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A Comparison and Analysis of IRS and SEC Examinations of 501(c)(3) Financings

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2011 NAHEFFA Conference
San Diego, CA

October 3, 2011

Purpose of Panel

- Review elements of IRS examination and SEC enforcement actions
- IRS examinations involving 501(c)(3) bonds reflect IRS private use and arbitrage concerns
- SEC ramping up enforcement area

Selection Criteria

IRS EXAMINATION

- Referrals from other Federal Agencies
- Informants
- News Articles
- Internal IRS Sources
- Studies
- Compliance Initiatives
- Related Cases
- Review of Claims and Returns Filed by Issuers

SEC INVESTIGATION

- Same
- Same
- Same
- Internal SEC Sources
- Routine Examinations
- Review of SEC Filings
- Related Investigations

Preliminary Screening

IRS EXAMINATION

- Public sources of information received to ensure selection criteria met for cases selected to implement annual work plan or compliance initiatives
- “Taint analysis” internally performed on cases where there is alleged noncompliance with IRS Code and Regulations

SEC INVESTIGATION

Informal inquiries

“Sweep exams”

IRS & SEC Examinations

Case Selected

IRS EXAMINATION

- Audit letter sent by IRS to the issuer if case selection criteria or “taint” is identified

- Four types of letters: General Program; Project Initiative; Referral and Identified Noncompliance

SEC INVESTIGATION

SEC staff recommends to Director of Division of Enforcement that formal order of investigation be issued

Formal order issued by Director and formal investigation begun

Selection of Counsel

- Discuss Approach to Resolving Audit
- Evaluate Potential Conflicts
- Insight Into the Responsibilities of the Parties to the Transaction
- Reputation within the IRS/SEC is key

How Information is Collected

IRS EXAMINATION

- Information document request sent to issuer
- May be followed by multiple information requests and site visit
- IRS treats issuer of bonds as the “taxpayer”
- Issuer typically brings in the “501(c)(3) borrower” to defend the exempt status of the bonds
- Third party information requests or summons an option

SEC INVESTIGATION

- Staff conducts investigation
- Document subpoenas
- Informal interviews
- Testimony under oath

IRS & SEC Examinations

Problem/Wrongdoing Believed to have Occurred

IRS EXAMINATION

- IRS Agent issues Form 5701 -
Notice of Proposed Adjustment
- Borrower prepares response

SEC INVESTIGATION

Staff initiates Wells process
if it believes wrongdoing occurred

Borrower can elect to make Wells
submission

Disclosure Implications

IRS EXAMINATION

- Under continuing disclosure agreements with underwriters issuer must give notice to EMMA, the official repository for municipal market disclosure of proposed or final determinations of taxability and Notices of Proposed Issue regardless of materiality

SEC INVESTIGATION

Decision to disclose on a case by case basis

IRS & SEC Examinations

IRS or SEC Persuaded No Compliance Problems or Wrongdoing

IRS EXAMINATION

- No change letter issued

SEC INVESTIGATION

Investigation ends
Issuance of closure letter discretionary

IRS & SEC Examinations

IRS Management/Commission Persuaded There is a Compliance Violation/Wrongdoing

IRS EXAMINATION

- Closing agreement entered into or IRS Agent requested to prepare a Proposed Adverse Determination

SEC INVESTIGATION

Negotiated settlement

or

Commission files administrative complaint and/or civil enforcement action

Action Taken by IRS or Commission

IRS EXAMINATION

- Proposed Adverse Determination letter issued

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SEC INVESTIGATION

SEC files order instituting administrative proceedings and/or civil complaint in federal court

Referral to U.S. Attorney for criminal prosecution

Borrower Response

IRS EXAMINATION

- Issuer and borrower enter into closing agreement with IRS or file protest within 90 days requesting an appeal to IRS'
- Appeals Division of TE/GE

SEC INVESTIGATION

Settlement negotiated
or issuer/borrower
prepares response/answer to action

IRS Case Review/SEC Case Adjudication

IRS EXAMINATION

- Protest reviewed by Manager, TEB, Compliance in Programs Management

SEC INVESTIGATION

Case adjudicated by administrative law judge or federal court (jury trial)

Case Settled or Appealed

IRS EXAMINATION

- Closing agreement entered into or case appealed to Appeals Division of TE/GE

SEC INVESTIGATION

Case settled, defense verdict or judge's order or court decision appealed

Case Disposition

IRS EXAMINATION

- Case settled in Appeals or
Bonds declared taxable

SEC INVESTIGATION

Case settled, defense verdict or
judges order
or court decision affirmed,
reversed or
vacated

Potential remedies include cease
and desist orders, bars,
disgorgement and penalties

THANK YOU

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