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Insights

Post-Issuance Compliance: Safeguarding Your Hospital's Access to Low-Cost Capital

October 9, 2025

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Tax-exempt healthcare organizations rely heavily on tax-exempt bond financing to fund facilities and equipment. While these financings provide critical access to lower-cost capital, borrowers must carefully observe post-issuance compliance requirements. Failure to comply can lead to IRS penalties, reputational harm, and even the loss of tax-exempt status. This alert highlights key compliance issues, consequences of noncompliance, and the importance of proactive monitoring.

Key Compliance Considerations

Effective post-issuance compliance extends well beyond maintaining a file of closing documents or even a "Post-Issuance Compliance Policy" document. Healthcare borrowers must actively monitor how tax-exempt bond proceeds are spent, how financed facilities and equipment are used, and how third-party arrangements are structured. The IRS has consistently focused on these areas in examinations and 501(c)(3) borrowers are required to make annual post-issuance compliance disclosures on IRS Form 990 Schedule K (which are signed by an officer under penalties of perjury). Even minor oversights can create significant risks of private business use or arbitrage violations. The following considerations highlight several common compliance touchpoints that warrant ongoing attention.

Proper Tracing of Bond Proceeds

Bond proceeds must be allocated primarily to qualified tax-exempt purposes, with only a limited allowance (generally up to 5% of the bond's net proceeds) for private business use under §141.[1] Accurate accounting and tracing of expenditures are essential to ensure compliance with this limitation and to avoid arbitrage issues or excessive private-use concerns.[2]

Review of Contracts and Leases

Management contracts should be reviewed for compliance with the IRS safe harbor rules under Rev. Proc. 2017-13. In contrast, there are no safe harbors for leases with private business users; each lease must be evaluated directly under the private business use rules of IRC §§141 and 145. Improperly structured agreements or leases may result in impermissible private business use and jeopardize the tax-exempt status of the bonds.

Unrelated Trade or Business Activities

Activities that generate unrelated business taxable income (UBTI) under IRC §§511–514 must be carefully evaluated. Even limited unrelated activity can taint the allocation of bond-financed property and contribute to private business use concerns.

Monitoring Bond-Financed Facilities and Equipment

Ongoing monitoring of bond-financed facilities, including square footage allocations, leased space, common areas, and equipment usage, is essential. The monitoring process should be informed by the results of the contract, lease, and unrelated activity reviews, ensuring that private-use restrictions are observed on an ongoing basis.[3]

Cross-Functional Coordination

Effective compliance requires collaboration between legal, treasury, finance, and tax functions. Each group plays a critical role in negotiating contracts, monitoring disbursements, tracking space usage, and ensuring accurate tax reporting.

Annual Reporting Obligations

501(c)(3) conduit borrowers must annually complete IRS Form 990 Schedule K, which requires disclosure of private use, arbitrage compliance, and monitoring procedures. Accurate disclosure is both a compliance requirement and a reputational safeguard.[4]

Consequences of Noncompliance

- Noncompliance may result in:
- IRS examinations and possible loss of tax-exempt status;
- Arbitrage rebate penalties;
- Reputational damage; and
- Increased borrowing costs on future financings.

Conclusion and Recommended Next Steps

Post-issuance compliance is not a one-time exercise but an ongoing obligation. Given the IRS's continued focus on tax-exempt bond compliance in the healthcare sector, it is more important than ever for organizations to maintain robust compliance policies.

- Our team can assist with:
- Drafting and implementing compliance policies;
- Reviewing management contracts and leases;
- Performing space allocation analyses; and
- Preparing or reviewing Form 990 Schedule K disclosures.

If you have questions about post-issuance compliance for tax-exempt bonds or this alert contact Kendall A. Schnurpel, Scott C. Frissell, Stephanie T. Eckerle or your Krieg DeVault attorney today.

[1] For qualified 501(c)(3) bonds, Internal Revenue Code §145 applies the private business use restrictions of §141 to the use of bond-financed property by the charitable organization and its affiliates. In this context, "private business use" includes use by any nongovernmental person or entity other than the 501(c)(3) borrower and certain related entities, subject to the general 5% allowance under §141(b)(1). See IRC §§141(b), 145(a).

[2] IRC §141

[3] Treas. Reg. §1.141-3

[4] Instructions for Schedule K (Form 990) (Rev. December 2024)

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