Post Issuance Compliance – Arbitrage Rebate Compliance for Tax Revenue Anticipation Notes and Tax Anticipation Notes

Questions and Answers

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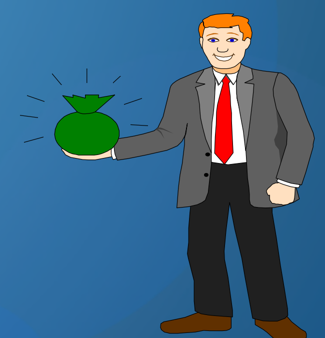
What is Arbitrage?

- Arbitrage = borrowing at a tax-exempt rate and investing at a taxable rate.
- Rebate = payment to federal government of the investment earnings in excess of the yield on the Notes.



Why do we have to do the arbitrage rebate calculation?

- Federal tax law requirement (precondition to tax exemption).
- Document requirement (covenant of the District).
- No rebate obligation if "six-month" exception met.
- Exception = cash flow deficit > initial public offering price within 6 months.

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What is the difference between arbitrage rebate calculations on TRANs and general obligation bonds?

- No difference in rebate calculation.
- Difference = expenditure of bond/not proceeds.
  - Note proceeds spent under “proceeds-spent-last” method.
  - Bond proceeds spent under “direct tracing” method.

Since the maturity date of the TRANs is December 30, 2021, when must the rebate amount be paid?

- Within 60-days of payment of the Notes.

Why can't we do the arbitrage rebate calculation now?

- Rebate calculation is:
  - Through the final maturity date.
  - Based on all investment earnings.

What is the cost to have Hawkins Delafield & Wood to assist a district with the rebate calculation?

- Fee = $2,000
- Fee increase if IRS audit.

What are the consequences of late payment or nonpayment of the rebate amount?

- Late interest.
- Penalty.
- Nonpayment could cause taxability of Notes.

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What Information do you need to provide?

- Tax Certificate and IRS Form 8038-G.
- Daily cash flow for the General Fund.
  - Example
- Investment and expenditure activities for Cost of Delivery Fund and Repayment Fund
  - Example
- Investment yields for the Los Angeles County Treasury Pool
  - Example

What is Included in the Arbitrage Report?

- Hawkins tax opinion
- Methodology and assumptions
- Summary of the rebate liability
- Details of the determination of the rebate liability

How Long Does It Take to Finish the Report?

- 2-3 weeks

What do you do after the Report is completed?

- Negative rebate liability = nothing.
- Positive rebate liability =
  - Payment to IRS by due date, and
  - File IRS Form 8038-T.
- Maintain Report in files.

How Long Should I keep the Report and Records?

- 3 years after payment of the Notes.

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How do you qualify as a small issuer?

- "Small issuers" = exempt from the rebate requirements.
- Qualification:
  - Maximum $15 million annually, and
  - No more than $5 million for non-construction purposes.
    - Example: District issues $5 million TRAN may issue up to $10 million of tax-exempt obligations for school construction projects.

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What are the requirements for arbitrage rebate compliance for a small issuer?

- Technically, “small issuers” do not have to show actual expenditures; only reasonable expectation at issuance that Note proceeds will be spent.
- Possible IRS challenge if District fails to spend a substantial portion of its Note proceeds within the required time period.
- Expenditure rule = maximum cumulative cash flow deficit > initial public offering price within 6 months of issuance.

What are the next steps for the Districts who need to complete an arbitrage rebate calculation?

- Execute contract with HDW.
- Gather needed information.
- Submit information to HDW.
- Sign IRS Form 8038-T.
- Send check for rebate amount with IRS Form 8038-T; and
- Keep report and record of payment.

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