Bond Lawyer (the “2008 Article”). It discussed “tax strategy” patents and other business method patents, that may have an effect on the practice of bond law. The second article appeared in the Summer/Fall 2010 edition of The Bond Lawyer (the “2010 Article”) and discussed the United States Supreme Court’s decision in Bilski v. Kappos 561 US_____, 130 S. Ct. 3218, 177 L. Ed. 792 (2010) and its implications for tax strategy patents and tax-exempt bond structure business patents. The below article discusses tax strategy and bond structure patents in light of the Leahy-Smith America Invents Act, H.R. 1249, P.L. 112-29, which was signed by President Obama on September 16, 2011.



Background.

“Business method” patents are patents on a method of doing business that achieves an advantage to the person using the patent. Prior to 1999, it was generally thought that business methods could not be patented, but the Federal Circuit Court decision in State Street Bank and Trust Company v. The Signature Financial Group, 149 F.3d 1368 (Fed. Cir., 1998) cert denied, 525 US 1093 (1999) (“State Street Bank”), held that business methods could be the subject of patents assuming they met other patentability requirements.

One of the types of business method patents that emerged in the aftermath of State Street Bank involved federal income tax strategies. These patents often describe a method of achieving compliance with, or a tax advantage under, the federal income tax laws by following a particular tax strategy. These patents are sometimes called “tax strategy” patents. As discussed in the 2008 Article, some tax strategy patents granted or requested involve methods of complying with or obtaining advantages under the portions of the federal income tax law that deal with tax-exempt bonds, and thus are of interest to bond lawyers. In addition to tax strategy patents, business method patents were requested and granted that involved tax-exempt bond structures of various types, sometimes involving a federal income tax aspect – a tax strategy patent – and sometimes not involving tax laws. These (the ones not including a tax strategy) are referred to as “bond structure” patents in this article. Several tax strategy and bond structure patents and patent applications are discussed in the 2008 Article.

Another Federal Circuit Court decision (In re Bilski, 545 F. 3d 943 (Fed. Cir., 2008) (en banc)) cast doubt on the patentability of business methods as described in State Street Bank, holding that for a business method to be patentable, it must involve a machine or transformation. This decision would have severely limited business method patents had it become the law. However, In re Bilski was appealed to the Supreme Court, which, while upholding the specific result in In re Bilski, breathed life back into business method patents. The Supreme Court identified four independent subject matter categories that may be patentable (processes, machines,

manufacturers, and compositions of matter) and, while holding that abstract ideas could not be patented, was ambiguous about whether a business method, including a tax strategy, was a patentable process or not. Bilski v. Kappos, 561 US_____, 130 S. Ct. 3218, 177 L. Ed. 792 (2010) (“Bilski”). See “The Impact of Bilski on Tax Strategy Patents” by Professor Ellen Aprill, cited in the 2010 Article. A Google search of Bilski v. Kappos will bring up several other commentators’ reviews of the results of that case.

The Leahy-Smith America Invents Act.

As a result of State Street Bank and the ambiguity left by Bilski, persons interested in tax patents continued with this debate in Congress. Ultimately, the opponents of tax strategy patents were successful in having tax strategy patents prohibited by the Leahy-Smith America Invents Act passed by Congress and signed by the President on September 16, 2011 (H.R. 1249, P.L. 112-29) (the “2011 Patent Act”). Section 14 of the 2011 Patent Act states:

- (a) In General- For purposes of evaluating an invention under section 102 or 103 of title 35, United States Code, any strategy for reducing, avoiding, or deferring tax liability, whether known or unknown at the time of the invention or application for patent, shall be deemed insufficient to differentiate a claimed invention from the prior art.
- (b) Definition- For purposes of this section, the term ‘tax liability’ refers to any liability for a tax under any Federal, State, or local law, or the law of any foreign jurisdiction, including any statute, rule, regulation, or ordinance that levies, imposes, or assesses such tax liability.
- (c) Exclusions- This section does not apply to that part of an invention that--
 - (1) is a method, apparatus, technology, computer program product, or system, that is used solely for preparing a tax or information return or other tax filing, including one that records, transmits, transfers, or organizes data related to such filing; or
 - (2) is a method, apparatus, technology, computer program product, or system used solely for financial management, to the extent that it is severable from any tax strategy or does not limit the use of any tax strategy by any taxpayer or tax advisor.
- (d) Rule of Construction- Nothing in this section shall be construed to imply that other business methods are patentable or that other business method patents are valid.
- (e) Effective Date; Applicability- This section shall take effect on the date of the enactment of this Act and shall apply to any patent application that is pending on, or filed on or after, that date, and to any patent that is issued on or after that date.

The effect of this section is that, generally, a tax strategy is deemed insufficient to differentiate a claimed invention from prior act and, consequently, can not be patented. The Patent Office was quick to begin to implement this provision. See Memorandum dated September 20, 2011, from Robert W. Bahr, Acting Associate Commissioner for Patent Examination Policy to the Patent Examining Corps, in the September 27, 2011 Edition of Tax Notes Today. The provisions of Section 14 of the 2011 Patent Act apply to tax strategies under federal, state, and local law, and the law of foreign jurisdictions, including the statutes, rules, regulations, or ordinances that levy or impose tax liabilities.

The 2011 Patent Act took effect on the date of enactment (September 16, 2011) and applies to any application that was pending on or is filed after that date and to any patent that is issued on or after that date. It does not apply to patents issued prior to that date. A list of Tax Strategy Patents that have already been granted can be found by visiting www.uspto.gov/patft on the internet, and entering the following query in the advanced search link, “ccl/705/36T.” This will show 165 patents granted in the area categorized as “tax strategies” by the Patent Office before September 16, 2011. The categorization by the Patent Office is not conclusive. Some tax strategy patents might not be listed using this search, and some of the results of this search might not be what a tax lawyer would consider to be a “tax strategy.”

In addition to action by Congress, proposed regulations released by the Internal Revenue Service on September 26, 2007, generally treat the use of a patented transaction, (defined in Prop. Treas. Reg. § 1.6011-4(b)(7)(i)) to be “a transaction for which a taxpayer pays (directly or indirectly) a fee of any amount to a patent holder or the patent holder’s legal agent for the legal right to use a tax planning method that the taxpayer knows or has reason to know is the subject of the patent”) as a “reportable transaction” under Prop. Treas. Reg. § 1.6001-4(b)(7). This proposed regulation is proposed to be effective retroactive to the date it was promulgated as a proposed regulation, September 26, 2007. Making tax strategies reportable transactions (albeit, through a proposed retroactive regulation) discouraged the use of tax strategy patents for many reasons, including those discussed in the 2008 Article. Such action did not, however, eliminate tax strategy patents, as evidenced by the 100 patents categorized as “tax strategy” patents granted between September 26, 2007 and September 16, 2011. However, considering both the provisions of the 2011 Patent Act and the proposed reportable transactions patent regulation contained in Prop. Treas. Reg. § 1.6001-4(b)(7), it is likely that most problems caused by tax strategy patents for a bond lawyer are gone.

Non-Tax Strategy Patent Issues.

As is mentioned in the two prior articles, however, while the problems posed to the bond lawyer by tax strategy patents may now be largely eliminated, a bond lawyer cannot completely ignore the area of patent law. Business method patents are apparently still alive and well. See the Supreme Court’s decision in Bilski cited above and Section (d) of Section 14 of the 2011 Patent Act (“Nothing in this section shall be construed to imply that other business methods are patentable or that those business method patents are valid”). At best, Bilski implies that business method patents continue to be viable, and the 2011 Patent Act does not appear to change that result.

Various business methods involving bond structures have been patented and more patents are pending. In many of these patents, there is no tax strategy involved. Consequently, bond counsel must continue to be diligent to avoid inadvertently using a patented bond structure and running the risk of an infringement action.

An interesting case involving a business method patent on a bond structure was recently decided by the United States Court of Appeals for the Second Circuit. See Williams v. Citigroup

Inc., ___ F.3d ___, 2011 WL 3506099 (C.A. 2 (N.Y.)) and Williams v. Citigroup Inc., 2011 WL 3510723 (C.A. 2 (N.Y.)) (both decided August 11, 2011). This is in part an antitrust case involving an allegation by the plaintiff that her then patent-pending structure for airline special facility bonds issued by municipalities to finance construction or renovation of airport terminals was being boycotted by Defendant Citigroup and others. (The Second Circuit dismissed the federal antitrust claims, but the court remanded the case for a decision on certain other matters including a motion to replead).

The specific patent involved in Williams v. Citigroup is not cited in the opinions. The plaintiff, however, was recently granted three patents involving a “Process and Architecture for Structuring Facilities Revenue Bond Financings.” See Patent Nos. 7,840,497 (11/23/10); 7,945,521 (5/17/11); and 7,953,672 (5/31/11). These may be viewed at Patent Office’s web site www.uspto.gov/patft, clicking “Quick Search” under “PatFt,” and entering the Patent Number as “Term 1” of the Query. It is worth examining these patents to see what a patent for a bond structure looks like and to ascertain whether or not the special facility bonds on which you are now working might infringe on these granted patents. The first of these patents is also described in an article in the December 1, 2010 edition of The Bond Buyer entitled, “Attorney Patents New Credit Structure for Airports.”

Conclusion.

Tax strategy patents in the tax-exempt bond area now appear to be nearly dead (rest in peace) as a result of the 2011 Patent Act and Prop. Treas. Reg. 1.6011-4(b)(7). Bond structure patents, however, continue to deserve attention from a careful bond attorney to avoid the risks and penalties associated with a patent infringement action against the bond lawyer’s client or, in some cases, the bond lawyer. These risks and penalties are described in the 2008 Article.

I hope that I have no further news to report on tax strategy patents or, for that matter, other bond structure patents and that the involvement of bond lawyers in patent law can end. At least in the area of bond structure patents, however, I am not completely confident that we are out of the woods.

