Instructions for Form 8038-T
(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 the investment of the 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)(i)(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

Special Rules
For rules on computing the arbitrage rebate for mortgage revenue bonds, see Temporary Regulations section 8a.103A-2(j)(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(k). 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.

Revenue Bonds
Section 143(g)(3) and section 103A(i)(4) of the Internal Revenue Code of 1986 (the 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.

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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 rebatting 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 1½ 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(i).

Yield Reduction Payments
Bond proceeds may be invested in higher yielding investments only during a temporary period described in the information reported on the original issue of QZABs at the same time and in the same manner as arbitrage rebate payments. The penalty is automatically waived if the yield reduction payments are made within 180 days of discovery of the failure.

An issuer may terminate the election to pay 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. The penalty is automatically waived if the yield reduction payments are made within 180 days of discovery of the failure.

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.

Penalty in Lieu of Arbitrage Rebate
Penalty in lieu of arbitrage rebate payment. A rebate installment payment must be made for a computation date that is not later than 5 years after the previous computation date for 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 previous computation date for which this payment relates. 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.


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-SC (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 01. 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-SC, 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 previous computation date for which an installation 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(b)(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.


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. Enter the amount of such fees. The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: 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.