



# Understanding the Tax Exempt Bonds Examination Process

The first part of this publication explains some of your most important rights as a taxpayer. The second part explains the Tax Exempt Bonds examination, appeal and compliance resolution processes.

## Declaration of Taxpayer Rights

### The IRS Mission

*Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.*

#### Useful IRS Publications

- [556](#) Examination of Returns, Appeal Rights, and Claims for Refund
- [3755](#) Tax Exempt Bonds—Filing Requirements
- [4077](#) Tax-Exempt Bonds for 501(c)(3) Charitable Organizations
- [4078](#) Tax-Exempt Private Activity Bonds
- [4079](#) Tax-Exempt Governmental Bonds

#### Tax Information

The IRS provides the following sources for forms, publications, educational resources and additional information.

**Internet:** [www.irs.gov/bonds](http://www.irs.gov/bonds)

**Bond Questions:** 202-283-2999

**Forms and Publications:** 800-829-3676

**Treasury Inspector General for Tax Administration:** If you want to confidentially report misconduct, waste, fraud, or abuse by an IRS employee, call 1-800-366-4484 (1-800-877-8339 for TTY/TDD). You can remain anonymous.

### I. Protection of Your Rights

IRS employees will explain and protect your rights as a taxpayer throughout your contact with us.

### II. Privacy and Confidentiality

The IRS will not disclose to anyone the information you give us, except as authorized by law. You have the right to know why we are asking you for information, how we will use it, and what happens if you do not provide requested information.

### III. Professional and Courteous Service

If you believe that an IRS employee has not treated you in a professional, fair, and courteous manner, you should tell that employee's supervisor. If the supervisor's response is not satisfactory, you should write to the Director, Tax Exempt Bonds or the center where you file your return.

### IV. Representation

You may either represent yourself or, with proper written authorization, have someone else represent you in your place. Your representative must be a person allowed to practice before the IRS, such as an attorney, certified public accountant, or enrolled agent. If you are in an interview and ask to consult such a person, then we must stop and reschedule the interview in most cases.

You can have someone accompany you at an interview. You may make sound recordings of any meetings with our examination, appeal, or collection personnel, provided you tell us in writing.

### V. Payment of Only the Correct Amount of Tax

You are responsible for paying only the correct amount of tax due under the law -no more, no less. If you cannot pay all of your tax when it is due, you may be able to make monthly installment payments.

### VI. Help with Unresolved Tax Problems

The Taxpayer Advocate Service can help you if you have tried unsuccessfully to resolve a problem with the IRS. Your local Taxpayer Advocate can offer you special help if you have a significant hardship as a result of a tax problem. For more information, call toll free 1-877-777-4778 (1-800-829-4059 for TTY/TDD) or write to the Taxpayer Advocate at the IRS office that last contacted you.

### VII. Appeals and Judicial Review

If you disagree with us about the amount of your tax liability or certain collection actions, you have the right to ask the Office of Appeals to review your case. You may also ask a court to review your case.

### VIII. Relief from Certain Penalties and Interest

The IRS will waive penalties when allowed by law if you can show you acted reasonably and in good faith or relied on the incorrect advice of an IRS employee. We will waive interest that is the result of certain errors or delays caused by an IRS employee.

## Introduction

The primary objective of an examination is to determine if a municipal debt issuance complies with Internal Revenue Code provisions.

This document discusses general rules and procedures that we follow in examinations and how certain compliance problems can be corrected.

## Selection of Returns

There are several ways a municipal debt issuance is selected for examination. It may be selected as a part of an initiative, project or referral, due to a questionable or unusual item on the return, or as a random selection. We use a centralized case selection and review process to enhance consistency of enforcement activities and to focus resources on the areas that will have the most positive impact on municipal debt issuances. Our tasks include identifying areas of noncompliance, developing corrective strategies, and assisting with those strategies.

## Your Role in the Process

The issuer of the municipal debt is treated as the "taxpayer" throughout the examination process. You, any conduit borrower and any other party to the transaction, have the responsibility of maintaining and producing adequate records to substantiate the tax-exempt status of the bonds. If the requested information is organized and complete, we can conduct the examination in a timely and efficient manner. For certain tax credit bonds where direct payment of the allowable credit has been elected, the issuer of the debt is the party subject to taxation. As the actual taxpayer, the general provisions of Publication 556, including those dealing with assessments, collections, and appeals, apply to you. Because qualified tax credit bonds are similar in many respects to tax-exempt bonds, the remainder of this publication may be useful in understanding the examination process of such bonds. See your examiner regarding questions about the difference between tax-exempt and tax credit bond examination processes.

## The Examination

A Tax Exempt Bonds (TEB) examiner notifies you by phone or letter that a municipal debt issuance has been selected for examination. If the initial contact is by phone, a confirmation letter will follow. The letter may indicate how the return was selected for examination and will detail the required items for the examination. We may, however, request additional items at a later date.

The examination may include a comprehensive review of the municipal debt issuance, or focus on specific aspects. The examination continues until the examiner is reasonably certain that the municipal debt issuance has met the applicable requirements.

You can authorize someone to represent you if they are eligible to practice before the IRS. If you have someone represent you in your absence, you must furnish written authorization. See Form 2848, Power of Attorney and Declaration of Representative, for more information.

Your representative may have a conflict of interest if they also had a role in the issuance of your municipal debt, such as providing the approving opinion as to the qualifications of the municipal debt issuance, or is also representing other parties to the transaction, such as the conduit borrower. A representative with a conflict of interest may not represent a client before the IRS unless: (1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client; (2) The representation is not prohibited by law; and (3) Each affected client gives informed consent, confirmed in writing. The examiner may request a copy of such written confirmation of your informed consent from your representative.

You may deem it appropriate to permit direct communication between the examiner and any conduit borrower. If the examiner agrees to conduct the examination in that manner, you must provide us with a Form 8821, Tax Information Authorization. This form permits the examiner to discuss your tax matter with the conduit borrower.

During the examination, we may need to contact various third parties including underwriters, financial advisors, bond counsel, and any other parties, as well as their counsel, with a transactional relationship to the municipal debt issue.

If the examiner identifies a potential problem, this problem will be discussed with you or your representative. In some instances, Form(s) 5701-TEB, Notice of Proposed Issue, and Form(s) 886-A, Explanation of Items, may be issued to identify any areas of noncompliance. Upon completion of the examination, all unresolved issues will be included in a Notice of Proposed Adverse Determination Letter and Form(s) 886-A, Explanation of Items.

## Resolving Qualification Issues— The Closing Agreement Process

With respect to tax-exempt bonds, a failure to comply with the federal tax laws that govern municipal debt issuances may result in the loss of the tax-exempt status of the bonds under examination. With respect to tax credit bonds, a failure to comply with the federal tax laws that govern municipal debt issuances may result in the loss of the tax credit status of the bonds under examination. As a result, holders of bonds issued as tax-exempt bonds would be taxed on the interest they received and holders of bonds issued as tax credit bonds would lose the ability to claim tax credits with respect to the bonds. In most situations,

however, the IRS will, as an alternative, allow the issuer to enter into a closing agreement where you agree to correct the compliance failures and pay a settlement amount to the US Treasury. As a result, the corrected violation will not cause the bond interest payable to the holders of tax-exempt bonds to lose its tax-exempt treatment or the holders of tax credit bonds to lose the ability to claim tax credits.

## Closing Letter

The final step in the examination process is a letter explaining the examiner's conclusions. Sometimes the conclusion results in a tax liability for related entities and/or individuals; and may require coordination with other business units within the IRS.

## Appeal Rights

The Office of Appeals settles unresolved issues. Your appeal rights are explained in detail in Publication 5, Your Appeal Rights and How to Prepare a Protest if You Don't Agree. Appeal requests must be in writing and timely. If not, we will issue a Notice of Final Adverse Determination. In certain situations, Fast Track Mediation, an expedited appeals process, is used. You should discuss this with your examiner. For more information about the appeals process, see Rev. Proc. 2006-40, Administrative Appeal of Proposed Adverse Determination of Tax-Exempt Status of Bond Issue.

## Post-issuance Compliance and the TEB Voluntary Closing Agreement Program

In furtherance of its mission, TEB promotes post-issuance compliance with federal tax requirements applicable to tax-exempt and tax credit bonds in order to prevent or correct violations before they are discovered during an examination. Issuers should understand and refer to their bond documents. Additionally, TEB encourages issuers to adopt and follow written procedures for monitoring and achieving post-issuance compliance with federal tax requirements applicable to their tax-exempt and/or tax credit bonds.

TEB has a Voluntary Closing Agreement Program (TEB VCAP) available to issuers who are not under exam and who have discovered a violation of the law associated with the issuance of tax-exempt or tax credit bonds. TEB VCAP is intended to encourage issuers and other parties involved in bond transactions to exercise due diligence in complying with applicable federal tax laws and to provide a vehicle to correct violations as expeditiously as possible before the violations are discovered during an examination. You can find additional information regarding TEB VCAP on the TEB website and in Notice 2008-31, Voluntary Closing Agreement Program for Tax-Exempt Bonds and Tax Credit Bonds.