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Taxation

Former TEB Head Says IRS Ignoring Violations

By Evan Fallor
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WASHINGTON – The former head of the Internal Revenue Service's tax-exempt bond office is accusing the office of ignoring alleged tax law violations in a $228 million tax-exempt financing for a Syracuse mall that benefited from tax breaks sought by Hillary Clinton when she was a Senate candidate.

The bonds were issued in February 2007 by the Syracuse Industrial Development Agency (SIDA), which loaned the proceeds to Destiny USA Holdings LLC to finance an expansion of the Carousel Center shopping complex in Syracuse. They were supposed to be "qualified green building and sustainable design project" bonds issued under tax law provisions pushed for by Clinton and Sen. Chuck Schumer, D-N.Y.

The IRS began auditing the bonds in March 2011 after SIDA and Destiny told the IRS in a letter that, because of a legal dispute and the recession, it had failed to meet the green bond requirements. The IRS later closed the audit with no change to the tax-exempt status of the bonds because SIDA had reasonably expected the requirements would be met.

Mark Scott, the former TEB director who spent 18 years at the IRS and represents whistleblowers in a private practice here, thinks the IRS is ignoring alleged tax law problems with the transaction because of politics.

Scott said he alerted IRS officials to roughly $30 million in fees paid to SIDA and Syracuse from bond proceeds as well as issuance costs that violated a 2% limit, both alleged tax law violations. The IRS told him it would not pursue these allegations.

Scott has written a five-page analysis of the transaction on his website detailing the alleged violations and warning that, by ignoring them, TEB is opening the door for other issuers to commit similar violations.

"In a stunning reversal of more than 30 years of existing law and its own Publication 5005, `Your Responsibilities as a Conduit Issuer of Tax Exempt Bonds,' the IRS Office of Tax-Exempt Bonds … has [decided] to not apply any limits on the amount of fees a government conduit issuer may be paid out of bond proceeds," Scott said in analysis.

IRS Publication 5005 states that while conduit issuers may charge fees payable out of bond proceeds, Section 148 of the Internal Revenue Code generally limits the size of such fees to prevent bonds from becoming taxable arbitrage bonds.

Scott argues that the issuer fees should have been added to the investment yield on the conduit borrower's obligation. Under the tax law, that investment yield should have been limited to one eighth of one percent. Instead, it was much higher, making the bonds arbitrage bonds.

"IRS officials are ignoring upwards of $30 million in issuer fees," Scott said, calling this "the largest violation of this provision I have ever seen."

"Any member of Congress worth his or her mettle would not allow their state or local government agencies to be penalized for behavior that the IRS has openly permitted to a much larger degree for another government agency," he added.

Scott also said the IRS is ignoring issuance costs that significantly exceed the limit of 2% of bond proceeds for private activity bonds. The issue price of the 2007 bonds was $238.5 million, which should limit issuance costs to $4.8 million. But the underwriters' discount for the bonds, in and of itself, took up most of the issuance costs, at $4.77 million.

Scott claims the 2% limit was exceeded by $2.6 million, which if included, would have pushed issuance costs over 3% of bond proceeds.

"As with its complete waiver of enforcing the previously described `issuer fee' limit, the IRS will be hard pressed to walk back this broader [issuance cost limit] waiver policy now that it is publicly known," Scott said in the analysis.

Scott told The Bond Buyer on Tuesday that his article is meant to prevent the TEB from hiding behind a "wall of secrecy" and to level the playing field for smaller issuers, who he believes would have been targeted for similar, but much smaller violations.

Scott said the decision not to proceed to pursue the alleged tax law violations was not made by one agent, but rather involved at least two IRS senior bond agents, a field manager, multiple senior managers, multiple senior analysists and multiple officials of the Tax Exempt & Government Entities Division, as well as Office of Chief Counsel officials,. As of Tuesday, neither the IRS TE/GE Division nor the Office of Chief Counsel had released formal or informal guidance on the issue. IRS officials did not respond to a request for comment. SIDA representatives also could not be reached for comment.

Scott believes the IRS has backed off this deal because of the appearance of impropriety and the election.

"In my view, there's an appearance of impropriety because the developer was a Friend of Bill [Clinton] who contributed to the Clinton Foundation and because of Hillary Clinton's involvement in getting legislation passed for this project," he said.

In early 2009, Hillary Clinton told The New York Times, "I've been a big supporter of Destiny. I worked successfully to get the green bonds bill passed. I think it would be a big shot in the arm. It would be a destination site for the area."

The mall has been rebranded Destiny USA.

The NYT reported that developer, Robert J. Congel, contributed about $100,000 to the Clinton Foundation at about the time Hillary Clinton helped secure the tax breaks. At that time, Congel told the NYT reporter: "There was no connection with Bill Clinton and the 'green bonds' and the contribution – none at all."

A spokesman for Clinton told the NYT that she supported the expansion of the mall "purely as part of her unwavering commitment to improving upstate New York's struggling economy and

nothing more."

Scott noted in his analysis that the bonds were "issued to finance a not-so-green shopping mall."

Scott said he expects SIDA will issue refunding bonds this week to refund the 2007 bonds, adding that the roughly $30 million issuer fee and issuance cost problems will likely be carried forward into the new financing.

Scott said both of the alleged violations will "continue to taint" the tax-exempt status of the interest paid to holders of the 2007 bonds for at least three more years.

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