POST ISSUANCE COMPLIANCE MANUAL

SOUTH DAKOTA BUILDING AUTHORITY

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SOUTH DAKOTA BUILDING AUTHORITY

Post-Issuance Compliance Manual

Manual for Tax and Securities Compliance

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SECTION 1. PREFACE

The focus of this manual is to provide information to issuers and users of bond financed property so that they may better understand and comply with general post-issuance compliance. Issuers and users need policies and procedures to insure proper recordkeeping and that the governmental entity monitors on a continuing basis the tax-exempt status of the financing, the project and the entities that use the project. Meierhenry Sargent, LLP has drafted this book to assist issuers and users comply with tax and securities laws after the bonds are issued.

This compliance manual is organized into the following sections:

- IRS Form 14002
- General post-issuance compliance
- General recordkeeping
- Investment and arbitrage compliance
- Expenditures and assets
- Private business use
- Secondary market disclosure
- Procedures and Forms

SECTION 2. IRS FORM 14002 GOVERNMENTAL BOND FINANCINGS COMPLIANCE QUESTIONNAIRE

IRS Launches Compliance Check on Governmental Bond Financings

The Tax Exempt Bonds function (TEB) of the IRS Tax Exempt and Government Entities division has initiated a compliance project to evaluate the post-issuance and record retention policies, procedures and practices of governmental issuers of tax-exempt bonds. Starting in 2009, TEB is sending compliance check questionnaires to 200 governmental entities that issued tax-exempt bonds in calendar year 2005, as indicated on their Form 8038-G, Information Return for Tax-Exempt Governmental Obligations. The first of the questionnaires was sent out on Monday, January 26, 2009.

The governmental bond financings project is designed to measure several aspects of the post-issuance compliance knowledge and practices of governmental issuers of tax-exempt bonds. The questionnaire covers:

- record retention requirements;
- qualified use of bond-financed property requirements;
- arbitrage yield restriction and rebate requirements;
- debt management policies and procedures; and
- awareness of voluntary compliance and educational resources.

It is important to review the questionnaire and be able to answer its questions <u>because it may show up in your mailbox</u>. A Copy of the questionnaire and cover letter are found on the following pages.

Internal Revenue Service | **Department of the Treasury**

Date:

Contact Person/ID Number:

Contact Telephone Numbers:

Response Due Date:

Employer Identification Number:

Dear Sir or Madam:

We are conducting a compliance check of your governmental bond as part of our ongoing efforts to increase voluntary compliance by governmental bond issuers. We are asking you to answer questions concerning your post-issuance bond compliance procedures.

General Information
Governmental bonds are tax-exempt bonds issued by a State or local government which are not private activity bonds as described in section 141 of the Internal Revenue Code.

The tax-exempt status of governmental bonds remains throughout the life of the bonds if all applicable federal tax laws are satisfied while the bonds are outstanding. Various requirements apply under the Internal Revenue Code and Income Tax Regulations including information filing and other requirements related to issuance, the proper and timely use of bond-financed property, and arbitrage yield restriction and rebate requirements.

To comply with these and any other applicable federal tax requirements, governmental bond issuers must ensure that the rules are met at the time the bonds are issued and throughout the term of the bonds. Generally, this includes the continued maintenance of records sufficient to establish compliance with all applicable federal tax requirements until three years after the final maturity of the bonds. Also, continued maintenance of records related to periods before the bonds are issued and after the bonds mature is oftentimes necessary, particularly in instances involving reimbursements of prior expenditures or refundings of prior bond issues.

What You Need To Do
Please complete the enclosed Form 14002, *Governmental Bond Financings Compliance Check Questionnaire,* and follow the instructions below for sending the questionnaire to us.

How To Send The Information To Us
Attach a copy of this letter to the front of the requested information, and send the information to us, by the due date shown above, using one of the following methods:

- Mail your reply to the address shown in the heading of this letter.
- Email your reply (in PDF format) or questions to teb.cpm@irs.gov and indicate "Governmental Bond Questionnaire" in the subject line. Be sure to include your name, telephone number and the best time to

reach you; as we will be replying to your questions by telephone. **Note: This email address is for replies or questions related to this letter only, we cannot respond to other information or questions.**

Failure to use the above mailing address or email address may result in processing delays. If you fail to reply by the above date, we may forward your governmental bond issue for examination consideration.

In the spaces below, please provide an official's name, title, telephone number and most convenient time for us to call should we need to speak with someone regarding your governmental bond issue.

Name of official: _____ Time: _____

Title: _____ Telephone Number: ( ) _____

More Information

Through our website at www.irs.gov/bonds, you can access materials relating to tax-exempt bonds including Publication 4079, *Tax Exempt Governmental Bonds Compliance Guide,* which provides an overview of the federal tax rules and filing requirements applicable to governmental bonds. You can find answers to frequently asked questions about record retention requirements under "Exempt Bond FAQ's." In addition, you will find an article entitled, "After the Bonds are Issued: Then What?" in Publication 4344, *Report of Recommendations - Advisory Committee on TE/GE,* intended for government officials in developing policies, procedures and systems to ensure that your bonds remain tax-exempt.

We have enclosed Publication 4386, *Compliance Checks,* which answers some frequently asked questions about compliance checks.

If you have any questions about this letter, you can contact the person named in the heading or email your questions to the address shown under **How To Send the Information to Us.**

Thank you for your cooperation.

Sincerely,

Steven A. Chamberlin
Manager, Compliance & Program Management
Tax Exempt Bonds

Enclosure(s):
Form 14002
Publication 4386

Letter 4408 (11-2008)
Catalog Number 52105E

Form **14002** (September 2008)	Department of the Treasury — Internal Revenue Service **Governmental Bond Financings Compliance Check Questionnaire**	OMB No. 1545-2071

This questionnaire asks for information regarding your post-issuance bond compliance and record retention practices. Please complete the questionnaire and follow the instructions in the accompanying letter for returning it to us.

Name of Governmental Entity: _____

Employer Identification Number: _____

PART I - POST-ISSUANCE COMPLIANCE - GENERAL

1. Do you have written procedures to ensure that governmental bond financings remain in compliance with the following federal tax requirements after the bonds are issued:

   a. Proper use of bond proceeds? ☐ Yes ☐ No
   If Yes, date they were implemented? _____ (dd/mm/yyyy)

   b. Timely expenditure of bond proceeds? ☐ Yes ☐ No
   If Yes, date they were implemented? _____ (dd/mm/yyyy)

   c. Proper use bond-financed property? ☐ Yes ☐ No
   If Yes, date they were implemented? _____ (dd/mm/yyyy)

   d. Arbitrage yield restriction and rebate? ☐ Yes ☐ No
   If Yes, date they were implemented? _____ (dd/mm/yyyy)

   e. Timely return filings and other general requirements? ☐ Yes ☐ No
   If Yes, date they were implemented? _____ (dd/mm/yyyy)

   f. Documenting compliance with other general requirements? ☐ Yes ☐ No
   If Yes, date they were implemented? _____ (dd/mm/yyyy)

   Describe in detail your procedures for each of the above items (a-f) and how you implement them, including dates of revisions, if any. In lieu of the above descriptions, you may attach a copy of your written procedures. If you have no written procedures, explain what guidelines you have in place and from what source these guidelines are derived that ensure bond financings are in compliance with federal tax requirements. *(Attach sheet with description)*

2. Who is primarily responsible for monitoring post-issuance compliance of bond financings?

   ☐ Elected or appointed officials — What is the person's title? _____
   ☐ Non-elected or non-appointed officials — What is the person's title? _____
   ☐ Staff Person — What is the person's title? _____
   ☐ Other Person — What is the person's title? _____
   ☐ None

3. If more than one individual is responsible for maintaining the records related to bond financings, do you have written procedures for assigning responsibilities that would ensure compliance with these financings? ☐ Yes ☐ No ☐ N/A

   If Yes, date they were implemented? _____ (dd/mm/yyyy)

   Describe in detail your procedures for assigning responsibility to each party involved and how you implement them, including dates of revisions, if any. In lieu of the above description, you may attach a copy of the written procedures used to assign responsibility to those individuals handling the bond financings. If you have no written procedures, explain what guidelines you have in place and from what source these guidelines are derived that ensure bond financings are in compliance with federal tax requirements. *(Attach sheet with description)*

4. Do you provide training or educational resources to personnel that are responsible for ensuring compliance with the post-issuance private use limitations for bond-financed property? ☐ Yes ☐ No

5. Are you aware of the following options available for voluntarily correcting failures to comply with post-issuance compliance activities?

   a. Taking remedial actions described under section 1.141-12 of the Income Tax Regulations? ☐ Yes ☐ No

   b. Entering into a closing agreement under the Tax-Exempt Bonds Voluntary Closing Agreement Program described in Notice 2008-31? ☐ Yes ☐ No

PART II - GENERAL RECORDKEEPING

6. Do you maintain records necessary to support the tax-exempt status of the bond financing? ☐ Yes ☐ No

   If yes, for how long?

   ☐ Less than life of bonds

   ☐ Life of bonds

   ☐ Life of bonds plus 3 years

7. How do you maintain your bond records?

   ☐ On Paper ☐ Electronic media (e.g.,CD, disks, tapes) ☐ Combination of paper and electronic

8. Do you maintain copies of the following records:

   a. Your Federal tax or information returns (e.g., Form 8038 series returns)? ☐ Yes ☐ No

   b. Your audited financial statements? ☐ Yes ☐ No

   c. Bond transcripts, official statements and other offering documents of your bond financings? ☐ Yes ☐ No

   d. Minutes and resolutions authorizing the issuance of your bond financings? ☐ Yes ☐ No

   e. Certifications of the issue price of your bond financings? ☐ Yes ☐ No

   f. Formal elections for bond financings (e.g., election to employ an accounting methodology other than specific tracing)? ☐ Yes ☐ No ☐ N/A

   g. Appraisals, demand surveys, or feasibility studies for bond-financed property? ☐ Yes ☐ No ☐ N/A

   h. Documents related to government grants associated with construction, renovation or purchase of bond-financed facilities? ☐ Yes ☐ No ☐ N/A

   i. Publications, brochures, and newspaper articles for your bond financings? ☐ Yes ☐ No ☐ N/A

   j. Trustee statements for your bond financings? ☐ Yes ☐ No ☐ N/A

   k. Correspondence (letters, e-mails, faxes, etc.) for your bond financings? ☐ Yes ☐ No

   l. Reports of any prior IRS examinations of your entity or bond financings? ☐ Yes ☐ No ☐ N/A

PART III - INVESTMENTS AND ARBITRAGE COMPLIANCE

9. Do you maintain records documenting the allocations and earnings and investments related to your bond financings? ☐ Yes ☐ No

10. Do you maintain records for investments of your bond financing proceeds related to:

    a. Investment contracts (e.g., guaranteed investment contracts)? ☐ Yes ☐ No ☐ N/A

    b. Credit enhancement transactions (e.g., bond insurance contracts)? ☐ Yes ☐ No ☐ N/A

    c. Financial derivatives (swaps, caps, etc.)? ☐ Yes ☐ No ☐ N/A

    d. Bidding of financial products? ☐ Yes ☐ No ☐ N/A

11. Do you maintain records of the following arbitrage documents related to your bond financings:

    a. Computations of bond yield? ☐ Yes ☐ No

    b. Computation of rebate and yield reduction payments? ☐ Yes ☐ No

    c. Form 8038-T, *Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate*? ☐ Yes ☐ No ☐ N/A

    d. Form 8038-R, *Request for Recovery of Overpayments Under Arbitrage Rebate Provisions*? ☐ Yes ☐ No ☐ N/A

12. Do you have written procedures for monitoring instances that will comply with the applicable yield restriction requirements when a subsequent reinvestment of bond proceeds results in a lower investment yield. ☐ Yes ☐ No ☐ N/A

    If Yes, date they were implemented? _____ (dd/mm/yyyy)

    Describe in detail your procedures and how you implement them, including dates of revisions, if any. In lieu of the above description, you may attach a copy of the written procedures. If you have no written procedures, explain what guidelines you have in place and from what source these guidelines are derived that ensure bond financings are in compliance with federal tax requirements. *(Attach sheet with description)*

13. Do you have specific written procedures that monitor bond financings you expect will comply with the arbitrage rules as a result of the application of a temporary period exception (section 148(c) and section 1.148-2(e) of the Income Tax Regulations) or a spending exception (Regulations section 148(f)(4) and section 1.148-7(c), (d), and (e))? ☐ Yes ☐ No ☐ N/A

    If Yes, date they were implemented? _____ (dd/mm/yyyy)

    Describe in detail your procedures and how you implement them, including dates of revisions, if any. In lieu of the above description, you may attach a copy of the written procedures. If you have no written procedures, explain what guidelines you have in place and from what source these guidelines are derived that ensure bond financings are in compliance with federal tax requirements. *(Attach sheet with description)*

PART IV - EXPENDITURES AND ASSETS

14. Do you maintain records documenting the allocation of bond-financing proceeds to expenditures (e.g., allocation of bond proceeds to expenditures for the construction, renovation, or purchase of facilities you own and use in the performance of your public purpose)?	☐ Yes	☐ No
15. Do you maintain records documenting the allocations of bond-financing proceeds to bond issuance costs?	☐ Yes	☐ No
16. Do you maintain copies of requisitions, draw schedules, draw requests, invoices, bills and cancelled checks related to bond proceeds spent during the construction period?	☐ Yes	☐ No
17. Do you maintain copies of all contracts entered into for the construction, renovation or purchase of bond-financed facilities?	☐ Yes	☐ No
18. Do you maintain records of expenditure reimbursements incurred prior to issuing bonds for facilities financed with bond proceeds?	☐ Yes	☐ No
19. Do you maintain an asset list or schedule of all bond-financed facilities or equipment?	☐ Yes	☐ No
20. Do you maintain depreciation schedules for bond-financed depreciable property?	☐ Yes	☐ No
21. Do you maintain records that track your purchases and sales of bond-financed assets?	☐ Yes	☐ No

PART V - PRIVATE BUSINESS USE

22. Do you maintain records of trade or business activities by or with non-governmental entities or persons with respect to your bond-financed facilities?	☐ Yes ☐ N/A	☐ No
23. Do you maintain copies of the following agreements when entered into with respect to your bond-financed property:		
a. Management and other service agreements?	☐ Yes ☐ N/A	☐ No
b. Research contracts?	☐ Yes ☐ N/A	☐ No
c. Naming rights contracts?	☐ Yes ☐ N/A	☐ No
d. Ownership documentation (e.g., deeds, mortgages)?	☐ Yes ☐ N/A	☐ No
e. Leases?	☐ Yes ☐ N/A	☐ No
f. Subleases?	☐ Yes ☐ N/A	☐ No
g. Leasehold improvement contracts?	☐ Yes ☐ N/A	☐ No
h. Joint venture arrangements?	☐ Yes ☐ N/A	☐ No
i. Limited liability corporation arrangements?	☐ Yes ☐ N/A	☐ No
j. Partnership arrangements?	☐ Yes ☐ N/A	☐ No

24. Do you have any additional comments on how you ensure your governmental bonds remain tax exempt after they are issued? *(Attach additional sheets, if necessary)*

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. We need it to ensure that you are complying with these laws.

The IRS may not conduct or sponsor, and an organization is 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 number. Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103 and 6104.

SECTION 3. POST-ISSUANCE COMPLIANCE- GENERAL

What is Post-Issuance Compliance?

In general, governmental issuers of tax-exempt bonds are responsible for ensuring that their financing satisfies all applicable federal tax requirements. The governmental issuers make covenants at the time of issuance that they satisfy all applicable federal tax requirements at the time of issuance and will continue to satisfy all applicable federal tax requirements for as long as such bonds remain outstanding.

If bonds are issued to finance a loan or lease to another entity as part of a conduit financing or a financing on behalf thereof, the responsibility of monitoring the post-issuance compliance and maintaining adequate records to substantiate compliance is often shared between the governmental issuer and the entity borrowing or benefiting from the facility financed with the bond proceeds.

Why do we need to do post-issuance compliance?

A failure to fulfill this responsibility may result in the bonds forfeiting their tax-exempt status.

How do we ensure post-issuance compliance?

To ensure post-issuance compliance, it is recommended that the governmental issuer :

1) adopt a written policy and procedure manual for post-issuance compliance;

2) initiate and undertake practices to comply with the policies; and

3) set up a periodic review and education programs concerning the policies and practices to ensure that post-issuance compliance is taking place.

How do we adopt the written policy?

This may be the easiest aspect of post-issuance compliance. It if has not been adopted previously as part of a bond resolution or ordinance, it is recommended that the governing body evidence the adoption of a written policy in their governing bodies minutes. A sample motion in substantially the following form would suffice:

> **Motion to adopt the Post-issuance Compliance Manual, a copy of which is on file with the _____, as its written procedural manual for post-issuance compliance.**

How do we start?

Once the post-issuance compliance writing is adopted, it is time to setup the procedures and identify the people who will be responsible for complying with the procedures.

What are the Procedures?

The procedures will include:

Proper Use of the Bond Proceeds

The use of bond proceeds and of bond-finance property is the basis for determining whether bonds are issued for general governmental purposes or for an activity of a nongovernmental purpose. Therefore, procedures need to be setup to assure the property use of the bonds proceeds.

Timely Expenditure of the Bond Proceeds

At the time of issuance the governmental issuer must reasonably expect to spend 85 percent of the spendable proceeds of the issue to carry out the governmental purposes of the issue within the 3-year period beginning on

the date the bonds are issued, and not more than 50 percent of the proceeds of the issue are invested in nonpurpose investments (as defined in § 148(f)(6)(A)) having a substantially guaranteed yield for 4 years or more. There may be additional spending requirements relating to arbitrage.

Proper Use of the Bond Finance Facility

If the bond financed facility is used by private business, the interest on the bonds may be taxable. Interest on the bonds may be taxable if the proceeds are used to finance private activities which are not specifically authorized by an exemption in the Internal Revenue Code. Bond proceeds may not be used by a nongovernmental person.

Timely Return filings and other general requirements?

At the time of issuance, governmental issuers must comply with certain information filing requirements under IRC 149(e). After every bond closing, the bond counsel will send the issuer and certain other participants what is called a "Bond Transcript". A bond transcript consists of all legal and financial documents, including bond counsel's legal opinion and other opinions, associated with the offering of the bonds. In the bond transcript should be the 8038 filings and any other information filings. Your bond issue may require the filing of an 8038T arbitrage rebate form. You need to know what information needs to be tracked to complete the filing.

Documenting compliance with other general requirements.

Documenting compliance with the Internal Revenue Code should be integrated into existing operations and state law requirements.

Identifying the individual or individuals primarily responsible for bond financed compliance.

Identify those who will be primarily and secondarily responsible for compliance. The governing body is responsible for periodically reviewing that those primarily and secondarily responsible are complying.

Education programs.

Finally, a program of education should be developed to educate and facilitate post issuance compliance.

SECTION 4. GENERAL RECORDKEEPING-RECORD RETENTION POLICY

Why keep records with respect to tax-exempt bond transactions?

Section 6001 of the Internal Revenue Code provides the general rule for the proper retention of records for federal tax purposes. Under this provision, every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Section 1.6001-1(a) of the Income Tax Regulations amplifies this general rule by providing that any person subject to income tax, or any person required to file a return of information with respect to income, must keep such books and records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by that person in any return of such tax or information.

The IRS regularly advises *taxpayers* to maintain sufficient records to support their tax deductions, credits and exclusions. In the case of a tax-exempt bond transaction, the primary taxpayers are the beneficial holders of the bonds. However, in most cases, the beneficial holders of tax-exempt bonds will not have any records to support their exclusion of the interest paid on those bonds. Instead, these records will generally be found in the bond transcript and the books and records of the issuer, the conduit borrower, and other participants to the transaction. Therefore, in order to ensure the continued exclusion of interest by the beneficial holders, it is important that the issuer, the conduit borrower and other participants retain sufficient records to support the continued exclusion being taken by the beneficial holders of the bonds. Pursuant to this statutory regime, IRS agents conducting examinations of tax-exempt bond transactions will look to these parties to provide books, records, and other informational documents supporting the bonds continued compliance with federal tax requirements.

Additionally, in the case of many private activity bonds, the conduit borrowers are also primary taxpayers. For instance, the conduit borrower will generally deduct the interest indirectly paid on the bond issue through the loan documents. Conduit borrowers are also often entitled to claim depreciation deductions for bond-financed property. Consequently, conduit borrowers should maintain sufficient records to support their interest deductions, depreciation deductions or other tax deductions, exclusions or credits related to the tax-exempt bond issue.

Moreover, issuers and conduit borrowers should retain sufficient records to show that all tax-exempt bonds related returns submitted to the IRS are correct. Such returns include, for example, IRS Forms 8038, 8038-G, 8038-GC, 8038-T, and 8038-R.

In addition to the general rules under section 6001, issuers and conduit borrowers are subject to specific recordkeeping requirements imposed by various other Code sections and regulations. For example, section 1.148-5(d)(6)(iii)(E) of the arbitrage regulations requires that an issuer retain certain records necessary to qualify for the safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.

What are the basic records that should be retained?

Although the required records to be retained depend on the transaction and the requirements imposed by the Code and the regulations, records common to most tax-exempt bond transactions include:

- Basic records relating to the bond transaction (including the trust indenture, loan agreements, and bond counsel opinion);
- Documentation evidencing expenditure of bond proceeds;
- Documentation evidencing use of bond-financed property by public and private sources (i.e., copies of management contracts and research agreements);
- Documentation evidencing all sources of payment or security for the bonds; and

- Documentation pertaining to any investment of bond proceeds (including the purchase and sale of securities, SLGs subscriptions, yield calculations for each class of investments, actual investment income received the investment of proceeds, guaranteed investment contracts, and rebate calculations).

In what format must the records be kept?

All records should be kept in a manner that ensures their complete access to the IRS for so long as they are material. While this is typically accomplished through the maintenance of hard copies, taxpayers may keep their records in an electronic format if certain requirements are satisfied.

Rev. Proc. 97-22, 1997-1 C.B. 652 provides guidance to taxpayers that maintain books and records by using an electronic storage system that either images their hardcopy (paper) books and records, or transfers their computerized books and records, to an electronic storage media. Such a system may also include reasonable data compression or formatting technologies so long as the requirements of the revenue procedure are satisfied. The general requirements for an electronic storage system of taxpayer records are provided in section 4.01 of Rev. Proc. 97-22. A summary of these requirements is as follows:

- The system must ensure an accurate and complete transfer of the hardcopy books and records to the electronic storage system and contain a retrieval system that indexes, stores, preserves, retrieves, and reproduces all transferred information.

- The system must include reasonable controls and quality assurance programs that (a) ensure the integrity, accuracy, and reliability of the system; (b) prevent and detect the unauthorized creation of, addition to, alteration of, deletion of, or deterioration of electronically stored books and records; (c) institute regular inspections and evaluations; and (d) reproduce hardcopies of electronically stored books and records that exhibit a high degree of legibility and readability.

- The information maintained in the system must be cross-referenced with the taxpayer's books and records in a manner that provides an audit trail to the source document(s).

- The taxpayer must maintain, and provide to the Service upon request, a complete description of the electronic storage system including all procedures relating to its use and the indexing system.

- During an examination, the taxpayer must retrieve and reproduce hardcopies of all electronically stored books and records requested by the Service and provide the Service with the resources necessary to locate, retrieve, read and reproduce any electronically stored books and records.

- The system must not be subject, in whole or in part, to any agreement that would limit the Service's access to and use of the system.

- The taxpayer must retain electronically stored books and records so long as their contents may become material in the administration of federal tax law.

How does this general rule apply to refundings?

For certain federal tax purposes, a refunding bond issue is treated as replacing the original new money issue. To this end, the tax-exempt status of a refunding issue is dependent upon the tax-exempt status of the refunded bonds. Thus, certain material records relating to the original new money issue and all material records relating to the refunding issue should be maintained until thee (3) years after the final redemption of both bond issues.

Can a failure to properly maintain records be corrected?

Yes, a failure to properly maintain records can be corrected through the Tax- Exempt Bonds Voluntary Closing Agreement Program (TEB VCAP). This program provides an opportunity for state and local government issuers, conduit borrowers, and other parties to a tax-exempt bond transaction to voluntarily come forward to resolve specific matters through closing agreements with the IRS. For example, the TEB Office of Outreach, Planning & Review has resolved arbitrage rebate concerns in cases where issuers have approached the IRS and reported a failure to retain sufficient records to determine, precisely, the correct amount of arbitrage rebate due on a bond issue. Notice 2001-60, 2001-40 I.R.B. 304 provides more information about this program including the procedures for submitting a VCAP request.

Section 5. INVESTMENT AND ARBITRAGE COMPLIANCE

The bonds will lose their tax-exempt status if they are **arbitrage bonds** under section 148 of the Internal Revenue Code (the "Code"). In general, arbitrage is earned when the gross proceeds of an issue are used to acquire investments that earn a yield materially higher than the yield on the bonds of the issue. The earning of arbitrage does not, however, necessarily mean that the bonds are arbitrage bonds. Two general sets of requirements under the Code must be applied in order to determine whether governmental bonds are arbitrage bonds:

1. yield restriction requirements of section 148(a); and

2. rebate requirements of section 148(f).

An issue may meet the rules of one of the above regimes yet fail the other. Even though interconnected, both sets of rules have their own distinct requirements and may result in the need for a payment to the U.S. Department of the Treasury in order to remain compliant. The following is an overview of the basic requirements of these two general rules. Additional requirements or exceptions may apply in certain instances. The requirements that apply to a specific bond issue will be found in the bond transcript. Therefore, it is imperative that the individual who is responsible for investment and arbitrage review the bonds specific investment and arbitrage requirements.

Yield Restriction Requirements

The yield restriction rules of section 148(a) of the Code generally provide that the direct or indirect investment of the gross proceeds of an issue in investments earning a yield materially higher than the yield of the bond issue causes the bonds of that issue to be arbitrage bonds. While certain exceptions to these rules may be available, the term "materially higher" is generally applied to certain types of investments as follows:

TYPE OF INVESTMENT`	MATERIALLY HIGHER
General rule for purpose and nonpurpose investments	1/8 of one percentage point
Investment in a refunding escrow	1/1000 of one percentage point
Program Investments	1 ½ percentage points
General rule for investments in tax-exempt bonds	No yield limitation

However, the investment of proceeds in materially higher yielding investments does not cause the bonds of an issue to be arbitrage bonds in the following three instances:

1) during a temporary period (i.e., generally, 3-year temporary period for capital projects and 13 months for restricted working capital expenditures);

2) as part of a reasonably required reserve or replacement fund; and

3) as part of a minor portion (an amount not exceeding the lesser of 5% of the sale proceeds of the issue or $100,000).

In many instances, issuers are allowed to make "yield reduction payments" to the U.S. Department of the Treasury to reduce the yield on yield-restricted investments when the yield on those earnings is materially higher than the yield of the bond issue.

Reasonable Expectations

Typically, the determination of whether an issue consists of arbitrage bonds under section 148(a) is based on the issuer's reasonable expectations as of the issue date regarding the amount and use of the gross proceeds of the issue.

Intentional Acts

A deliberate, intentional action to earn arbitrage taken by the issuer or person acting on the issuer's behalf, after the issue date, will cause the bonds of an issue to be arbitrage bonds if that action, had it been reasonably expected on the issue date, would have caused the bonds to be arbitrage bonds. Intent to violate the requirements of section 148 is not necessary for an action to be intentional.

Rebate Requirements

The rebate requirements of section 148(f) of the Code generally provide that, unless certain earnings on nonpurpose investments allocable to the gross proceeds of an issue are paid to the U.S. Department of the Treasury, the bonds in the issue will be arbitrage bonds. The arbitrage that must be rebated is based on the excess (if any) of the amount actually earned on nonpurpose investments over the amount that would have been earned if those investments had a yield equal to the yield on the issue, plus any income attributable to such excess. Under section 1.148-3(b) of the Treasury regulations, the future values (as of the computation date) of all earnings received and payments made with respect to nonpurpose investments are included in determining the amount of rebate due. There are, however, two broad exceptions to the general rebate requirements applicable to governmental bonds: the small issuer exception; and the spending exceptions.

Small Issuer Exception

This exception provides that governmental bonds issued by certain small governmental issuers, with general taxing powers, are treated as meeting the arbitrage rebate requirement. A governmental entity has general taxing powers if it has the power to impose taxes of general applicability which, when collected, may be used for its general purposes.

An issue (other than a refunding issue) qualifies for the small issuer exception only if the issuer reasonably expects as of the issue date to issue, or in fact issues, $5 million or less in tax-exempt governmental bonds during that calendar year. The aggregation rules of section 148(f)(4)(D) of the Code should be considered when determining whether this exception applies. The $5 million limit shall be increased when financing public school capital expenditures by the lesser of $10 million or so much of the aggregate face amount of the bonds attributable to financing the construction.

Spending Exceptions

There are three spending exceptions to the rebate requirements as follows.

Spending Period	Spending Exception
6-month spending exception	Section 1.148-7(c) of the Treasury regulations provides an exception to rebate if the gross proceeds of the bond issue are allocated to expenditures for governmental or qualified purposes that are incurred within 6 months after the date of issuance.
18-month spending exception	Section 1.148-7(d) of the Treasury regulations provides an exception to rebate if the gross proceeds of the bond issue are allocated to expenditures for governmental or qualified purposes which are incurred within the following schedule:

	1) 15% within 6 months after the date of issuance; 2) 60% within 12 months after the date of issuance; and 3) 100% within 18 months after the date of issuance.
2-year spending exception	Section 1.148-7(e) of the Treasury regulations provides that an exception to rebate is available with respect to construction issues financing property to be owned by a governmental entity or 501(c)(3) organization when certain available construction proceeds are allocated to construction expenditures within the following schedule: 1) 10% within 6 months after the date of issuance; 2) 45% within 12 months after the date of issuance; 3) 75% within 18 months after the date of issuance; and 4) 100% within 24 months after the date of issuance.

Issuers may still owe rebate on amounts earned on nonpurpose investments allocable to proceeds not covered by one of the spending exceptions, which may include earnings in a reasonably required reserve or replacement fund.

Arbitrage Rebate/Yield Reduction Filing

Requirements—Form 8038-T

Issuers of tax-exempt bonds file IRS Form 8038-T, *Arbitrage Rebate and Penalty in Lieu of Arbitrage Rebate*, to make the following types of arbitrage payments:

1) yield reduction payments;
2) arbitrage rebate payments;
3) penalty in lieu of rebate payments;
4) the termination of the election to pay a penalty in lieu of rebate; and
5) penalty for failure to pay arbitrage rebate on time.

This form can also be downloaded from the Internet at *www.irs.gov/bonds*.

A yield reduction payment and/or arbitrage rebate installment payment is required to be paid no later than 60 days after the end of every 5th bond year throughout the term of a bond issue. The payment must be equal to at least 90% of the amount due as of the end of that 5th bond year. Upon redemption of a bond issue, a payment of 100% of the amount due must be paid no later than 60 days after the discharge date.

A failure to timely pay arbitrage rebate will be treated as not having occurred *if* the failure is not due to willful neglect and the issuer submits a Form 8038-T with a payment of the rebate amount owed,

plus penalty and interest. The penalty may be waived under certain circumstances. For more information, see section 1.148-3(h)(3) of the Treasury regulations.

Request for Recovery of Overpayment of Arbitrage Rebate—Form 8038-R

In general, a request for recovery of overpayment of arbitrage rebate can be made when the issuer can establish that an overpayment occurred. An overpayment is the excess of the amount paid to the U.S. Department of the Treasury for an issue under section 148 of the Code over the sum of the rebate amount for the issue as of the most recent computation date and all amounts that are otherwise required to be paid under section 148 as of the date the recovery is requested. The request can be made by completing and filing IRS Form 8038-R, *Request for Recovery of Overpayments Under Arbitrage Rebate Provisions*, with the IRS.

Section 6. PRIVATE BUSINESS USE

There are two types of bond categories, 1) governmental bonds and 2) private activity bonds. While interest on governmental bonds is not included in gross income (tax-exempt), private activity bonds includes interest in gross income (taxable) unless the bond is a qualified bond. Therefore, careful attention needs to be paid to the use or the bond proceeds and of the bond financed property.

Definition of Private Activity Bonds.

Private activity bonds are any bonds that meet specific private business use and payments tests or a private loan financing test. Interest paid on private activity bonds is taxable unless they are so-called "qualified" private activity bonds used to finance various purposes, such as:

- airports,
- docks and wharves,
- sewage or solid waste facilities,
- 501(c)(3) facilities,
- small business manufacturing,
- mortgage loans, and
- certain other facilities.

Other bonds issued to finance governmental purposes may be treated as private activity bonds if the amount of private involvement in the financed facilities is too high.

Reasonable Expectations.

The federal government uses a complicated series of rules to decide whether private involvement is too high. They are based on what the State or local governmental issuers reasonably expect at the time the bonds are issued and what the issuer or user of bond proceeds actually does after the issue date with the money and with the facilities built with bonds.

Private Business Tests

Congress established two sets of tests to determine who are the private beneficiaries of tax-exempt bond proceeds and how much they benefit. The most commonly used set of tests includes both a business use test and a private payments test. These tests limit private business use and require that interest and principal (debt service) on the bonds be paid primarily from government sources. The second set of tests, which will be discussed in detail below, is the private loan financing test. The private loan financing test prohibits governments from loaning money to private persons. The goals of all these tests are for bonds to be used for governmental purposes.

Congress meets these goals for the private business tests by a complicated set of rules. Bonds will be treated as taxable private activity bonds if more than 10% of the bond proceeds are used for private business, and if payment of more than 10% of the debt service on the bonds is directly or indirectly secured by an interest in property used for private business or is derived from payments in respect of property or borrowed money used for private business. Thus, if the tests are met, then the bonds are taxable.

Private Business Use

"Private business use" is defined as use of the bond proceeds or the bond financed facility for the trade or business of a non-governmental unit. This includes tax-exempt non-profits and the Federal government. Unrelated business income is not necessary for there to be a private business use.

Examples of private business use on a campus may include:

- Contracts for facility management
- Bookstore operations
- Food services
- Vending
- Private organization leases, contracts, agreements, regular usage
- Sports and entertainment events, performances
- Seminar events, groups
- Alumni associations
- Research agreements with private entities
- Student group service agreements with private entities (e.g. legal services, business services, design services etc.)
- Allowing members of certain groups access to services
- Naming rights
- Licensing agreements
- Leases

Private Business Users.

Bonds meet the private business use test if more than 10% of the proceeds are used in the trade or business of an entity that is not a State or local government. State or local government for these purposes includes any political subdivision, such as city, county, school district, sanitary district, housing and redevelopment commission, or road district established under state law. Other entities, including the federal government or charitable hospitals, are treated as private users.

Trade or business means any activity carried on by any corporation, partnership or other entity, and includes individuals who are acting in their trade or business. For example, a prison that is leased to the federal government to house federal prisoners violates the private business use test. Likewise, a municipal office building that is leased or sold to private corporations or to individuals doing business is a facility with private business use.

General Public Use Exception.

Although a toll bridge used by trucks, taxis, and other private business users is used in private business, under the Income Tax Regulations use as a member of the general public it is not treated as private use if the business use is on the same basis as the general public. Thus, if the toll bridge is intended to be available to the general

public, and is in fact available to the public, then use by private business is not counted to determine the 10% limit. Similarly, a city-owned parking garage used by the general public as well as business users on a first-come, first-served basis is not used in private business for purposes of the private business use test.

The regulations with respect to general public use also contain complicated provisions dealing with the extent long-term arrangements, some for as little as 30 days, may be treated as private business use even if the facility is otherwise available to the general public.

Private Business Arrangements.

A facility not used by the general public may be used for governmental or private business purposes. Some common types of private business arrangements that lead to private use include leases and certain management contracts that give the manager an interest as an owner or lessor in the property. For example, a management contract that provides for compensation based on a share of net profits from the facility gives the manager an ownership interest, because the manager may benefit from a profitable operation or runs the risk of loss if the operation is unsuccessful.

In addition, an arrangement that conveys priority rights to the use or capacity of a facility, such as the right to take a stated percentage of a power plant or the right to use a specific area of a parking garage or set the parking rates in the garage, will lead to private business use.

Measurement of Private Business Use.

The amount of private business use of property is based on the economic life of the property and the maturity of bonds issued to finance the property. The private use is averaged over time comparing the governmental use with the private use. Again, a series of complicated rules assist in determining the manner in which private use is averaged and what private use is taken into account.

Private Security or Payment Test.

The private security or payment test deals with the source of payment, and the security, for bonds.

Private Payments.

The private payment portion of the test takes into account the payment of debt service on the bonds derived from payments in respect of property or borrowed money used for private business. For example, if a city issues bonds to build a 4-story municipal office building and leases one of the floors to a private business, then that floor (25% of the bond-financed building) is used for private business purposes.

Private Security.

The private security portion of the test takes into account the payment of the debt service on the bonds secured by an interest in property used for private business or payments in respect of property used for private business. For example, the city uses general obligation bond proceeds for an urban renewal project to purchase and rehabilitate downtown properties, then sells or leases the improved buildings to private businesses. The payments from the leases and sales are treated as payments securing the bonds. The underlying property may also be treated as security for the bonds, if the bondholders could foreclose on the properties.

Generally Applicable Taxes.

What is not taken into account as private payments or security are “generally applicable taxes.” These are defined as “enforced contributions” pursuant to legislative authority imposed and collected for the purpose of raising revenue for government purposes. For example, property taxes are generally applicable taxes. A tax limited to the property or a person benefited by an improvement is not a generally applicable tax. For example, a stadium built for a professional sports team and financed with bonds to be paid from a countywide sales tax would be financed through generally applicable taxes. Ticket taxes on the sports team’s games at the stadium,

however, are not generally applicable taxes. (See also the section below regarding tax assessment loans for essential governmental functions.)

Private Letter Rulings and Revenue Procedures

This manual includes private letter rulings and revenue procedures to assist the board and staff better understand private business use rule interpretation by the Internal Revenue Service. It is recommended that the board and staff review Section Private Business Use Private Letter Rulings and Revenue Procedures

Section 7. SECURITIES LAW DISCLOSURE FOR MUNICIPAL SECURITIES (SEC Rule 15c2-12)

Introduction (SEC RULE 15C2-12)

Historically, local governments have been largely exempt from ongoing reporting requirements for their bonds, notes or other securities. The practice in the industry was to prepare disclosure, usually in the form of an Official Statement, only when engaged in a new offering of municipal securities. Now, however, the rules have changed. Disclosure does not stop upon successful completion of the primary offering. Rather, the U.S. Securities and Exchange Commission (the"SEC") has declared that future investors trading in the secondary market are entitled to receive virtually the same level of information that was furnished in the primary offering stage.

For municipal securities issued after July 3, 1995, SEC Rule 15c2-12 (the "Rule") mandates continuing disclosure unless the bonds qualify for an exemption from the Rule. Specific exemptions are discussed in greater detail below. The Rule does not apply to municipal securities issued before July 3, 1995.

Who must provide continuing disclosure?

The Rule applies to "obligated persons," which the SEC defines as: any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account ... committed by contract or other arrangements to support payment of all, or part of the obligations on municipal securities....". The key to identifying the obligated person(s) is a "nexus" to the financing through contract or other arrangements structured to support payment of the bonds. The Rule requires disclosure commitment from those parties for whom financial information and operating data are presented in the Official Statement are covered. Thus, a purely conduit issuer of nonrecourse revenue bonds may opt out of continuing disclosure so long as the conduit borrower contracts to provide secondary market information. For pooled financings with multiple participants, objective criteria (e.g., percentage of overall payment support) will determine the identity of the appropriate disclosure parties are.

The Rule excludes providers of most forms of credit enhancement (bond insurance).

How are disclosure obligations determined?

The undertaking to provide continuing disclosure may be included in the principal documents under which the securities are issued (e.g., the trust indenture, ordinance, or resolution), or it may be included in a separate agreement or certificate entered into for the benefit of bondholders.

An underwriter must receive reasonable assurance regarding the continuing disclosure commitment before agreeing to act as underwriter. In negotiated offerings, this assurance will be obtained at the time of signing the underwriting agreement or bond purchase contract. In competitive offerings, such assurance should be contained in the issuer's notice of sale.

The Rule allows for delegation of information dissemination responsibilities to designated agents or to indenture trustees. The Rule does not enumerate the consequences if an issuer breaches its disclosure undertaking. Remedies for breach will vary under state law and, the SEC concludes, are a subject for negotiations between the parties. The Rule does require, however, that issuers disclose in their final Official Statements all instances in the previous five years in which they have failed to comply with any continuing disclosure obligations.

What must be disclosed?

Two areas must be disclosed under the Rule: annual financial information and certain material events. Annual financial information is defined as, "financial information or operating data, provided at least annually, of the type included in the final Official Statement with respect to an obligated person."

The Rule does not dictate strict form and content requirements for what constitutes the "annual financial information." The written undertaking by the issuer or obligated person, as well as the final Official Statement,

must specify in reasonable detail those categories of information that will be included. The undertaking must also specify the date by which the annual financial information will be provided (e.g., so many days following the end of the fiscal year).

The undertaking must describe the accounting principles used in preparation of the annual financial information, including whether or not audited financial statements will be prepared. An undertaking that references generally accepted accounting principles (GAAP), as modified by the Government Accounting Standards Board (GASB), or mandated state statutory principles as in effect from time to time would satisfy this provision of the Rule.

"Operating data" is a subset of annual financial information and refers to quantitative information given in the Official Statement to help investors place the financial information in context. For example, in a health care financing, operating data would include a description of hospital administration and management, service area and economic base, capital plan and operating statistics (such as bed use), admissions criteria, payor utilization, etc.

Since the Rule's enactment, the final Official Statement has assumed even greater significance because it serves as the template for future disclosure. It establishes which elements of a financing are "material" and therefore subject to ongoing disclosure. Issuers and obligated persons should carefully consider both the content and the context of how financial information is presented in the final Official Statement. Since the Rule requires that financial information and operating data "of the type" in the Official Statement be updated annually, issuers should consider formatting their Official Statements to group all material financial information and operating data under one or more conspicuous headings to highlight the information which investors should expect to be updated annually.

In addition to annual disclosure of financial information, the Rule requires "timely" disclosure of eleven listed events, if material. These are:

1) Principal and interest payment delinquencies.

2) Non-payment related defaults.

3) Unscheduled draws on debt service reserves reflecting financial difficulties.

4) Unscheduled draws on credit enhancement reflecting financial difficulties.

5) Substitution of credit or liquidity providers or their failure to perform.

6) Adverse tax opinions or events affecting the tax-exempt status of the securities.

7) Modifications to rights of security holders.

8) Bond calls.

9) Defeasances.

10) Release, substitution or sale of property securing repayment of the security.

11) Rating changes.

12) Failure to provide annual financial information by the date specified in the written undertaking is also a disclosure item.

The determination of whether other events also should be the subject of notification is left to the parties. But issuers should beware of undertaking to provide notice of material events beyond those specifically listed in the Rule. Issuers may provide notice of other events as they see fit, but should not contractually obligate themselves to do so. Undertakings that expand the list of eleven with open-ended disclosure commitments like "... and any other material events" should be avoided.

The SEC does not specify what constitutes "timely" disclosure due to the wide variety of events and issuer circumstances. In general, the determination must take into account the time needed to discover the event, assess its materiality, and prepare and disseminate the notice.

Where are disclosures made?

Annual financial information must be submitted:

(i) to each Nationally Recognized Municipal Securities Information Repository (abbreviated in the Rule as "NRMSIR"), and

(ii) to the appropriate state information depository, if there is one. Beginning July 1, 2009, the SEC has designated the Municipal Securities Rulemaking Board (MSRB), http://emma.msrb.org/ to act as NRMSIRs.

Disclosure of material events must be made (i) to each NRMSIR or to the Municipal Securities Rulemaking Board (the "MSRB") which will notify the NRMSIRs, and (ii) to the appropriate state information depository, if any. Obviously, the simplest route in terms of material event disclosure is a single filing with the MSRB.

Starting July 1, 2009, disclosures will be made solely to the MSRB's Electronic Municipal Market Access (EMMA).

Can the disclosure undertaking be modified or terminated?

Generally, the undertaking to provide continuing disclosure may not be modified after the fact. However, an undertaking that includes an amendment provision may comply with the Rule if certain conditions are met. An issuer or obligated person may terminate their continuing disclosure obligations when they cease to have any liability for payment on the bonds. The SEC has stated that this occurs upon (i) redemption in full of the securities, or (ii) legal defeasance and release of any lien securing the bonds.

Although it is not expressly permitted by the Rule, many issuers include a provision authorizing them to terminate their disclosure undertaking if they obtain an opinion of bond counsel.

Are there any exemptions from continuing disclosure?

1) Bond issues of less than $1 million in aggregate principal amount are exempt from the Rule altogether.

2) Bond issues in large minimum denominations (i.e., $100,000 or more) are exempt from the Rule if:

    a. They are privately placed with no more than 35 sophisticated investors; or

    b. They have a maturity of 9 months or less; or

    c. They may be optionally tendered at par at least every 9 months.

Effectively, this means that most private placements and variable rate issues are exempt from the Rule.

3) Short-term notes and other municipal securities whose stated maturity is 18 months or less are exempt from the financial information disclosure requirements of the Rule. However, issuers must still undertake to provide timely notice of material events.

4) Prior to July 1, 2009, municipal securities whose issuer or obligated person has less than $10 million aggregate outstanding amount of municipal securities (including those being issued) on the issuance date qualify for a limited exemption from the Rule. Specifically, it is an exemption from the annual financial information filing requirement. However, the obligated person(s) must still undertake to provide upon request to any person (or at least annually to the appropriate state information depository, if any) financial information or operating data. The information and data must include at least that which is customarily prepared by such obligated person and is publicly available. Furthermore, under the limited exemption the obligated person must undertake to provide timely notice of material events.

AFTER JULY 1, 2009, THE ISSUER OR OBLIGATED PERSON WILL BE REQUIRED ANNUALLY TO FINAL ANNUAL REPORTS AND FINANCIAL INFORMATION AND IF AVAILABLE AUDITED FINANCIAL INFORMATION.

Conclusion

Rule 15c2-12 affects different bonding programs in different ways, particularly with respect to the "obligated person" analysis. Issuers must consider the kinds of debt they issue (e.g., general obligation, revenue, special assessment, etc.) and their own unique circumstances. This would include establishing a protocol for who will speak on an issuer's behalf and when, what they will say and how they will say it. Issuers with multiple bonding programs should also try to maintain consistency in their contractual undertakings. Standardizing the form of undertaking and the schedule for reporting should ease some of the administrative burden of providing continuing disclosure on numerous programs. Finally, when in doubt about disclosure obligations, issuers should consult with their bond counsel.

Municipal Secondary Market Disclosure Information Cover Sheet

This cover sheet should be sent with all submissions made to the Municipal Securities Rulemaking Board, Nationally Recognized Municipal Securities Information Repositories, and any applicable State Information Depository, whether the filing is voluntary or made pursuant to Securities and Exchange Commission rule 15c2-12 or any analogous state statute.

See www.sec.gov/info/municipal/nrmsir.htm for list of current NRMSIRs and SIDs

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IF THIS FILING RELATES TO A SINGLE BOND ISSUE:

Provide name of bond issue exactly as it appears on the cover of the Official Statement (please include name of state where Issuer is located):

_____

_____

_____

_____

_____

Provide nine-digit CUSIP* numbers if available, to which the information relates:

_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

IF THIS FILING RELATES TO ALL SECURITIES ISSUED BY THE ISSUER OR ALL SECURITIES OF A SPECIFIC CREDIT OR ISSUED UNDER A SINGLE INDENTURE:

Issuer's Name (please include name of state where Issuer is located): _____

Other Obligated Person's Name (if any): _____
(Exactly as it appears on the Official Statement Cover)

Provide six-digit CUSIP* number(s) if available, of Issuer: _____

*(Contact CUSIP's Municipal Disclosure Assistance Line at 212.438.6518 for assistance with obtaining the proper CUSIP numbers.)

TYPE OF FILING:

☐ Electronic (number of pages attached) _____ ☐ Paper (number of pages attached) _____

If information is also available on the Internet, give URL: _____

WHAT TYPE OF INFORMATION ARE YOU PROVIDING? (Check all that apply)

A. ☐ Annual Financial Information and Operating Data pursuant to Rule 15c2-12
(Financial information and operating data should not be filed with the MSRB.)

Fiscal Period Covered: _____

B. ☐ Financial Statements or CAFR pursuant to Rule 15c2-12

Fiscal Period Covered: _____

C. ☐ Notice of a Material Event pursuant to Rule 15c2-12 (Check as appropriate)

1. ☐ Principal and interest payment delinquencies
2. ☐ Non-payment related defaults
3. ☐ Unscheduled draws on debt service reserves reflecting financial difficulties
4. ☐ Unscheduled draws on credit enhancements reflecting financial difficulties
5. ☐ Substitution of credit or liquidity providers, or their failure to perform
6. ☐ Adverse tax opinions or events affecting the tax-exempt status of the security
7. ☐ Modifications to rights of security holders
8. ☐ Bond calls
9. ☐ Defeasances
10. ☐ Release, substitution, or sale of property securing repayment of the securities
11. ☐ Rating changes

D. ☐ Notice of Failure to Provide Annual Financial Information as Required

E. ☐ Other Secondary Market Information (Specify): _____

I hereby represent that I am authorized by the issuer or obligor or its agent to distribute this information publicly:

Issuer Contact:

Name _____ Title _____

Employer _____

Address _____ City _____ State _____ Zip Code _____

Telephone _____ Fax _____

Email Address _____ Issuer Web Site Address _____

Dissemination Agent Contact, if any:

Name _____ Title _____

Employer _____

Address _____ City _____ State _____ Zip Code _____

Telephone _____ Fax _____

Email Address _____ Relationship to Issuer _____

Obligor Contact, if any:

Name _____ Title _____

Employer _____

Address _____ City _____ State _____ Zip Code _____

Telephone _____ Fax _____

Email Address _____ Obligor Web Site Address _____

Investor Relations Contact, if any:

Name _____ Title _____

Telephone _____ Email Address _____

Section 8. VOLUNTARY CLOSING AGREEMENT PROGRAM

The IRS has developed the Voluntary Closing Agreement Program (VCAP) which encourages bond issuers to comply with the Internal Revenue Code and provides a vehicle for issuers to correct violations. The most common use of the VCAP settlement agreements has been in the following five areas:

- **Change in Use** – Unapproved change in use of the proceeds on the bonds.
- **Arbitrage/Excess Yield** - Issuer's investments earned a yield materially higher than the yield on the bonds of the issue.
- **Guaranty-** Bonds were inappropriately directly or indirectly guaranteed by the Federal Government with respect to the payment of principal or interest.
- **Hospital Closing Agreements**-Hospital affiliation transactions where 501(c)(3) organizations agreed to inappropriately merge their operations.
- **SLGS Arbitrage**- Impermissible use of bond proceeds by Issuers to acquire a higher yielding investment or to replace funds used to acquire higher yielding investments.

If a problem arises with respect to the bond issue, the issuer needs to know the appropriate use of VCAP. Notice 2008-31 is provided hereafter.

Voluntary Closing Agreement Program For Tax-Exempt Bonds and Tax Credit Bonds

Notice 2008-31

SECTION 1. PURPOSE

This Notice provides information about the voluntary closing agreement program for tax-exempt bonds and tax credit bonds ("TEB VCAP"). In particular, the Notice updates procedures whereby issuers of tax-exempt bonds and tax credit bonds can resolve violations of the Internal Revenue Code (the "Code") through closing agreements with the Internal Revenue Service (the "Service"). The Tax Exempt Bonds Compliance & Program Management ("TEB CPM") function of Tax Exempt and Government Entities (TE/GE) is continuing to develop voluntary compliance initiatives to insure compliance by issuers of tax-exempt bonds and tax credit bonds with applicable provisions of the Code. TEB VCAP is part of the TEB CPM voluntary compliance initiatives and provides appropriate remedies when issuers voluntarily come forward and express a desire to resolve violations of the Code. TEB VCAP is intended to encourage issuers and conduit borrowers to exercise due diligence in complying with the Code and to provide a vehicle to correct violations of the Code. It is the continuing policy of the Service to attempt to resolve violations of the Code without taxing bondholders. TEB VCAP reflects this policy.

The Service is continuing to work on more detailed procedures about the program, and intends to provide those procedures in forthcoming guidance. For example, the Service anticipates specifying standardized closing agreement terms and amounts for particular violations.

SECTION 2. CHANGES

This Notice modifies and supersedes Notice 2001-60, 2001-2 C.B. 304. In general, Notice 2001-60 is amended by: (1) changing references to Outreach Planning and Review (OPR) to Compliance & Program Management (CPM); (2) incorporating tax credit bonds into the TEB VCAP program; (3) simplifying section 5(a) by referring to

Internal Revenue Manual ("IRM") 7.2.3 for the specific information required for a VCAP submission; (4) clarifying that under section 5(b) CPM staff will obtain additional information as needed; (5) clarifying that all information for a VCAP submission must be provided in electronic format; and (6) providing email and regular mail addresses for submissions.

SECTION 3. BACKGROUND

Gross income does not include interest on any state or local bond that meets the requirements of section 103 and related provisions of the Code. A credit against tax is provided to a holder of a qualified tax credit bond issued under sections 54, 1397E or 1400N that meets the requirements of those sections and related provisions of the Code. Under certain circumstances, an issuer may take remedial action under provisions such as sections 1.141-12, 1.142-2, 1.144-2, 1.145-2, and 1.147-2 of the Income Tax Regulations and similar provisions that are applicable to tax credit bonds in order to cure a violation of the Code.

The Service has previously provided formal tax-exempt bond closing agreement programs such as the program described in Rev. Proc. 97-15, 1997-1 C.B. 635. Violations of section 103 and related provisions of the Code that cannot be remediated under existing remedial action provisions or other tax-exempt bond closing agreement programs contained in regulations or other published guidance may be resolved by entering into a closing agreement under TEB VCAP.

Section 7121 of the Code and the regulations thereunder authorize the Commissioner to enter into written closing agreements with any person in connection with the tax liability of such person (or of the person or estate for which he acts). Section 301.7121-1 of the Income Tax Regulations provides, in part, that a closing agreement may be entered into in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or if good and sufficient reasons are shown by the taxpayer for desiring a closing agreement and it is determined by the Commissioner that the United States will sustain no disadvantage through consummation of such an agreement.

SECTION 4. SCOPE OF TEB VCAP

Under TEB VCAP, an issuer may request a closing agreement with respect to its bonds to resolve violations of sections 103, 54, 1397E, 1400N and related provisions of the Code. TEB VCAP is not available when:

(a) Absent extraordinary circumstances, the violation can be remediated under existing remedial action provisions or tax-exempt bond closing agreement programs contained in regulations or other published guidance.

(b)The bond issue is under examination. A bond issue is generally treated as

under examination on the date a letter opening an examination on the bond issue is sent.

(c) The tax-exempt status of the bonds or qualified status of tax credit bonds is at issue in any court proceeding or is being considered by the IRS Office of Appeals.

(d) The Service determines that the violation was due to willful neglect.

SECTION 5. PROCEDURES FOR REQUESTING A CLOSING AGREEMENT UNDER TEB VCAP

(a) Information Required in Requests. An issuer or its authorized representative requesting a closing agreement must submit the information specified in IRM 7.2.3 and the information reporting return for the applicable bonds on IRS Form 8038 or other comparable form that was filed with respect to the issue. (For convenience of reference, the relevant portions of the Internal Revenue Manual (IRM) are available on the IRS website, at www.irs.gov, in the section on the Tax-Exempt Bond Community, under the subheading of Published Guidance.) All information concerning the closing agreement must be submitted under penalty of perjury signed by an official of the issuer with knowledge of the issue and authorized to make the submissions on behalf of the issuer. The request may also contain a Form 2848 with the name, address, phone number, and fax number of an authorized contact person.

(b) Additional Information for Requests. CPM staff may require additional information depending on the facts and circumstances. All additional information must be submitted under penalty of perjury signed by the person who initially signed the submission or who would have been authorized to make the original submission.

(c) Electronic Format. All information submitted in support of a closing agreement request must be provided in an electronic format that is either emailed in PDF format or provided on a compact disc ("CD") sent via regular mail to the address provided by this Notice. Hard copies of the submissions can be provided but are not required.

(d) Anonymous Closing Agreement Requests. An issuer or its authorized representative may initiate discussions regarding the appropriate terms of a closing agreement on an anonymous basis. An anonymous request may be made on behalf of a group of similarly situated issuers. However, the execution of a closing agreement must be between the Service and a disclosed issuer, and all terms of a closing agreement must be consistent with section 7121 of the Code. Until the name of the bond issue is disclosed to the Service, a request for a closing agreement under TEB VCAP will not prevent the Service from beginning an examination of the bond issue. An issue for which a request has been submitted under this paragraph (d) that has been placed under examination prior to the date the issue is identified to the Service will no longer be eligible for TEB VCAP.

(e) TEB VCAP Mailing Address. TEB VCAP submissions should be mailed to:

Internal Revenue Service Attn: TEB VCAP 1122 Town & Country Commons St. Louis, MO 63017

(f) TEB VCAP E-Mail Address. In the alternative, VCAP information may be submitted in PDF format to TEBVCAP@irs.gov. TEB CPM will provide an acknowledgement of receipt of an email request.

SECTION 6. CLOSING AGREEMENT TERMS

Closing agreements under TEB VCAP will generally follow the model closing agreement in IRM 4.81.1, Exhibit 9, as the same may be modified or changed. Specific closing agreement terms will depend on the facts and circumstances of the case, including the degree of diligence exercised by the issuer and any conduit borrower. Any standardized closing agreement terms that are developed for TEB VCAP will be set forth in the Internal Revenue Manual and/or other published guidance.

SECTION 7. EFFECT OF CLOSING AGREEMENT EXECUTED UNDER TEB VCAP

A closing agreement properly executed by the issuer and the Service will protect bondholders from including in their gross income any interest on the bonds or from recapturing tax credits during the period specified in the agreement for any violation described in the agreement. A closing agreement executed under section 7121 of the

Code shall be final and conclusive except that: (1) the matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of a material fact; (2) it is subject to the sections of the Code that expressly provide that effect be given to their provisions (including any stated exception for section 7122 of the Code) notwithstanding any other law or rule of law; and (3) it is subject to any law, enacted after the date of the agreement, that applies to a tax period ending after the date of the agreement covered by the agreement.

SECTION 8. REQUESTS FOR COMMENTS

We anticipated that TEB VCAP will continue to be expanded and refined over time based on experience and public comment. The Service welcomes comments regarding the format and operation of TEB VCAP, and suggestions with regard to the general framework of closing agreement terms including standardized closing agreement terms and amounts that may be specified for particular violations. Comments should be submitted in writing and should be emailed to

Steven.A.Chamberlin@irs.gov or mailed to the following address:

Steven A. Chamberlin Manager, Tax Exempt Bonds Compliance & Program Management SE:T:GE:TEB:CPM 1122 Town & Country Commons St. Louis, MO 63017

SECTION 9. EFFECT ON OTHER DOCUMENTS

Notice 2001-60, 2001-2 C.B. 304, is modified and superceded.

SECTION 10. EFFECTIVE DATE

TEB VCAP is effective February 27, 2008.

SECTION 11. DRAFTING INFORMATION

The principal authors of this notice are Steven A. Chamberlin of Tax Exempt Bonds Compliance & Program Management, Tax Exempt & Government Entities, and Carla Young of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice contact Steven Chamberlin at (636) 255-1290 or Carla Young at (202) 622-3980 (not toll-free calls).

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IRM 7.2.3 Tax Exempt Bonds Voluntary Closing Agreement Program

7.2.3.1 In General

1. This section sets forth procedures for the voluntary closing agreement program for tax-exempt bonds and tax credit bonds known as TEB VCAP. Through TEB VCAP, issuers of tax-exempt bonds and tax credit bonds can voluntarily resolve violations of the Internal Revenue Code (the "Code") on behalf of their bondholders through closing agreements with the Service.

2. The Tax Exempt Bonds Compliance & Program Management ("CPM") function is responsible for the administration and oversight of TEB VCAP as part of its voluntary compliance initiatives. The TEB VCAP Inventory Coordinator will review the operations of the program and report to the Manager, Compliance & Program Management.

3. Notice 2008-31 provides general guidance on the scope of authority and procedural requirements applicable to TEB VCAP.

7.2.3.1.1 Objectives

1. The primary objective of TEB VCAP is to encourage issuers and other parties to the tax-exempt bond or tax credit bond transaction to exercise due diligence in complying with the Code and applicable Income Tax Regulations (the "Regulations") and to provide a vehicle to correct violations of the Code and applicable Regulations as expeditiously as possible.

2. TEB VCAP reflects the continuing policy of TEB to attempt to resolve all violations of federal tax law applicable to tax-exempt bonds and tax credit bonds at the transaction level instead of the bondholder level.

7.2.3.1.2 Scope

1. Gross income does not include interest on any state or local bond that meets the requirements of section 103 and related provisions of the Code. Violations of section 103 or related provisions of the Code or applicable Regulations may be resolved under TEB VCAP with certain exceptions.

2. A credit against tax is provided to a holder of a qualified tax credit bond issued under section 54, 1397E or 1400N that meets the requirements of those sections and related provisions of the Code. Violations of section 54, 1397E or 1400N or related provisions of the Code or applicable Regulations may be resolved under TEB VCAP with certain exceptions.

3. TEB VCAP is generally not available if, absent extraordinary circumstances, the violation can be remediated under existing remedial action provisions or tax-exempt bond closing agreement programs contained in regulations or other published guidance.

An issuer may remediate violations impacting tax-exempt bonds under sections 1.141-12, 1.142-2, 1.144-2, 1.145-2, and 1.147-2 of the Regulations.

An issuer may remediate violations impacting tax credit bonds under section 1.1397E-1T(h)(7) of the Regulations.

An issuer may resolve certain violations resulting from a change in the use of tax-exempt bond proceeds or tax-exempt bond-financed property through the execution of a closing agreement under the program described in Rev. Proc. 97-15, 1997-1 C.B. 635.

4. TEB VCAP is not available if the bond issue is under examination. A bond issue is generally treated as under examination on the date a letter opening an examination on the bond issue is sent.

5. TEB VCAP is not available if the tax-exempt status of the tax-exempt bonds or qualified status of the tax credit bonds is at issue in any court proceeding or is being considered by the IRS Office of Appeals.

6. TEB VCAP is not available if TEB determines that the violation was due to willful neglect.

7.2.3.1.3 Effect of TEB VCAP Closing Agreement

1. Closing agreements, including closing agreements executed under TEB VCAP, are final and conclusive and may not, in the absence of fraud, malfeasance, or misrepresentation of material fact, be reopened as to matters agreed upon or be modified by an officer, employee or agent of the United States.

2. Any violation resolved pursuant to a closing agreement under TEB VCAP will not be reopened by the Service in any future examination of the tax-exempt bond issue or tax credit bond issue unless so permitted under section 7121 of the Code.

7.2.3.1.4 Audit Selection of VCAP Cases

1. Absent extraordinary circumstances, a bond issue will not be classified and selected for examination while it is under review in TEB VCAP.

2. Any bond issue previously reviewed in TEB VCAP will be subject to general or project classification and may be selected for examination. However, the resolution of any specific violation through a closing agreement under TEB VCAP will be final and conclusive and may not be reconsidered under examination unless so permitted under section 7121 of the Code.

7.2.3.1.5 Special Procedures for Anonymous Requests

1. A TEB VCAP request may be submitted to inquire as to the appropriate resolution terms for an identified violation on an anonymous basis. The anonymous request option is intended to assist issuers in evaluating complex or unique violations as part of their post-issuance compliance due diligence. It is not intended to encourage issuers to delay the submission of a fully disclosed TEB VCAP request relating to relatively simple or straightforward violations. As such, when evaluating an anonymous request concerning a straightforward violation, CPM will consider whether the submission of the anonymous request represents a less than good faith effort on the part of the issuer to resolve the identified violation as expeditiously as possible.

2. An anonymous request may be made on behalf of one issuer or a group of similarly situated issuers. However, the execution of a closing agreement must be between the Service and a disclosed issuer, and all terms of a closing agreement must be consistent with section 7121 of the Code.

3. Until the name of the issuer and the bond issue are disclosed to the Service, a request for a closing agreement under TEB VCAP will not prevent the Service from beginning an examination of the bond issue. An issue relating to an anonymous request which has been opened for examination prior to identification to CPM will no longer be eligible for TEB VCAP.

7.2.3.1.6 Information Required in Submission Request

1. The following information and items are required to be included in a TEB VCAP submission request. The failure to include any of these items will result in CPM declining to consider the request.

2. An issuer or its authorized representative requesting a closing agreement under TEB VCAP must submit a statement(s) under penalty of perjury including the following information:

    A. Information identifying the governmental issuer of the bond issue including: (1) the name; (2) employer identification number; (3) street address, city, state, and zip code; and (4) name, title, and telephone number of an official of the issuer who may be contacted for additional information.

B. Information identifying the bond issue including: (1) the name of the bond issue; (2) issue price; (3) final maturity date; (4) CUSIP number; and (5) type of Form 8038 series information return filed with respect to the issuance of the bonds.

C. Information identifying the violation including: (1) a clear statement of the specific federal tax requirement which is the subject of the violation; (2) a description of the violation, including its nature, when it occurred, and the facts and circumstances surrounding it; and (3) a statement as to when and how the violation was discovered.

D. Description of the proposed settlement terms for resolving the identified violation. If the proposal includes the payment of a closing agreement amount, include a description of the computation methodology determining the amount and a statement that such payment will not be made with proceeds of bonds described under IRC section 103. If the proposal includes the redemption, defeasance, or tender of any amount of the bonds comprising the bond issue, include a statement of the source of funds to be used to effectuate such action.

E. Statements of good faith including: (1) a statement that the bond issue is not under examination, the subject in any court proceeding, or under consideration by the IRS Office of Appeals; (2) a statement that, on the issue date, the issuer reasonably expected to comply with section 103 and all related provisions of the Code; (3) a description of the policies or procedures which have been or will be implemented to prevent this type of violation from recurring with this or any other bond issues; and (4) a statement that the request for a closing agreement was promptly undertaken upon the discovery of the violation.

3. The statement(s) described in paragraph (2) above must be submitted under the following declaration, signed by the party making the submission: "Under penalties of perjury, I declare that I have examined this submission, including accompanying documents and statements, and to the best of my knowledge and belief, the submission contains all the relevant facts relating to the request, and such facts are true, correct, and complete."

4. The request must include a copy of the Form 8038 series information return filed in connection with the issuance of the bond issue.

5. The request may include an executed Form 2848, Power of Attorney and Declaration of Representative, declaring a representative authorized to represent the issuer before the Service with respect to the bond issue.

7.2.3.1.7 Receipt and Perfection of Submission Request

1. Submission requests under TEB VCAP are typically emailed to TEBVCAP@irs.gov and/or may be mailed to:

Internal Revenue Service
Attn: TEB VCAP
1122 Town & Country Commons
St. Louis, MO 63017

2. Upon receipt of a TEB VCAP submission request, the TEB VCAP Inventory Coordinator will review the submission request to verify that all of the required information described in section 7.2.3.1.6 is complete.

3. If the submission request is complete, the Coordinator will process the case for assignment in accordance with section 7.2.3.2.

4. If the submission request is not complete, the Coordinator will provide the issuer with written notification that the request has been received, but that certain missing information is required before the request can be processed for assignment. The Coordinator will also contact the authorized representative (if any) by telephone to request the missing information. If the Coordinator is unable to obtain the missing information after reasonable attempts, the submission request will be closed without resolution.

7.2.3.2 TEB VCAP Case Processing Procedures

1. This section sets forth the case processing procedures for TEB VCAP cases.

7.2.3.2.1 Case Establishment and Assignment

1. Upon determining that the submission request is complete, the TEB VCAP Inventory Coordinator will request that the TEB Inventory Processing Unit establish a compliance activity within the TE/GE Reporting & Electronic Examination System ("TREES") for the TEB VCAP case. For this purpose, each individual Form 8038 series information return relating to the submission request is established as a separate compliance activity.

2. Once the compliance activity is established within TREES, the Manager, Compliance & Program Management ("CPM Manager") will assign the activity to a CPM specialist. A CPM team leader will concurrently be assigned as a reviewer.

7.2.3.2.2 Case Development

1. Upon receipt of an assigned TEB VCAP case within TREES, the specialist will notify the issuer or its authorized representative of the specialist’s contact information.

2. Upon initiation of the case, the specialist will update the case to status 12 within TREES and notify the TEB VCAP Inventory Coordinator of the status update. The specialist will review the submission request to determine if any additional information is necessary. If additional information is necessary, the specialist will request the information from the issuer or its authorized representative and will generally follow up with a written request specifying the information requested and the due date.

3. Upon receipt of all required information, the specialist (with the assistance of the assigned reviewer) will analyze the information, make a determination as to the recommended resolution of case, and take appropriate steps for case resolution.

If the violation identified in the submission request is covered in section 7.2.3.3, the specialist will prepare the Committee Briefing Memorandum following the applicable resolution standards and forward the Committee Briefing Memorandum through the reviewer to the CPM Manager for review and concurrence.

If the violation identified in the submission request is not covered in section 7.2.3.3, the specialist will prepare a Memorandum for Reviewers which will include a discussion of the key facts, applicable law, issuer’s proposed settlement offer, and specialist’s recommendation for case resolution. The specialist will forward the Memorandum for Reviewers through the reviewer to the CPM Manager for review and concurrence.

If it is determined to resolve the case through the execution of a closing agreement, upon concurrence of the CPM Manager, the specialist will prepare and forward both a Committee Briefing Memorandum and a draft closing agreement through the reviewer to the CPM Manager for review and concurrence.

If it is determined to resolve the case through correspondence (e.g. an anonymous request), upon concurrence of the CPM Manager, the specialist will prepare and forward both a Committee Briefing Memorandum and the appropriate resolution letter through the reviewer to the CPM Manager for review and concurrence.

7.2.3.2.3 Case Resolution

1. If the proposed resolution requires approval of the TEB Closing Agreement Committee, the CPM Manager will forward the Committee Briefing Memorandum to the Closing Agreement Committee for review. If approved by the Committee, upon notification from the CPM Manager, the specialist will follow the closing agreement execution procedures provided in section 7.2.3.2.4. If disapproved by the Committee, the CPM Manager will notify the specialist of the need for further development.

2. If the proposed resolution does not require approval of the TEB Closing Agreement Committee, the CPM Manager will review the resolution letter and notify the specialist of concurrence or the need for further development. Upon approval of the CPM Manager, the specialist will prepare the case for closure.

7.2.3.2.4 Closing Agreement Execution

1. Upon approval of the draft closing agreement by the CPM Manager, the specialist will forward the draft to the issuer or its authorized representative for comments. The specialist will discuss any comments with the reviewer and CPM Manager and make any necessary changes.

2. Once the closing agreement is finalized, the specialist will electronically send the final closing agreement, the transmittal letters (i.e., the execution cover letter and transmittal letter to power of attorney) to the TEB VCAP Inventory Coordinator. The Coordinator will make the required number of agreement copies (number of signatories plus one), coordinate the signing of the transmittal letters and mail the package to the issuer. A copy of the closing agreement and transmittal letter to the issuer will be mailed to the authorized representative.

3. The Coordinator will notify the specialist following the mailing of the packages. The specialist will notify the issuer or its authorized representative that the closing agreements have been mailed. The specialist will also remind the issuer or its authorized representative that: (i) the closing agreement payment (if any) must be submitted prior to execution; (ii) the executed agreements must be returned to the CPM office in St. Louis, Missouri; and (iii) a copy of the confirmation of the Electronic Federal Tax Payment System ("EFTPS") deposit (if any) must be included with the executed agreements.

4. Upon receipt of the closing agreement from the issuer, the Coordinator will verify that the agreement has not been altered, check for required signatures, and monitor receipt and proper accounting of the closing agreement payment, if applicable. Once the payment has been confirmed, the Coordinator will forward the closing agreement to the CPM Manager for execution and notify the specialist that the case is ready for closure.

7.2.3.2.5 Case Closing

1. The specialist will electronically forward the final case closing letter and transmittal letter to power of attorney (if applicable) to the TEB VCAP Coordinator to coordinate signature and transmission.

If the case resolution requires a closing agreement, the issuer is notified that the case is closed through the executed closing agreement letter transmitted with the executed copy(s) of the closing agreement.

If the case resolution does not require a closing agreement, the issuer is notified that the case is closed through the approved resolution letter.

2. Upon the execution and mailing of the applicable closing letter, the Coordinator will notify the specialist that the applicable closing letter has been signed and transmitted. The specialist will then provide the issuer or its authorized representative with a status update, request closure of the case within TREES, and forward the paper file, if any, to the CPM Manager.

3. After reviewing the case, the CPM Manager will approve closure within TREES.

7.2.3.2.6 Unresolved Case Resolution

1. In certain situations, it is appropriate to close a TEB VCAP case without a final resolution. For example, an issuer may withdraw the submission request. Alternatively, CPM may determine that an issuer's nonresponsiveness to requests for additional information rise to the level of willful neglect for purposes of establishing eligibility for TEB VCAP under Notice 2008-31. In these or other situations, the specialist and reviewer will recommend to the CPM Manager to initiate an unresolved closure of the case.

2. The specialist will prepare the appropriate closing letter and forward through the reviewer to the CPM Manager for review and concurrence. Upon approval of the CPM Manager, the specialist will follow the case closing procedures in section 7.2.3.2.5.

7.2.3.3 TEB VCAP Resolution Standards

1. Under Notice 2008-31, the Service requested comments regarding the operation of TEB VCAP, including suggestions with regard to the standardization of closing agreement terms and amounts that may be specified for particular violations. Additionally, on June 11, 2008, the Advisory Committee on Tax Exempt and Government Entities issued a report titled *The Streamlined Closing Agreement For Tax-Exempt Bonds: A Cure For Common Violations* providing recommendations for the creation of programs to provide streamlined treatment of certain tax law violations.

2. This section of IRM section 7.2.3.3 sets forth resolution standards under TEB VCAP for specific violations. TEB anticipates expanding the list of resolution standards for specified violations over time.

7.2.3.3.1 Objectives and Scope

1. The primary compliance objective of the TEB VCAP resolution standards identified in this section is to promote due diligence on the part of issuers and other parties to the tax-exempt bond or tax credit bond transaction in resolving violations. The Service recognizes that due diligence is encouraged by providing certainty to issuers and other parties in understanding the methodology available to resolve their particular violation(s).

2. The primary administrative objective of the TEB VCAP resolution standards identified in this section is to streamline the closing agreement process with respect to the specific violations resulting in the more efficient processing of cases.

3. The resolution standards under this section are not available when:

   A. The specific violation is not within the jurisdiction of TEB VCAP

   B. The specific violation identified in the TEB VCAP request is not a violation identified under this section.

   C. CPM determines that the violation is not appropriate for resolution under the terms described in this section.

7.2.3.3.2 Identified Violations

1. *Excessive Nonqualified Use.* Certain use of proceeds requirements are imposed upon governmental bonds and various qualified private activity bonds under IRC sections 141(b), 142(a), 143(b)(1),

144(a)(12)(B), 144(b)(2), 144(c)(1), 145(a), 147(g), 1394(a), and 7871(c)(3)(B). These provisions allow for certain defined percentages of proceeds to be allocated to nonqualified purposes.

A violation occurs when the amount of proceeds allocated to such nonqualified purposes exceeds the defined percentage limitations.

When the issuer submits the request within 180 days of the date of the deliberate action, this violation may be resolved under the following closing agreement terms when the amount of proceeds allocated to nonqualified purposes exceeds the defined percentage: (1) The issuer (or the conduit borrower through the issuer) will pay an amount equal to 100% of the taxpayer exposure on the nonqualified bonds for the period beginning on the date of the deliberate action and ending on the date the nonqualified bonds are either redeemed or defeased; and (2) The issuer will redeem the nonqualified bonds prior to the date the closing agreement is executed by the IRS. If the nonqualified bonds cannot be redeemed prior to the execution date, the issuer will either: (a) redeem the nonqualified bonds on the earliest call date and calculate the amount described above to include the extended period of time that the nonqualified bonds will remain outstanding; or (b) prior to the date the closing agreement is executed by the IRS, establish a defeasance escrow to defease the nonqualified bonds on their first call date.

When the issuer submits the request more than 180 days but within 1 calendar year of the date of the deliberate action, this violation may be resolved under the terms described in the above paragraph, substituting 110% of taxpayer exposure for 100% of taxpayer exposure in calculating the closing agreement payment.

2. *Failure to Provide Notice of Defeasance.* Under ITR sections 1.141-12(d)(3) and 1.150-5(a)(1), an issuer remediating nonqualified bonds through the establishment of an irrevocable defeasance escrow must provide written notice to CPM within 90 days of the date the defeasance escrow is established.

   A failure to successfully remediate nonqualified bonds occurs when the issuer fails to timely provide CPM with written notice of the establishment of a defeasance escrow to remediate nonqualified bonds under ITR section 1.141-12(d).

   This failure may be resolved under a closing agreement whereby the issuer agrees to pay an amount equal to the lesser of $1/day for the period beginning the date of the failure to notify and ending of the date written notification was provided to CPM or $1,000.

3. *Failure to Defease Within 10.5 Years of Issuance.* Under ITR section 1.141-12(d)(4), an issuer may only remediate nonqualified bonds through the establishment of defeasance escrow if the period between the issue date of the bonds and the first call date of the bonds is 10.5 years or less.

   A failure to successfully remediate nonqualified bonds occurs when all or a portion of the bonds comprising the issue are not callable within 10.5 years of the issue date.

   This failure may be resolved under a closing agreement whereby the issuer agrees to pay an amount equal to the taxpayer exposure on the bonds with the offending maturities for the period beginning on the date 10.5 years after the issue date and ending on the date the bonds will be redeemed under the defeasance escrow.

4. *Alternative Minimum Tax Adjustment.* Under IRC section 57(a)(5), the interest on certain qualified private activity bonds is treated as an item of tax preference for purposes of the alternative minimum tax. IRC section 57(a)(5)(C)(ii) provides an exception to this rule for qualified 501(c)(3) bonds.

   A violation occurs where a change in the use of the proceeds of a governmental issue occurs resulting in the bonds being recharacterized as certain qualified private activity bonds other than qualified 501(c)(3) bonds.

   When the issuer submits the request within 180 days of the date of the deliberate action, this violation may be resolved under a closing agreement requiring the payment of an amount equal to 100% of the alternative minimum tax adjustment with respect to the bonds of the issue from the date of the deliberate action to the date the bonds are no longer outstanding.

When the issuer submits the request more than 180 days but within 1 calendar year of the date of the deliberate action, this violation may be resolved as described in the above paragraph, substituting 110% of the alternative minimum tax adjustment for 100% of the alternative minimum tax adjustment in calculating the closing agreement payment.

5. *Capital Expenditure Limitation Failure.* Under IRC section 144(a)(4), an issuer may elect for certain qualified small issue bonds to apply a $10,000,000 limitation on the sum of the aggregate amount of certain outstanding qualified small issue bonds described in IRC section 144(a)(2) and the aggregate amount of capital expenditures with respect to facilities described in IRC 144(a)(4)(B) (as modified by IRC section 144(a)(4)(G), when applicable).

   A violation occurs when the sum of outstanding bonds and capital expenditures to be taken into account for purposes of this requirement exceeds $10,000,000 (as modified by IRC section 144(a)(4)(G), when applicable).

   When the issuer submits the request within 180 days of the date of the deliberate action, this violation may be resolved under the following closing agreement terms: (1) The issuer (or the conduit borrower through the issuer) will pay an amount equal to 100% of the taxpayer exposure on the nonqualified bonds for the period beginning on the date the violation occurs and ending on the date the nonqualified bonds are either redeemed or defeased; and (2) The issuer will redeem the nonqualified bonds prior to the date the closing agreement is executed by the IRS. If the nonqualified bonds cannot be redeemed prior to the execution date, the issuer will either: (a) redeem the nonqualified bonds on the earliest call date and calculate the amount described above to include the extended period of time that the nonqualified bonds will remain outstanding; or (b) prior to the date the closing agreement is executed by the IRS, establish a defeasance escrow to defease the nonqualified bonds on their first call date. For this purpose, the nonqualified bonds are an amount of the bonds equal to the amount exceeding the applicable limitation which will not result in the average maturity of the remaining bonds being greater than the average maturity of the bond issue.

   When the issuer submits the request more than 180 days but within 1 calendar year of the date of the deliberate action, this violation may be resolved under the terms described in the above paragraph, substituting 110% of taxpayer exposure for 100% of taxpayer exposure in calculating the closing agreement payment.

6. *Maturity Exceeding 120% of Economic Life.* Under IRC section 147(b), the average maturity of certain qualified private activity bonds may not exceed 120% of the average reasonably expected economic life of the facilities being financed with the net proceeds of the issue.

   A violation occurs when the average maturity of the bonds exceeds 120% of the average reasonably expected economic life of the financed property.

   This violation may be resolved under a closing agreement where the issuer and conduit borrower agree to redeem or defease an amount of the bonds sufficient to reduce the weighted average maturity to 110% of the economic life of the financed property.

7. *Impermissible Advance Refunding.* Under IRC section 149(d), there is a general prohibition on the advance refunding of: (1) any qualified private activity bond issue other than a qualified 501(c)(3) bond issue; or (2) any governmental bond issue or qualified 501(c)(3) bond issue that has already been advance refunded. Under ITR section 1.150-1(d)(3), a current refunding issue is defined as a refunding issue that is issued not more than 90 days before the final payment of principal and interest on the prior refunded issue and an advance refunding issue is defined as a refunding issue which is not a current refunding issue.

   A violation occurs when the proceeds of a refunding issue are used to pay the principal or interest on a prior issue more than 90 days from the issue date of the refunding issue when the prior issue is not permitted to be advance refunded under IRC section 149(d).

When the issuer submits the request within 180 days of the date of the violation, this violation may be resolved under a closing agreement where the issuer agrees to pay an amount equal to 100% of the taxpayer exposure on the refunding bonds for the period beginning on the issue date of the refunding bonds and ending on the date 90 days before the final redemption of the prior refunded issue.

When the issuer submits the request more than 180 days but within 1 calendar year of the date of the violation, this violation may be resolved under the terms described in the above paragraph, substituting 110% of taxpayer exposure for 100% of taxpayer exposure in calculating the closing agreement payment.

8. *Failure to Timely Reinvest Proceeds into 0% SLGS.* Under IRC section 148(a), an issue shall be treated as consisting of arbitrage bonds if any portion of the proceeds are intentionally used directly or indirectly to acquire higher yielding investments. For this purpose, definitions of materially higher yield are provided under ITR section 1.148-2(d). For example, investments held in a refunding escrow are treated as higher yielding investments when the yield on those investments over the life of the escrow produces a yield which is more than $1/1000^{th}$ of 1% higher than the yield on the bond issue.

   A violation occurs where a party to the escrow agreement fails to meet their requirements under the agreement as a result of a failure to timely reinvest proceeds of a refunding issue as directed upon the maturity of investments (e.g., failure to reinvest in 0% U.S. Treasury Securities – State and Local Government Series (SLGS) in an efficient escrow).

   When the issuer submits the request within 60 days of the next required computation date following the date of the reinvestment failure, this violation may be resolved under a closing agreement whereby the issuer (or the escrow agent through the issuer) agrees to pay an amount equal to the sum of the following: (1) An amount which, if treated as a payment with respect to the investments held in the escrow, reduces the yield on the escrow to the bond yield; plus (2) An amount equaling interest accrued at the underpayment rate under IRC section 6621 beginning on the date the payment would have been due if treated as a yield reduction payment and ending on the date the payment is actually paid to the IRS. For this purpose, proceeds held by the trustee due to this reinvestment failure may be treated as invested at the applicable federal funds rate where the trustee certifies under penalty of perjury that its customary practice is to invest its overnight balances at a rate which approximates the applicable federal funds rate and the proceeds were likely invested in such a manner.

Remedial actions - 26 CFR § 1.141–12.

(a) *Conditions to taking remedial action.* An action that causes an issue to meet the private business tests or the private loan financing test is not treated as a deliberate action if the issuer takes a remedial action described in paragraph (d), (e), or (f) of this section with respect to the nonqualified bonds and if all of the requirements in paragraphs (a) (1) through (5) of this section are met.

(1) *Reasonable expectations test met.* The issuer reasonably expected on the issue date that the issue would meet neither the private business tests nor the private loan financing test for the entire term of the bonds. For this purpose, if the issuer reasonably expected on the issue date to take a deliberate action prior to the final maturity date of the issue that would cause either the private business tests or the private loan financing test to be met, the term of the bonds for this purpose may be determined by taking into account a redemption provision if the provisions of § 1.141–2(d)(2)(ii) (A) through (C) are met.

(2) *Maturity not unreasonably long.* The term of the issue must not be longer than is reasonably necessary for the governmental purposes of the issue (within the meaning of § 1.148–1(c)(4)). Thus, this requirement is met if the weighted average maturity of the bonds of the issue is not greater than 120 percent of the average reasonably expected economic life of the property financed with the proceeds of the issue as of the issue date.

(3) *Fair market value consideration.* Except as provided in paragraph (f) of this section, the terms of any arrangement that results in satisfaction of either the private business tests or the private loan financing test are bona fide and arm's-length, and the new user pays fair market value for the use of the financed property. Thus, for example, fair market value may be determined in a manner that takes into account restrictions on the use of the financed property that serve a bona fide governmental purpose.

(4) *Disposition proceeds treated as gross proceeds for arbitrage purposes.* The issuer must treat any disposition proceeds as gross proceeds for purposes of section 148. For purposes of eligibility for temporary periods under section 148(c) and exemptions from the requirement of section 148(f) the issuer may treat the date of receipt of the disposition proceeds as the issue date of the bonds and disregard the receipt of disposition proceeds for exemptions based on expenditure of proceeds under § 1.148–7 that were met before the receipt of the disposition proceeds. (5) *Proceeds expended on a governmental purpose.* Except for a remedial action under paragraph (d) of this section, the proceeds of the issue that are affected by the deliberate action must have been expended on a governmental purpose before the date of the deliberate action.

(b) *Effect of a remedial action*—(1) *In general.* The effect of a remedial action is to cure use of proceeds that causes the private business use test or the private loan financing test to be met. A remedial action does not affect application of the private security or payment test.

(2) *Effect on bonds that have been advance refunded.* If proceeds of an issue were used to advance refund another bond, a remedial action taken with respect to the refunding bond proportionately reduces the amount of proceeds of the advance refunded bond that is taken into account under the private business use test or the private loan financing test.

(c) *Disposition proceeds*—(1) *Definition. Disposition proceeds* are any amounts (including property, such as an agreement to provide services) derived from the sale, exchange, or other disposition (disposition) of property (other than investments) financed with the proceeds of an issue.

(2) *Allocating disposition proceeds to an issue.* In general, if the requirements of paragraph (a) of this section are met, after the date of the disposition, the proceeds of the issue allocable to the transferred property are treated as financing the disposition proceeds rather than the transferred property. If a disposition is made pursuant to an installment sale, the proceeds of the issue continue to be allocated to the transferred property. If an issue does not meet the requirements for remedial action in paragraph (a) of this section or the issuer does not take an appropriate remedial action, the proceeds of the issue are allocable to either the transferred property or the disposition proceeds, whichever allocation produces the greater amount of private business use and private security or payments.

(3) *Allocating disposition proceeds to different sources of funding.* If property has been financed by different sources of funding, for purposes of this section, the disposition proceeds from that property are first allocated to the outstanding bonds that financed that property in proportion to the principal amounts of those outstanding bonds. In no event may disposition proceeds be allocated to bonds that are no longer outstanding or to a source

of funding not derived from a borrowing (such as revenues of the issuer) if the disposition proceeds are not greater than the total principal amounts of the outstanding bonds that are allocable to that property. For purposes of this

paragraph (c)(3), principal amount has the same meaning as in § 1.148–9(b)(2) and outstanding bonds do not include advance refunded bonds.

(d) *Redemption or defeasance of nonqualified bonds—*

(1) *In general.* The requirements of this paragraph (d) are met if all of the nonqualified bonds of the issue are redeemed. Proceeds of tax-exempt bonds must not be used for this purpose, unless the tax-exempt bonds are qualified bonds, taking into account the purchaser's use of the facility. If the bonds are not redeemed within 90 days of the date of the deliberate action, a defeasance escrow must be established for those bonds within 90 days of the deliberate action.

(2) *Special rule for dispositions for cash.* If the consideration for the disposition of financed property is exclusively cash, the requirements of this paragraph (d) are met if the disposition proceeds are used to redeem a pro rata portion of the nonqualified bonds at the earliest call date after the deliberate action. If the bonds are not redeemed within 90 days of the date of the deliberate action, the disposition proceeds must be used to establish a defeasance escrow for those bonds within 90 days of the deliberate action.

(3) *Notice of defeasance.* The issuer must provide written notice to the Commissioner of the establishment of the defeasance escrow within 90 days of the date the defeasance escrow is established.

(4) *Special limitation.* The establishment of a defeasance escrow does not satisfy the requirements of this paragraph (d) if the period between the issue date and the first call date of the bonds is more than 10 1/2 years.

(5) *Defeasance escrow defined.* A defeasance escrow is an irrevocable escrow established to redeem bonds on their earliest call date in an amount that, together with investment earnings, is sufficient to pay all the principal of, and interest and call premium on, bonds from the date the escrow is established to the earliest call date. The escrow may not be invested in higher yielding investments or in any investment under which the obligor is a user of the proceeds of the bonds.

(e) *Alternative use of disposition proceeds*—(1) *In general.* The requirements of this paragraph (e) are met if— (i) The deliberate action is a disposition for which the consideration is exclusively cash; (ii) The issuer reasonably expects to expend the disposition proceeds within two years of the date of the deliberate action; (iii) The disposition proceeds are treated as proceeds for purposes of section 141 and are used in a manner that does not cause the issue to meet either the private business tests or the private loan financing test, and the issuer does not take any action subsequent to the date of the deliberate action to cause either of these tests to be met; and (iv) If the issuer does not use all of the disposition proceeds for an alternative use described in paragraph (e)(1)(iii) of this section, the issuer uses those remaining disposition proceeds for a remedial action that meets paragraph (d) of this section.

(2) *Special rule for use by 501(c)(3) organizations.* If the disposition proceeds are to be used by a 501(c)(3) organization, the nonqualified bonds must in addition be treated as reissued for purposes of sections 141, 145, 147, 149, and 150 and, under this treatment, satisfy all of the applicable requirements for qualified 501(c)(3) bonds. Thus, beginning on the date of the deliberate action, nonqualified bonds that satisfy these requirements must be treated as qualified 501(c)(3) bonds for all purposes, including sections 145(b) and 150(b).

(f) *Alternative use of facility.* The requirements of this paragraph (f) are met if— (1) The facility with respect to which the deliberate action occurs is used in an alternative manner (for example, used for a qualifying purpose by a nongovernmental person or used by a 501(c)(3) organization rather than a governmental person);

(2) The nonqualified bonds are treated as reissued, as of the date of the deliberate action, for purposes of sections 55 through 59 and 141, 142, 144, 145, 146, 147, 149 and 150, and under this treatment, the nonqualified bonds satisfy all the applicable requirements for qualified bonds throughout the remaining term of the nonqualified bonds;

(3) The deliberate action does not involve a disposition to a purchaser that finances the acquisition with proceeds of another issue of tax-exempt bonds; and

(4) Any disposition proceeds other than those arising from an agreement to provide services (including disposition proceeds from an installment sale) resulting from the deliberate action are used to pay the debt

service on the bonds on the next available payment date or, within 90 days of receipt, are deposited into an escrow that is restricted to the yield on the bonds to pay the debt service on the bonds on the next available payment date.

(g) *Rules for deemed reissuance.* For purposes of determining whether bonds that are treated as reissued under paragraphs (e) and (f) of this section are qualified bonds— (1) The provisions of the Code and regulations thereunder in effect as of the date of the deliberate action apply; and

(2) For purposes of paragraph (f) of this section, section 147(d) (relating to the acquisition of existing property) does not apply.

(h) *Authority of Commissioner to provide for additional remedial actions.* The Commissioner may, by publication in the FEDERAL REGISTER or the Internal Revenue Bulletin, provide additional remedial actions, including making a remedial payment to the United States, under which a subsequent action will not be treated as a deliberate action for purposes of § 1.141–2.

(i) *Effect of remedial action on continuing compliance.* Solely for purposes of determining whether deliberate actions that are taken after a remedial action cause an issue to meet the private business tests or the private loan financing test— (1) If a remedial action is taken under paragraph (d), (e), or (f) of this section, the private business use or private loans resulting from the deliberate action are not taken into account for purposes of determining whether the bonds are private activity bonds; and

(2) After a remedial action is taken, the amount of disposition proceeds is treated as equal to the proceeds of the issue that had been allocable to the transferred property immediately prior to the disposition. See paragraph (k) of this section, *Example 5.*

(j) *Nonqualified bonds*—(1) *Amount of nonqualified bonds.* The percentage of outstanding bonds that are nonqualified bonds equals the highest percentage of private business use in any 1-year period commencing with the deliberate action.

(2) *Allocation of nonqualified bonds.* Allocations to nonqualified bonds must be made on a pro rata basis, except that, for purposes of paragraph (d) of this section (relating to redemption or defeasance), an issuer may treat bonds with longer maturities (determined on a bond-by-bond basis) as the nonqualified bonds.

(k) *Examples.* The following examples illustrate the application of this section:

Example 1. Disposition proceeds less than outstanding bonds used to retire bonds. On June 1, 1997, City C issues 30-year bonds with an issue price of $10 million to finance the construction of a hospital building. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the building. On the issue date, C reasonably expects that it will be the only user of the building for the entire term of the bonds. Six years after the issue date, C sells the building to Corporation P for $5 million. The sale price is the fair market value of the building, as verified by an independent appraiser. C uses all of the $5 million disposition proceeds to immediately retire a pro rata portion of the bonds. The sale does not cause the bonds to be private activity bonds because C has taken a remedial action described in paragraph (d) of this section so that P is not treated as a private business user of bond proceeds.

Example 2. Lease to nongovernmental person. The facts are the same as in *Example 1,* except that instead of selling the building, C, 6 years after the issue date, leases the building to P for 7 years and uses other funds to redeem all of the $10 million outstanding bonds within 90 days of the deliberate act. The bonds are not treated as private activity bonds because C has taken the remedial action described in paragraph (d) of this section.

Example 3. Sale for less than fair market value. The facts are the same as in *Example 1,* except that the fair market value of the building at the time of the sale to P is $6 million. Because the transfer was for less than fair market value, the bonds are ineligible for the remedial actions under this section.

The bonds are private activity bonds because P is treated as a user of all of the proceeds and P makes a payment ($6 million) for this use that is greater than 10 percent of the debt service on the bonds, on a present value basis.

Example 4. Fair market value determined taking into account governmental restrictions. The facts are the same as in *Example 1,* except that the building was used by C only for hospital purposes and C determines to sell the building subject to a restriction that it be used only for hospital purposes. After conducting a public bidding procedure as required by state law, the best price that C is able to obtain for the building subject to this restriction is $4.5 million from P. C uses all of the $4.5 million disposition proceeds to immediately retire a pro

rata portion of the bonds. The sale does not cause the bonds to be private activity bonds because C has taken a remedial action described in paragraph (d) of this section so that P is not treated as a private business user of bond proceeds.

Example 5. Alternative use of disposition proceeds. The facts are the same as in Example 1, except that C reasonably expects on the date of the deliberate action to use the $5 million disposition proceeds for another governmental purpose (construction of governmentally owned roads) within two years of receipt, rather than using the $5 million to redeem outstanding bonds. C treats these disposition proceeds as gross proceeds for purposes of section 148. The bonds are not private activity bonds because C has taken a remedial action described in paragraph (e) of this section. After the date of the deliberate action, the proceeds of all of the outstanding bonds are treated as used for the construction of the roads, even though only $5 million of disposition proceeds was actually used for the roads.

Example 6. Alternative use of financed property. The facts are the same as in Example 1, except that C determines to lease the hospital building to Q, an organization described in section 501(c)(3), for a term of 10 years rather than to sell the building to P. In order to induce Q to provide hospital services, C agrees to lease payments that are less than fair market value. Before entering into the lease, an applicable elected representative of C approves the lease after a noticed public hearing. As of the date of the deliberate action, the issue meets all the requirements for qualified 501(c)(3) bonds, treating the bonds as reissued on that date. For example, the issue meets the two percent restriction on use of proceeds of finance issuance costs of section 147(g) because the issue pays no costs of issuance from disposition proceeds in connection with the deemed reissuance. C and Q treat the bonds as qualified 501(c)(3) bonds for all purposes commencing with the date of the deliberate action. The bonds are treated as qualified 501(c)(3) bonds commencing with the date of the deliberate action.

Example 7. Deliberate action before proceeds are expended on a governmental purpose. County J issues bonds with proceeds of $10 million that can be used only to finance a correctional facility. On the issue date of the bonds, J reasonably expects that it will be the sole user of the bonds for the useful life of the facility. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the facility. After the issue date of the bonds, but before the facility is placed in service, J enters into a contract with the federal government pursuant to which the federal government will make a fair market value, lump sum payment equal to 25 percent of the cost of the facility. In exchange for this payment, J provides the federal government with priority rights to use of 25 percent of the facility. J uses the payment received from the federal government to defease the nonqualified bonds. The agreement does not cause the bonds to be private activity bonds because J has taken a remedial action described in paragraph (d) of this section. See paragraph (a)(5) of this section.

Example 8. Compliance after remedial action. In 1997, City G issues bonds with proceeds of $10 million to finance a courthouse. The bonds have a weighted average maturity that does not exceed 120 percent of the reasonably expected economic life of the courthouse. G uses $1 million of the proceeds for a private business use and more than 10 percent of the debt service on the issue is secured by private security or payments. G later sells one-half of the courthouse property to a nongovernmental person for cash. G immediately redeems 60 percent of the outstanding bonds. This percentage of outstanding bonds is based on the highest private business use of the courthouse in any 1- year period commencing with the deliberate action. For purposes of subsequently applying section 141 to the issue, G may continue to use all of the proceeds of the outstanding bonds in the same manner (that is, for both the courthouse and the existing private business use) without causing the issue to meet the private business use test. The issue, however, continues to meet the private security or payment test. The result would be the same if D, instead of redeeming the bonds, established a defeasance escrow for those bonds, provided that the requirement of paragraph (d)(4) of this section was met.

Section 9. PRIVATE BUSINESS USE – PRIVATE LETTER RULINGS AND REVENUE PROCEDURES

This section has been added for informational purposes only. The rulings and revenue procedures should give you a better understanding of how the IRS looks at private business use. The following rulings were directed only to the taxpayers requesting them. Section 6110(k)(3) of the IRS Code provides that rulings may not be used or cited as precedent.

Private Letter Ruling 200132017- Private Business Tests-Research Agreements

This letter is in reply to your request for a ruling that the proceeds of the Bonds may be allocated to the portions of the Research Facilities (hereinafter defined) used for research arrangements that do not constitute private business use based on a revenue allocation test.

Facts and Representations

You make the following factual representations. The Authority is a body corporate and politic constituting a public benefit corporation created by the State, and has been granted the authority to issue bonds to finance facilities for, in part, certain not-for-profit institutions.

The University is a 501(c)(3) organization. The Medical School is a part of the University. One of the objectives of the Medical School is the creation, acquisition, and dissemination of new knowledge as the result of fundamental research in the delivery of health care. It is also an objective of the Medical School to foster the development of research collaboration between its faculty and the private sector, both to expand its faculty's access to emerging therapeutic technologies and to ensure the transfer of new discoveries and inventions made by its faculty and students to full application in patient care.

Currently, the University owns facilities in which research is conducted. Those facilities were not financed with the proceeds of tax-exempt bonds. The University enters into research arrangements (*e.g.*, contracts, gifts, grants) of varying length and subject matter with various parties, including the federal government, state or local government units or state universities, 501(c)(3) organizations, private industry sources, and foundations and other organizations that do not constitute 501(c)(3) organizations.

All of the University's research arrangements are in furtherance of the exempt purposes of the Medical School. Some arrangements do not constitute private business use within the meaning of § 141(b) ("Qualified Research Arrangements"). Other arrangements constitute private business use under § 141(b) ("Non-Qualified Research Arrangements").

Over the last a years, Medical School research revenue from Qualified Research Arrangements, net of royalties and license fees (the "Qualified Research Revenue"), has averaged b percent of gross research revenue annually, net of royalties and license fees. Over that same period, Medical School research revenue from Non-Qualified Research Arrangements, net of royalties and license fees (the "Non-Qualified Research Revenues"), has averaged c percent of gross research revenue annually, net of royalties and license fees.

Pursuant to resolutions adopted by the Authority on Date 1 and Date 2, the Authority proposes to issue the Bonds and apply a portion of the proceeds thereof, together with other amounts, to finance a portion of the costs of new research facilities (the "Research Facilities") for the Medical School. The amount of the Bonds issued to finance the Research Facilities is expected to be approximately $d.

More than 5 percent of the Research Facilities will be used for Non-Qualified Research Arrangements each year throughout the term of the Bonds. Payments received by the Medical School pursuant to such arrangements will exceed 5 percent of the present value of the debt service on the Bonds.

Based on the University's current experience with its existing facilities, the University represents the following: (1) the research performed pursuant to Non-Qualified Research Arrangements and Qualified Research Arrangements will take place simultaneously in all laboratories within the Research Facilities; (2) all laboratory equipment in the Research Facilities will be available continuously for use by workers who will perform research under Non-Qualified Research Arrangements and Qualified Research Arrangements; (3) a researcher will often use a single laboratory in the Research Facilities to perform identical research that may be funded either by a Non-Qualified Research Arrangement or a Qualified Research Arrangement; (4) many of the procedures conducted by the researchers in the Research Facilities may relate to any number of research projects, some of which may be Non-Qualified Research Arrangements and some of which may be Qualified Research Arrangements; and (5) as a result of the foregoing, it is not possible for the Medical School to allocate the usage of the laboratories and equipment in the Research Facilities between Non-Qualified Research Arrangements and Qualified Research Arrangements other than based on the relative amounts of revenue from such arrangements.

The University does not believe the manner in which it will operate the Research Facilities to be unique. This is the manner in which the University's existing facilities are operated and how it believes many other research

institutions are operated. The University believes that to segregate researchers and research labs by funding source would be inefficient, impracticable, and would impose an unacceptable burden on medical research.

As a result, the Authority proposes that proceeds of the Bonds be allocated to the portions of the Research Facilities used for Qualified Research Arrangements, and not to the portions of the Research Facilities used for Non-Qualified Research Arrangements, with such portions based on the ratio of the present value of Qualified Research Revenue to the present value of gross research revenue (Qualified Research Revenue plus Non-Qualified Research Revenue), using the yield on the Bonds (determined under § 148) as the discount rate.

Law and Analysis

Section 103(a) provides that gross income does not include interest on a State or local bond. Section 103(b)(1) provides that § 103(a) does not apply to any private activity bond, unless it is a qualified bond under § 141.

Section 141(a) provides that the term "private activity bond" means any bond issued as part of an issue (1) which meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or (2) which meets the private loan financing test of § 141(c).

Section 141(b)(1) provides in general that an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Private business use is defined in § 141(b)(6) as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For this purpose, any activity carried on by a person other than a natural person is treated as a trade or business.

Section 141(b)(2) provides in general that an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of the issue is (under the terms of the issue or any underlying arrangement) directly or indirectly (A) secured by any interest in property used or to be used for a private business use, or payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(e) provides that a qualified bond includes a qualified 501(c)(3) bond.

Section 145(a) provides that, except as otherwise provided in § 145, the term qualified 501(c)(3) bond means any private activity bond issued as part of an issue if all of the property that is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and such bond would not be a private activity bond if § 501(c)(3) organizations were treated as governmental units with respect to their activities that do not constitute unrelated trades or businesses, determined by applying § 513(a). For this purpose, paragraphs (1) and (2) of § 141(b) are applied by substituting "5 percent" for "10 percent" each place it appears and "net proceeds" for "proceeds" each place it appears.

Section 1.145-2(a) of the Income Tax Regulations provides that §§ 1.141-0 through 1.141-15 generally apply to § 145(a).

Section 1.141-3 provides rules pertaining to the definition of private business use. Section 1.141-3(a) states, in part, that the use of financed property is treated as the direct use of proceeds. In determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct use of the proceeds. Use of proceeds by all nongovernmental persons is aggregated.

Section 1.141-3(b) provides that both actual and beneficial use by a nongovernmental person may be treated as private business use. In most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or other incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

Section 1.141-3(b)(6)(i) provides in part that an agreement by a nongovernmental person to sponsor research performed by a governmental person may result in private business use of the property used for the research, based on all of the facts and circumstances.

Section 1.141-3(g)(1) provides that, in general, the private business use of proceeds is allocated to property under § 1.141-6. The amount of private business use of that property is determined according to the average percentage of private business use of that property during the measurement period.

Section 1.141-3(g)(2)(i) provides in general that the measurement period of property financed by an issue begins on the later of the issue date of that issue or the date the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the issue financing the property (determined without regard to any optional redemption dates). In general, the period of reasonably expected economic life of the property for this purpose is based on reasonable expectations as of the issue date.

Section 1.141-3(g)(4)(iii) provides in general that for a facility in which governmental use and private business use occur simultaneously, the entire facility is treated as having private business use. However, if there is simultaneous private business use and actual government use on the same basis, the average amount of private business use may be determined on a reasonable basis that properly reflects the proportionate benefit to be derived by the various users of the facility (*e.g.,* reasonably expected fair market value of use). This provision is illustrated by *Example 1* set forth in § 1.141-3(g)(8), as follows:

University U, a state owned and operated university, owns and operates a research facility. U proposes to finance general improvements to the facility with the proceeds of an issue of bonds. U enters into sponsored research agreements with nongovernmental persons that result in private business use because the sponsors will own title to any patents resulting from the research. The governmental research conducted by U and the research U conducts for the sponsors take place simultaneously in all laboratories within the research facility. All laboratory equipment is available continuously for use by workers who perform both types of research. Because it is not possible to predict which research projects will be successful, it is not reasonably practicable to estimate the relative revenues expected to result from the governmental and nongovernmental research. U contributed 90 percent of the cost of the facility and the nongovernmental persons contributed 10 percent of the cost. Under this section, the nongovernmental persons are using the facility for a private business use on the same basis as the government use of the facility. The portions of the costs contributed by the various users of the facility provide a reasonable basis that properly reflects the proportionate benefit to be derived by the users of the facility. The nongovernmental persons are treated as using 10 percent of the proceeds of the issue.

Section 1.141-4 provides rules pertaining to the private security or payment test. Section 1.141-4(a)(1) provides that the private security or payment test relates to the nature of the security for, and the source of, the payment of debt service on an issue. The private payment portion of the test takes into account the payment of debt service on the issue that is directly or indirectly to be derived from payments (whether or not to the issuer or any related party) in respect of property, or borrowed money, used or to be used for a private use. The private security portion of the test takes into account the payment of the debt service on the issue that is directly or indirectly secured by any interest in property used or to be used for a private business use or payments in respect of property used or to be used for a private business use.

Section 1.141-4(b) provides that in determining whether an issue meets the private security or payment test, the present value of the payments or property taken into account is compared to the present value of the debt service to be paid over the term of the issue. For this purpose, present values are determined by using the yield on the issue as the discount rate and by discounting all amounts to the issue date.

Section 1.141-6(a) provides in part that, for purposes of allocating proceeds to expenditures, allocations generally may be made using any reasonable, consistently applied accounting method.

The Report on the Committee of Ways and Means of the House of Representatives on H.R. 3838, H.R. Rep. No. 426, 99th Cong., 1st Sess. 538 (1985), 1986-3 (Vol. 2) C.B. 538 (the "House Report"), states as follows:

The committee understands that certain facilities eligible for financing with section 501(c)(3) organization bonds may comprise part of a larger facility otherwise ineligible for such financing or that portions of a section 501(c)(3) organization facility may be used for activities of persons other than section 501(c)(3) organizations. The committee intends that the Treasury Department may adopt rules for allocating the costs of such mixed use facilities (including common elements) according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the various users of the facility. Only the portions of such mixed use facilities owned and used by a section 501(c)(3) organization may be financed with bonds for such organizations.

The same language appears in the Report of the Committee on Finance of the Senate on H.R. 3838, S. Rep. No. 99-313, 99th Cong., 1st Sess. 841 (1986), 1986-3 (Vol. 3) C.B. 841 (the "Senate Report").

The issue presented here is whether the proceeds of the Bonds may be allocated to portions of the Research Facilities that are used for research arrangements that do not constitute private business use based on a revenue allocation test, with the result being that such portions qualify for tax exempt financing under § 145.

Both the House Report and the Senate Report acknowledge that there are facilities used by 501(c)(3) organizations that qualify for tax exempt financing under § 145 that may be part of a larger facility that, for whatever reason, do not qualify for such financing. In these cases, the portion of such "mixed use" facilities owned and used by a 501(c)(3) organization may be financed under § 145 to the extent that the costs of such facilities are allocated according to a reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the various users of the facility.

You represent that the only reasonable method for the Medical School to allocate the costs of the Research Facility is a revenue allocation test that allocates use between governmental use and private business use based on the relative amounts of Qualified Research Revenue and Non-Qualified Research Revenue. Any other method would be unworkable due to the manner in which the Research Facilities operate. In particular, the research performed pursuant to Non-Qualified Research Arrangements and Qualified Research Arrangements will take place simultaneously in all laboratories within the Research Facilities. Moreover, all laboratory equipment in the Research Facilities will be available continuously for use by workers who will perform research under Non-Qualified Research Arrangements and Qualified Research Arrangements. A researcher will often use a single laboratory in the Research Facilities to perform identical research that may be funded either by a Non-Qualified Research Arrangement or a Qualified Research Arrangement. Many of the procedures conducted by the researchers in the Research Facilities may relate to any number of research projects, some of which may be Non-Qualified Research Arrangements and some of which may be Qualified Research Arrangements. Finally, the University does not believe that the manner in which it will operate the Research Facilities to be unlike other research institutions.

Accordingly, and because other available methods are unworkable, the revenue allocation method is reasonable. Allocating the portion of the Research Facilities that may be financed with the Bonds based on the relative amounts of Qualified Research Revenue and Non-Qualified Research Revenue is a reasonable method of allocating the costs of the Research Facilities. This allocation method properly reflects the proportionate benefit to be derived, directly or indirectly, by the various users of the Research Facilities.

Conclusion

We conclude that the proceeds of the Bonds may be allocated to the portions of the Research Facilities that are used for Qualified Research Arrangements, with such portions based on the ratio of the present value of Qualified Research Revenue to the present value of gross research revenue (Qualified Research Revenue plus Non-Qualified Research Revenue), using the yield on the Bonds (determined under § 148) as the discount rate. As a result, the University may finance such portions of the Research Facilities under § 145.

Except as specifically ruled above, no opinion is expressed concerning this transaction under any provision of the Code or regulations thereunder. Specifically, no opinion is expressed concerning whether interest on the Bonds will be excludable from gross income under § 103(a) or regarding the application of the change in use rules to the Bonds should the relative percentages of Qualified Research Revenue and Non-Qualified Research Revenue change.

Private Letter Ruling 200_11003-Private Business Test-Fitness Facility

This is in response to your request for a ruling that the proposed use of the Center by specified groups of users ("proposed user groups") and for the specified uses ("proposed uses") described in the request does not constitute private business use under § 141 of the Internal Revenue Code (the "Code").

FACTS AND REPRESENTATIONS

You represent the following facts. The University is a land-grant, state university, publicly funded and governed by State laws. The Issuer, the governing body of the University, is a body corporate of the State and is authorized to issue bonds in order to carry out its function under State law. On Date, the Issuer issued the Bonds, in part, for the purpose of paying a portion of the costs of acquiring, constructing, and equipping of the Center and related capital improvements at the University and reimbursing the University for certain prior capital expenditures made for such purpose. The Hospital is an instrumentality of the State, established pursuant to State law as a 501(c)(3) corporation and created, in part, to provide teaching facilities for the University.

The Center is a multipurpose fitness and recreation center with the following facilities: two swimming pools; a wet classroom; two gymnasiums for basketball, volleyball and badminton; weight and fitness areas; a climbing wall; a running and walking track; racquetball and squash courts; multipurpose rooms for aerobics, martial arts and dance activities; an outdoor recreation equipment center; a wellness center; a resource library; study areas; a classroom; a conference room; a juice bar; and socialization areas. The Center is operated by University employees.

The Center will be used for credit-bearing University courses including internships or practical training for exercise physiology, occupational therapy, sports management, recreation and physical education, and other curricular activities. In addition, the Center furthers the educational mission of the University by facilitating health and fitness activities with the goal of teaching health and fitness values and establishing lifelong wellness habits to its users.

Students are automatically members of the Center. Faculty and staff may join upon payment of a membership fee. Activity fees paid by students are used as the primary source of repayment for the Bonds. Membership fees paid by faculty and staff are intended solely to cover the attendant costs of operating the center. The Center was opened for use by students, faculty, and staff in July of Year.

In addition to students, faculty, and staff already using the Center, the University would like to open the Center for use by the proposed user groups and for the proposed uses. The proposed user groups and the proposed uses are described as follows:

Spouses and dependent children of students, faculty, and staff of the University. The use by this group will be conditioned upon the payment of additional fees. As with the faculty and staff membership fees, the additional fees for this group are intended to cover the attendant costs of operating the Center.

Retired faculty and staff of the University who continue to obtain their health insurance coverage through the University. Eligible retired faculty and staff of the University are offered access to health care coverage through the University based upon their prior employment with the University.

Employees of the Hospital and their spouses and dependent children. The Hospital is the successor to the prior University-owned teaching hospital. As part of the transition from the University-owned and operated teaching hospital to the Hospital, employees of the University-operated hospital were permitted to elect either to become Hospital employees or to remain University employees. Consequently, the Hospital is staffed by University employees and, distinct from them, Hospital employees.

Limited number of guests of members of the Center. Guest passes would be available to out-of-town guests (limited to two per visit) or to University employees interested in membership at a cost of $7 per visit. The use of the Center by guests will be restricted to use for their personal health, recreational, and educational use.

Participants in on-campus programs sponsored, presented, and operated by the University such as professional enrichment conferences. Aside from its function of education of undergraduate and graduate students, the University provides agricultural, fire safety, and other educational programs that are open to the general public on the same basis to all. These programs require preregistration and payment of fees which are retained by the University. The University may contract with an individual to make one or more presentations as part of a

conference that is sponsored, presented, and operated by the University. The Center will not be used by contracted individuals for their presentations. The compensation paid to the contracted individuals will be a flat fee and will not be based upon the number of program participants. The Center will not be open for use by participants in programs sponsored, presented, or operated by any nongovernmental person.

Participants in University-sponsored on-campus programs such as summer youth sports camps. The University sponsors and operates summer youth sports camps on the University campus as part of its community educational mission. The camp personnel are compensated through the University employee payroll and operate the youth sport camps

in the capacity of University employees. The fees collected for these activities are deposited into and expended from special State revenue accounts.

Participants in University-sponsored non-credit classes at the Center. The University offers to the general public, on the same basis to all, non-credit classes such as yoga, aerobics, dance, nutrition, and self-defense classes. These classes are taught by University employees and require preregistration and payment of designated fees which are retained by the University.

Students participating in activities conducted by the County Board of Education and the Commission. The University is located in County. The University proposes to open the Center for use by students of the District aquatics program. Such use would be regulated by a contract between the University and the County Board of Education, a public body and governmental instrumentality of the District, which is a political subdivision of the State. Also, the University proposes to open the swimming pools at the Center for use in the interscholastic swimming competitions sponsored by the Commission, a governmental agency of the State.

Persons being recruited by the University as students, faculty, and staff. The University proposes to open the Center to persons who are visiting the University while being recruited as students, faculty, and staff.

Members undergoing health and fitness appraisals, for which there is a fee. The University proposes to make available to the members of the Center health and fitness appraisals. The health and fitness appraisals will be conducted by University employees. The additional fee charged for the appraisal will be retained by the University and is intended solely to cover the cost of the appraisals.

Use by members of University-employed personal trainers, for which there is a fee. The University proposes to make available to the members of the Center the services of personal trainers. The personal trainers will be employed by the University. The additional fee charged for the use of personal training services will be retained by the University and is intended to cover the cost of the training, including the cost of employing personal trainers.

Use by members of equipment necessary for outdoor recreational activities, for which there is a fee. The University proposes to rent outdoor recreational equipment such as canoes, bicycles, skis, etc., to the members of the Center. The equipment is owned by the University. The rental counter, located in the Center, is operated by University employees. The additional fee charged for the rental is retained by the University and is intended solely to cover the cost of upkeep and periodic replacement of the equipment.

Use of juice bar, which is located in an area accessible to the public, by nonmembers. A juice bar, located in an area of the Center open to the general public, serves snacks such as

juice and muffins. The juice bar is operated by University employees. The University proposes to open the juice bar for use by the general public.

LAW AND ANALYSIS

Section 103(a) excludes from gross income interest on any state or local bond. Section 103(b) provides that § 103(a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) provides that the term "private activity bond" means any bond issued as part of an issue which meets (1) the private business use test under § 141(b)(1) and the private security or payment test under § 141(b)(2), or (2) the private loan financing test under § 141(c). *** Under § 1.141-2(a) of the Income Tax Regulations, private activity bond tests serve to identify arrangements that have the potential to transfer the benefits of tax-exempt financing, as well as arrangements that actually transfer these benefits, to a nongovernmental person.

Under § 141(b)(1), the private business use test is met by an issue if more than 10 percent of the proceeds of the issue are used for any private business use. Section 1.141-3(a)(2) provides that, for the purpose of the private business use test, the use of financed property is treated as the direct use of proceeds. Under § 141(b)(6)(A), private business use means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Under § 1.141-1(b), a governmental person is a state or any local governmental unit as defined in § 1.103-1 or any instrumentality thereof.

Section 1.103-1(b) defines a state or governmental unit, in part, as any state or political subdivision thereof. Section 1.103-1(b) also provides that a political subdivision for purposes of § 103 denotes any division of any state or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit. As examples of what may be considered a political subdivision of a State or local governmental unit, § 1.103-1(b) lists special assessment districts and divisions such as road, water, sewer, gas light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of any such unit.

Under § 141(b)(6)(B), any activity carried on by a person other than a natural person shall be treated as a trade or business. Section 141(b)(7) provides that government use means any use other than a private business use.

Section 1.141-3(b)(7)(i) provides that any arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to special legal entitlements described in § 1.141-3(b)(2), (3), (4), (5), or (6) results in private business use. Section 1.141-3(b)(7)(ii) provides that, when the financed property is not available for use by the general public (within the meaning of § 1.141-3(c)), private business use may be established solely on the basis of a special economic benefit to one or more nongovernmental persons even if those nongovernmental persons have no special legal entitlements to use of the property. Section 1.141-3(b)(7)(ii) further provides that, in determining whether special economic benefit gives rise to private business use, it is necessary to consider all of the facts and circumstances, including one or more of the following factors: (A) whether the financed property is functionally related or physically proximate to property used in the trade or business of a nongovernmental person; (B) whether only a small number of nongovernmental persons receive the special economic benefit; and (C) whether the cost of the financed property is treated as depreciable by any nongovernmental person.

Section 1.141-3(c)(1) provides that use as a member of the general public (general public use) is not private business use. Section 1.141-3(c)(1) further provides that use of financed property by nongovernmental persons in their trades or business is treated as general public use only if the property is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade or business. Section 1.141-3(c)(2) provides that use of bond proceeds under an arrangement that conveys priority rights or other preferential benefits is not use on the same basis as the general public. Section 1.141-3(c)(2) further provides that arrangements providing for use that is available to the general public at no charge or on the basis of rates that are generally applicable and uniformly applied do not convey priority rights or other preferential benefits.

The direct use of the Center by the individuals comprising each proposed user group would constitute use by natural persons. In order to meet the private business use test, the proposed use must be (directly or indirectly) in a trade or business by any person other than a governmental unit. As represented by the Issuer, the proposed use by the individual users would be for personal health, recreational, and educational purposes and not in a trade or business. Under § 141(b)(6), use of proceeds by natural persons not engaged in a trade or business does not constitute private business use and, thus, would not meet the private business use test of § 141(b)(1).

The University will be, directly or indirectly, benefitting by the use of the Center by the proposed user groups or for the proposed uses. However, the University is an integral part of the State. Similarly, use of the Center by the employees of the Hospital and their spouses and dependent children will inure indirectly to the benefit of the Hospital, which is an instrumentality of the State. Likewise, the County Board of Education is a governmental instrumentality of the District, which is a political subdivision of the State, and the Commission is an agency of the State. Accordingly, under §§ 1.103-1 and 1.141-1(b), use of proceeds by the University, as an integral part of the State, the Hospital and County Board of Education, as governmental instrumentalities, and the Commission, as an agency of the State, is use by governmental units within the meaning of § 141(b)(6) and, thus, does not meet the private business use test of § 141(b)(1).

The University may contract with individuals to make one or more presentations as part of the on-campus programs sponsored, presented, and operated by the University such as professional enrichment conferences. There is potential for an indirect beneficial use of the Center by these contracted individuals because such programs will include the use of the Center by program participants. This potential, however, is eliminated by the representation that the Center will not be used by contracted individuals for their presentations and the compensation paid to the contracted individuals will be a flat fee not based upon the number of program participants.

The use of the Center by the participants at the professional enrichment conferences and the University-sponsored non-credit classes, as well as the use of the juice bar at the Center are intended to be available and will be reasonably available to nongovernmental persons in a trade or business on the same basis as natural persons not engaged in a trade or business. Therefore, under § 1.141-3(c)(1), any use in a trade or business by nongovernmental persons would not be private business use.

CONCLUSION

As demonstrated above, none of the proposed user groups or proposed uses involve any use of the Center by a nongovernmental person in a trade or business that is taken into account for purposes of the private business use test. Accordingly, use of the Center by the proposed user groups and for the proposed uses would not constitute private business use under § 141(b)(1) of the Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter under any other provision of the Code or regulation thereunder, including §§ 103 and 141 through 150. Specifically, no opinion is expressed concerning whether interest on the Bonds is excludable from gross income under § 103(a).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of the letter is being sent to your authorized representative.

on behalf of the Issuer for a ruling regarding the qualified 501(c)(3) bonds (the "Bonds") that it proposes to issue to finance a portion of the construction of the Facility. You have requested a ruling that the proceeds of the Bonds may be allocated to University and government use of the Facility.

FACTS AND REPRESENTATIONS

The Facility will be a multi-purpose arena that is part of a larger redevelopment project in City's downtown area. The Issuer will issue the Bonds along with taxable bonds (the "Taxable Bonds") to finance the construction of the Facility and will lease the Facility to City under a financing lease.

University, a tax-exempt organization under § 501(c)(3) of the Internal Revenue Code (the "Code"), is located in the vicinity of the proposed Facility and wishes to use the Facility for its home basketball games and practices and for commencement exercises. City has agreed to sublease the Facility to University for these activities in return for rent payments based on a portion of the debt service on the Bonds. The Issuer reasonably expects that University's use of the Facility each year during the term of the Bonds will be approximately a percent of the total time the Facility will be in actual use. University represents that its use of the Facility will not constitute unrelated trade or business for University within the meaning of § 513(a) of the Code.

In addition, University will have naming rights to the Facility and the right to select the decor to match University's colors and emblems. It will not transfer the naming rights to a nongovernmental person engaged in a trade or business. University itself will name the Facility after one of the following: University; a benefactor of University who is a natural person; or a natural person who is designated by such benefactor. Any gift by a benefactor to University for the Facility will not be conditioned upon the naming of the Facility after such benefactor or its designee. The benefactor or a related person is expected to be a private business user of the Facility.

City also has agreed to sublease the Facility to Team Owner to be used for home games played by the Team, a minor league sports team, in exchange for rent payments equal to the debt service on the Taxable Bonds. The Issuer reasonably expects the Team's use of the Facility each year during the term of the Bonds will be approximately b percent (a percentage greater than 10 percent) of the total time the Facility will be in actual use. City does not expect the fair market value of this private business use to be significantly greater than that of the government or University use.

The Issuer reasonably expects that government use each year during the term of the Bonds will account for the rest, or approximately c percent, of the total time the Facility will be in actual use.

To build the Facility, the Issuer plans to issue the Bonds and the Taxable Bonds simultaneously. The Issuer will issue the Taxable Bonds in an amount sufficient to finance at least: (1) the costs of any discrete portions of the Facility the actual use of which the Issuer expects to be solely by private business users, such as concession areas,[FN1] (2) the costs of any discrete portions of the Facility that are not otherwise eligible for tax-exempt financing as qualified 501(c)(3) bonds, such as luxury boxes, (3) a portion of the costs of the remainder of the Facility, other than the common areas within the Facility (the "Remainder"), equal to the percentage of total time in actual use that the Issuer reasonably expects the Remainder to be used for private business use by the Team (the "Private Time Percentage"), and (4) a portion of the costs of the common areas within the Facility (the "Common Costs"), equal to the sum of (a) the product of the Common Costs and the percentage of the usable space of the Facility used for the purposes described in (1) and (2) (the "Discrete Common Costs"), and (b) the product of the difference between the Common Costs and the Discrete Common Costs and the Private Time Percentage. The Issuer will issue the Bonds to finance the balance of the costs, *i.e.*, an amount equal to or less than the sum of the costs of the Remainder not described in (3) above and any Common Costs not described in (4) above

LAW AND ANALYSIS

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 141(a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) provides that the term "private activity bond" means any bond issued as part of an issue (1) which meets the private business use test of § 141(b)(1), and the private security or payment test of § 141(b)(2), or (2) which meets the private loan financing test of § 141(c). Section 141(b)(1) provides that, except as otherwise provided, an issue meets the test of § 141(b)(1) if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(2) provides that, except as otherwise provided, an issue meets the test of § 141(b)(2) if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by any interest in (i) property used or to be used for a private business use, or (ii) payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(b)(6)(A) defines "private business use" as use (directly or indirectly) in a trade or business carried on by a person other than a governmental unit. For purposes of the preceding sentence, use as a member of the general public shall not be taken into account. Section 141(b)(7) defines "government use" as any use other than a private business use.

Section 141(e) provides, in part, that the term "qualified bond" means a qualified 501(c)(3) bond. Section 145(a) provides in general that the term "qualified 501(c)(3) bond" means any private activity bond issued as part of an issue if (1) all property which is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and (2) such bond would not be a private activity bond if (A) 501(c)(3) organizations were treated as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying § 513(a), and (B) §§ 141(b)(1) and (2) were applied by substituting "5 percent" for "10 percent" each place it appears and by substituting "net proceeds" for "proceeds" each place it appears.

Section 1.141-1(b) of the Income Tax Regulations provides that the term common areas means portions of a facility that are equally available to all users of a facility on the same basis for uses that are incidental to the primary use of the facility. For example, hallways and elevators generally are treated as common areas if they are used by the different lessees of a facility in connection with the primary use of the facility.

Section 1.141-1(b) provides that the term discrete portion means a portion of a facility that consists of any separate and discrete portion of a facility to which use is limited, other than common areas. A floor of a building and a portion of a building separated by walls, partitions, or other physical barriers are examples of a discrete portion.

Section 1.141-3(a) provides, in part, that the use of the financed property is treated as the direct use of proceeds.

Section 1.141-3(g)(1) provides that, in general, the private business use of proceeds is allocated to property under § 1.141-6. The amount of private business use of that property is determined according to the average percentage of private business use of that property during the measurement period.

Section 1.141-3(g)(2)(i) provides that, in general, the measurement period of property financed by an issue begins on the later of the issue date of that issue or the date the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the issue financing the property (determined without regard to any optional redemption dates). In general, the period of reasonably expected economic life of the property for this purpose is based on reasonable expectations as of the issue date.

Section 1.141-3(g)(3) provides that the average percentage of private business use is the average of the percentages of private business use during the 1-year periods within the measurement period. Appropriate adjustments must be made for beginning and ending periods of less than 1 year.

Section 1.141-3(g)(4)(i) provides that the percentage of private business use of property for any 1-year period is the average private business use during that year. This average is determined by comparing the amount of private business use during the year to the total amount of private business use and use that is not private business use (government use) during that year. Section 1.141-3(g)(4)(ii) through (v) apply to determine the average amount of private business use for a 1-year period.

Section 1.141-3(g)(4)(ii) provides that, for a facility in which actual government use and private business use occur at different times (for example, different days), the average amount of private business use generally is based on the amount of time that the facility is used for private business use as a percentage of the total time for

all actual use. In determining the total amount of actual use, periods during which the facility is not in use are disregarded.

Section 1.141-3(g)(4)(iv) provides that, for purposes of § 1.141-3(g), measurement of the use of proceeds allocated to a discrete portion of a facility is determined by treating that discrete portion as a separate facility.

Section 1.141-3(g)(4)(v) provides that, for purposes of § 1.141-3(g)(4) (ii) through (iv), if private business use is reasonably expected as of the issue date to have a significantly greater fair market value than government use, the average amount of private business use must be determined according to the relative reasonably expected fair market values of use rather than another measure, such as average time of use. This determination of relative fair market value may be made as of the date the property is acquired or placed in service if making this determination as of the issue date is not reasonably possible (for example, if the financed property is not identified on the issue date). In general, the relative reasonably expected fair market value for a period must be determined by taking into account the amount of reasonably expected payments for private business use for the period in a manner that properly reflects the proportionate benefit to be derived from the private business use.

Section 1.141-3(g)(5) provides that the amount of private business use of common areas within a facility is based on a reasonable method that properly reflects the proportionate benefit to be derived by the users of the facility. For example, in general, a method that is based on the average amount of private business use of the remainder of the entire facility reflects proportionate benefit.

Section 1.141-6(a) provides that, for purposes of §§ 1.141-1 through 1.141-15, the provisions of §§ 1.148-6(d) apply for purposes of allocating proceeds to expenditures. Thus, allocations generally may be made using any reasonable, consistently applied accounting method, and allocations under § 141 and § 148 must be consistent with each other.

Section 1.145-2(a) provides generally that §§ 1.141-0 through 1.141-15 apply to § 145(a). Section 1.145-2(b) provides that, in applying §§ 1.141-0 through 1.141-15 to § 145(a), (1) references to governmental persons include 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under § 513(a); (2) references to "10 percent" and "proceeds" in the context of the private business use test and the private security or payment test mean "5 percent" and "net proceeds"; and (3) references to the private business use test in § § 1.141-2 and 1.141-12 include the ownership test of § 145(a)(1). Section 1.145-2(c)(2) provides that § 1.141-3(g)(6) does not apply to § 145(a)(2) to the extent that it provides that costs of issuance are allocated ratably among the other purposes for which the proceeds are used. For purposes of § 145(a)(2), costs of issuance are treated as private business use.

The Report of the Committee of Ways and Means of the House of Representatives on H.R. 3838, H.R. Rep. No. 99-426, at 538 (1985), 1986-3 (Vol. 2) C.B. 538 (the "1985 House Report"), states as follows:

The committee understands that certain facilities eligible for financing with section 501(c)(3) organization bonds may comprise part of a larger facility otherwise ineligible for such financing or that portions of a section 501(c)(3) organization facility may be used for activities of persons other than section 501(c)(3) organizations. The committee intends that the Treasury Department may adopt rules for allocating the costs of such mixed use facilities (including common elements) according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the various users of the facility. Only the portions of such mixed use facilities owned and used by a section 501(c)(3) organization may be financed with bonds for such organizations.

The same language appears in the Report of the Committee on Finance of the Senate on H.R. 3838, S. Rep. No. 99-313, at 841 (1986), 1986-3 (Vol. 3) C.B. 841 (the "Senate Report").

Section 147(e) provides that a private activity bonds shall not be a qualified bond if issued as part of an issue and any portion of the proceeds of such issue is to be used to provide any airplane, skybox or other private luxury box, health club facility, facility primarily used for gambling, or store the principal business of which is the sale of alcoholic beverages for consumption off premises.

The predecessor to § 147(e), § 103(b)(18) of the Internal Revenue Code of 1954 (the "1954 Code"), was added to the 1954 Code by the Tax Reform Act of 1984, § 627(c), 1984-3 C.B. (Vol. 1) 1, 438. The Supplemental

Report of the Committee on Ways and Means of the U.S. House of Representatives on H.R. 4170, H. Rep. No. 98-432 (Part 2), at 1693 (1984), (the "1984 House Report") states:

In the case of skyboxes or other private luxury boxes, the committee does not intend to prohibit the use of IDBs to finance the construction, renovation or refurbishing of a facility solely because skyboxes are included in the project, so long as the project otherwise qualifies for tax-exempt financing. Rather, no portion of the proceeds of the IDB may be used to provide any skybox. For this purpose, the skybox shall be deemed to include the interior furnishing of the box (*e.g.*, the box's plumbing, electrical and decorating costs) and the structural components required for the box (*e.g.*, the box's walls, ceilings, special enclosures), but does not include the normal components of the stadium, such as structural supports, to the extent they would have been required for the remaining portion of the stadium if no skyboxes (and no regular seats in lieu of skyboxes) had been built.

The Issuer proposes to use proceeds of the Taxable Bonds to cover the costs attributable to any discrete portions of the Facility the actual use of which the Issuer expects to be solely by private business users and any discrete portions used for other purposes, such as luxury boxes, not eligible for financing with the proceeds of tax-exempt 501(c)(3) bonds. The Issuer proposes to finance the Remainder with a combination of proceeds of the Taxable Bonds and of the Bonds based on the expected percentage of time that the Remainder is actually used, respectively, for (1) private business use and (2) combined government and University use. The Issuer proposes to finance the Common Costs with a combination of proceeds of the Taxable Bonds and of the Bonds based on the expected percentage of the Facility that is actually used, respectively, for (1) private business use and (2) combined government and University use.

We first consider the two types of discrete portions mentioned above. It is clear from the 1984 House Report cited above that while luxury boxes may not be funded with tax-exempt private activity bonds, the other parts of a facility that include luxury boxes may be so funded if otherwise eligible. We think that treating discrete portions used for private business use in a similar fashion as luxury boxes is appropriate. Accordingly, because the Issuer will fund the discrete portions described above with proceeds of the Taxable Bonds, the presence of these discrete portions within the Facility will not preclude the Bonds from being tax-exempt.

We next consider the Remainder. The projected private business use of the Remainder, as measured in accordance with § 1.141-3(g)(4)(ii), will exceed ten percent. The issue is whether the Issuer may use a time-based allocation method to allocate the proceeds of the Bonds to University and government use, so that a portion of the Remainder may qualify for tax-exempt financing under § 145.

The 1985 House Report and the Senate Report recognize that portions of facilities used by 501(c)(3) organizations also may be used by other persons. While the larger facility so used may not qualify for tax-exempt financing, the legislative history indicates that tax-exempt financing under § 145 is permitted for the portion owned and used by the 501(c)(3) organization to the extent that the allocation of the costs of the facility is made using a reasonable method that properly reflects the proportionate benefit to be derived by the various users of the facility.

Even though the legislative history refers to the portion owned and used by a 501(c)(3) organization, we can see no reason not to extend this treatment to government ownership and use. Foremost, § 145 permits government use and ownership of financed property. Further, the legislative history appears to be addressing those situations where a facility otherwise would not be eligible for tax-exempt financing under § 145. Use and ownership by a governmental unit would not lead to such a situation.

The time-based method of allocation of use proposed by the Issuer is a reasonable method to allocate use. It would be applied in the same way as the time-based method of measuring private business use, thus reflecting the proportionate benefit to the various users. The fair market value of the private business use is not significantly greater than that of the government or 501(c)(3) use. Further, the percentages of use by the various users are expected to be substantially level over the term of the Bonds. Thus, we need not consider the situation where the percentages of use vary over the measurement period. The allocation of the costs of the Remainder is a reasonable method that reflects the proportionate benefit derived by the users of the Remainder, because the Issuer's proposed allocations of costs are consistent with the allocations of use, both using the time-based method. As a result, the portions of the Remainder allocated to University and government use, *i.e.*, a + c percent, or a total of d percent, of the Remainder, are eligible for financing under § 145.

Finally, we consider the common areas within the Facility. Consistent with our treatment of the Remainder, it is appropriate to allocate the proceeds of the Bonds to a portion of the Common Costs based on the amount of

University and government use of the rest of the Facility, so that a portion of the common areas may qualify for tax-exempt financing under § 145.

The Issuer proposes to determine the portion of the common areas that may be financed with the Bonds based on the rules set forth in § 1.141-3(g)(5), treating the discrete portions of the Facility that may not be financed with qualified 501(c)(3) bonds (i.e., the luxury boxes) as giving rise to private business use. The allocation of the costs using the methodology set forth in § 1.141-3(g)(5) is a reasonable method that reflects the proportionate benefit derived by the users of the Facility. The method of allocation of use proposed by the Issuer would be applied in the same way as the method of measuring private business use of common areas. In particular, the computation reflects both the private business use of the discrete portions of the Facility and the private business use of the Remainder based on the amount of time that it is used for a private business use.

CONCLUSIONS

We conclude as follows:

(1) Because the Issuer will fund the discrete portions described above with proceeds of the Taxable Bonds, the presence of these discrete portions within the Facility will not preclude the Bonds from being tax-exempt.

(2) The proceeds of the Bonds may be allocated to University and government use of the Remainder using a time-based method of allocation. As a result, the portions of the Remainder allocated to University and government use, *i.e.*, a total of d percent of the Remainder, are eligible for financing under § 145.

(3) The proceeds of the Bonds may be allocated to the common areas within the Facility based on the portion of the Facility not used for a private business use under § 1.141-3(g)(5). As a result, a portion of the common areas within the Facility, based on the amount of the Facility used for University and government use are eligible for financing under § 145.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether the interest on the Bonds will be excludable from gross income under § 103(a).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

FN1. In this ruling, other than in the recitations of the law, our use of the phrase “private business use” means private business use other than use by the University.

Private Letter Ruling #200336001-Private Business Test-Cable Programming Provider

This is in response to your request for a ruling that the distribution of the District cable television programming by the Provider, under the facts and terms described below, does not constitute private business use under § 141(b)(1) of the Internal Revenue Code of 1986 (the "Code") of facilities used to produce that programming.

FACTS AND REPRESENTATIONS

The District makes the following representations. The District is a political subdivision of State established by the residents of County under State law. The District's boundaries are coterminous with the boundaries of County, which encompass several cities and towns. The District's purpose is to deliver higher educational opportunities within County. The District furthers that purpose by offering various credit and non-credit courses, some using evolving methods such as television, radio, and the internet.

The District has begun using digital cable television to deliver educational programming (the "Programming") and plans to include credit and noncredit classes in its Programming. Students will not be required to subscribe to digital cable television to obtain course credit; the District provides alternative methods for students to obtain the information (e.g., internet, video tape, and free on-campus access to the channel that provides the Programming).

The District purchases or receives free from third parties a significant portion of the Programming. Other Programming will be produced by the District at the District's facilities. Some of these facilities were financed with bonds that were sold as taxexempt obligations (the "Facilities").

The Provider is a for-profit corporation in the area of cable programming, telecommunications, and technology. The Provider's cable systems offer its customers basic, expanded, and premium packages of cable programming. The Provider is the only significant provider of digital cable television in County.

As part of the Provider's franchise agreement with various cities within the County, the Provider must make cable access available to educational institutions. The franchise agreements do not require the Provider to create or provide the educational programming and do not specify which education institution must be given access.

The Provider and the District have entered into an agreement (the "Agreement") that allocates one digital cable channel (the "Channel") to the District to distribute the

Programming within the County. The Provider will distribute the Programming at no cost to the District.

Subscribers to any of the Provider's digital cable subscription packages will receive the Programming at no additional cost, but the Provider will retain all subscriber fees. The District represents that it and the Provider do not anticipate that the Provider will have more than an insignificant amount of additional subscribers solely because of the Programming. Apart from the subscription fees, the Provider will receive no income from the Channel or the Programming.

The Programming will transfer to the Provider through equipment owned by the Provider that is located at a studio owned by the District (the "Studio"). The Studio was not financed with tax-exempt bonds.

The Programming gets to the end user directly in "real time" with only technical processing of the signal by the Provider. The Provider does not control or manipulate the content of the Programming; the subscribers see the Programming as produced and created by the District. The District may acknowledge on the Channel that the Provider is providing the Channel to the District.

More specific provisions under the Agreement include as follows:

1. The District will be responsible for the Programming, including editorial control, scheduling, and making the Programming available to the Provider at the Studio. The District will provide at least a hours of Programming per day, b days per week. This minimum program requirement satisfies some of Provider's obligations under at least one of the franchise agreements.

2. The Provider will establish and maintain a fiber connection from its network to the Studio and digitally compress the District's Programming signal; distribute the Programming over its network; build, rebuild and maintain its cable television network within the Provider's digital service area; and provide advice to the District but without any ability to control or change the Programming and without any staff at the Facilities or Studio.

3. Each party will be responsible for its own costs incurred in connection with the distribution of the Programming through the Provider's cable television network.

4. The District and the Provider will design a distinct Programming identity and logos to market and promote the Programming. The Provider received a nonexclusive worldwide license to use any Programming marks, logos, or identity solely for the benefit of the Programming and in furtherance of the Provider's obligations under the Agreement. The District represents that it and the Provider believe that the license will have no monetary or non-monetary value to the Provider. Typical use of the logo will be on the Provider's program schedules or to advertise the Channel on other Provider channels.

5. The term of the Agreement is one year, renewable automatically. The Agreement may be terminated by either party, without penalty, by providing the other party with c-months prior notice.

6. The Provider will have no exclusive distribution rights to any Programming. The District can distribute the Programming through other cable companies or broadcasters.

The Provider has no ownership interest in, and bears no risk of loss with respect to, any of the Facilities or to the Programming produced at the Facilities. None of the bond-financed facilities are treated as depreciable by the Provider or any other nongovernmental person.

LAW AND ANALYSIS

Section 103(a) of the Code provides that gross income does not include interest on any state or local bond. Section 103(b)(1) provides that § 103(a) does not apply to a private activity bond, unless it is a qualified bond under § 141.

Section 141(a) provides that a private activity bond is any bond issued as part of an issue that meets either 1) the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or 2) the private loan financing test of § 141(c).

Section 141(b)(1) provides that generally a bond issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(6)(A) generally provides that the term “private business use” means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For purposes of § 141(b)(6)(A), use as a member of the general public shall not be taken into account. Section 141(b)(6)(B) provides that, for purposes of § 141(b)(6)(A), any activity carried on by a person other than a natural person shall be treated as a trade or business.

Section 1.141-3(a)(1) provides that the private business use test relates to the use of the proceeds of an issue, and, for this purpose, the use of financed property is treated as the direct use of proceeds. Section 1.141-3(a)(2) provides that in determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct uses of proceeds.

Section 1.141-3(b)(1) generally provides that both actual and beneficial use by a nongovernmental person may be treated as private business use. Section 1.141-3(b)(1) further provides that, in most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. Section 1.141-3(b)(1) also provides that, in general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract. Arrangements that convey special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to the arrangements in the prior sentence also result in private business use. § 1.141-3(b)(7)(i). For example, an arrangement that conveys priority rights to the use or capacity of a facility generally results in private business use.

Section 1.141-3(b)(7)(ii) provides that, in the case of financed property that is not available for use by the general public (within the meaning of § 1.141-3(c)), private business use may be established solely on the basis of a special economic benefit to one or more nongovernmental persons, even if those nongovernmental persons have no special legal entitlements to the use of the property. In determining whether special economic benefit gives rise to private business use, it is necessary to consider all of the facts and circumstances, including one or more of the following factors-

(A) Whether the financed property is functionally related or physically proximate to property used in a trade or business of a nongovernmental person;

(B) Whether only a small number of nongovernmental persons receive the special economic benefit; and

(C) Whether the cost of the financed property is treated as depreciable by any nongovernmental person.

Section 1.141-3(c)(1) provides that use of financed property by nongovernmental persons in their trades or businesses is treated as general public use only if the property is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade or business.

Section 1.141-3(f), Example 6, provides an example of other actual or beneficial use. J, a political subdivision, owns and operates a hydroelectric generation plant and related facilities. Pursuant to a take or pay contract, J sells 15 percent of the output of the plant to Corporation K, an investor-owned utility. K is treated as a private business user of the plant. Under the license issued to J for operation of the plant, J is required by federal regulations to construct and operate various facilities for the preservation of fish and for public recreation. J issues its obligations to finance the fish preservation and public recreation facilities. K has no special legal entitlements for beneficial use of the financed facilities. The fish preservation facilities are functionally related to the operation of the plant. The recreation facilities are available to natural persons on a short-term basis according to generally applicable and uniformly applied rates. Under § 1.141-3(c), the recreation facilities are treated as used by the general public. Under § 1.141-3(b)(7), K's use is not treated as private business use of the recreation facilities because K has no special legal entitlements for beneficial use of the recreation facilities. The fish preservation facilities are not of a type reasonably available for use on the same basis by natural persons not engaged in a trade or business. Under all of the facts and circumstances (including the functional relationship of the fish preservation facilities to property used in K's trade or business) under § 1.141-3(b)(7), K derives a special economic benefit from the fish preservation facilities. Therefore, K's private business use may be established solely on the basis of that special economic benefit, and K's use of the fish preservation facilities is treated as private business use.

The issue presented is whether the Provider, by transmitting the Programming, including Programming produced at the Facilities, will be a private business user of the Facilities.

The Provider has no legal entitlement to use the Facilities or the Programming that is produced at the Facilities. While the District must deliver to the Provider a hours of Programming b days per week, the District can meet that obligation with Programming not produced at the Facilities. Also, the Provider has no right to control or change the Programming or to have personnel at the Facilities.

Section 1.141-3(b)(7)(ii) provides a test for financed property that is not available for use by the general public. Under this test, private business use may be established solely on the basis of special economic benefit. See § 1.141-3(f), Example 6. The Programming is available for viewing by natural persons not engaged in a trade or business who are located in the Provider's service area and who subscribe to one of the Provider's digital packages. The Provider, however, is distributing the Programming; a use that differs from the subscribers' use. Thus, there is a question about whether the test set forth in § 1.141-3(b)(7)(ii) applies in this case. Without concluding that the test applies in the instant case, under all the facts and circumstances, including those listed below, we would conclude, if we were to apply that test, that the Provider does not have special economic benefits (within the meaning of § 1.141-3(b)(7)(ii)) to the financed property.

1. The cost of the Facilities is not depreciated by any nongovernmental entity.

2. We do not know whether any of the Facilities are located close to the Provider's property. For purposes of this ruling, we assume that at least some of the Facilities will be proximate to the Provider's property.

3. The District is not obligated to use the Provider to distribute its Programming and may terminate the Agreement with c-months notice. This factor is offset by the fact that the Provider is the only significant provider of digital cable television in County.

4. The Provider has no right to Programming from the Facilities. While the District must provide a minimum amount of Programming to the Provider, the District can and does satisfy its obligation with Programming not produced at the Facilities.

5. The Provider will distribute the Programming to any subscriber to its digital service without additional fees.

6. It is not clear whether the Provider will experience an increase in its subscribers because of the Programming. Students of the District will not be required to use digital cable television to get class credit or to obtain class materials - alternative methods of delivery of class material will be available.

7. The District does not pay the Provider for use of the Channel and Provider is not receiving any revenue in connection with the Channel or the Programming, apart from the subscription fees.

8. The Provider has a nonexclusive right or license to use the District, Channel, or Programming identity, marks, or logos, but may use such identity, marks, or logos solely for the benefit of the District, to promote the Programming, and to perform its obligations under the Agreement.

9. The District may acknowledge on the Channel that the Provider is providing the Channel to the District.

Further, the fact that the Provider by distributing the Programming may satisfy its legal obligations under the franchise agreements to provide access to educational facilities does not itself create private business use. The arrangement under the Agreement is distinguishable from the arrangement in § 1.141-3(f), Example 6. In that case, federal law required that, to operate the output facility, the fish preservation facilities be built. Here the Provider does not have to use the Facilities or the Programming from the Facilities to satisfy its obligation under the franchise agreements.

CONCLUSION

The Provider will not be a private business user under § 141(b)(1) of the Facilities because it distributes the Programming under the terms described above.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied with respect to any other contract, agreement, service, or arrangement between the District and the Provider.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Private Letter Ruling 200347009-Private Business Tests-License Agreement

This responds to your request for the following three rulings: (1) the License Agreement described below will not cause the Series A and Series B Bonds (collectively, "the Bonds") to satisfy the private business use test under §§ 145(a)(2)(B) and 141(b)(1) of the Internal Revenue Code; (2) the Scientist Agreement described below will not cause the Bonds to satisfy the private business use test under §§ 145(a)(2)(B) and 141(b)(1); (3) the right of the Large Contributors described below to require the Organization to transfer shares of the Corporation's Class A Stock to one or more § 501(c)(3) organizations chosen by the Large Contributors will not cause the Bonds to satisfy the private business use test under §§ 145(a)(2)(B) and 141(b)(1). For the reasons described below, we decline to rule on the second and third issues presented.

FACTS AND REPRESENTATIONS

The Internal Revenue Service has determined that the Institute is exempt from federal income tax under § 501(a) as an organization described in § 501(c)(3). On Dates 1 and 2, the Issuer issued the Bonds and loaned the proceeds to the Institute. The Institute financed the construction of a state-of-the-art laboratory complex (the "Facility"), with the proceeds of the Bonds. The Institute conducts basic biomedical research (the "Research") at the Facility. The Internal Revenue Service has determined that the research activities the Institute conducts at the Facility are and will be substantially related to the furtherance of the Institute's exempt purposes and will not constitute an unrelated trade or business.

The Corporation is a for-profit State corporation that will commercialize and market the Research for the Institute. In order to achieve this result, the Institute plans to enter into a license agreement with the Corporation (the "License Agreement").

Pursuant to the License Agreement, the Institute will grant the Corporation an exclusive, perpetual, non-terminable, worldwide license to any and all Research and to all patents the Institute has obtained or for which an application is pending (hereinafter, "the Research" includes patents and pending applications). The exclusive license will apply to Research that is created both before and during the term of the License Agreement and will arise automatically at the time that the Research is created. The Corporation's exclusive license includes the right to grant all sublicenses regarding the Research to any individual or entity, provided that the sublicenses further the Corporation's purpose of commercializing and marketing the Research.

The License Agreement will also require the Institute to assign to the Corporation the exclusive right to a portion of the Institute's net income that will be derived from the Research (the "Corporation Royalty Interest"). The Corporation Royalty Interest is equal to 100 percent of the costs that the Corporation incurs to commercialize any particular Research, plus 50 percent of any net income that the particular Research produces. The Institute will retain the right to receive the 50 percent of the net income after the Corporation recovers its costs (the "Institute Royalty Interest").

The License Agreement does not permit the Corporation to direct or control the types of research activities that the Institute undertakes or the manner in which any research activities are performed. The Corporation will not provide financial or other support to the Institute in the same or a similar manner to the support that would be provided by a sponsor as that term is defined in § 3.03 of Rev. Proc. 97-14, 1997-1 C.B. 634.

The Corporation will issue two classes of common stock (the "Class A Stock" and the "Class B Stock", collectively, "the Stock"). Although the Class A Stock will have certain voting rights, the Class B Stock will have superior voting rights compared to the Class A Stock.

Initially, the Organization will own 100 percent of the Class A Stock and 100 percent of the Class B Stock. The Organization is a supporting organization for the Institute, which the Internal Revenue Service has determined is exempt from federal income tax under § 501(a) as an organization described in § 501(c)(3).

The Organization may sell shares of Class A Stock to third parties in order to generate additional funding for the Research. However, the Organization will sell Class A Stock only to § 501(c)(3) organizations for the foreseeable future. In addition, when an individual or entity makes a contribution to the Organization in the amount of $a or more (the "Large Contributor"), the Large Contributor will be entitled to require the Organization to transfer a portion of the Class A Stock to any § 501(c)(3) organization that the Large Contributor chooses.[FN1] The Organization does not plan to sell any shares of the Class B Stock. The Class B Stock is not subject to the Large Contributors' designation.

The Institute will enter into an incentive compensation agreement with scientists who perform research activities at the Facility (the "Scientist Agreement"). The Scientist Agreement will provide that the scientist who discovers particular Research that the Corporation commercializes will receive all or a portion of the Institute Royalty Interest (the "Scientist Royalty Share"). The Issuer represents that, for federal income tax purposes, each of the scientists with whom it will enter into a Scientist Agreement is an employee of the Institute and the scientists' compensation, including the Scientist Royalty Share, is reasonable compensation.

LAW AND ANALYSIS

Section 103(a) of the Internal Revenue Code provides that gross income shall not include interest on any state or local bond. Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of § 141).

Section 145(a)(2) provides that a bond is a qualified 501(c)(3) bond if the bond would not be a private activity bond if 501(c)(3) organizations were treated as governmental units with respect to their activities which do not constitute unrelated trades or business, determined by applying § 513(a), and paragraphs (1) and (2) of § 141(b) were applied by substituting "5 percent" for "10 percent" each place it appears and by substituting "net proceeds" for "proceeds" each place it appears.

Section 141(a) provides, in part, that the term "private activity bond" means any bond issued as part of an issue which meets the private business use test of § 141(b)(1). Under § 141(b)(1), an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(6)(A) defines the term "private business use", in part, as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit, but use as a member of the general public is not taken into account. Under § 141(b)(6)(B), any activity carried on by a person other than a natural person shall be treated as a trade or business.

Section 1.141-3(a)(2) of the Income Tax Regulations provides that in determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct use of proceeds.

Section 1.141-3(b)(1) provides that, in general, both actual and beneficial use by a nongovernmental person may be treated as private business use. Section 1.141-3(b)(1) further provides as follows. In most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements, such as a take or pay or other output-type contract.

Section 1.141-3(b)(2) provides that, subject to certain exceptions that are not material to this ruling request, ownership by a nongovernmental person of financed property is private business use of that property. Section 1.141-3(b)(2) further provides that ownership refers to ownership for federal income tax purposes.

Under § 1.141-3(b)(6)(i), except as provided in § 1.141-3(d), an agreement by a nongovernmental person to sponsor research performed by a governmental person may result in private business use of the property used for the research, based on all of the facts and circumstances.

Section 1.141-3(b)(7)(i) provides, in part, that any other arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to special legal entitlements described in § 1.141-(3)(b)(2) results in private business use. Section 1.141-3(b)(7)(i) further provides that, for example, an arrangement that conveys priority rights to the use or capacity of a facility generally results in private business use.

Section 1.145-2(a) provides that, with certain exceptions that are not material to this ruling request, § 1.141-0 through 1.141-15 apply to § 145(a).

Rev. Proc. 97-14 sets forth conditions under which a research agreement does not result in private business use under § 141(b) and applies to determinations of whether a research agreement causes the test in § 145(a)(2)(B) to be met for qualified 501(c)(3) bonds. See Rev. Proc. 97-14, § 1. Section 5.02 of Rev. Proc. 97-14 generally provides that a research agreement relating to property used for basic research supported by a sponsor does not cause the research agreement to result in private business use of the bond-financed facility if any license or other use of resulting technology by the sponsor is permitted only on the same terms as the recipient would permit that

use by any unrelated, non-sponsoring party (that is, the sponsor must pay a competitive price for its use), with the price paid for that use determined at the time the license or other resulting technology is available for use. Section 3.03 of Rev. Proc. 97-14 defines a sponsor as any person, other than a qualified user, that supports or sponsors research under a contract.

Whether the License Agreement will cause the Bonds to satisfy the private business use test under §§ 145(a)(2)(B) and 141(b)(1)?

Because the Issuer represents that the Corporation will not control the type of or manner of performing the Research and will not provide financial or other support to the Institute in a manner described in § 3.03 of Rev. Proc. 97-14, the Corporation is not a sponsor of the Research. Consequently, we analyze the License Agreement under the regulations set forth at § 1.141-3(b)(7).

The Corporation's rights under the License Agreement include an exclusive, perpetual, non-terminable, worldwide license to all of the Research created at the Facility and the exclusive right to sublicense the Research to any person of the Corporation's choice. These rights conveyed to Corporation under the License Agreement are among the various rights that are inherent in the Institute's ownership of the Facility and the Research. Consequently, under § 1.141-3(b)(7)(i), these rights are special legal entitlements for beneficial use of the Facility that are comparable to an ownership interest in the Facility. The fact that the Corporation is also entitled to receive 50 percent of the total net income that the Research created at the Facility produces further demonstrates that the Corporation's interest in the Facility is comparable to an ownership interest.

The Corporation is neither a governmental unit nor a natural person. Consequently, its license to the Research and its resulting interest in the Facility are activities that constitute a trade or business under § 141(b)(6)(B).

CONCLUSION

We conclude that the License Agreement will cause the Bonds to satisfy the private business use test under §§ 145(a)(2)(B) and 141(b)(1) because, under § 1.141-3(b)(7)(i), the rights conveyed to the Corporation pursuant to the License Agreement are special legal entitlements for the Corporation's beneficial use of the Facility that are comparable to an ownership interest. Because the remaining two issues regarding the Scientist Agreement and the Large Contributors depend on a favorable ruling with respect to the License Agreement, we decline to rule on these remaining two requests for rulings.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

FN1. The portion of the Class A Stock to be transferred will have an aggregate fair market value equal to b percent of the amount of the contribution. The fair market value of the Class A Stock will be determined by an independent, qualified appraiser at the time the contribution is made to the Organization.

Private Letter Ruling 200441025-Private Business Tests-Parking Ramps/Contractual Agreements

This is in response to your request for the following rulings:

1) That the proposed allocation of proceeds of the Bonds to the Parking Unit (defined below) is reasonable.

2) That certain contractual arrangements for the use of the Project (defined below) will not cause the Bonds to meet the private business tests under section 141(b) of the Internal Revenue Code.[FN1]

FACTS AND REPRESENTATIONS:

The Proposed Bonds

The City is a political subdivision of State. On Date 1, the City Council adopted an initial resolution approving the issuance of the Bonds.

The Bonds will be general obligation bonds of the City and will not be secured by a specific project. The Bonds are expected to be issued as fixed rate bonds in the principal amount of a and will be used to finance certain costs related to the construction of a parking and retail structure located in the City (the Project).

The Project

The Project will consist of a multi-level parking ramp, a retail structure adjacent to the ground floor of the parking ramp, a roof deck constructed to accommodate development on top of the parking ramp, and related infrastructure improvements. The total costs of the Project, including land acquisition and construction, are estimated to be b.

The City has made a declaration of condominium under State law creating separate properties within the Project: the Parking Unit and the Retail Units. The Parking Unit consists of c parking spaces on *** levels of the parking ramp (the "Parking Ramp") and the roof of the parking ramp (the "Roof Deck"). The Retail Units will accommodate a mix of retail and office and are expected to be transferred to the Developer pursuant to the Development Agreement (described below).

The Parking Unit is expected to be used by the City for public parking and related purposes. In addition, under the declaration of condominium, each Retail Unit owner will have the nonexclusive right to use all of the vehicular parking and traffic areas, the elevators, stairways and other pedestrian areas in the Parking Unit in the same manner as members of the general public and subject to the City's imposition of fees and other rules.

The City expects that the Roof Deck will be used to support a condominium project that will be owned or operated by a nongovernmental person. The cost of the Roof Deck, including the additional costs of constructing the Parking Ramp because of the location of the Roof Deck, is expected to be d. None of the Bond proceeds will be used for these costs. The City proposes to allocate the proceeds of the Bonds to the costs of constructing the Parking Ramp that are not associated with the Roof Deck. These costs of the Parking Ramp are estimated to be e. All costs related to the construction of the Roof Deck, include costs for the structural components of the Parking Ramp that are required solely because of the location of the Roof Deck, will be paid from the City's revenues or the proceeds of taxable bonds (the "City's Equity"). City's Equity will also be used to finance a portion of the costs of the Parking Ramp. Thus, f percent of the Parking Ramp will be financed with the proceeds of the Bonds. The proceeds of the Bonds and the City's Equity will be proportionately allocated to all costs of the Parking Ramp.

The Development Agreement

The Retail Units will consist of separate, commercial space located at ground level on two sides of the Parking Ramp. The City's Equity will be used to complete the first stage of constructing the Retail Units. No Bond proceeds will be used to construct the Retail Units. The Developer will pay the additional costs necessary for completing construction of the Retail Units.

Under the Development Agreement between the City and the Developer, two fees will be paid to the City: the Annual Development Fee and the Initial Development Fee. The Initial Development Fee, in the amount of g, is to be paid by the Developer to the City at the time title to the Retail Units is transferred to the Developer.

The Annual Development Fee paid by the Developer has a term of h years commencing in Year 1. For the first 5 years of the Agreement, the minimum annual amount of the fee is i. Thereafter, the annual fee will be j.

Pursuant to the Development Agreement, the Developer has the option, exercisable until Date 2, to reserve and pay for up to k parking spaces. The option terms and fee for the parking spaces will be substantially the same as those contained in the Supplemental Lease (discussed below). The City also agrees to reserve no less than l parking spaces on levels two and three of the Parking Ramp for use by the general public. The City represents that the spaces that will be reserved for the general public will be available for use on the same basis by persons not engaged in a trade or business.

The Parking Agreements

In addition to the Development Agreement, the City has entered into the following arrangements with respect to the Project:

1) A parking lot lease agreement between the City and Corporation 1 (the Primary Lease);

2) A parking lot lease agreement between the City and Partnership (the Supplemental Lease); and

3) A parking lot lease agreement between the City and Corporation 2 (the Master Lease) (The Master Lease; the Primary Lease; and the Supplemental Lease are referred to collectively as the "Parking Agreements").

The Primary Lease provides for the lease of m parking spaces in the Parking Ramp to Corporation 1 during the term of the contract. The rent for the first 10 years of the Primary Lease is n per month per parking space. Thereafter, the rates will be adjusted every five years to the fair market rent at the beginning of the five year period.

The terms of the Supplemental Lease are substantially the same as the Primary Lease, including the rate per space, except it provides for the lease of l parking spaces to the Partnership and provides the Partnership with the option to lease an additional o spaces on the same terms.

The Master Lease provides Corporation 2 the right to lease up to p spaces in the Parking Ramp. However, the Master Lease is subordinate to both the Primary Lease and the Supplemental Lease. Thus, Corporation 2 has no right to lease parking spaces that are being leased under either the Primary Lease or the Supplemental Lease. Rental payments under the Master Lease are set at the same rates as the Primary Lease and the Supplemental Lease.

Payments received under all the Parking Agreements are gross rent amounts and are not reduced by the ordinary and necessary expenses attributable to the operation and maintenance of the Parking Ramp. The City represents that the expected ordinary and necessary expenses attributable to the operation and maintenance of the Parking Ramp related to the use of the p spaces under the Parking Agreements is q and the present value of those payments is r.

LAW:

Generally, section 103(a) provides that gross income does not include interest on any State or local bond. Section 103(b)(1) provides that this exclusion does not apply to any private activity bond unless it is a qualified bond under section 141.

Section 141(a) provides that a bond is a private activity bond if the bond satisfies the private business use test and the private security or payment test of section 141(b) or the private loan financing test of section 141(c).

Under section 141(b)(1), an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Private business use is defined in section 141(b)(6) as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For this purpose, any activity carried on by a person other than a natural person is treated as a trade or business.

Section 141(b)(2) provides, in general, that an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of the issue is (under the terms of the issue or any underlying arrangement) directly or indirectly (A) secured by any interest in property used or to be used for a private business use, or payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 1.141-2(d)(1) provides that an issue is an issue of private activity bonds if the issuer reasonably expects, as of the issue date, that the issue will meet either the private business tests or the private loan financing test. Section 1.141-2(d)(1) further provides that an issue is also an issue of private activity bonds if the issuer takes a deliberate action, subsequent to the issue date, that causes the conditions of the private business tests or the private loan financing test to be met.

Section 1.141-3 provides rules relating to the definition of private business use. Section 1.141-3(a)(1) provides, in part, that the use of financed property is treated as the direct use of proceeds. Under section 1.141-3(a)(2), in determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct uses of proceeds.

Under section 1.141-3(b)(1), both actual and beneficial use by a nongovernmental person may be treated as private business use. Section 1.141-3(b)(1) further provides that, in most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other outputtype contract.

Under section 1.141-3(b)(7)(i), any other arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to ownership, leases, management contracts, output contracts, or research agreements results in private business use. For example, an arrangement that conveys priority rights to the use or capacity of a facility generally results in private business use.

Section 1.141-3(g) provides the rules for measurement of private business use. Section 1.141-3(g)(1) provides that in general, the private business use of proceeds is allocated to property under section 1.141-6. Section 1.141-6(a) provides that allocations generally may be made using any reasonable, consistently applied method, and that allocations under section 141 and section 148 must be consistent with each other.

Section 1.141-3(g)(1) also provides that the amount of private business use of property to which bond proceeds have been allocated is determined according to the average percentage of private business use of that property during the measurement period. Section 1.141-3(g)(2) provides that, in general, the measurement period of property financed by an issue begins on the later of the issue date of that issue or on the date the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the Issue financing the property (determined without regard to any optional redemption dates).

Section 1.141-3(g)(3) provides that the average percentage of private business use is the average of the percentages of private business use during the one-year periods within the measurement period. Section 1.141-3(g)(4) provides that the percentage of private business use of property for any one-year period is the average private business use during that year. This average is determined by comparing the amount of private business use during the year to the total amount of private business use and use that is government use during that year.

Section 1.141-3(g)(4)(iii) provides, in general, that for a facility in which government use and private business use occur simultaneously, the entire facility is treated as having private business use. For example, a governmentally owned facility that is leased or managed by a nongovernmental person in a manner that results in private business use is treated as entirely used for a private business use. If, however, there is also private business use and actual government use on the same basis, the average amount of private business use may be determined on a reasonable basis that properly reflects the proportionate benefit to be derived by the various users of the facility (e.g., reasonably expected fair market value of use). For example, the average amount of private business use of a garage with unassigned spaces that is used for government use and private business use is generally based on the number of spaces used for private business use as a percentage of the total number of spaces.

Section 1.141-3(g)(4)(iv) provides that the measurement of the use of proceeds allocated to a discrete portion of a facility is determined by treating that discrete portion as a separate facility. Section 1.141-1(b) provides that the term discrete portion means a portion of a facility that consists of any separate and discrete portion of a facility to which use is limited, other than common areas.

Section 1.141-3(g)(5) provides rules for common areas. The amount of private business use of common areas within a facility is generally based on a reasonable method that properly reflects the proportionate benefit to be derived by the users of the facility. Section 1.141-1(b) defines "common areas" as portions of a facility that are equally available to all users of a facility on the same basis for uses that are incidental to the primary use of the facility. For example, hallways and elevators generally are treated as common areas if they are used by the different lessees of a facility in connection with the primary use of that facility.

The Report of the Committee of Ways and Means of the House of Representatives on H.R. 3838, H.R. Rep. No. 99-426, at 538 (1985), 1986-3 (Vol. 2) C.B. 538 (the "1985 House Report"), states as follows:

The committee understands that certain facilities eligible for financing with section 501(c)(3) organization bonds may comprise part of a larger facility otherwise ineligible for such financing or that portions of a section 501(c)(3) organization facility may be used for activities of persons other than section 501(c)(3) organizations. The committee intends that the Treasury Department may adopt rules for allocating the costs of such mixed use facilities (including common elements) according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the various users of the facility. Only the portions of such mixed use facilities owned and used by a section 501(c)(3) organization may be financed with bonds for such organizations.

Section 147(e) provides that a private activity bonds shall not be a qualified bond if issued as part of an issue and any portion of the proceeds of such issue is to be used to provide any airplane, skybox or other private luxury box, health club facility, facility primarily used for gambling, or store the principal business of which is the sale of alcoholic beverages for consumption off premises.

The predecessor to section 147(e), section 103(b)(18) of the Internal Revenue Code of 1954 (the "1954 Code"), was added to the 1954 Code by the Tax Reform Act of 1984, section 627(c), 1984-3 C.B. (Vol. 1) 1, 438. The Supplemental Report of the Committee on Ways and Means of the U.S. House of Representatives on H.R. 4170, H. Rep. No. 98-432 (Part 2), at 1693 (1984), (the "1984 House Report") states:

In the case of skyboxes or other private luxury boxes, the committee does not intend to prohibit the use of IDBs to finance the construction, renovation or refurbishing of a facility solely because skyboxes are included in the project, so long as the project otherwise qualifies for tax-exempt financing. Rather, no portion of the proceeds of the IDB may be used to provide any skybox. For this purpose, the skybox shall be deemed to include the interior furnishing of the box (e.g., the box's plumbing, electrical and decorating costs) and the structural components required for the box (e.g., the box's walls, ceilings, special enclosures), but does not include the normal components of the stadium, such as structural supports, to the extent they would have been required for the remaining portion of the stadium if no skyboxes (and no regular seats in lieu of skyboxes) had been built.

Section 1.141-4 provides rules pertaining to the private security or payment test. Section 1.141-4(a)(1) provides that the private security or payment test relates to the nature of the security for, and the source of, the payment of debt service on an issue. The private payment portion of the test takes into account the payment of debt service on the issue that is directly or indirectly to be derived from payments (whether or not to the issuer or any related party) in respect of property, or borrowed money, used or to be used for a private use**.** The private security portion of the test takes into account the payment of the debt service on the issue that is directly or indirectly secured by any interest in property used or to be used for a private business use or payments in respect of property used or to be used for a private business use.

Section 1.141-4(b) provides that in determining whether an issue meets the private security or payment test, the present value of the payments or property taken into account is compared to the present value of the debt service to be paid over the term of the issue. For this purpose, present values are determined by using the yield on the issue as the discount rate and by discounting all amounts to the issue date.

Under section 1.141-4(c)(2)(i)(A), both direct and indirect payments made by any nongovernmental person that is treated as using proceeds of the issue are taken into account as private payments to the extent allocable to the proceeds used by that person. Payments are taken into account as private payments only to the extent that they are made for the period of time that proceeds are used for a private business use. Payments for a use of proceeds include payments (whether or not to the issuer) in respect of property financed (directly or indirectly) with those proceeds, even if not made by a private business user. Payments are not made in respect of financed property if those payments are directly allocable to other property being directly used by the person making the payment and those payments represent fair market value compensation for that other use.

Section 1.141-4(c)(2)(i)(C) further provides that payments by a person for a use of proceeds do not include the portion of any payment that is properly allocable to the payment of ordinary and necessary expenses (as defined under section 162) directly attributable to the operation and maintenance of the financed property used by that person. For this purpose, general overhead and administrative expenses are not directly attributable to those operations and maintenance.

Under section 1.141-4(c)(3)(i), private payments for the use of property are allocated to the source or different sources of funding of property. For this purpose, different sources of funding may include taxable issues and amounts that are not derived from a borrowing, such as revenues of an issuer (equity). Section 1.141-4(c)(3)(ii) provides that payments for the use of a discrete facility (or a discrete portion of a facility) are allocated to the source or different sources of funding of that discrete property.

Section 1.141-4(c)(3)(iii) further provides that, in general, except as provided in section 1.141-4(c)(3)(iv) or (v), if a payment is made for the use of property financed with two or more sources of funding, that payment must be allocated to those sources of funding in a manner that reasonably corresponds to the relative amounts of those sources of funding that are expended on that property.

ANALYSIS:

1) Allocation of Proceeds to Costs of the Project

The City proposes to allocate the proceeds of the Bonds to a portion of the costs of constructing the Parking Ramp. The City represents that no Bond proceeds will be used to finance costs of the Retail Units or the Roof Deck. Rather, the City proposes to use the City's Equity to finance the portions of the Project that are expected to be used by nongovernmental persons; the Retail Units and the Roof Deck. The costs of the Roof Deck that will be financed with the City's Equity include the cost of structural components of the Parking Ramp that are required solely because of the location of the Roof Deck. *See generally* the 1984 House Report.

Based on the facts described above, the Parking Ramp, the Retail Units, and the Roof Deck will be separate and discrete portions of the Project with limited and specific use. We conclude that the proposed method of allocating proceeds of the Bonds to the costs of the discrete portions of the project is a reasonable allocation method that reflects the expected use of those discrete portions of the Project. The proposed allocations will also be made consistently for purposes of section 141 and 148.

2) Application of the Private Business Tests to the Agreements for Use of the Project

The Parking Agreements

The Parking Agreements provide special legal entitlements to use a total of p of the c parking spaces in the Parking Ramp by nongovernmental persons during the term of the agreements. As a result, the private business use test is met because there is expected to be more than 10 percent private business use of the Parking Ramp.

Measurement of the exact amount of private business use is relevant in this case, however, because it will impact the application of the private payment test. On the facts presented, private business use and actual government use of the Parking Ramp occur simultaneously on the same basis. Therefore, the average amount of private business use may be determined on a reasonable basis that properly reflects the proportionate benefit to be derived by the various users of the facility. In this case, the average amount of private business use of the Parking Ramp resulting from the Parking Agreements is the number of spaces used for private business use pursuant to the Parking Agreements as a percentage of the total number of spaces in the Parking Ramp. This approach is consistent with the parking garage example in section 1.141-3(g)(4)(iii).

For purposes of section 141, private payments are taken into account to the extent that they are made for the period of time that proceeds are used for a private business use. Thus, private payments taken into account in this case will include payments for the parking spaces privately used pursuant to the Parking Agreements. Moreover, for purposes of determining the amount of private payments, the City assumes that the Partnership will exercise its option under the Supplemental Lease. Thus, payments under the option are also taken into account.

Under section 1.141-4(c)(3)(i), private payments for the use of property are allocated to the source or different sources of funding of property. In this case, there are two sources of funding for the costs of the Parking Ramp; the proceeds of the Bonds and the City's Equity. The proceeds of the Bonds financed f percent of the Parking

Ramp. The remaining costs were financed with the City's Equity. The proceeds of the Bonds and the City's Equity proportionately financed the costs of the Parking Ramp.

For purposes of the private security or payment test, payments received pursuant to the Parking Agreements are allocated to the Bond proceeds and the City's Equity in the same proportion as those funds were used to finance the Parking Ramp in accordance with section 1.141-4(c)(3)(iii). Moreover, under section 1.141-4(c)(2)(i)(C), the private payments for the use of the Parking Ramp are reduced by ordinary and necessary expenses to the extent that those expenses are directly attributable to the operation and maintenance of the Parking Ramp related to the use under the Parking Agreements. Accordingly, we conclude that, based on the City's expectations regarding the payments under the Parking Agreements and the related operating expenses, the Parking Agreements will not cause the Bonds to meet the private payment or security test.

The Development Agreement

The Development Agreement provides that ownership of the Retail Units will be transferred to the Developer after payment of the Initial Development Fee. However, no Bond proceeds

were used to finance the construction of the Retail Units. Thus, the Developer's ownership of the Retail Units does not, in and of itself, result in private business use of the Project.

Under the Development Agreement, however, the Developer also receives an option to lease an additional k parking spaces in the Parking Ramp. For purposes of the private business tests, the City assumes that the option will be exercised and that there will be private business use of the specified number of parking spaces.

The Development Agreement also provides that the City agrees to reserve no less than l parking spaces in the Parking Ramp for general public use. Although the Developer receives no special legal entitlements with respect to the reserved spaces, it may receive an indirect benefit from the City's reservation of spaces for public parking. In this case, however, this indirect benefit does not rise to the level of private business use because the spaces will be reserved for the general public and will be available for use on the same basis by persons not engaged in a trade or business.

For purposes of the private payment test, the portion of the Annual Development Fee that is equal to the expected fair market value of the k optioned parking spaces is taken into account. Nonetheless, when these payments are aggregated with the payments made under the Parking Agreements, the aggregate payments do not cause the private payment or security test to be met.

The City proposes to allocate the remaining payments under the Development Agreement (including the Initial Development Fee and the portion of the Annual Development Fee not allocated to the k parking space option) to the Developer's use of the Retail Units, a discrete portion of the Project that will be financed entirely with the City's Equity. The present value of the Development Agreement payments also approximates the City's cost of constructing the Retail Units. Based on the facts and circumstances presented here, the proposed allocation of the Developer's payments is consistent with the purposes of section 141 and does not cause the private security or private payments test to be met.

Thus, based on the City's representations and current expectations, the agreements for the use of the Project discussed herein do not cause the Bonds to meet the private business tests

CONCLUSIONS:

Based on the information submitted and representations made, we conclude that the proposed allocation of Bond proceeds and City's Equity to the costs of the Parking Ramp, the Retail Units, and the Roof Deck is reasonable. Furthermore, we conclude that the contracts for the use of the Project discussed herein will not cause the Bonds to meet the private business tests under section 141. We express no opinion as to the result if the actual payments or expenses related to the Parking Agreements or Development Agreement differ from the City's representations made in connection with this ruling request. We also express no opinion as to whether any future arrangements for use of the Roof Deck may cause the Bonds to meet the private business tests.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

FN1. Unless otherwise stated, all section references are to the Internal Revenue Code of 1986.

Private Letter Ruling 200502012-Private Business Test-Acquiring Property Interests

This responds to the Authority's request for a ruling that the acquisition of various interests in land (the "Property Interests") and related arrangements as described below will not give rise to private business use within the meaning of § 141 of the Internal Revenue Code. The Authority also requests a ruling that the related arrangements are uses related and not disproportionate to the government use of the proceeds.

FACTS AND REPRESENTATIONS:

The City created the Authority for the purpose of acquiring, operating, and maintaining property for the City. The Authority will acquire the Property Interests through arm's length negotiations with the current landowners (the "Sellers"), typically farmers and ranchers. The Authority will not pay more than fair market value for any such Property Interest. By purchasing a Property Interest with respect to a parcel of property, the Authority will secure the development rights so that the parcel may be preserved as open space for the scenic enjoyment of the public, for agricultural use, and to conserve the natural habitat (the "Open Space Program").

The Authority intends to issue bonds to finance at least a portion of some of the Property Interests. The Authority will issue some of the bonds in the form of an installment sale note to the Seller (the "Note"). Payment of the Note may be secured by the Authority's rights in the Property Interest or by a general obligation pledge from the City.

Based on the negotiations between the particular Seller and the Authority, the Authority will acquire a parcel for the Open Space Program through one of the following types of arrangements.

1) The Authority may purchase a conservation easement in perpetuity from the Seller. The conservation easement will restrict the Seller's use of the parcel subject to the easement, generally to residential and agricultural uses, so that the Seller's use will not impinge upon the Authority's use of the parcel for the Open Space Program.

2) The Authority may purchase a future interest in fee simple in the parcel, with the Seller retaining a life estate.

3) The Authority may purchase a present interest in fee simple in the parcel and enter into a lease with the Seller or a third party, granting the leaseholder certain agricultural rights to the parcel (the "Lease"). Examples of the agricultural rights include haying, grazing, raising of livestock, farming of marketable crops, and water storage.

4) The Authority may purchase a present interest in fee simple in the parcel, subject to a *profit à prendre* interest[FN1] retained by the Seller. The *profit à prendre* interest will allow the holder to enter the parcel for limited agricultural purposes, such as haying and grazing of animals. The rights and uses permitted under the *profit à prendre* interest will be less extensive than those under the Lease and will not impinge upon the Authority's use of the parcel.

5) Lastly, the Authority may acquire a present interest in fee simple in the parcel and convey a *profit à prendre* interest in the parcel to a third party. The *profit à prendre* interest will be exactly as that described directly above. The value of the *profit à prendre* interest conveyed by the Authority, when aggregated with other private business use of the parcel, will not exceed 10 percent of the proceeds of the issue used to acquire the parcel.

LAW:

Section 103(a) provides, in general, that gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(a) defines private activity bond to mean any bond issued as part of an issue which meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or which meets the private loan financing test of § 141(c).

An issue meets the private business use test of § 141(b)(1) if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(6) defines private business use as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Section 141(b)(7) defines government use as any use other than a private business use.

Section 1.141-3(a)(1) of the Income Tax Regulations provides that the private business use test relates to the use of the proceeds of an issue. The 10 percent private business test of § 141(b)(1) is met if more than 10 percent of the proceeds of an issue is used in a trade or business of a nongovernmental person. For this purpose, the use of

financed property is treated as the direct use of proceeds. Any activity carried on by a person other than a natural person is treated as a trade or business. Unless the context or a provision clearly requires otherwise, this section also applies to the private business use test under § 141(b)(3) (unrelated or disproportionate use).

Section 1.141-3(a)(2) provides that in determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct uses of proceeds. For example, a facility is treated as being used for a private business use if it is leased to a nongovernmental person and subleased to a governmental person or if it is leased to a governmental person and then subleased to a nongovernmental person, provided that in each case the nongovernmental person's use is in a trade or business. Similarly, the issuer's use of the proceeds to engage in a series of financing transactions for property to be used by nongovernmental persons in their trades or businesses may cause the private business use test to be met. In addition, proceeds are treated as used in the trade or business of a nongovernmental person if a nongovernmental person, as a result of a single transaction or a series of related transactions, uses property acquired with the proceeds of an issue.

Section 1.141-3(a)(3) provides that the use of proceeds by all nongovernmental persons is aggregated to determine whether the private business use test is met.

Section 1.141-3(b) provides for the types of arrangements that will be considered to give rise to private business use. Section 1.141-3(b)(1) provides that both actual and beneficial use by a nongovernmental person may be treated as private business use. In most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

Section 1.141-3(b)(2) provides generally that ownership by a nongovernmental person of a financed property is private business use of that property. For this purpose, ownership refers to ownership for federal income tax purposes.

Section 1.141-3(b)(3) provides generally that the lease of financed property to a nongovernmental person is private use of that property. For this purpose, any arrangement that is properly characterized as a lease for federal income tax purposes is treated as a lease.

Section 1.141-3(b)(7) provides that any other arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to special legal entitlements such as ownership or leases (or other arrangements not relevant for this purpose) results in private business use. For example, an arrangement that conveys priority rights to the use or capacity of a facility generally results in private business use.

Section 1.141-3(g)(1) provides, in general, that the private business use of proceeds is allocated to property under § 1.141-6. The amount of private business use of that property

is determined according to the average percentage of private business use of that property during the measurement period.

Section 1.141-3(g)(2) provides, in general, that the measurement period of property financed by an issue begins on the later of the issue date of that issue or the date the property is placed in service and ends on the earlier of the last date of any bond of the issue financing the property (determined without regard to any optional redemption dates).

Section 1.141-3(g)(3) provides that the average percentage of private business use is the average of the percentages of private business use during the 1-year periods within the measurement period. Appropriate adjustments must be made for beginning and ending periods of less than 1 year.

Section 1.141-3(g)(4) provides for determining the average amount of private business use for a 1-year period. In general, the percentage of private business use of property for any 1-year period is the average private business use during that year. This average is determined by comparing the amount of private business use during the year to the total amount of private business use that is not private use (government use) during that year.

In general, for a facility in which government use and private business use occur simultaneously, § 1.141-3(g)(4)(iii) provides that the entire facility is treated as having private business use. For example, a

governmentally owned facility that is leased or managed by a nongovernmental person in a manner that results in private business use is treated as entirely used for a private business use. If, however, there is also private business use and actual government use on the same basis, the average amount of private business use may be determined on a reasonable basis that properly reflects the proportionate benefit to be derived by the various users of the facility (for example, reasonably expected fair market value of use). For example, the average amount of private business use of a garage with unassigned spaces that is used for government use and private business use is generally based on the number of spaces used for private business use as a percentage of the total number of spaces.

For purposes of paragraphs (g)(4)(ii) through (iv) of § 1.141-3, if private business use is reasonably expected as of the issue date to have a significantly greater fair market value than government use, the average amount of private business use must be determined according to the relative reasonably expected fair market values of use rather than another measure, such as average time of use. This determination of relative fair market value may be made as of the date the property is acquired or placed in service if making this determination as of the issue date is not reasonably possible (for example, if the financed property is not identified on the issue date). In general, the relative reasonably expected fair market value for a period must be determined by taking into account the amount of reasonably expected payments for private business use for the period in a manner that property reflects the proportionate benefit to be derived from the private business use.

Section 141(b)(3)(A) provides that an issue shall be treated as meeting the tests of § 141(b)(1) if such tests would be met by substituting 5 percent for 10 percent in § 141(b)(1) by taking into account only the proceeds of the issue which are to be used for any private business use which is not related to any government use of such proceeds and the disproportionate related business use proceeds of the issue.

For purposes of § 141(b)(3)(A), § 141(b)(3)(B) provides that the disproportionate related business use proceeds of an issue is an amount equal to the aggregate of the excesses (determined under the following sentence) for each private business use of the proceeds of an issue which is related to a government use of such proceeds. The excess determined under this sentence is the excess of (i) the proceeds of the issue which are to be used for the private business use, over (ii) the proceeds of the issue which are to be used for the government use to which such private business use relates.

Section 1.141-9(a) provides in general, that under § 141(b)(3) (the unrelated or disproportionate use test), an issue meets the private business tests if the amount of private business use and private security or payments attributable to unrelated or disproportionate private business use exceeds 5 percent of the proceeds of the issue. For this purpose, the private business use test is applied by taking into account only use that is not related to any government use of proceeds of the issue (unrelated use) and use that is related by disproportionate to any government use of those proceeds (disproportionate use).

Under § 1.141-9(a)(2)(i), the unrelated or disproportionate use test is applied by first determining whether a private business use is related to a government use. Next, private business use that relates to a government use is examined to determine whether it is disproportionate to that government use.

Under 1.141-9(a)(2)(ii), all the unrelated use and disproportionate use financed with the proceeds of an issue are aggregated to determine compliance with the unrelated and disproportionate use test. The amount of permissible unrelated and disproportionate

private business use is not reduced by the amount of private business use financed with the proceeds of an issue that is neither unrelated use nor disproportionate use.

Section 1.141-9(b)(1) provides that whether a private business use is related to a government use financed with the proceeds of an issue is determined on a case-bycase basis, emphasizing the operational relationship between government use and the private business use. In general, a facility that is used for a related private business use must be located within, or adjacent to, the governmentally used facility.

Section 1.141-9(b)(2) provides that use of a facility by a nongovernmental person for the same purpose as use by a governmental person is not treated as unrelated use if the government use is not insignificant. Similarly, a use of a facility in the same manner both for private business use that is related use and private business use that is unrelated use does not result in unrelated use if the related use is not insignificant. For example, a privately owned pharmacy in a governmentally owned hospital does not ordinarily result in unrelated use solely because the pharmacy also serves individuals not using the hospital. In addition, use of parking spaces in a garage by a

nongovernmental person is not treated as unrelated use if more than an insignificant portion of the parking spaces are used for a government use (or a private business use that is related to a government use), even though the use by the nongovernmental person is not directly related to that other use.

Under § 1.141-9(c)(1), a private business use is disproportionate to a related government use only to the extent that the amount of proceeds used for that private business use exceeds the amount of proceeds for the related government use. For example, a private use of $100 of proceeds that is related to a government use of $70 of proceeds results in $30 of disproportionate use.

Section 1.141-9(c)(2) provides that if two or more private business uses of the proceeds of an issue relate to a single government use of those proceeds, those private business uses are aggregated to apply the disproportionate test.

ANALYSIS:

Private Business Use under § 141(b)(1)

In determining whether the Authority's acquisition of the various Property Interests and related arrangements will give rise to private business use of bond proceeds, we look to the use of the bond-financed property in each type of arrangement. We note that the type of property interest is not the sole factor in our determination.

1) In the case of the purchase of the conservation easement described in this case, the easement is the bond-financed property (*i.e.*, the bond-financed facility). The Authority and the Seller will have distinct property interests in the parcel, granting them different rights. The use by the Seller of the retained interest in the parcel will not impinge upon the use of the parcel by the Open Space Program. The Authority will be the owner of the easement in perpetuity, and thus the Seller will not have any interest in the easement, such as a reversionary interest. The Seller, as owner of the parcel subject to the conservation easement, will be restricted in use of the parcel by the easement. Thus, we consider only the use of the conservation easement in determining whether the Seller's use of the parcel will be private business use of the proceeds. The City and the public will have beneficial use of the easement through the Open Space Program. The Seller's only use of the easement will be as a member of the general public. Other than as a member of the general public, the Seller's use of the parcel is not use of the bond-financed property. Thus, the Authority's acquisition of the conservation easement will not give rise to private business use of the proceeds.

2) In the case of the purchase of the future interest in fee simple with the Seller retaining a life estate, the Authority is purchasing the future interest. The future interest is the bond-financed property. The Authority and the Seller will have distinct property interests, and although their rights are similar, these rights will occur at different times. The use of the parcel by the Seller during the retained life interest will not impinge upon the use by the Open Space Program during the Authority's future interest. Thus, we consider only the use of the future interest in determining whether the Seller's use will be private business use of the proceeds. Because the Seller's use of the parcel will end with the termination of the life estate, the Seller will not use the bond-financed property. Accordingly, the Authority's acquisition of the future interest in fee simple does not give rise to private business use of the proceeds.

3) In the case of the purchase of a present interest in fee simple with the granting of a Lease, the Authority is purchasing the fee simple. The fee simple is the bond-financed property. The Authority will then lease the bond-financed property to a nongovernmental person. Under § 1.141-3(b)(3) and (g)(4)(iii), the lease of property to a nongovernmental person is private use of that property and is treated as use of the entire property. Thus, the Lease will give rise to private business use during the term of the Lease of 100 percent of the proceeds used to acquire the parcel.

4) In the case of the purchase of a present interest in fee simple subject to the *profit à prendre* interest described in this case, the Authority will be purchasing the fee simple subject to, or less, the *profit à prendre* interest. Under the facts of this case, the fee simple subject to the *profit à prendre* interest is the bond-financed property. This is the converse of the situation involving the conservation easement described above. This time, the Authority, as owner of the fee simple subject to the *profit à prendre* interest, will have a possessory right to use the parcel. The Seller, as holder of the *profit à prendre* interest, will have a non-possessory right to use the parcel for limited purposes. Again, however, the Authority and the Seller will have distinct interests in the parcel, granting them different rights. The permitted uses by the holder under the *profit à prendre* interest herein will not impinge upon the use of the parcel by the Open Space Program. Thus, we consider only the use of the

Authority's interest in determining whether the Seller's use will be private business use of the proceeds. The Seller's only use of the Authority's interest will be as a member of the general public. Other than as a member of the general public, the Seller's use of the parcel is not use of the bond-financed property. Accordingly, the Authority's acquisition of a present interest in fee simple subject to a *profit à prendre* interest will not give rise to private business use of the proceeds.

5) In the case of the purchase of a present interest in fee simple (not subject to a *profit à prendre* interest) where the Authority conveys the *profit à prendre* interest to a third party, the fee simple (not subject to a *profit à prendre* interest) is the bond-financed property. When the Authority sells the *profit à prendre* interest, it will be conveying a portion of the fee simple to a nongovernmental person. The Authority's conveyance of the *profit à prendre* interest will result in private business use of the bond-financed property. There will be no private business use of the interest retained by the Authority. The issue then is how to measure the amount of private business use of the bond-financed property. The *profit à prendre* interest, like a discrete portion of a facility, is a distinct property interest. The holder of the *profit à prendre* interest has rights different from those of the Authority under its remaining interest in the parcel. The use of the *profit à prendre* interest by the holder will not impinge upon the use of the parcel by the Open Space Program. Therefore, it is appropriate to measure the private business use based on a reasonable basis that reflects the proportionate benefit to the users, such as the fair market value of the interests. The Authority has represented that the value of any such *profit à prendre* interest in addition to any other private business use of the parcel will not exceed 10 percent of the proceeds of the issue.

Unrelated or Disproportionate Use

The Authority also has requested a ruling regarding the applicability of § 141(b)(3) to the transactions involving the life estate, the Lease, and the *profit à prendre* interest. The questions to be considered are whether use of proceeds for these purposes is unrelated to the government use of the issue and, if not, whether such use is disproportionate related use. Because we have concluded that the acquisition of the fee simple with the reservation of the life estate will not result in private business use of proceeds, we need not address the life estate. For the same reason, we need not address the *profit à prendre* interest retained by the Seller.

Both the Lease and the *profit à prendre* interest conveyed by the Authority will result in private business use of the fee simple acquired by the Authority. The location of the government use and the private business use, thus, will be the same. The purposes of the Open Space Program are to preserve the parcel for open space for scenic enjoyment, for agricultural use, and to conserve natural habitat. The agricultural use by the holder of the Lease or the *profit à prendre* interest will be complementary and contribute to the Open Space Program. We conclude that the private business use arising under the Lease and the *profit à prendre* interest conveyed by the Authority will be uses related to the government use.

To determine whether a related use is disproportionate, we look for the excess of the proceeds used for the private business use over the proceeds used for the government use to which it relates. The Lease is treated as 100 percent use of the proceeds used to acquire the parcel for the term of the Lease. Where the terms of any such Leases on a specific

parcel in the aggregate exceed the period of government use of the parcel, this excess will be the disproportionate use.

A comparison of the value of the *profit à prendre* interest to the value of remaining portion of the fee simple is needed to make a determination for this type of private business use. Where the value of the *profit à prendre* interest exceeds the value of the interest retained by the Authority, this excess will be the disproportionate use. The Authority has represented that the value of the *profit à prendre* interest will not exceed 10 percent of the issue. Thus, where the proceeds of the issue are used solely for the purpose of purchasing one fee simple parcel (such as the Note), private business use of the proceeds used to acquire the parcel will not exceed 10 percent, and accordingly, such private business use will not be disproportionate to the government use. We do not rule on this question where proceeds of the bond issue are used for purposes in addition to acquiring one fee simple parcel.

CONCLUSIONS:

1. a. The Authority's purchase of a conservation easement, purchase of a future interest in fee simple with the Seller retaining a life estate, or purchase of a present interest in fee simple with the Seller retaining a *profit à prendre* interest as described herein will not give rise to private business use.

b. The Authority's purchase of a present interest in fee simple and entering into the Lease will give rise to private business use of 100 percent of the proceeds for the term of the Lease.

c. The Authority's purchase of a present interest in fee simple with the conveyance of a *profit à prendre* interest as described herein will give rise to private business use, but not in excess of 10 percent of the issue.

2. a. The Lease will be a use related to the government use. This use will be disproportionate if the terms of any such Leases on a specific parcel in the aggregate exceed the period of government use of the parcel.

b. The conveyance of a *profit à prendre* interest will result in a use related to the government use. Where the value of the *profit à prendre* interest exceeds the value of the interest retained by the Authority, this excess will be the disproportionate use. Where the proceeds of the issue are used solely for the purpose of purchasing one fee simple parcel, the private business use will not be disproportionate.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed on whether the conveyance of a *profit à prendre* interest will result in a private loan under § 141(c).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

FN1. A *profit à prendre* interest is an interest in real property defined under State law as an easement that confers the right to enter and remove timber, minerals, oil, gas, game, or other substances from land in the possession of another. In contrast to the possessory rights of a leaseholder, the rights of a holder of a *profit à prendre* interest are non-possessory.

Private Letter Ruling 200330010-Private Business Tests-Management Contract

This letter responds to Issuer's request for a ruling that the management contract described below (the "Contract") will not cause bonds (the "Bonds") to be issued by Issuer to finance the Facilities (as defined below), to meet the private business use test of § 141(b)(1) of the Internal Revenue Code (the "Code"). For this purpose, the Issuer requests a ruling that the Contract meets the requirements of Rev. Proc. 97-13, 1997-1 C.B. 692 or, in the alternative, that the Contract will not cause the Bonds to meet the private business use test under § 141(b)(1) based on all of the facts and circumstances.

Facts and Representations:

Issuer is a nonprofit corporation, organized under the laws of State to assist the City in acquiring and financing municipal property and equipment, including a proposed new water treatment plant, a raw water intake and pumping station, and a raw water transmission line (the "Facilities").

Issuer represents that the Facilities will be a "public utility" within the meaning of Rev. Proc. 97-13 and § 168(i)(10). Issuer also represents that the reasonably expected useful life of the Facilities will be greater than Y years based on the 50 year safe harbor economic life for water utilities under Rev. Proc. 62-21, 1962-2 C.B. 418, 428.

Pursuant to a resolution adopted on Date 1, Issuer intends to issue the Bonds in separate issues in the aggregate amount of approximately $ X on behalf of City and will loan the proceeds to the City. City will use the proceeds of the Bonds to finance the costs of the Facilities. The City will own the Facilities.

The City intends to enter into the Contract with a private entity to design and construct the Facilities as well as to operate and maintain the Facilities. The City has qualified three private entities and proposes to enter into the Contract with one of the three private entities (the "Manager") on Date 2.

According to the Contract, subsequent to the development and construction periods (the "Construction Periods"), the Manager will operate the Facilities for a period equal to the first partial year and 15 full years after the provisional acceptance date (the "Management Period"). The provisional acceptance date is the date on which the Facilities are accepted by the City after construction. The City has the sole option to renew the Contract for an additional five-year period. Issuer represents that the initial term of the Contract, which includes the Construction Period and the Management Period, will not exceed 20 years.

Payments to the Manager under the Contract during the Management Period include: (1) the "base operating charge"; (2) the "reimbursable costs charge"; and (3) the "extraordinary items" charge or credit.

(1) The base operating charge

The base operating charge includes components called a "fixed component" and a "variable component".

The fixed component of the base operating charge is structured as a three-tiered payment arrangement described in the Contract (the ""fixed fee groups"). For each annual period during the Management Period, the Manager will be paid the amount stated in one of the three fixed fee groups. Each fixed fee group represents a stated dollar amount for management services required to meet the reasonably expected water demand for the coming annual period under the Contract. Each fixed fee group corresponds to an entitlement by City of a specified average annual volume amount of finished water.

Once the City chooses a fixed fee group, the City cannot choose a different fixed fee group unless it gives written notice to the Manager 60 days before the start of the coming annual period under the Contract. The amount to be paid the Manager under the selected fixed fee group will increase each year by a fixed percentage of the annual change of the Consumer Price Index (the "CPI"). Issuer represents that the fixed fee group payments will constitute at least 80% of the Manager's compensation for each annual period during the Management Period of the Contract.

The variable component of the base operating charge will consist of the following: (1) the excess demand element, (2) the electricity savings element, and (3) the extra chlorine element. The excess demand element will be an amount paid to the Manager based on the amount of water required by the City in excess of the amount specified in the fixed fee group chosen for that year. The electricity savings element will be an incentive paid to

the Manager for reducing electricity consumption, the cost of which is paid by the City. The extra chlorine element will be an amount that compensates the Manager for providing residual chlorine in excess of the amount of Z in the finished water.

The Manager's variable compensation (not including reimbursable costs) will be capped at 20% of the total compensation in each annual period and any portion of potential variable compensation that is constrained by the 20% cap may be carried forward for potential payment to Manager in a future year, if any, during which payment will be within the 20% cap.

(2) The reimbursable costs

The reimbursable costs charge covers direct, actual expenses paid by the Manager to third parties (without markup for profit, administration, or otherwise) for providing security for the Facilities and for residual chlorine in amounts greater than ZZ in the finished water.

(3) The extraordinary items

The extraordinary items component includes, among other specified items, payments to the Manager as a result of (1) increased costs of Manager due to “uncontrollable circumstances”; and (2) “capital modifications” necessitated by uncontrollable circumstances. Some examples of uncontrollable circumstances are: change in law; contamination of the site by hazardous waste; naturally occurring events such as an earthquake or landslide; war, terrorism, or sabotage; shortfalls in delivery of raw water; government preemption or condemnation of the Facilities; labor disputes; subcontractor failures; maintenance failures by other utility providers; City failures to finish certain related facilities; and City requested change orders not due to Manager fault. Issuer expects that payment under the extraordinary items component related to uncontrollable circumstances will only occur under extraordinary, remote and rare circumstances.

For most situations defined as uncontrollable circumstances under the Contract, the City and the Manager will negotiate a lump sum payment before the Manager begins any work or repair necessitated by the uncontrollable circumstance. For uncontrollable circumstances that are emergency situations requiring the Manager to begin work or repair immediately, with no time to negotiate payment, the Manager will be reimbursed for its costs plus reasonable overhead.

For payments resulting from uncontrollable circumstances, the City and the Manager will be required to designate and treat payments under the extraordinary items component as one of the following: 1) an ongoing adjustment or one-time payment under the fixed component; 2) as part of the variable component; or 3) as reimbursement of direct, actual expenses payable to third parties; or (4) as otherwise described hereafter. Payments with respect to “capital modifications” that are in the nature of capital expenditures for the Facilities, will be treated as capital expenditures rather than compensation for management services. Payments for breach, nonperformance, or default of the City will be characterized as liquidated damages.

Under the Contract, the City will have the sole right to terminate the Contract for convenience and without cause upon 60 days notice during the Management Period, but if it does so it must pay the Manager a termination payment. The termination payment will be a fee equal to $ R less S of that amount for each month that has elapsed following the start of the Management Period including the month in which termination occurs. The City may also terminate the Contract for convenience and without cause during the Management Period, without paying the termination payment, upon the occurrence of certain uncontrollable circumstances.

Issuer represents that the Manager will not have any role or relationship that will substantially limit the City's ability to exercise any rights, including cancellation rights, under the Contract. Issuer also represents that not more than 20 percent of the voting power of the governing body of the City in the aggregate will be vested in the Manager and its directors, officers, shareholders, and employees. Also, there will be no overlapping board members of the City and the Manager. Issuer represents that the City and the Manager will not be related parties as defined in § 1.150-1(b) of the Income Tax Regulations.

Law

Section 103(a) provides that gross income does not include interest on any state or local bond. Section 103(b)(1) provides that § 103(a) does not apply to any private activity bond that is not a qualified bond (within the meaning of § 141).

Section 141(a)(1) defines a private activity bond as any bond issued as part of an issue that meets both the private business use test of § 141(b)(1) and the private security payment test of § 141(b)(2); or is part of an issue that meets the private loan financing test of § 141(c).

Under §§ 141(b)(1) and 141(b)(6)(A), private business use occurs if more than10 percent of the proceeds of the bonds are to be used (directly or indirectly) in a trade or business carried on by a person other than a governmental unit. Any activity carried on by a person other than a natural person is treated as trade or business use. Under § 1.141-3(b)(1), generally private business use can arise as a result of ownership; actual or beneficial use of

property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay, or other output type contract.

Section 1.141-3(b)(4)(i) provides that a management contract with respect to financed property may result in private business use of that property based on all of the facts and circumstances. A management contract with respect to financed property generally results in private business use of that property if the contract provides for compensation for services rendered with compensation based, in whole or in part, on a share of net profits from the operation of the facility.

Under § 1.141-3(b)(4)(ii), a management contract is defined as a management, service, or incentive payment contract between a governmental person and a service provider under which the service provider provides services involving all, a portion of, or a function of, a facility.

Under § 1.141-3(b)(4)(iii)(C), a contract to provide for the operation of a facility or system of facilities that consists predominantly of public utility property is generally not treated as a management contract that gives rise to private business use if the only compensation is the reimbursement of actual and direct expenses of the service provider and reasonable administrative overhead expenses of the service provider.

Under § 1.141-3(b)(4)(iii)(D), a contract to provide for services is generally not treated as a management contract that gives rise to private business use if the only compensation is the reimbursement of actual and direct expenses of the service provider and reasonable administrative overhead expenses of the service provider.

Revenue Procedure 97-13 sets forth conditions under which a management contract does not result in private business use under § 141(b). Under § 5.02, the management contract must provide for reasonable compensation for services rendered with no compensation based, in whole or in part, on a share of net profits from the operation of the facilities. Reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties is not by itself treated as compensation. In addition, § 5.02(3) provides that for purposes of § 1.141-3(b)(4)(i) and Rev. Proc. 97-13, a productivity award equal to a stated dollar amount based on increases or decreases in gross revenues (or adjusted gross revenues), or reductions in total expenses (but not both increases in gross revenues or adjusted gross revenues and reductions in total expenses) in any annual period during the term of the contract generally does not cause the compensation to be based on a net share of profits.

There are six specific arrangements that satisfy § 5 of Rev. Proc. 97-13. Under § 5.03(2), at least 80 percent of the compensation for services for each annual period during the term of the contract must be based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80 percent of the reasonably expected useful life of the financed property and 10 years. For the purposes of this section, a fee does not fail to qualify as a periodic fixed fee as a result of a one-time incentive award during the term of the contract under which compensation automatically increases when a gross revenue or expense target (but not both) is reached if that award is equal to a single, stated dollar amount.

Section 5.03(3) of Rev. Proc. 97-13 provides that if all of the financed property subject to the contract is a facility consisting of predominantly public utility property (as defined under § 168(i)(1)), then 20 years is substituted for 10 years in § 5.03(2).

The term “public utility property” is defined in general, under § 168(i)(10), as property predominantly used in the trade or business of furnishing or sale of electric energy, water, or sewage disposal services if the rates from such furnishing or sale, as the case may be, have been established or approved by a state or political subdivision thereof.

Section 3.05 of Rev. Proc. 97-13 defines a “periodic fixed fee” to mean a stated dollar amount for services rendered for a specified period of time. The stated dollar amount may automatically increase according to a specified, objective, external standard that is not linked to output or production of a facility.

Section 3.06 of Rev. Proc. 97-13 defines a “per-unit fee” to mean a fee based on a unit of service provided specified in the contract or otherwise specifically determined by an independent third party.

Section 3.08 of Rev. Proc. 97-13 provides that a renewal option means a provision under which the service provider has a legally enforceable right to renew the contract. Thus, for example, a provision under which a contract is automatically renewed for one year periods absent cancellation by either party is not a renewal option (even if it is expected to be renewed).

Section 5.04(1) of Rev. Proc. 97-13 provides in general that a service provider must not have any role or relationship with the qualified user (the state or local government or instrumentality that is a party to the management contract) that substantially limits the qualified user's ability to exercise its rights, including cancellation rights, based on all the facts and circumstances. Under § 5.04(2), the qualified user's rights are not substantially limited if the following requirements are satisfied: (1) not more than 20 percent of the voting power of the governing body of the qualified user in the aggregate is vested in the service provider and its directors, officers, shareholders, and employees; (2) overlapping board members do not include the chief executive officers of the service provider or its governing body or the qualified user or its governing body; and (3) the qualified user and the service provider under the contract are not related parties, as defined in § 1.150-1(b).

Analysis:

The Manager's compensation under the Contract does not meet the requirements of Rev. Proc. 97-13 for the reasons stated below. Therefore, whether the Contract results in private business use under § 141(b)(1) and § 1.141-3(b)(4) depends on all of the facts and circumstances. In determining whether the facts and circumstances indicate private business use, the principles set forth in Rev. Proc. 97-13 are useful reference points.

A permissible fee arrangement for the purposes of § 5.03(2) of Rev. Proc. 97-13 requires that at least 80 percent of the Manager's payment during any annual period during the Management Period of the Contract be a periodic fixed fee. Although City can choose one of three fixed fee groups for any year, the fixed component to be paid to Manager for any given year of the Management Period of the Contract is fixed subject only to a changes based on changes of the CPI and changes caused by certain uncontrollable circumstances and extraordinary items. Moreover, the fixed component of the base operating charge will be at least 80 percent of the payment to the Manager's compensation for each annual period during the Management Period of the Contract.

Nevertheless, we do not believe that the fixed component of the base operating charge meets the requirements of Rev. Proc. 97-13 because of the adjustments to this component permitted for certain uncontrollable circumstances and extraordinary items. Although these circumstance are represented to be remote, and separately may be remote, the totality of circumstances described as uncontrollable strongly suggests that one or more may happen during the term of the Contract. This possibility is significantly increased because of the length of the Management Period of the Contract.

Although we do not believe that the fixed component meets the requirements of § 5.03(2) of Rev. Proc. 97-13, we nevertheless conclude that payments under the fixed component of the Contract do not result in private business use of the Facilities for purposes of § 141. These payments, including those for certain uncontrollable circumstances and extraordinary items, are based on services to be provided by the Manager rather than revenues from the Facilities. Furthermore, payments of the fixed component will constitute at least 80 percent the total compensation to the Manager for each annual period during the Management Period of the Contract. Thus, these payments are not based on a share of net profit of the Facilities.

The variable component of the base operating charge also does not result in private business use of the Facilities. The extra chlorine and the excess demand charges are fees which are not based on net profit because each is based on an expense to the Manager and not on a share of the City's revenue from the Facilities. The electricity savings element is also not based on net profits because it is derived from a decrease of a limited expense element and is not associated with an increase in gross or adjusted revenues of City from the Facilities.

The reimbursable costs charges will not be compensation to the Manager because, under § 1.141-3(b)(4)(iii)(D) and Rev. Proc. 97-13, a payment to the Manager of actual and direct expenses paid by the Manager to third parties is not compensation to the Manager.

The extraordinary items component of the service fee under the Contract requires the City and the Manager to treat the payments made under that provision, among other specified items, as a one time or ongoing adjustment to the fixed component, reimbursement of costs paid to third parties, part of the Manager's variable compensation, or as an amount paid for a capital modification. Although the ability to adjust the fixed component causes the Contract to not meet Rev. Proc. 97-13, payments made for extraordinary items do not result in private business use under § 141. These payments are based on services provided by Manager rather than net profits from the Facilities. Also, § 1.141-3(b)(4)(iii)(C) allows reimbursement of the actual and direct expenses and reasonable administrative overhead expenses of the service provider in public utility management contracts.

Payments with respect to capital modifications that are in the nature of capital expenditures for the Facilities represent payment for work separate from the Manager's management services and are not considered management compensation under the Contract. As a result, we disregard these payments for purposes of analyzing Manager's compensation.

Finally, neither the length of the Contact nor any relationship between Manager and City will cause there to be private business use of the Facilities. The initial term of the Contract (including the Construction Periods and the Management Period) will not exceed the 20 year term allowable for public utilities under Rev. Proc. 97-13. Also, the Manager will have no role or relationship with the City that will substantially limit the City's ability to exercise any rights under the Contract, including cancellation rights. There will be no overlapping board members of the City and the Manager and the City and the Manager will not be related parties as defined in § 1.150- 1(b).

Conclusion:

Based on all of the facts and circumstances, we conclude that the Contract does not result in private business use of the Facilities under § 141(b) and § 1.141-3(b)(4)(i).

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification upon examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Revenue Procedure 97-13 Private Business Use-Management Contract

26 CFR 1.145-2: *Application of private activity bond regulations.*

Tax-exempt bonds; private activity bonds. This procedure sets forth conditions under which a management contract does not result in private business use under section 141(b) of the Code. This procedure also applies to determinations of whether a management contract causes the test in section 145(a)(2)(B) to be met for qualified 501(c)(3) bonds.

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth conditions under which a management contract does not result in private business use under § 141(b) of the Internal Revenue Code of 1986. This revenue procedure also applies to determinations of whether a management contract causes the test in § 145(a)(2)(B) of the 1986 Code to be met for qualified 501(c)(3) bonds.

SECTION 2. BACKGROUND

.01 Private Business Use.

(1) Under § 103(a) of the 1986 Code, gross income does not include interest on any state or local bond. Under § 103(b)(1) of the 1986 Code, however, § 103(a) of the 1986 Code does not apply to a private activity bond, unless it is a qualified bond under § 141(e) of the 1986 Code. Section 141(a)(1) of the 1986 Code defines "private activity bond" as any bond issued as part of an issue that meets both the private business use and the private security or payment tests. Under § 141(b)(1) of the 1986 Code, an issue generally meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Under § 141(b)(6)(A) of the 1986 Code, private business use means direct or indirect use in a trade or business carried on by any person other than a government unit. Section 145(a) of the 1986 Code also applies the private business use test of § 141(b)(1) of the 1986 Code, with certain modifications.

(2) Corresponding provisions of the Internal Revenue Code of 1954 set forth the requirements for the exclusion from gross income of the interest on state or local bonds. For purposes of this revenue procedure, any reference to a 1986 Code provision includes a reference to the corresponding provision, if any, under the 1954 Code.

(3) Private business use can arise by ownership, actual or beneficial use of property pursuant to a lease, a management or incentive payment contract, or certain other arrangements. The Conference Report for the Tax Reform Act of 1986, provides as follows:

The conference agreement generally retains the present-law rules under which use by persons other than governmental units is determined for purposes of the trade or business use test. Thus, as under present law, the use of bond-financed property is treated as a use of bond proceeds. As under present law, a person may be a user of bond proceeds and bond-financed property as a result of (1) ownership or (2) actual or beneficial use of property pursuant to a lease, a management or incentive payment contract, or (3) any other arrangement such as a take-or-pay or other output-type contract.

2 H.R.Conf.Rep. No. 841, 99th Cong., 2d Sess. II-687-688, (1986) 1986-3 (Vol. 4) C.B. 687-688 (footnote omitted).

(4) A management contract that gives a nongovernmental service provider an ownership or leasehold interest in financed property is not the only situation in which a contract may result in private business use.

(5) Section 1.141-3(b)(4)(i) of the Income Tax Regulations provides, in general, that a management contract (within the meaning of § 1.141-3(b)(4)(ii)) with respect to financed property may result in private business use of that property, based on all the facts and circumstances.

(6) Section 1.141-3(b)(4)(i) provides that a management contract with respect to financed property generally results in private business use of that property if the contract provides for compensation for services rendered with compensation based, in whole or in part, on a share of net profits from the operation of the facility.

(7) Section 1.141-3(b)(4)(iii), in general, provides that certain arrangements generally are not treated as management contracts that may give rise to private business use. These are-

(a) Contracts for services that are solely incidental to the primary governmental function or functions of a financed facility (for example, contracts for janitorial, office equipment repair, hospital billing or similar services);

(b) The mere granting of admitting privileges by a hospital to a doctor, even if those privileges are conditioned on the provision of de minimis services, if those privileges are available to all qualified physicians in the area, consistent with the size and nature of its facilities;

(c) A contract to provide for the operation of a facility or system of facilities that consists predominantly of public utility property (as defined in § 168(i)(10) of the 1986 Code), if the only compensation is the reimbursement of actual and direct expenses of the service provider and reasonable administrative overhead expenses of the service provider; and

(d) A contract to provide for services, if the only compensation is the reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties.

(8) Section 1.145-2(a) provides generally that §§ 1.141-0 through 1.141-15 apply to § 145(a) of the 1986 Code.

(9) Section 1.145-2(b)(1) provides that in applying §§ 1.141-0 through 1.141-15 to § 145(a) of the 1986 Code, references to governmental persons include section 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or business under § 513(a) of the 1986 Code.

.02 Existing Advance Ruling Guidelines. Rev. Proc. 93-19, 1993-1 C.B. 526, contains advance ruling guidelines for determining whether a management contract results in private business use under § 141(b) of the 1986 Code.

SECTION 3. DEFINITIONS

.01 *Adjusted gross revenues* means gross revenues of all or a portion of a facility, less allowances for bad debts and contractual and similar allowances.

.02 *Capitation fee* means a fixed periodic amount for each person for whom the service provider or the qualified user assumes the responsibility to provide all needed services for a specified period so long as the quantity and type of services actually provided to covered persons varies substantially. For example, a capitation fee includes a fixed dollar amount payable per month to a medical service provider for each member of a health maintenance organization plan for whom the provider agrees to provide all needed medical services for a specified period. A capitation fee may include a variable component of up to 20 percent of the total capitation fee designed to protect the service provider against risks such as catastrophic loss.

.03 *Management contract* means a management, service, or incentive payment contract between a qualified user and a service provider under which the service provider provides services involving all, a portion of, or any function of, a facility. For example, a contract for the provision of management services for an entire hospital, a contract for management services for a specific department of a hospital, and an incentive payment contract for physician services to patients of a hospital are each treated as a management contract. See §§ 1.141-3(b)(4)(ii) and 1.145-2.

.04 *Penalties* for terminating a contract include a limitation on the qualified user's right to compete with the service provider; a requirement that the qualified user purchase equipment, goods, or services from the service provider; and a requirement that the qualified user pay liquidated damages for cancellation of the contract. In contrast, a requirement effective on cancellation that the qualified user reimburse the service provider for ordinary and necessary expenses or a restriction on the qualified user against hiring key personnel of the service provider is generally not a contract termination penalty. Another contract between the service provider and the qualified user, such as a loan or guarantee by the service provider, is treated as creating a contract termination penalty if that contract contains terms that are not customary or arm's- length that could operate to prevent the qualified user from terminating the contract (for example, provisions under which the contract terminates if the management contract is terminated or that place substantial restrictions on the selection of a substitute service provider).

.05 *Periodic fixed fee* means a stated dollar amount for services rendered for a specified period of time. For example, a stated dollar amount per month is a periodic fixed fee. The stated dollar amount may automatically increase according to a specified, objective, external standard that is not linked to the output or efficiency of a facility. For example, the Consumer Price Index and similar external indices that track increases in prices in an

area or increases in revenues or costs in an industry are objective external standards. Capitation fees and per-unit fees are not periodic fixed fees.

.06 *Per-unit fee* means a fee based on a unit of service provided specified in the contract or otherwise specifically determined by an independent third party, such as the administrator of the Medicare program, or the qualified user. For example, a stated dollar amount for each specified medical procedure performed, car parked, or passenger mile is a per-unit fee. Separate billing arrangements between physicians and hospitals generally are treated as per-unit fee arrangements.

.07 *Qualified user* means any state or local governmental unit as defined in § 1.103-1 or any instrumentality thereof. The term also includes a section 501(c)(3) organization if the financed property is not used in an unrelated trade or business under § 513(a) of the 1986 Code. The term does not include the United States or any agency or instrumentality thereof.

.08 *Renewal option* means a provision under which the service provider has a legally enforceable right to renew the contract. Thus, for example, a provision under which a contract is automatically renewed for one-year periods absent cancellation by either party is not a renewal option (even if it is expected to be renewed).

.09 *Service provider* means any person other than a qualified user that provides services under a contract to, or for the benefit of, a qualified user.

SECTION 4. SCOPE

This revenue procedure applies when, under a management contract, a service provider provides management or other services involving property financed with proceeds of an issue of state or local bonds subject to § 141 or § 145(a)(2)(B) of the 1986 Code.

SECTION 5. OPERATING GUIDELINES FOR MANAGEMENT CONTRACTS

.01 *In general.* If the requirements of section 5 of this revenue procedure are satisfied, the management contract does not itself result in private business use. In addition, the use of financed property, pursuant to a management contract meeting the requirements of section 5 of this revenue procedure, is not private business use if that use is functionally related and subordinate to that management contract and that use is not, in substance, a separate contractual agreement (for example, a separate lease of a portion of the financed property). Thus, for example, exclusive use of storage areas by the manager for equipment that is necessary for it to perform activities required under a management contract that meets the requirements of section 5 of this revenue procedure, is not private business use.

.02 General compensation requirements.

(1) *In general.* The contract must provide for reasonable compensation for services rendered with no compensation based, in whole or in part, on a share of net profits from the operation of the facility. Reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties is not by itself treated as compensation.

(2) *Arrangements that generally are not treated as net profits arrangements.* For purposes of § 1.141-3(b)(4)(i) and this revenue procedure, compensation based on-

(a) A percentage of gross revenues (or adjusted gross revenues) of a facility or a percentage of expenses from a facility, but not both;

(b) A capitation fee; or

(c) A per-unit fee is generally not considered to be based on a share of net profits.

(3) *Productivity reward.* For purposes of § 1.141-3(b)(4)(i) and this revenue procedure, a productivity reward equal to a stated dollar amount based on increases or decreases in gross revenues (or adjusted gross revenues), or reductions in total expenses (but not both increases in gross revenues (or adjusted gross revenues) and reductions in total expenses) in any annual period during the term of the contract, generally does not cause the compensation to be based on a share of net profits.

(4) *Revision of compensation arrangements.* In general, if the compensation arrangements of a management contract are materially revised, the requirements for compensation arrangements under section 5 of this revenue

procedure are retested as of the date of the material revision, and the management contract is treated as one that was newly entered into as of the date of the material revision.

.03 *Permissible Arrangements.* The management contract must be described in section 5.03(1), (2), (3), (4), (5), or (6) of this revenue procedure.

(1) *95 percent periodic fixed fee arrangements.* At least 95 percent of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80 percent of the reasonably expected useful life of the financed property and 15 years. For purposes of this section 5.03(1), a fee does not fail to qualify as a periodic fixed fee as a result of a one-time incentive award during the term of the contract under which compensation automatically increases when a gross revenue or expense target (but not both) is reached if that award is equal to a single, stated dollar amount.

(2) *80 percent periodic fixed fee arrangements.* At least 80 percent of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80 percent of the reasonably expected useful life of the financed property and 10 years. For purposes of this section 5.03(2), a fee does not fail to qualify as a periodic fixed fee as a result of a one-time incentive award during the term of the contract under which compensation automatically increases when a gross revenue or expense target (but not both) is reached if that award is equal to a single, stated dollar amount.

(3) *Special rule for public* utility property. If all of the financed property subject to the contract is a facility or system of facilities consisting of predominantly public utility property (as defined in § 168(i)(10) of the 1986 Code), then "20 years" is substituted-

(a) For "15 years" in applying section 5.03(1) of this revenue procedure; and

(b) For "10 years" in applying section 5.03(2) of this revenue procedure.

(4) *50 percent periodic fixed fee arrangements.* Either at least 50 percent of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee or all of the compensation for services is based on a capitation fee or a combination of a capitation fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 5 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the third year of the contract term.

(5) *Per-unit fee arrangements in certain 3-year contracts.* All of the compensation for services is based on a per-unit fee or a combination of a per-unit fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 3 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the second year of the contract term.

(6) *Percentage of revenue or expense fee arrangements in certain 2-year contracts.* All the compensation for services is based on a percentage of fees charged or a combination of a per-unit fee and a percentage of revenue or expense fee. During the start-up period, however, compensation may be based on a percentage of either gross revenues, adjusted gross revenues, or expenses of a facility. The term of the contract, including renewal options, must not exceed 2 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the first year of the contract term. This section 5.03(6) applies only to-

(a) Contracts under which the service provider primarily provides services to third parties (for example, radiology services to patients); and

(b) Management contracts involving a facility during an initial start-up period for which there have been insufficient operations to establish a reasonable estimate of the amount of the annual gross revenues and expenses (for example, a contract for general management services for the first year of operations).

.04 No Circumstances Substantially Limiting Exercise of Rights.

(1) *In general.* The service provider must not have any role or relationship with the qualified user that, in effect, substantially limits the qualified user's ability to exercise its rights, including cancellation rights, under the contract, based on all the facts and circumstances.

(2) *Safe harbor.* This requirement is satisfied if-

(a) Not more than 20 percent of the voting power of the governing body of the qualified user in the aggregate is vested in the service provider and its directors, officers, shareholders, and employees;

(b) Overlapping board members do not include the chief executive officers of the service provider or its governing body or the qualified user or its governing body; and

(c) The qualified user and the service provider under the contract are not related parties, as defined in § 1.150-1(b).

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 93-19, 1993-1 C.B. 526, is made obsolete on the effective date of this revenue procedure.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for any management contract entered into, materially modified, or extended (other than pursuant to a renewal option) on or after May 16, 1997. In addition, an issuer may apply this revenue procedure to any management contract entered into prior to May 16, 1997.

DRAFTING INFORMATION

The principal author of this revenue procedure is Loretta J. Finger of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure contact Loretta J. Finger on (202) 622-3980 (not a toll-free call).

Rev. Proc. 97-13, 1997-5 I.R.B. 18, 1997-1 C.B. 632, 1997 WL 8805 (IRS RPR)

Revenue Procedure 2007-47-Private Business Use-Research Agreement (Modifies and Supercedes Revenue Procedure 97-14)

26 CFR 1.141-3: *Definition of private business use.*

(Also: §§ 103, 141,145; 1.141-3, 1.145-2.)

This procedure sets forth conditions under which a research agreement does not result in private business use under section 141(b) of the Code. Rev. Proc. 97-14 modified and superseded.

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth conditions under which a research agreement does not result in private business use under § 141(b) of the Internal Revenue Code of 1986 (the Code). This revenue procedure also addresses whether a research agreement causes the modified private business use test in § 145(a)(2)(B) of the Code to be met for qualified 501(c)(3) bonds. This revenue procedure modifies and supersedes Rev. Proc. 97-14, 1997-1 C.B. 634.

SECTION 2. BACKGROUND

.01 Private Business Use.

(1) Under § 103(a) of the Code, gross income does not include interest on any State or local bond. Under § 103(b)(1), however, § 103(a) does not apply to a private activity bond, unless it is a qualified bond under § 141(e). Section 141(a)(1) defines "private activity bond" as any bond issued as part of an issue that meets both the private business use and the private security or payment tests. Under § 141(b)(1), an issue generally meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Under § 141(b)(6)(A), private business use means direct or indirect use in a trade or business carried on by any person other than a governmental unit. Section 150(a)(2) provides that the term "governmental unit" does not include the United States or any agency or instrumentality thereof. Section 145(a) also applies the private business use test of § 141(b)(1) to qualified 501(c)(3) bonds, with certain modifications.

(2) Section 1.141-3(b)(1) of the Income Tax Regulations provides that both actual and beneficial use by a nongovernmental person may be treated as private business use. In most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

(3) Section 1.141-3(b)(6)(i) provides generally that an agreement by a nongovernmental person to sponsor research performed by a governmental person may result in private business use of the property used for the research, based on all the facts and circumstances.

(4) Section 1.141-3(b)(6)(ii) provides generally that a research agreement with respect to financed property results in private business use of that property if the sponsor is treated as the lessee or owner of financed property for Federal income tax purposes.

(5) Section 1.141-1(b) provides that the term "governmental person" means a State or local governmental unit as defined in § 1.103-1 or any instrumentality thereof. Section 1.141-1(b) further provides that governmental person does not include the United States or any agency or instrumentality thereof. Section 1.141-1(b) further provides that "nongovernmental person" means a person other than a governmental person.

(6) Section 1.145-2 provides that §§ 1.141-0 through 1.141-15 apply to qualified 501(c)(3) bonds under § 145(a) of the Code with certain modifications and exceptions.

(7) Section 1.145-2(b)(1) provides that, in applying §§ 1.141-0 through 1.141-15 to § 145(a) of the Code, references to governmental persons include § 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under § 513(a).

.02 Federal Government rights under the Bayh-Dole Act.

(1) The Patent and Trademark Law Amendments Act of 1980, as amended, 35 U.S.C. § 200 et seq. (2006) (the "Bayh-Dole Act"), generally applies to any contract, grant, or cooperative agreement with any Federal agency for the performance of research funded by the Federal Government.

(2) The policies and objectives of the Bayh-Dole Act include promoting the utilization of inventions arising from federally supported research and development programs, encouraging maximum participation of small business firms in federally supported research and development efforts, promoting collaboration between commercial concerns and nonprofit organizations, ensuring that inventions made by nonprofit organizations and small business firms are used in a manner to promote free competition and enterprise, and promoting the commercialization and public availability of inventions made in the United States by United States industry and labor.

(3) Under the Bayh-Dole Act, the Federal Government and sponsoring Federal agencies receive certain rights to inventions that result from federally funded research activities performed by non-sponsoring parties pursuant to contracts, grants, or cooperative research agreements with the sponsoring Federal agencies. The rights granted to the Federal Government and its agencies under the Bayh-Dole Act generally include, among others, nonexclusive, nontransferable, irrevocable, paid-up licenses to use the products of federally sponsored research and certain so-called "march-in rights" over licensing under limited circumstances. Here, the term "march-in rights" refers to certain rights granted to the sponsoring Federal agencies under the Bayh-Dole Act, 35 U.S.C. § 203 (2006), to take certain actions, including granting licenses to third parties to ensure public benefits from the dissemination and use of the results of federally sponsored research in circumstances in which the original contractor or assignee has not taken, or is not expected to take within a reasonable time, effective steps to achieve practical application of the product of that research. The general purpose of these rights is to ensure the expenditure of Federal research funds in accordance with the policies and objectives of the Bayh-Dole Act.

SECTION 3. DEFINITIONS

.01 *Basic research,* for purposes of § 141 of the Code, means any original investigation for the advancement of scientific knowledge not having a specific commercial objective. For example, product testing supporting the trade or business of a specific nongovernmental person is not treated as basic research.

.02 *Qualified user* means any State or local governmental unit as defined in § 1.103-1 or any instrumentality thereof. The term also includes a § 501(c)(3) organization if the financed property is not used in an unrelated trade or business under § 513(a) of the Code. The term does not include the United States or any agency or instrumentality thereof.

.03 *Sponsor* means any person, other than a qualified user, that supports or sponsors research under a contract.

SECTION 4. CHANGES

This revenue procedure modifies and supersedes Rev. Proc. 97-14 by making changes that are described generally as follows:

.01 Section 6.03 of this revenue procedure modifies the operating guidelines on cooperative research agreements to include agreements regarding industry or federally sponsored research with either a single sponsor or multiple sponsors.

.02 Section 6.04 of this revenue procedure provides special rules for applying the revised operating guidelines under section 6.03 of this revenue procedure to federally sponsored research. These special rules provide that the rights of the Federal Government and its agencies mandated by the Bayh-Dole Act will not cause research agreements to fail to meet the requirements of section 6.03, upon satisfaction of the requirements of section 6.04 of this revenue procedure. Thus, under the stated conditions, such rights themselves will not result in private business use by the Federal Government or its agencies of property used in research performed under research agreements. These special rules do not address the use by third parties that actually receive more than non-exclusive, royalty-free licenses as the result of the exercise by a sponsoring Federal agency of its rights under the Bayh-Dole Act, such as its march-in rights.

SECTION 5. SCOPE

This revenue procedure applies when, under a research agreement, a sponsor uses property financed with proceeds of an issue of State or local bonds subject to § 141 or § 145(a)(2)(B) of the Code.

SECTION 6. OPERATING GUIDELINES FOR RESEARCH AGREEMENTS

.01 *In general.* If a research agreement is described in either section 6.02 or 6.03 of this revenue procedure, the research agreement itself does not result in private business use. In applying the operating guidelines under section 6.03 of this revenue procedure to federally sponsored research, the special rules under section 6.04 of this revenue procedure (regarding the effect of the rights of the Federal Government and its agencies under the Bayh-Dole Act) apply.

.02 *Corporate-sponsored research.* A research agreement relating to property used for basic research supported or sponsored by a sponsor is described in this section 6.02 if any license or other use of resulting technology by the sponsor is permitted only on the same terms as the recipient would permit that use by any unrelated, non-sponsoring party (that is, the sponsor must pay a competitive price for its use), and the price paid for that use must be determined at the time the license or other resulting technology is available for use. Although the recipient need not permit persons other than the sponsor to use any license

or other resulting technology, the price paid by the sponsor must be no less than the price that would be paid by any non-sponsoring party for those same rights.

.03 *Industry or federally-sponsored research agreements.* A research agreement relating to property used pursuant to an industry or federally-sponsored research arrangement is described in this section 6.03 if the following requirements are met, taking into account the special rules set forth in section 6.04 of this revenue procedure in the case of federally sponsored research --

(1) A single sponsor agrees, or multiple sponsors agree, to fund governmentally performed basic research;

(2) The qualified user determines the research to be performed and the manner in which it is to be performed (for example, selection of the personnel to perform the research);

(3) Title to any patent or other product incidentally resulting from the basic research lies exclusively with the qualified user; and

(4) The sponsor or sponsors are entitled to no more than a nonexclusive, royalty-free license to use the product of any of that research.

.04 *Federal Government rights under the Bayh-Dole Act.* In applying the operating guidelines on industry and federally-sponsored research agreements under section 6.03 of this revenue procedure to federally sponsored research, the rights of the Federal Government and its agencies mandated by the Bayh-Dole Act will not cause a research agreement to fail to meet the requirements of section 6.03, provided that the requirements of sections 6.03(2), and (3) are met, and the license granted to any party other than the qualified user to use the product of the research is no more than a nonexclusive, royalty-free license. Thus, to illustrate, the existence of march-in rights or other special rights of the Federal Government or the sponsoring Federal agency mandated by the Bayh-Dole Act will not cause a research agreement to fail to meet the requirements of section 6.03 of this revenue procedure, provided that the qualified user determines the subject and manner of the research in accordance with section 6.03(2), the qualified user retains exclusive title to any patent or other product of the research in accordance with section 6.03(3), and the nature of any license granted to the Federal Government or the sponsoring Federal agency (or to any third party nongovernmental person) to use the product of the research is no more than a nonexclusive, royalty-free license.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97-14 is modified and superseded.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for any research agreement entered into, materially modified, or extended on or after June 26, 2007. In addition, an issuer may apply this revenue procedure to any research agreement entered into prior to June 26, 2007.

SECTION 9. DRAFTING INFORMATION

The principal authors of this revenue procedure are Vicky Tsilas and Johanna Som de Cerff of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact Johanna Som de Cerff at (202) 622-3980 (not a toll-free call).

Section 10. POST ISSUANCE PROCEDURES AND FORMS

Post Issuance Procedures

Governing Body

The governing body should undertake the following with regard to post issuance compliance.

- Assign an individual or individuals post issuance compliance duties. (At or before the issuance of bonds)
- (Optional) Retention of service provider or providers to assist in the post issuance compliance (e.g. arbitrage calculation, post issuance audit review, post issuance compliance reminders)
- The Governing Board not less than annually should review post issuance compliance and review information provided by officers and staff. (*see Governing Body Post Issuance Compliance Questionnaire*)
- Set schedules for education on post issuance compliance.

Officers, Staff and Service Providers Procedure

Transcript Review

- Review Bond Transcript:
    - Bonds are in registered form
    - 8038G was filed
    - Review Arbitrage or tax certificate
        - Spend down requirements
        - Investment limitations
        - Fund requirements or restrictions

Tax Continuing Compliance

- Review investment of bond proceeds
- Keep records of investments of the bond proceeds
- Review bond proceed expenditures (make sure expended for intended purpose)
- Keep records of bond proceed expenditures
- Keep all records with regard to investment contracts, credit enhancements, swaps, caps and bidding documents
- Keep records of bid documents(investment and project)
- Review arbitrage rebate requirements

- Review private business use or private payment activity with regard the bonds and the bond financed project
- Periodic review and updating of procedures to meet current conditions and regulations

Continuing Disclosure

- Monitor for any material event notice
- File annual reports and audited financial statements

Getting Started

Many of the records that are required for post issuance compliance are required to be kept under South Dakota law. Therefore, officers and staff should examine existing systems and integrate the post issuance compliance procedures therein. For example, assets purchased with a specific bond issue could be designated in the accounting system so as to allow identification of the asset with the bond issue. Officers and staff should develop for continuing compliance:

- an integration plan (integrating post issuance compliance with current systems)
- a self audit plan (tickler review list), and
- checklists and forms

Attached hereafter are sample forms to get you started and assist in post issuance compliance.

Assignment form

The following form should be filled out assigning not less than one person or entity per item. The governing body should note the assignment of task in their meeting minutes.

Activity Name	Primary Responsible Party	Secondary Responsible Party	Date
RECORDS			
Annual Financing Statements			Annual from date of closing, Annual Audit
Cash Flow Analysis of Project Funds			According to Draw Down Schedule, Annual Audit
IRS 8038-G and other filings			Closing and Annual
Arbitrage Yield Restriction and Rebate (8038T)			Annual
Site Tours			Annual
Certificate of Project Completion			30 days from completion
Bond Fund			Ongoing and Annual
Project Funds prior to Completion			According to Draw Down Schedule, Annual
Contracts Related to Construction Project			Upon execution of contract, Annual
PRIVATE USE			
Unrelated Trade or Business Activities at Project			Ongoing and Annual
Management or Other Service Agreements			Ongoing and Annual

Research Agreements			Ongoing and Annual
Ownership/Lease Rights, Agreements			Ongoing and Annual
Naming Rights			Ongoing and Annual
SITE REVIEWS			
Private business use			Ongoing and Annual
Record retention-site			Ongoing and Annual
Record retention-funds and investments			Ongoing and Annual

Record Retention form

RULE: LIFE + 3 (IRS) ALL RECORDS REGARDING THE BONDS MUST BE RETAINED FOR THE LIFE OF THE BOND ISSUE (THE LAST MATURITY) PLUS 3 YEARS. FOR PAYMENT OF INDIVIDUAL BOND LIFE + 6 (SD Contract).

The Bond Records Retention Schedule provides guidance as to the minimum period of time that financial, investment and various other business records maintained by the university or special school must be retained. This schedule authorizes, but does not require, the disposal of records after the expiration of the applicable retention period specified in this publication. A governmental may choose to retain records beyond the periods listed herein, or special circumstances may require such retention, therefore, nothing prevents a governmental entity from retaining records for longer periods.

To make it easier to use as a reference source, the schedule is divided into the following functional areas:

- accounting;
- purchasing;
- legal;
- bond;
- project budget;
- state and federal grants; and
- general correspondence.

The schedule contains an extensive list of records in an attempt to provide specific guidance on the multitude of financial records maintained by the issuer or user of bond financed property.

Although the schedule includes an extensive listing of various business records that are required to be maintained, it should not be viewed as being all-inclusive. Public entities may be required to maintain other business records by State or federal statutes or regulations that are not listed. Guidance should be sought from legal counsel regarding any records not listed. Any business records or work schedules that are not required to be created or maintained by any state or federal statute or regulation or are prepared for internal use only may be destroyed at the option of the public entity.

This record retention schedule addresses the issue of how long records are to be maintained. No attempt has been made to identify how the records are to be maintained, i.e. original records, photocopies, microfilm, computer disc (CD) or other electronic means.

Tax-Exempt Record Retention Form

Dated:_____

Types of Records	Current Location/format	Archive Location/format
Accounting Records:		
Cash Collection Records:		
Cash collection records		
Receipt books		
Bank Records:		
Bank deposit slips		
Bank statements and reconciliations		
Canceled checks		
Financial Records:		
Annual financial reports and supporting schedules		
Monthly and annual financial reports		
Audit reports		
Chart of accounts		
Check registers		
General ledger		
Journal entries		
Revenue and expense journals		
Revenue and expense summaries		
Fixed Asset Records:		
Appraisal records		
Depreciation and Disposal records		
Inventory of fixed assets – current file		
Inventory of fixed assets – printed reports		
Reports of lost, damaged or stolen property		
Investment and Deposit Records:		
Electronic transfer confirmations		
Letters of transmittal		
Log of investments		

List of pledged securities		
Appropriation Records:		
Transmittal reports from the State Other sources of funds		
Purchasing Records:		
Bid documents:		
Bid advertisements		
Bid awards		
Bid specifications		
Bidder lists		
Request for Information (RFI), Request for Proposals		
(RFP), Request for Quotations (RFQ)		
Performance, payment, litigation, and maintenance		
Bids on construction contracts		
Schedule of prevailing wages on construction contracts		
Purchase documents:		
Purchase requisitions		
Purchase orders		
Invoices		
Receiving reports		
Contracts (except personnel):		
Intergovernmental agreements		
Land contracts and purchase agreements		
Construction records, contract documents, inspection records		
Legal:		
Contracts (except personnel)		
Intergovernmental agreements		
Land contracts and purchase agreements, surveys and appraisals		
Construction records, contract documents, inspection records		

Bond Records:		
All related bond issue records		
Transcript of bond proceeding		
Other bond issue records		
Bonds		
Feasibility studies, Publications, brochures, and newspaper articles concerning bond financing		
Letters, emails, faxes, concerning bond financing		
Investment contracts including GICs		
Credit enhancement and bond insurance contracts		
Derivatives, swaps, caps		
Bidding of financial products		
Records of bond yield, computation dates for rebate, computations		
Project Budget Records:		
Budget preparation instructions, worksheets		
Proposed project budgets approved		
Final budget reports		
Budget supplement and transfer requests - signature page		
Budget supplement and transfer requests – budget journal entries		
State and Federal Grants:		
Categorical State and Federal Aid Reports, including, but not limited to: Project applications, grant awards, (includes all related documents and correspondence), Proposals and supporting records, Program monitoring reports		
General Correspondence:		
Routine correspondence		
Legal or significant policy issues		
Fund Raising Material:		
Any documents regarding fund raising for any project which is funded with bonds		

Federal Tax Information		
Tax Returns, information returns, examination documentation, correspondence regarding federal tax matters, IRS reports		

GOVERNING BOARD ANNUAL REVIEW QUESTIONNAIRE

Tax-Exempt Bond Post-Issuance Compliance-General

1) Do we have written procedures or guidelines to ensure that the governmental bond financing in which we either as issuer or user of the proceeds remains in compliance with federal tax requirements after the bonds are issued?

Yes ☐ No ☐

2) Do we track the proper and timely use of bond proceeds and bond-financed property?

Yes ☐ No ☐

If the answer is No, briefly describe who tracks bond proceeds and the bond financed property.

3) Who is primarily responsible for post-issuance compliance?

	Name & Title and responsibility
☐ Board Member	
☐ Management	
☐ Official	
☐ Staff	
☐ Other	
☐ None	

4) Who is secondarily responsible for monitoring post-issuance compliance of bond financings?

	Name & Title and responsibility
☐ Board Member	

☐ Management	
☐ Official	
☐ Staff	
☐ Other	
☐ None	

If the answer is none, we need to assign duties immediately.

5) Who is responsible for filing 8038G, 8038T or any other required filing?

	Name & Title and responsibility
☐ Board Member	
☐ Management	
☐ Official	
☐ Staff	
☐ Other	
☐ None	

If the answer is none, we need to assign duties immediately.

6) Do we provide training or educational resources to personnel that are responsible for ensuring compliance with the post-issuance private use limitations for bond-refinanced property?

Yes ☐ No ☐

7) Do we know about the following options for voluntarily correcting failures to comply with post-issuance compliance requirements?

Yes ☐ No ☐

8) Do we understand remedial actions described under section 1.141-12 of the income tax regulations?

Yes ☐ No ☐

9) Do we know what a closing agreement under Tax-Exempt Bonds Voluntary Closing Agreement Program described into Notice 2001-60?

Yes ☐ No ☐

GENERAL RECORDKEEPING

10) Do we retain records pertaining to our tax-exempt bonds must be retained for the life of the bond plus three years.

Yes ☐ No ☐

Do we have a record of the location of our repository?

Yes ☐ No ☐

11) What medium or mediums do we use to maintain our bond records?

Paper ☐

Electronic media (CD, disks, tapes) ☐

Both paper and electronic ☐

12) Is there any correspondence between our organization and the Internal Revenue Service related to a significant change in our activities?

Yes ☐ No ☐

13) Do we maintain the following records?

a. Organizing documents (articles of incorporation, bylaws and amendments)?

Yes ☐ No ☐

b. Audited financial statements?

Yes ☐ No ☐

c. Bond transcripts, Official Statements and other offering documents of our bond financings?

Yes ☐ No ☐

d. Minutes and resolutions authorizing the issuance of our bond financings?

Yes ☐ No ☐

e. Certifications of the issue price of our bond financings?

Yes ☐ No ☐

f. Any former elections for bond financings (e.g., election to employ an accounting methodology other than specific tracing)?

Yes ☐ No ☐

g. Appraisals, demand surveys, or feasibility studies for bond-financed property?

Yes ☐ No ☐

h. Documents related to government grants associated with construction, renovation or purchase of bond-financed facilities?

Yes ☐ No ☐

i. Publications, brochures, and newspaper articles for our bond financings?

Yes ☐ No ☐

j. Trustee statements for our bond financings?

Yes ☐ No ☐

k. Correspondence (letters, e-mails, faxes, etc.) for our bond financings?

Yes ☐ No ☐

l. Reports of any prior IRS examinations of our organization or bond financings?

Yes ☐ No ☐

INVESTMENTS AND ARBITRAGE COMPLIANCE

14) Do we maintain documentation of allocations of investments and investment earnings to our bond financing?

Yes ☐ No ☐

15) Do we maintain documentation for investments of our bond financing proceeds related to:

a. Investment contracts (e.g., guaranteed investment contracts)?

Yes ☐ No ☐

b. Credit enhancement transactions (e.g., bond insurance contracts)?

Yes ☐ No ☐

c. Financial derivatives (swaps, caps, etc.)?

Yes ☐ No ☐

d. Bidding of financial products?

Yes ☐ No ☐

16) Do we maintain copies of the following arbitrage-related documents for our bond financings:

a. Computations of bond yield?

Yes ☐ No ☐

b. Computation of rebate and yield reduction payments?

Yes ☐ No ☐

c. Form 8038-T, Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate?

Yes ☐ No ☐

d. Form 8038-R, Request for Recovery of Overpayments Under Arbitrage Rebate Provisions?

Yes ☐ No ☐

17) Do we have procedures or guidelines for monitoring instances where compliance with applicable yield restrictions requirements depends on subsequent reinvestment of bond proceeds in loour yielding investments?

Yes ☐ No ☐

18) Do we have specific procedures or guidelines for monitoring bond financings that we expect will comply with the arbitrage rules as a result of the application of a temporary period exception (section 148 (c) and section 1.148-2(e))or a spending exception (section 148(f)(4) and section 1.148-7 (c), (d), and (e))?

Yes ☐ No ☐

EXPENDITURES AND ASSETS

19) Do we maintain documentation of allocations of bond-financing proceeds to expenditures (e.g., allocation of bond proceeds to expenditures for the construction, renovation or purchase of facilities we own and use in the performance of our exempt purpose)?

Yes ☐ No ☐

20) Do we maintain documentation of allocations of bond-financing proceeds to bond issuance costs?

Yes ☐ No ☐

21) Do we maintain copies of requisitions, draw schedules, draw requests, invoices, bills and cancelled checks related to bond proceeds spent during the construction period?

Yes ☐ No ☐

22) Do we maintain copies of all contracts entered into for the construction, renovation or purchase of bond-financed facilities?

Yes ☐ No ☐

23) Do we maintain records of expenditure reimbursements incurred prior to issuing bonds for facilities financed with bond proceeds?

Yes ☐ No ☐

24) Do we maintain a list or schedule of all bond-financed facilities or equipment?

Yes ☐ No ☐

25) Do we maintain depreciation schedules for bond-financed depreciable property?

Yes ☐ No ☐

26) Do we maintain documentation that tracks our purchase and sale of bond-financed assets?

Yes ☐ No ☐

PRIVATE BUSINESS USE

27) Do we maintain records of all unrelated trade or business activities allocated to our bond-financed facilities?

Yes ☐ No ☐

28) Do we maintain records of trade or business activities by third parties that we allocate to our bond-financed facilities

Yes ☐ No ☐

29) Have we entered into any of the following arrangements for bond-financed property:

- Management and other service agreements? Yes ☐ No ☐
- Research contracts? Yes ☐ No ☐
- Naming rights contracts? Yes ☐ No ☐

- Ownership? Yes ☐ No ☐
- Leases? Yes ☐ No ☐
- Subleases? Yes ☐ No ☐
- Leasehold improvements contracts? Yes ☐ No ☐
- Joint venture arrangements? Yes ☐ No ☐
- Limited liability corporation arrangements? Yes ☐ No ☐
- Partnership arrangements? Yes ☐ No ☐

30) Do we maintain copies of the following agreements when entered into with respect to our bond-financed property:

- Management and other service agreements? Yes ☐ No ☐
- Research contracts? Yes ☐ No ☐
- Naming rights contracts? Yes ☐ No ☐
- Ownership? Yes ☐ No ☐
- Leases? Yes ☐ No ☐
- Subleases? Yes ☐ No ☐
- Leasehold improvements contracts? Yes ☐ No ☐
- Joint venture arrangements? Yes ☐ No ☐
- Limited liability corporation arrangements? Yes ☐ No ☐
- Partnership arrangements? Yes ☐ No ☐

This questionnaire was reviewed and answered by the Board at its meeting on the _____, 20__.

_____
Chairman

Tax-Exempt Bond Compliance On-Site Tour
Private Business Use

Compliance Review Date		By:	
Description of building or improvement			
Bond Issue			

Property

d

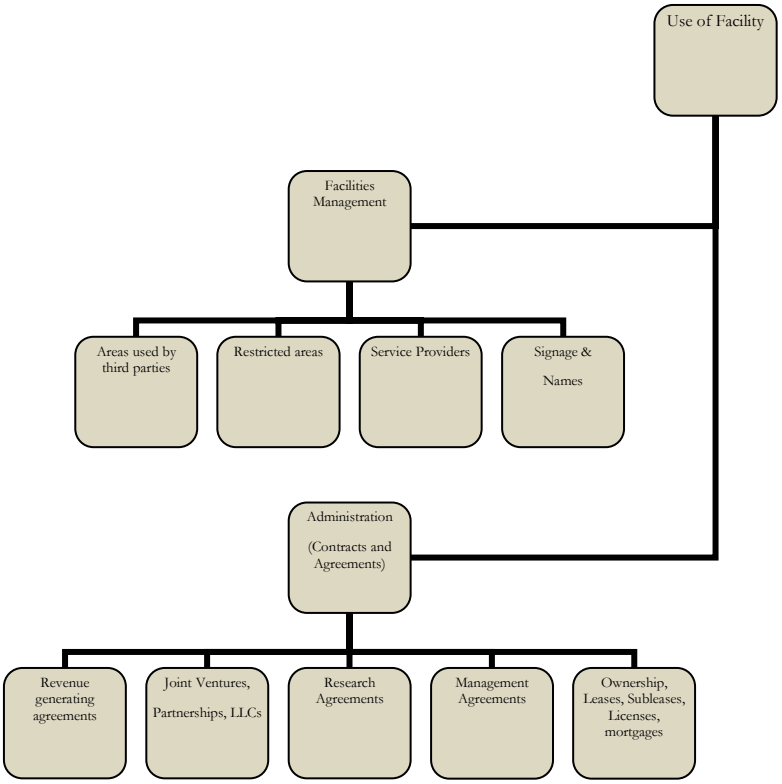
s not

Facility Site Tours

Step 1: **Bond Financed Facility**. Determine what portions of the facility were financed with bond proceeds.

Step 2: **Facility Drawings.** If possible obtain site drawings or hand draw facility.

Step 3: **Walking Tour.** Tour facility outside to inside. Begin by walking the perimeter of the facility. View the grounds, parking lot and entrances to the facility. Locate any signs of commercial activity, U.S. Government presence, non-profit activity or any other non-governmental activity or use. In the parking lot are there any parking spaces which indicate they are leased to non-governmental entities? Look for any signs of advertisement in the parking lot or around the building grounds. Take note of any privately owned machines (incidental use) such as:



- pay telephones
- vending machines,
- advertising displays
- television cameras.
- containers such as garbage service.

Anything that uses space, with the name of a non-governmental entity, should be noted. Amount of space used should be estimated and noted on drawing.

Tax-Exempt Bond
Record Retention Review

Record Retention Review Date		By:	
Description of building or improvement			
Bond Issue			

Documents	Location of Record	Responsible Party	Need for Follow-up
Organizational Documents			
Organizational Chart of Employees for responsible areas listed in this site audit			
Audited Financial Statements			
Bond Transcript			
Any other land surveys, building studies, other building records			
Governing Board Reviews			
Trustee Statements			
Documents related to government grants			

Accounting Procedures

	Location of Record	Responsible Party	Need for Follow-up
Drawdown Schedule			
Investment Contracts			
Bond Insurance Contracts			
Arbitrage related documents			
Computations			
Form 8038-T "Arbitrage Rebate, Yield Reduction and Penalty in Lieu of Arbitrage Rebate"			
Procedure for monitoring reinvestment of bond proceeds			

	Location of Record	Responsible Party	Need for Follow-up
Copies of invoices, bills and payments			
Construction Contracts, renovation or other building work			
Descriptions, drawings, engineer renderings, surveys, lists, schedules or other information defining bond-financed building, renovation or project			

Depreciation schedules			
Useful Life of Building Schedules			

	Location of Record	Responsible Party	Need for Follow-up
Trade or business activities in the building			
Non governmental activities (Events, Groups, and Meetings)			
Management or other service agreements			
Research contracts			
Naming rights			
Leases/subleases (kiosks, vending, merchandise sales)			
Leasehold improvement agreements			
Limited liability corporation/partnership agreements			

Comments:

Building Usage Record - Non Governmental

(Fill out this form when bond financed facilities are used by non Governmental Person)

Building _____

Date _____ Reported by :_____

	Organization	Contact Person	Purpose and description of building area used
6:00 am			
7:00 am			
8:00 am			
9:00 am			
10:00am			
11:00 am			
12:00 pm			
1:00 pm			
2:00 pm			
3:00 pm			
4:00 pm			
5:00 pm			
6:00 pm			
7:00 pm			
8:00 pm			
9:00 pm			
10:00 pm			
11:00 pm			
12:00 pm			
12:01 am - 6:00 am			

NOTES:

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