
1808 TAX-EXEMPT BOND POLICIES

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I. POLICY TO TRACK PRIVATE USE OF TAX-EXEMPT FINANCED SPACE

PURPOSE:

The Internal Revenue Service ("IRS") requires organizations to monitor private use of tax-exempt financed facilities and equipment financed with tax-exempt bonds. This policy outlines tracking procedures to monitor private use so that limitations for tax-exempt facilities are not exceeded.

POLICY/PROCEDURE:

Policy

Private use of tax-exempt financed facilities and equipment financed with tax-exempt bonds requires monitoring procedures to ensure that the private use stays within the legal limitations. Excessive private use may jeopardize the tax-exempt status of the bonds. Additionally, private business use information must also be reported annually on Form 990. For this reason, activities that might result in private use of tax-exempt facilities and equipment (such as through lease arrangements, management contracts and/or research agreements) require the review and approval of Comptroller's Office, Treasurer's Office and Office of General Counsel. Further, Comptroller's Office, Treasurer's Office and Office of General Counsel must periodically monitor and measure the private use of tax-exempt financed facilities.

Potential sources of private use of tax-exempt financed space may include the following:

- Unrelated trade or business activities
- Management and other service arrangements
- Sponsored research contracts
- Naming rights contracts

- Leases and subleases of facilities
- Joint venture/limited liability corporations/partnership arrangements

Procedure

Initial Issuance Procedures

Upon the initial issuance of a new series of bonds, Bond Counsel will produce a due diligence report that will outline anticipated sources of private business use of the tax-exempt bonds. This expected private use should be recorded and tracked throughout the life of the bond in addition to any new sources of private use after the bonds are issued.

Continued Tracking Procedures

Requests to use or lease facilities that are tax-exempt bond financed must be submitted to Comptroller's Office, Treasurer's Office and Office of General Counsel for review and approval under the following conditions:

1. Use of the tax-exempt bond financed facility by employees to operate an unrelated trade or business;
2. Use of a tax-exempt bond financed facility by individuals not employed by the university or a private party;
3. Use of tax-exempt bond financed facility in a joint venture/limited liability corporation/partnership agreement between the university and another entity.

Research sponsored by private non-government parties where the sponsor obtains rights to resulting technology or intellectual property may result in private use of the tax-exempt financed facility. Specific procedures have been established to monitor this type of use- See "Research Policy- Private Business Use Review Analysis." Comptroller's Office, Treasurer's Office and Office of General Counsel should review these contracts prior to acceptance to determine whether they meet the safe harbor for research agreements (Rev. Rul. 97-14).

On a periodic basis, the Comptroller's Office, Treasurer's Office and Office of General Counsel should evaluate requests from departments and individuals to use tax-exempt bond financed facilities. The amount of private use of bond proceeds that results from all private uses of the tax-exempt bond financed facilities should be recorded and tracked throughout the life of the bond.

Comptroller's Office, Treasurer's Office and Office of General Counsel on a regular basis, should hold discussions or circulate a questionnaire to departments to determine whether there has been any private business use of the tax-exempt financed facilities. Comptroller's Office, Treasurer's Office and Office of General Counsel may also find it beneficial to periodically provide education sessions to appropriate personnel within the various departments.

Calculation Procedures

Once identified, private use of bonds will be calculated on a yearly basis. This calculation should be completed for each bond issue separately.

Corrective Actions

The goal of ongoing tracking and monitoring is to ensure that all tax-exempt bonds remain qualified and are held in compliance with regulatory standards. Such monitoring also ensures that any actual or

potential violations of federal tax requirements can be timely identified and corrected via self-remediation or through the IRS voluntary closing agreement program, if self-remediation is not available under applicable IRS regulations.

Central recordkeeping environment

Tracking records must be filed with Comptroller's Office, Treasurer's Office and Office of General Counsel for the life of the financing plus 3 years in order to meet the recordkeeping requirements of the IRS.

II. TRACKING OF ASSETS AND PROCEEDS ASSOCIATED WITH TAX-EXEMPT BOND ISSUES

PURPOSE:

Organizations are required to track the use of tax-exempt bond proceeds and to identify what assets are tax-exempt bond financed. This policy outlines procedures associated with the expenditure of tax-exempt bond proceeds and the tracking of the purchase/sale of tax-exempt bond-financed assets.

POLICY/PROCEDURE:

Policy

In its Official Statement and supporting documentation, the University of Pennsylvania will identify how it expects to spend the bond proceeds. Treasurer's Office will monitor the actual expenditure of bond proceeds to ensure they agree with these projected expenditures. Treasury will also need to track the assets purchased with bond proceeds so they can be identified for purposes of calculating private use and for tracking any dispositions.

Procedure

Initial Expenditures

Invoices should be first sent to the office of the VP of Facilities where, upon review and approval, should forward the invoices to Accounts Payable for processing. At the same time, Treasury should review the invoices for appropriateness of reimbursement by bond proceeds. Expenditures as reviewed and approved by Treasury should then be sent to the applicable bond trustee for reimbursement. In general, the University of Pennsylvania should request reimbursement from the applicable bond trustee within an allowable time frame from the original date of payment of the invoice.

Identification and Tracking of Assets

The University of Pennsylvania should ensure that bond-financed assets are identified and tracked. If a bond-financed asset is disposed of special care should be taken to identify the consequences of such disposal.

Central Recordkeeping requirement

Tracking records must be filed in the Finance Department to meet the recordkeeping requirements. See Section V, Record Retention Policy, for additional recordkeeping information.

III. UNRELATED BUSINESS INCOME

Purpose:

The University of Pennsylvania is exempt from income tax under Section 501(c)(3) of the Internal Revenue Code ("IRC") on income from activities that are substantially related to its educational and health care missions, which serve as the basis for its tax exemption.

However, the University of Pennsylvania is subject to tax on the net income of any unrelated business activities conducted, even though such activities may bring in funds to support the University of Pennsylvania's exempt operations. This policy outlines procedures to identify and track activities subject to the unrelated business income tax ("UBIT") for purposes of determining private business use.

Policy/Procedure:

Policy

Unrelated Business Income ("UBI") is the income from a trade or business activity that is regularly carried on by an exempt organization and that is not substantially related to the performance by the organization of its exempt purpose or function. Thus, for UBI to occur, three requirements must be met: (1) a trade or business activities, (2) which is regularly carried on, and (3) is not substantially related to the tax-exempt purpose of the University or the reporting affiliate. Any unrelated business use is deemed to be private business use.

For each UBI-generating activity identified, if it is determined that such activity is conducted in a tax-exempt bond-financed property, the amount of private use generated from such activity will be calculated and tracked based upon the "Tax-Exempt Bonds - Policy to Track Private Business Use of Tax-Exempt Financed Space" policy.

Tax-exempt organizations are required to annually report unrelated business income on Form 990-T (Federal).

Procedure

Identification of Activities (Revenue and Expense)

As indicated in Section I, Policy to Track Private Business Use of Tax-Exempt Financed Space, on a continuing basis, the Tax Department should evaluate requests from departments and individuals to use tax-exempt bond financed facilities. Procedures for these requests are outlined in a separate policy entitled "Private Use of Tax-Exempt Financed Facilities." The amount of private use of bond proceeds that results from all private uses of the tax-exempt bond financed facilities should be recorded and tracked throughout the life of the bond.

Finance, on a regular basis, should hold discussions or circulate a questionnaire to departments to determine whether there has been any private business use of the tax-exempt financed facilities. Finance may also find it beneficial to periodically provide education sessions to appropriate personnel within the various departments.

Reporting of Activities

The Tax Department will be responsible for completing Form 990-T (Federal) and any applicable state/local filings to report unrelated business income. The Tax Department should evaluate on a yearly basis the allocation of income and expense to unrelated business activities.

Central recordkeeping requirement

Records must be filed in the Tax Department to meet the recordkeeping requirements of the IRS.

IV. ARTBITRAGE REBATE CALCULATION POLICY

Purpose:

The IRC has strict rules regarding the investment of tax-exempt bond proceeds. Failure to comply with these requirements can result in the loss of tax-exempt status of the bonds. This policy outlines procedures associated with completing arbitrage rebate requirements.

Policy/Procedure:

Policy

IRC §148(f) requires payment to the Internal Revenue Service of the excess of the amount earned on the investment of bond proceeds over the bond yield investment rate. All of the funds and accounts established under a bond issue are subject to this rebate requirement. There are special rules associated with construction and refunding issues. The procedures outlined below are intended to assist in assuring that the rebate requirement is met. These procedures outline general requirements under the IRC and regulations. A review of the bond tax certificate should be performed to determine the specific requirements for any one particular issue.

Procedure

Upon issuance of the bonds, Finance personnel should review the tax certificate to determine if there are any specific arbitrage rebate requirements for the bond issue in addition to the statutory requirements. At a minimum, unless certain exceptions apply, a rebate calculation is required at the end of the fifth bond year, at the end of every fifth bond year thereafter, and upon retirement of the bond. Treasury shall be responsible for ensuring that arbitrage requirements are fulfilled by contracting with a third party to fulfill such requirements.

Special Circumstances

Special circumstances with regards to a bond issue may require more detailed monitoring of arbitrage rebate requirements. These circumstances include:

- Monitoring expenditures prior to semi-annual target dates for six-month, 18-month and 24-month spending exceptions.
- For advance refunding escrows, confirming that any scheduled purchases of State and Local Government series obligations (SLGs) are made on scheduled dates.
- More frequent computations based on an agreement with bond trustee may be required.

Central recordkeeping requirement

Arbitrage rebate records must be filed in the Finance Department to meet the recordkeeping requirements. See Section V, Record Retention Policy, for additional recordkeeping information.

V. RECORD RETENTION POLICY

Purpose:

The IRS provides general rules for the proper retention of records for federal tax purposes. This policy outlines procedures for complying with the record retention rules in connection with tax-exempt bonds.

Policy/Procedure:

Policy

The University of Pennsylvania will retain the records regarding its tax-exempt bonds and their use necessary to support the exclusion from tax.

Procedure

Records to Retain

Certain records in connection with the tax-exempt bonds must be retained for the life of the bond plus 3 years. These records include:

- Basic records relating to the bond transaction (including the trust indenture, loan agreements and bond counsel opinions). These items are also found in the closing binder.
- Documents evidencing expenditure of bond proceeds.
- Documentation evidencing use of bond-financed property by public and private sources (i.e. copies of leases, management contracts and research agreements).
- Documentation evidencing all sources of payment or security for the bonds.
- Documentation pertaining to any investment of bond proceeds (including the purchase and sale of securities, SLGs subscriptions, yield calculation for each class of investments, actual investment income received from the investment of proceeds, guaranteed investment contracts, and rebate calculations).

This list is not inclusive. Each issuance is unique and may therefore have additional documents that are material to the financing. The decision as to whether a certain record is material should be evaluated by Comptroller's Office, Treasurer's Office and Office of General Counsel.

Record Format

Records may be kept in paper or electronic format.

Record Retention

Records should be retained for as long as the bonds are outstanding plus 3 years after the final redemption of the bonds. If upon redemption the bonds are being refunded (another bond is being used to pay back the bonds) then documentation associated with the original bond (the refunded bond) should be maintained until 3 years after the final redemption date of both bond issues.