

## Arbitrage Compliance – maintaining tax-exempt status

Tax-exempt bonds are a valuable tool for state and local governments, as well as conduit borrowers. However, to maintain their tax-exempt status, issuers and borrowers must ensure that they meet Code and Regulations requirements for as long as the bonds remain outstanding.

They must comply with two independent sets of arbitrage rules; the yield restriction rules under Code Section 148(a) and the rebate rules under Code Section 148(f).

### What Needs to Be Done

Arbitrage compliance is a complex and challenging area of reporting; failure to report and pay when due could result in penalties and interest or an issuer's bonds being declared taxable. A good tracking system is essential for timely reporting, whether you have several issues outstanding or a few.

### Springsted Can Help

Springsted's team of specialized arbitrage staff assists clients with compliance needs. Our arbitrage team is led by registered municipal advisors held to the Securities Exchange Commission and Municipal Securities Rulemaking Board rigorous training and testing requirements. Springsted has a well-developed approach to each calculation. Our work on each bond issue includes:

- Logging the transaction into our compliance database to facilitate tracking and information requests, with clients notified in advance of upcoming information needs
- Determining the relevant arbitrage provisions contained in Section 148 of the Internal Revenue Code
- Reviewing applicable sections of bond documents to determine what arbitrage considerations were anticipated at the time of issuance
- Calculating the fixed or variable yield on the bonds
- Calculating the amount of arbitrage liability, including rebate and yield restriction, and issuing a detailed report that lays out the treatment of all identified proceeds of the issue
- Discussing with the client any unusual or unexpected finding
- Discussing with the client any payment identified and coordinating payment requirements
- Preparing any IRS Form 8038-Ts or 8038-Rs required and providing instructions for filing
- Maintaining relevant documentation as a back-up to your own records



## Q&A – Arbitrage Compliance

### What is an Arbitrage Bond?

To be an arbitrage bond, certain monies associated with the bonds are used to acquire investments with a yield above the bond yield. When the investment yield is higher than the bond yield, the excess is called “arbitrage earnings.” However, having arbitrage earnings does not automatically mean that the bonds are arbitrage bonds.

### What are the reporting requirements?

Generally, the initial computation must be made within 5 years from the date of issue; thereafter, every 5 years and at final redemption or maturity. Arbitrage liabilities must be paid within 60 days of the computation date and are filed with Form 8038-T.

### I am a small issuer, so I don't need a calculation.

This is a common misconception. An issuer that qualifies for the small issuer exception is exempt from rebate but is still subject to the yield restriction rules which limit the investment yield that may be earned.

### What if I receive a notice from examination from the IRS?

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