Instructions for Form 8038-T

Department of the Treasury
Internal Revenue Service

(Rev. January 2005)

Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate

Section references are to the Internal Revenue Code of 1986 unless otherwise noted.

General Instructions

Purpose of Form

Under section 148(f), interest on a state or local bond is not tax exempt unless the issuer of the bond rebates to the United States arbitrage profits earned from investing proceeds of the bond in higher yielding nonpurpose investments. Use this form to make arbitrage rebate and related payments.

Mortgage Revenue Bonds

Section 143(g)(3) and section 103A(i)(4) of the Internal Revenue Code of 1954 (1954 Code) provide special arbitrage rebate rules for qualified mortgage bonds and qualified veterans' mortgage bonds. Under these special rules, issuers may pay the rebate either to mortgagors, or if an election is made before issuance of the bond, to the United States. Use this form only if you have elected to pay the rebate to the United States.

Qualified Zone Academy Bonds

A qualified zone academy bond (QZAB) is a bond issued by a state or local government to finance certain eligible public school purposes. An issuer may establish a defeasance escrow to cure a failure to properly use QZAB proceeds. An issuer must pay 100 percent of the investment earnings on amounts in the defeasance escrow. Use this form to make payments of investment earnings on amounts in defeasance escrows. See Proposed Regulations section 1.1397E-1(h)(7)(ii)(C), 2004-16 I.R.B. 793.

Note. Use a separate Form 8038-T for each issue.

Who Must File

Issuers of tax-exempt bonds must file Form 8038-T to pay:

1. Arbitrage rebate.
2. Yield reduction payments.
3. The penalty:
   - In lieu of arbitrage rebate or
   - To terminate the election to pay a penalty in lieu of arbitrage rebate.
4. Penalties and interest on the failure to pay on time any amounts in 1-3 above.

Qualified Zone Academy Bonds

Issuers of QZABs that establish a defeasance escrow under the Proposed Regulations must file Form 8038-T to pay 100 percent of the investment earnings on amounts in the defeasance escrow.

Applicable Regulations

General

Unless otherwise stated, regulation sections referenced in these instructions are to the 1993 regulations, as amended. Generally, an issuer may apply these regulations to bonds that are outstanding on July 8, 1997. For the 1993 regulations, see T.D. 8476, 1993-2 C.B. 13, and T.D. 8538, 1994-1 C.B. 26. For the 1997 amendments to the 1993 regulations, see T.D. 8718, 1997-1 C.B. 47. The 1992 regulations generally apply to bonds issued before July 1, 1993. For the 1992 regulations, see T.D. 8418, 1992-1 C.B. 29.

Special Rules

For rules on computing the arbitrage rebate for mortgage revenue bonds, see Temporary Regulations section 6a.103A-2(i)(4).

For rules on computing the arbitrage rebate for bonds subject to section 103(c)(6)(D) of the 1954 Code, see Temporary Regulations section 1.103-15AT, T.D. 8005, 1985-1 C.B. 39, if the issuer has not applied the later regulations.

For qualified zone academy bonds, see Proposed Regulations section 1.1397E-1. For rules on the effective dates of regulations for QZABs, see Proposed Regulations 1.1397E-1(k).

Arbitrage Rebate

Computation of Arbitrage Rebate

The rebate amount for an issue is based on the difference between the amount actually earned on nonpurpose investments and the amount that would have been earned if those investments had a yield equal to the yield on the issue.

Exceptions

General. A number of exceptions may relieve an issuer of the rebate requirement for all or a part of an issue of bonds.

Note. The following exceptions may apply only to a portion of an issue. In such cases, the rebate requirement continues to apply to the portion of the issue not covered by the exception.

Small Issuer Exception. The rebate requirement does not apply to certain bonds issued by governmental units issuing no more than $5 million of bonds in a calendar year.

The exception is modified as follows: a governmental unit may issue up to $10 million in bonds after 1997 ($15 million after 2001) per calendar year, provided no more than $5 million of proceeds are used to finance expenditures other than public school capital expenditures. See section 148(f)(4)(D) and Regulations section 1.148-8.

6-Month Exception. The rebate requirement is considered to be met for gross proceeds of an issue (as defined in Regulations section 1.148-7(c)(3)) if those gross proceeds are spent within 6 months of the issue date. The 6-month exception is the only exception available for refunding issues.

See section 148(f)(4)(B) and Regulations section 1.148-7(a) – (c).

18-Month Exception. The rebate requirement is considered to be met for gross proceeds of an issue if those gross proceeds are spent according to an 18 month expenditure schedule measured from the issue date.

See Regulations section 1.148-7(a), (b) and (d).

2-Year Exception. The "available construction proceeds" of a construction issue are treated as meeting the rebate requirement if those proceeds are spent in accordance with a 2 year expenditure schedule measured from the issue date.

See section 148(f)(4)(C) and Regulations section 1.148-7(a), (b) and (e) – (j).

Exception for Certain Investments. The rebate requirement generally does not apply to gross proceeds that are invested in certain tax-exempt bonds, certain tax-exempt mutual funds or certain demand deposit securities purchased directly from the United States Treasury.

Penalty in Lieu of Arbitrage Rebate

Penalty

An issuer may elect to pay a penalty in lieu of rebating arbitrage for the available construction proceeds of an issue if the spending requirements of the 2-year exception are not satisfied. The penalty is equal to $1\frac{1}{2}$ percent of the amount of the available construction proceeds that do not meet the spending requirements.

See section 148(f)(4)(C) and Regulations section 1.148-7(a), (b) and (e) – (k).

Election to Terminate 1½ Percent Penalty

An issuer may terminate the election to pay penalty in lieu of rebate by paying an amount equal to 3 percent of the unspent available construction proceeds multiplied by the number of years in the initial temporary period. The termination election also requires other actions, such as yield restricting the unspent proceeds and using such proceeds to redeem bonds.

See Code section 148(f)(4)(C)(viii) and (ix) and Regulations section 1.148-7(l).

Yield Reduction Payments

Bond proceeds may be invested in higher yielding investments only during a temporary period described in Regulations section 1.148-2(e). After expiration of an applicable temporary period, proceeds must be yield restricted.

One method of complying with the yield restriction requirement is to make "yield reduction payments." For certain investments, a yield reduction payment is taken into account in computing the yield on that investment. See Regulations section 1.148-5(c).

For investments with excess yield that are not eligible for yield reduction payments (such as an incorrectly invested advance refunding escrow fund), see Notice 2001-60, Voluntary Closing Agreement Program for Tax-Exempt Bonds.

Where to File

File Form 8038-T with the Internal Revenue Service Center, Ogden, UT 84201–0027.

When to File

Arbitrage Rebate

An issuer must pay rebate in installments for computation dates that occur at least once every 5 years. Rebate payments are due within 60 days after each computation date. The final rebate payment for an issue is due within 60 days after the issue is discharged.

See Regulations section 1.148-3(e) through (g).

Special rules. For an issue retired within 3 years of issuance, the final rebate payment need not occur before the end of 8 months after the issue date or during the period the issuer expects to meet any of the spending exceptions under Regulations section 1.148-7.

For rules concerning qualified mortgage bonds and qualified veterans' mortgage bonds see section 143(g)(3) and section 103A(i)(4) of the 1954 Code.

Penalty in Lieu of Arbitrage Rebate and Termination Penalty

Penalty in lieu of arbitrage rebate payments must be paid within 90 days of the end of the applicable spending period.

Payment of the 3 percent penalty to terminate the penalty in lieu of arbitrage rebate election must be made within 90 days of (a) the end of the initial temporary period if the termination election was made under section 148(f)(4)(C)(viii), or (b) the date of the termination election if it was made under section 148(f)(4)(C)(ix).

Yield Reduction Payments

Yield reduction payments are payable at the same time as arbitrage rebate payments.

See Regulations section 1.148-5(c)(2).

Qualified Zone Academy Bonds

The issuer must pay 100 percent of the investment earnings on amounts in a defeasance escrow established for an issue of QZABs at the same time and in the same manner as arbitrage rebate payments.

Failure to Pay Timely

General

A failure to pay the required amounts of arbitrage rebate, yield reduction, or penalty payments on time may cause bonds to be treated as not being, and as never having been, tax exempt.

If the failure is not due to willful neglect, the failure will be disregarded if the issuer pays a penalty to the United States.

For governmental and qualified 501(c)(3) bonds, the penalty equals 50 percent of the rebate amount not paid when required to be paid, plus interest on that amount. Otherwise the penalty equals 100 percent of the rebate amount not paid when required to be paid, plus interest on that amount.

The penalty is automatically waived if the rebate amount plus interest is paid within 180 days of discovery of the failure.

See Regulations section 1.148-3(h).

For issues to which the 1992 Regulations apply, see 1992 Regulations section 1.148-1(c) for rules relating to innocent failure, willful neglect, computation of the correction amount and penalty and interest. In general, these rules also apply to the Penalty in Lieu of Arbitrage Rebate and the Termination Penalty. See 1992 Regulations section 1.148-6(n)(4).

Recovery of Overpayment

In general, an issuer may recover an overpayment for an issue of tax-exempt bonds by establishing to the Internal Revenue Service that an overpayment occurred. Payments that may be recovered include:

- Arbitrage rebate,
- Yield reduction,
- Penalty in lieu of arbitrage rebate, and
- Penalty to terminate penalty in lieu of arbitrage rebate.

See Regulations section 1.148-3(i) and Form 8038-R, Request for Recovery of Overpayments Under Arbitrage Rebate Provisions.

Specific Instructions

Part I—Reporting Authority and Filing Information

Amended Return

An issuer may file an amended return to change or add to the information reported on a previously filed return for the same date of issue. If you are filing to correct errors or change a previously filed return, check the "*Amended Return*" box in the heading of the form.

The amended return must provide all the information reported on the original return, in addition to the new or corrected information. Attach an explanation of the reason for the amended return.

Lines 1-10

General. Enter the same information that was entered on Form 8038, 8038-G or 8038-GC (the "initial filing"), making any necessary changes, for example, a change of address.

Line 1. Enter the name of the governmental entity that issued the bonds, not the name of the entity receiving the benefit of the financing or the eligible taxpayer claiming the QZAB credit.

Line 4. After the preprinted "7", enter the last two digits of the year corresponding with the computation date to which this filing relates. For example, for a payment made for a computation date in 2001, enter a report number of 701. Alternatively, an issuer may consistently use any system of assigning report numbers so long as a number is not duplicated for an issue over its life.

Line 11. Enter the same type of issue that was entered on Form 8038 or 8038-G. For bonds previously reported on Form 8038-GC, enter "Small Governmental Bond." Also enter the total issue price that was listed on the initial filing for this issue. For QZABs enter "qualified zone academy bond" and the total issue price.

Part II—Arbitrage Rebate and Yield Reduction Payments

Line 12. Enter the computation date to which this payment relates. The first rebate installment payment must be made for a computation date that is not later than 5 years after the issue date. Subsequent rebate installment payments must be made for a computation date that is not later than 5 years after the previous computation date for which an installment payment was made.

Line 13. Enter the amount of the rebate payment. A rebate installment payment must be in an amount that, when added to the future value, as of the computation date, of previous rebate payments made for the issue, equals at least 90 percent of the rebate amount as of that date. A final rebate payment must be paid in an amount that, when added to the future value of previous rebate payments made for the issue, equals 100 percent of the rebate amount as of that date.

See Regulations section 1.148-3(f).

For issues to which the 1992 Regulations apply, see 1992 Regulations section 1.148-1(b)(3).

Line 14. For investments covered by the special yield reduction rule, rebate and yield reduction payments are included in the computation of yield for that investment.

See Regulations section 1.148-5(c).

Line 15. Enter the amount equal to 100 percent of the investment earnings in a QZAB defeasance escrow.

Part III—Penalty in Lieu of Arbitrage Rebate

Complete this section only if, on or before the issue date of the bonds, an election was made under section 148(f)(4)(C)(vii).

Line 16. Check the appropriate box for the number of months between the issue date of the bonds and the end of the spending period for which this Form 8038-T is being filed. For periods greater than 24 months, check the box marked "Other" and fill in the number of months since the date of issue.

Note. File a separate Form 8038-T for each 6-month spending period.

Lines 17–19. See *Penalty in Lieu of Arbitrage Rebate* on page 1.

Part IV— Late Payments

Line 20. Under the current regulations, in order to qualify for a waiver of penalty, a failure to pay must not be due to willful neglect. Attach an explanation of the failure and the basis for concluding that the failure is not due to willful neglect.

Line 21. For a failure that does not qualify for a waiver of penalty, the failure will be disregarded if the issuer pays a penalty to the United States. For governmental and qualified 501(c)(3) bonds, the penalty equals 50 percent of the rebate amount not paid timely plus interest on that amount. For other bonds, the penalty is 100 percent of the rebate amount not paid timely plus interest on that amount.

Line 22. Compute interest at the underpayment rate under section 6621, beginning on the date the correct rebate amount is due and ending on the date 10 days before it is paid.

For issues to which the 1992 Regulations apply, see 1992 Regulations section 1.148-1(c)(2) for computation of the correction amount.

Part V—Total Payment

Line 23. Combine all payment amounts on lines 13, 14, 15, 17, 19, 21, and 22. Enclose a check or money order for the total amount made payable to the "United States Treasury." Include the issuer's name, address, EIN, "Form 8038-T", and the date on the payment.

Part VI—Miscellaneous

Line 24. Enter the amount of proceeds (consisting of sale, investment and transferred proceeds) not allocated to expenditures for a governmental purpose of the issue.

Line 25. Enter the amount of proceeds used to pay principal of and call premiums on the bonds for which this form is being filed.

Line 26. Under Regulations section 1.148-5(e)(2), qualified administrative costs are taken into account in determining payments and receipts on nonpurpose investments. Regulations section 1.148-5(e)(2)(iii) and (iv) provide special rules for qualified administrative costs for guaranteed investment contracts and yield restricted defeasance escrows. Enter the amount of any qualified administrative costs taken into account in computing the rebate amount under these special rules.

Line 27. Under Regulations section 1.148-4(f), fees properly allocable to payments for a qualified guarantee for an issue are treated as additional interest in computing the yield on that issue. Enter the amount of such fees.

Line 28. A variable rate issue is an issue that contains a bond that has a yield that is not fixed and determinable on the issue date.

Line 29. In general, payments made or received by an issuer under a qualified hedge are taken into account to determine the yield on the issue. A hedge may be entered into before, at the same time as, or after the date of issue. See Regulations section 1.148-4(h). Enter the name of the provider of the hedge and term of the hedge to the nearest tenth of a year (for example, 2.4 years). Attach additional sheets if necessary.

Line 30. Enter "yes" if any gross proceeds of the issue were invested in a guaranteed investment contract ("GIC"). A GIC includes any nonpurpose investment that has specifically negotiated withdrawal or reinvestment provisions and a specifically negotiated interest rate, and also includes any agreement to supply investments on two or more dates (for example, a forward supply contract). Enter the name of the provider of the GIC and term of the GIC to the nearest tenth of a year. Attach additional sheets if necessary.

Line 31. Indicate if any gross proceeds were invested beyond the temporary periods set forth in Regulations section 1.148-2(e) or 1.148-9(d).

Line 32. Indicate who prepared the calculations necessary for the filing of this form. If other than "Issuer", indicate the name of the entity or individual preparing the calculations.

Signature

Form 8038-T must be signed by an authorized representative of the issuer.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to collect the right amount of arbitrage rebate, yield reduction payments, and penalties.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	10 hr., 2 min.
Learning about the law or the form	5 hr., 51 min.
Preparing, copying, assembling, and sending the form to the IRS	6 hr., 16 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, IR-6406, Washington, DC 20224. Do not send the form to this address. Instead, see *Where to File* on page 2.