Review of IRS Reimbursement Regulations

Counties, cities, villages, towns, school districts and other governmental units often will pay capital costs out of available cash in anticipation of long-term financing with tax-exempt bonds. Bonds or other municipal obligations issued to permanently finance prior expenditures in this way are commonly called "reimbursement bonds."

Although the final IRS regulations regarding reimbursement bonds were effective in June, 1993, questions frequently arise about them. This update summarizes the pertinent provisions.

General Rules

Three general rules must be followed in order for a governmental unit to undertake tax-exempt financing for the purpose of reimbursing itself for prior expenditures.

Official Intent: If a prior expenditure is to be permanently financed by the later issue of tax-exempt obligations, the governmental unit must declare its reasonable intent to do so within 60 days of the date the expenditure is made. Without this declaration of intent, the ability to obtain permanent tax-exempt financing for that expenditure is lost unless the preliminary expenditure or deminimus exceptions described below apply).

Requisite "official intent" has four basic requirements:

First, the declaration of official intent must be made in any reasonable form (resolution, legislative authorization, approved budget documents). The declaration of official intent usually will be stated in a resolution approved by the governmental unit's governing body or by an authorized representative of the governmental unit, and must:

1. describe the project (i.e. property, project, or program) for which the expenditure will be made OR identify the fund or account (by name and functional purpose) used to pay for the expenditure; AND
2. state the maximum principal amount of obligations expected to be issued for the project.

Second, the declaration must contain a general functional description of the property to which the reimbursement relates or an identification of the fund or account from which the expenditure is to be paid and a general functional description of the purposes of such fund or account. Thus, references to a "highway capital improvement program," a "hospital equipment acquisition" or a "school building renovation" will suffice. Reasonable deviations between the project described in the declaration and the actual project ultimately financed will not invalidate the official intent but the actual project must reasonably relate in function to the project described in the declaration.

Third, the declaration must indicate the maximum principal amount of borrowing expected for reimbursement.

Local governments should put procedures in place if they plan to reimburse prior expenditures with tax-exempt obligations.

Fourth, in general, a declaration of official intent is reasonable only if, as of the date of declaration, the governmental unit reasonably expects to reimburse the expenditure with proceeds of a borrowing. Whether a governmental unit's expectation that the reimbursement will occur is reasonable will be determined under all of the available facts and circumstances, including whether the governmental unit has a history of making declarations of intent without following through with an actual reimbursement or of making declarations in amounts substantially in excess of the amounts expect to be necessary. Blanket declarations of official intent which are routinely adopted and indiscriminately cover all or most of a governmental unit's expenditures are not sufficient.

Reimbursement Period (18-Month Rule): Generally, the reimbursement bonds must be issued not later than 18 months after the later of (a) the date on which the expenditure is made or (b) the date the financed property is placed in service or abandoned, but in no event later than 3 years after the expenditure is made. Small issuers (governmental units that issue $5,000,000 or less of tax-exempt bonds during the calendar year) get a 3 year period instead of 18 months. A special rule for long-term construction projects permits a 5 year rather than 3 year reimbursement period if both the issuer and a licensed architect or engineer certify that 5 years is necessary to complete construction of the project.

Nature of Expenditure Requirement: The expenditures to be reimbursed must be capital expenditures, costs of issuance for a bond, extraordinary nonrecurring items, a grant, a qualified student loan, qualified mortgage loan, or qualified veteran's mortgage loan. Local governments cannot reimburse amounts spent to repay outstanding obligations from a tax-exempt borrowing.

Preliminary Expenditure and Deminimus Exceptions

The official intent requirement and the reimbursement period requirement do not apply to "preliminary expenditures" which include architectural, engineering, surveying, soil testing, reimbursement bond issuance, and similar costs that are incurred prior to commencement of construction, rehabilitation or acquisition of a project. Preliminary costs do not include land acquisition, site preparation, and similar costs incident to the commencement of construction. Preliminary expenditures, however, cannot exceed 20% of the issue price of the related reimbursement bond issue. A special exception also applies for amounts not in excess of the lesser of $100,000 or 5% of the proceeds of the issue.

Comment

Many governmental units have adopted resolutions authorizing certain officials to declare official intent on their behalf. Others have adopted specific reimbursement resolutions. Many initial borrowing resolutions approved by governing bodies will satisfy the official intent requirement. We recommend that all governmental units review the reimbursement regulations and put procedures in place so they can preserve the ability to reimburse prior capital expenditures with tax-exempt obligations.

Sample resolutions are available upon request.

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