



REPORT TO COUNCIL

City of Sacramento

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915 I Street, Sacramento, CA 95814-2604
www.CityofSacramento.org

CONSENT
September 7, 2010

**Honorable Mayor and
Members of the City Council**

Title: Arbitrage Rebate Liability – 1995 Gas Tax Revenue Bonds

Location/Council District: Citywide

Recommendation: Adopt a **Resolution** authorizing the expenditure of funds in an amount not to exceed \$680,000.00 to pay arbitrage rebate liability to the Internal Revenue Service (IRS) for the 1995 Gas Tax Revenue Bonds.

Contact: Russell T. Fehr, City Treasurer, (916) 808-5832

Presenters: N/A

Departments: City Treasurer

Division: Debt

Organization No: 05001011

Description/Analysis:

Issue: Arbitrage is the profit that results from borrowing funds in the cheaper tax-exempt market and investing the proceeds in higher-yielding markets. The City is required to rebate arbitrage to the IRS for each tax-exempt bond issue. This must be done every five years and at the final maturity of the bond. The purpose of the rebate requirement is to prevent tax-exempt borrowers from abusing the exemption and issuing bonds solely to earn arbitrage.

During preparation of the final arbitrage calculation for the 1995 Gas Tax Bonds, inaccuracies were discovered in the first five-year calculation, originally computed in calendar year 2000. The original calculation incorrectly concluded that there was no arbitrage liability when in fact the City owed the IRS a rebate, which is now past due. Staff has validated the revised calculation and is requesting appropriation of funds to rebate to the IRS.

Policy Considerations: IRS regulations require that positive arbitrage earnings be rebated to the federal government. Every five years, the City is required to report any arbitrage liability to the IRS and to pay the rebate amount owed. Failure to comply with federal rebate requirements could lead to substantial late-filing penalties and interest; it also could potentially lead to the loss of tax-exempt status for the bonds. (26 C.F.R. § 1.148-3.) Accordingly, as soon as staff learned that a rebate liability existed, we proceeded to remedy the situation with haste and within 180 days of discovery.

Environmental Considerations:

California Environmental Quality Act (CEQA): This action is not subject to the CEQA because it is not a "project" as defined in section 15378 of the CEQA Guidelines.

Sustainability Considerations: None

Commission/Committee Action: None.

Rationale for Recommendation: Approval of the funding appropriation permits the City Treasurer to comply with IRS regulations and the 1995 Gas Tax Bonds Tax Certificate.

Financial Considerations: Based on a payment date of September 10, 2010, the rebate liability is \$679,239.29, composed of \$383,601.65 in accumulated rebate liabilities and \$295,637.64 in interest. Should the payment not occur on this date, interest will continue to accrue until a final payment is made to the IRS. The Gas Tax Fund (2002) has been identified as the source of funding for the payment to the IRS. Staff recommends that the accumulated rebate liability and interest be paid from this fund as it originally benefitted from the bond proceeds as well as interest earnings. If during further analysis of the benefitting funds staff finds that the allocations pro-rata share is inequitable, the Finance Director shall make a final adjustment to reflect a more equitable share.

Emerging Small Business Development (ESBD): Not Applicable

Respectfully Submitted by: 
Kimberlie Gladden
Senior Debt Analyst

Approved: 
Janelle Gray
Debt Manager

Recommendation Approved:

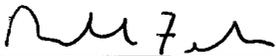

Russell T. Fehr
City Treasurer

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BACKGROUND

On May 30, 1995, the City Council and Sacramento City Financing Authority adopted resolutions authorizing the City Treasurer to issue the Sacramento City Financing Authority Gas Tax Revenue Bonds, Series 1995A. Proceeds of the sale were used to provide funds to pay costs of acquisition and construction of the 1995 Street Improvement Project and other bond-related issuance costs.

The Office of the City Treasurer is responsible for the calculation of arbitrage rebate on approximately 70 bond issues, ranging in size and complexity from small assessment-district financings to large capital-improvement bonds that involve multiple programs. The federal government defines arbitrage as the excess of the amount earned on all non-purpose investments over the amount that would have been earned if the non-purpose investments were invested at a rate equal to the bond yield, plus any income attributable to the excess amount.

RESOLUTION NO 2010 - _____

ADOPTED BY THE SACRAMENTO CITY COUNCIL

AUTHORIZE THE EXPENDITURE OF FUNDS IN AN AMOUNT NOT TO EXCEED \$680,000.00 TO PAY ARBITRAGE REBATE TO THE INTERNAL REVENUE SERVICE (IRS) FOR THE 1995 GAS TAX REVENUE BONDS

BACKGROUND:

- A. In April 1995, City Council authorized the issuance and sale of the 1995 Gas Tax Revenue Bonds. Proceeds of the sale were used to pay costs of acquisition and construction of the 1995 Street Improvement Project and related costs of issuance.
- B. Federal regulations require that positive arbitrage earnings be rebated to the federal government. Every five years, the City is required to report any arbitrage liability to the IRS and to pay the rebate amount owed. Failure to comply with federal rebate requirements could lead to substantial late-filing penalties and interest, as well as the potential loss of tax-exempt status for the bonds. (26 C.F.R. § 1.148-3.)
- C. Approval of this funding permits the City Treasurer to comply with federal regulations and the 1995 Gas Tax Bonds Tax Certificate.

BASED ON THE FACTS SET FORTH IN THE BACKGROUND, THE CITY COUNCIL RESOLVES AS FOLLOWS:

- Section 1.** The City Council hereby authorizes the expenditures of funds in an amount not to exceed \$680,000.00 from the Gas Tax Fund (2002) to pay the accumulated rebate liabilities and interest to the IRS.
- Section 2.** The City Treasurer is hereby authorized to modify the payment to the IRS based on the actual rebate liability and interest due at the time of payment and as needed to carry out the intent of the payment in accordance with IRS regulations and City Policy.
- Section 3.** The Finance Director is hereby authorized to: 1) allocate funds as deemed necessary to equitably distribute the liability between the Gas Tax (2002) and other benefitting funds as indentified in the future; and 2) adjust project budgets in the Gas Tax Fund (2002) as may be necessary to make the required payment.
- Section 4.** This resolution takes effect immediately upon its adoption.