

Rev. Proc. 2006-40

ADMINISTRATIVE APPEAL OF PROPOSED ADVERSE DETERMINATION OF TAX-EXEMPT STATUS OF BOND ISSUE

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SECTION 1. PURPOSE

This revenue procedure provides procedures for an issuer of tax-exempt bonds to request an administrative appeal to the Office of Appeals (Appeals) within the Internal Revenue Service (Service) from a proposed adverse determination by the Service's Office of Tax Exempt Bonds (TEB) of the Tax Exempt & Government Entities Division (TE/GE) to the effect that an issue of bonds fails to qualify for the exclusion of the interest on the bonds from the gross income of the owners under section 103 of the Internal Revenue Code (the Code) and related provisions of the Income Tax Regulations (the Regulations) (Proposed Adverse Determination). This revenue procedure also provides procedures for an issuer of tax-exempt bonds to request such an administrative appeal from a denial by TEB of a claim for recovery of an asserted overpayment of arbitrage rebate under section 148 of the Code (Arbitrage Rebate Claim Denial).

SECTION 2. BACKGROUND

Prior to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, 112 Stat. 685 (1998 IRS Restructuring Act), procedures did not exist for an issuer to appeal a Proposed Adverse Determination by the Service that the interest on an issue of bonds failed to qualify for the exclusion from the gross income of the owners of those bonds under section 103 of the Code. Section 3105 of RRA 98 directs the Service to modify its administrative procedures to allow issuers an expeditious appeal of a proposed adverse determination by the Service to Appeals with respect to a bond issue before the Service proceeded to tax bondholders. As a result, Rev. Proc. 99-35, 1999-2 C.B. 501, was published to set forth procedures for issuers to appeal a proposed adverse determination by an Employee Plans/Exempt Organizations Key District under the Service's prior organizational structure. Subsequently, the Service updated its organizational structure and created TEB as a separate examination division for tax-exempt bond matters within its updated organizational structure. This revenue procedure modifies and supersedes Rev. Proc. 99-35 to take into account the Service's updated organizational structure and to apply the revised appeal procedures to a Proposed Adverse Determination or an Arbitrage Rebate Claim Denial.

SECTION 3. SCOPE

.01 *In general.* An appeal of a Proposed Adverse Determination by TEB is initiated by the issuer as described in section 4 of this revenue procedure. Any issue raised by TEB in a Proposed Adverse Determination that would cause interest on a bond issue to fail to qualify for the exclusion from gross income under section 103 of the Code or any Arbitrage Rebate Claim Denial that involves a denial by TEB of a claim for recovery of arbitrage rebate payments under section 148 of the Code with respect to a bond issue is appropriate for consideration by Appeals.

.02 *Appeals procedures.* Established appeals procedures, including those governing submissions and taxpayer conferences, apply to appeals regarding bond issues. See section 601.106 et seq. of the Regulations.

.03 *Issuers as taxpayers.* In order to expeditiously conduct an examination (including any related administrative appeal) of a tax-exempt bond issue, an issuer is generally treated as the taxpayer on behalf of any unidentified beneficial owners of the bonds comprising the issue under examination. See section 5.02 of this revenue procedure regarding other parties that may participate in an Appeals proceeding.

.04 *Bondholders as taxpayers.* TEB must concurrently treat all identified owners of the bonds as taxpayers for all aspects of an examination, including taxpayer communications and the assessment of tax on past interest paid on that bond issue. The appeal rights of a bondholder are independent and separate from the appeal rights of an issuer described under this revenue procedure.

.05 *Conduit borrowers as taxpayers.* In appropriate circumstances, Appeals may consider issues relating to those raised in a Proposed Adverse Determination with respect to a bond issue which affect the tax liability (other than any potential penalties) of the borrower of bond proceeds of a conduit financing issue concurrently with the issuer's appeal. Appeals will only consider an issue relating to the borrower's tax liability if the borrower is under examination with respect to the issue, the resolution of that issue is affected by the determination of whether the interest on an issue of bonds is excludable from gross income under section 103 (e.g. issues under sections 150(b) or 168(g) of the Code), and the borrower agrees to resolve the issue concurrently with the issuer's appeal under this revenue procedure. See section 5.02 of this revenue procedure for Appeals procedures governing the participation of parties other than the issuer.

.06 *Technical advice.* Revenue Procedure 2006-2, 2006-1 I.R.B. 89 explains, in part, when and how the Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities) issues technical advice memoranda to TEB and Appeals. In accordance with section 7.02 of Rev. Proc. 2006-2, or subsequent revenue procedure, an issuer may submit a request to TEB or Appeals that a tax matter be referred for technical advice in accordance with the procedures contained therein while the bond issue is under the jurisdiction of TEB or Appeals respectively.

.07 *Alternative dispute resolution programs.* TEB and Appeals offer certain alternative dispute resolution and fast track settlement programs pertaining to the examination of bond issues. These programs, described by revenue procedure, announcement or other published guidance, permit senior Appeals officers to mediate or otherwise assist in the resolution of matters identified during the course of an examination prior to the issuance of a Proposed Adverse Determination. See Revenue Procedure 99-28, 1999-2 C.B. 109 and Announcement 2003-36, 2003-1 C.B. 1093.

SECTION 4. INITIATING THE APPEAL PROCESS

.01 *In general.* Sections 4.02 through 4.06 of this revenue procedure describe the circumstances and procedures under which an issuer may appeal a Proposed Adverse Determination or an Arbitrage Rebate Claim Denial.

.02 *Availability of appeal request to issuer.* An issuer is eligible to request an appeal under this revenue procedure upon the receipt from TEB of either a Proposed Adverse Determination or an Arbitrage Rebate Claim Denial. Except as provided in section 3.07 of this revenue procedure, the appeal rights under this revenue procedure are not available to an issuer prior to the receipt of either such a Proposed Adverse Determination or an Arbitrage Rebate Claim Denial.

.03 *Requesting an appeal.* The issuer's appeal request must be submitted in writing to TEB within 30 days of the date of TEB's Proposed Adverse Determination or Arbitrage Rebate Claim Denial. The appeal request must include the information listed in section 4.04 of this revenue procedure. TEB may extend the 30-day submission requirement following a written request by the issuer justifying such extension.

.04 *Required information and signature.* The appeal request must include a detailed written response to TEB's Proposed Adverse Determination or Arbitrage Rebate Claim Denial, including a full and complete explanation of the issuer's position regarding the issue(s) in dispute. The appeal request must include a declaration in the following form: "Under penalties of perjury, I declare that I have examined this request for an appeal, including accompanying documents, and that, to the best of my knowledge and belief, the facts presented are true, correct, and complete." The issuer or the issuer's authorized representative must sign an appeal request. An issuer may designate an authorized representative by submitting a duly executed Form 2848, Power of Attorney and Declaration of Representative, when making an appeal request under this revenue procedure.

.05 *Response to an appeal request.* Upon receipt of an appeal request, TEB will review the request to determine whether it meets the requirements of this revenue procedure. If the request does not meet the requirements of this revenue procedure, TEB will notify the issuer of the request's deficiencies. If the request meets the requirements of this revenue procedure and does not contain any new information or analysis of the taxpayer's position, TEB will transfer the case file to Appeals in the manner described in section 4.07 of this revenue procedure. If the request meets the requirements of this revenue procedure but the request contains new information or analysis of the taxpayer's position, TEB will notify the issuer that the new information submitted in the request may change the case's outcome and requires further discussions prior to transferring the case file to Appeals in the manner described in section 4.07 of this revenue procedure.

.06 *Failure to make appeal request.* If the issuer does not submit a written appeal request within the time period set forth in section 4.03 (including any filing extension granted by TEB) and in the manner described in section 4.04 of this revenue procedure, TEB's Proposed Adverse Determination or Arbitrage Rebate Claim Denial shall become final.

.07 *Transfer of case file.* Upon receipt of an appeal request, TEB Field Operations (TEB FO) will send the case file to TEB Compliance & Program Management (TEB CPM) for review and transfer to Appeals. To facilitate the appeals process, TEB CPM will expeditiously review the case file to ensure that the factual and legal matters therein support the issues raised by TEB FO in the Proposed Adverse Determination or Arbitrage Rebate Claim Denial. Once the review process is complete, TEB CPM will close the case at the examination level and transfer the case file to Appeals. The file should include copies of the following:

1. the technical advice memorandum, if any;
2. all information received by TEB from the issuer regarding the bond issue;
3. all work papers related to TEB's examination of the bond issue;
4. TEB's written Proposed Adverse Determination or Arbitrage Rebate Claim Denial;
5. the issuer's written protest; and
6. TEB's response to positions stated by the issuer in its protest.

.08 *Jurisdiction over tax matters.* Once TEB CPM sends the case file to Appeals, jurisdiction over the issues raised in the Proposed Adverse Determination or Arbitrage Rebate Claim Denial will transfer from TEB to Appeals. Except as provided in section 3.05 of this revenue procedure, TEB will retain jurisdiction over all tax matters related to the bond issue which are not specifically raised as an issue in the Proposed Adverse Determination (e.g. section 6700 penalties) or Arbitrage Rebate Claim Denial.

SECTION 5. RESOLVING AN APPEAL ISSUE(S)

.01 *In general.* In accordance with the directive in the 1998 IRS Restructuring Act, an appeal by an issuer under this revenue procedure will be assigned to a senior Appeals officer specializing in tax-exempt bonds. Appeals will consider the case a priority assignment and will resolve the case as expeditiously as possible.

.02 *Other participants in the appeals process.* The issuer may authorize any person (e.g. a borrower) to inspect or receive confidential information during the Appeals process by submitting a duly executed Form 8821, Taxpayer Information Authorization, to the Appeals officer.

.03 *New information provided.* If the issuer provides additional information not previously given to TEB, Appeals may forward such information to TEB CPM for comment or return jurisdiction over the case to TEB if it determines that the significance of any new information warrants further case development by TEB FO.

.04 *If agreement is reached.* If Appeals and the issuer agree that no action is necessary with respect to the issues raised in a Proposed Adverse Determination or an Arbitrage Rebate Claim Denial, Appeals will provide written notification to the issuer that the Proposed Adverse Determination or Arbitrage Rebate Claim Denial has been

withdrawn. If Appeals and the issuer reach an agreement with respect to the bond issue, Appeals will generally prepare a closing agreement using the model closing agreement provided in Exhibit 4.81.1-9 of the Internal Revenue Manual. Under either scenario, Appeals will provide TEB CPM with copies of the Appeals case memorandum and the executed closing agreement (if any), close the case at the appeal level, and send the case file to the Ogden Submission Processing Center.

.05 *If agreement is not reached.* If Appeals and the issuer cannot reach an agreement, Appeals will provide written notification to the issuer that TEB's Proposed Adverse Determination or Arbitrage Rebate Claim Denial has become final. Appeals will send the case file (including a copy of the Appeals case memorandum) to TEB CPM and close the case at the appeal level.

SECTION 6. EFFECT OF FINAL ADVERSE DETERMINATION

A Proposed Adverse Determination becomes final if there is no timely appeal under section 4 or if Appeals and the issuer cannot reach agreement with respect to an appeal under section 5.05. Once a Proposed Adverse Determination becomes final with respect to a bond issue, the interest on those bonds will no longer be treated as excludable from gross income under section 103 of the Code and TEB may initiate procedures to impose tax on the bondholders with respect to the interest on the bonds. Once a Proposed Adverse Determination becomes final with respect to a bond issue, TEB generally will not re-open settlement negotiations with an issuer regarding matters identified in the examination of the bond issue.

SECTION 7. NO USER FEE

There is no user fee for either requesting an appeal or executing a closing agreement pursuant to this revenue procedure.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Revenue Procedure 99-35, 1992-2 C.B. 501, is modified and superseded.

SECTION 9. EFFECTIVE DATE

These procedures are generally effective on September 27, 2006, the date this revenue procedure is released to the public, with respect to Proposed Adverse Determinations or Arbitrage Rebate Claim Denials for bond issues for which a closing agreement has not been executed.

SECTION 10. REQUEST FOR COMMENTS

The Service requests comments to be taken into consideration as the Service develops alternative dispute resolution programs to expeditiously resolve tax matters relating to tax-exempt bond issues during the examination and administrative appeal

process. In particular, the Service is seeking comments on how TEB and Appeals may utilize mediation or other formal fast-track settlement programs. Comments should refer to Rev. Proc. 2006-40, and should be submitted to:

Internal Revenue Service
SE:T:GE:TEB
1111 Constitution Ave., NW, PE-583
Washington, DC 20224

DRAFTING INFORMATION

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