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Decreasing the time and expense of an I.R.S. Bond Audit

It takes, on average, several weeks shy of a year for the Internal Revenue Service to work a bond examination, measured from the date the opening letter is sent to the date the closing letter is mailed.

The I.R.S. is not going to accept blame for the length of its bond audit. Instead, during a recent bond lawyers' teleconference, Karen Skinder, an IRS bond field manager, blamed the length of an audit on my brethren controversy counsel by publicly berating their slow responses to I.R.S. requests. During the call, Karen complained "the information document request goes out and we never hear again from the representative, and when we finally contact them they say 'yeah, yeah, I'll get to it.'" Another month goes by and [the representative says] 'I'm going on vacation; I'll get to it when I get back' or 'the records are going to come in next week and then it will take me a month to review them.'" Karen is right, in part.

It is important to recognize that there may be instances where slow responses work in your favor. However, I will assume that most government officials would prefer to have their audit completed as soon as possible. The want for a speedy completion can come out of, for instance, the desire to sell new bonds in the market without the cloud of an ongoing examination.

Municipal bond controversy is not rocket science; therefore, it should not be difficult or time-consuming. In order to get through your bond examination without spending too much time or money, you should focus on your preparation and timeliness. By doing so, you should be able to reduce your audit time and expense by 50 percent or more.

In order to successfully prepare for the examination, you should delegate the responsibility to retain records prior to the issue date. You should also set up parameters for where and how long records should be kept. Your attorney should review the support for bond counsel's opinion and ensure that critical support records are appropriately included in the bond transcript. In addition, you should document discussions with bond and tax counsel. In conduit transactions, delineating in the bond transcript the rights and duties over the audit proceeding can streamline the process. Most importantly, the issuer's counsel should consider and describe, if possible, in the bond transcript, how the issuer will be compensated or reimbursed for audit costs. Also, prior to the examination of the bonds, you should consider setting policies on the use of municipal derivatives and formulating disclosure guidelines. All of these steps will reduce the number of issues that must be resolved during an audit.

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In order to save time once the examination is opened, you should share the I.R.S. examination opening letter immediately with the conduit borrower and with your bond counsel. You should also quickly decide who will represent the bond transaction before the I.R.S. and start to pull your records together.

Your first goal after receiving the I.R.S. opening letter is to find out why the I.R.S. picked your bonds to examine. You and your counsel should carefully review the opening letter. Afterwards, your counsel should advise whether the I.R.S. classified your opening as a random audit, a random audit being conducted within a suspect area, or a targeted audit. Your counsel should find out any further information he or she can about why your bonds are being audited by contacting I.R.S. personnel. This is useful because you will want to use this information to narrow and focus your preparation and responses to the issues the I.R.S. wants to resolve.

Your second goal after receiving the audit letter is to assemble a quick response team. This is helpful because it will enable you to respond quickly to the I.R.S.'s requests for information. The issuer and borrower are primarily responsible for assembling this team as most of the information the I.R.S. requests will be under their control. Your counsel's goal should be to gather the information from you or the borrower and to respond to the I.R.S. within twenty-four to forty-eight hours of the receipt of an information document request.

To avoid further complications, you should advise your counsel to avoid belittling or treating the agent rudely. This is a strange, but not uncommon "tactic" used to try to scare agents. If you treat agents fairly and with respect, you will almost always be treated fairly in return. If you do not, they have the capacity to make your situation miserable and to draw out the examination process.

Another mistake to avoid is hiring and staying with the wrong controversy counsel. It is fine to initially hire your bond counsel to represent you during the audit, and often that is your best option. However, you need to be wary of a few signs that tell you it is time to make a change. It may be time to hire new counsel when your counsel comes looking for a conflict of interest waiver, when the examination is not completed timely, or when you are confused about the status of the examination. A good attorney with a background in municipal bond tax law should be able to come up to speed on the bond examination within several hours. It is a costly and time-consuming mistake when you decide to continue working with the wrong attorney.

In conclusion, a few simple guidelines can help you save a lot of money and time during the examination process. Be sure to prepare well by thinking of the "worst case scenario," researching why the I.R.S. is examining your bonds, assembling a quick response team, and hiring the best counsel available. If these simple steps are followed in a timely manner, you can avoid the tedious complications that often accompany the bond examination process.

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