TO: ALL COUNTY PERSONNEL

FROM: VERDENIA C. BAKER,
COUNTY ADMINISTRATOR

PREPARED BY: OFFICE OF FINANCIAL MANAGEMENT & BUDGET (OFMB)

SUBJECT: MONITORING THE PRIVATE USE OF FACILITIES FINANCED WITH TAX-EXEMPT BONDS TO COMPLY WITH FEDERAL TAX REGULATIONS AND MAINTAIN THE TAX-EXEMPT STATUS OF COUNTY BONDS AND RELATED POST ISSUANCE COMPLIANCE PROCEDURES

PPM#: CW-F-077

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ISSUE DATE	**EFFECTIVE DATE**
January 29, 2025	**January 29, 2025**

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PURPOSE:

To reduce the risk of jeopardizing the tax-exempt status of Palm Beach County's bonds by establishing procedures for: (1) identifying uses that may constitute private use or non-qualified use; (2) managing and tracking changes in use, (3) identifying and monitoring payments received with respect to privately used property and (4) accomplishing remedial action when necessary.

UPDATES:

Future updates to this PPM are the responsibility of the Director of OFMB.

AUTHORITY:

- Internal Revenue Code, Section 141, Treasury Regulation§§1.141-1 through 1.141-9 and §1.141-12, Revenue Procedure 2007-47 and Revenue Procedure 2017-13[1], as may be amended.
- Florida Statutes, Sections 125.01, 125.013 and 129.06, as may be amended
- Palm Beach County Administrative Code, Sections 101.00, 301.00, 303.00, 304.00 311.00 and 312.00, as may be amended
- PPM CW-F-065, Industrial Development Revenue Bonds, as may be amended.

[1] Revenue Procedure 2017-13 superseded Revenue Procedure 97-13, as amended. Revenue Procedure 2017-13 allows the use of all of the Rev. Proc. 97-13 rules for management contracts executed prior to August 18, 2017. The provisions of Rev. Proc. 2017-13 may be applied to management contracts executed on or after January 17, 2017 and must be applied to (i) new management contracts executed on or after August 18, 2017 or (ii) existing management contract materially modified on or after August 18, 2017. **For management contracts in effect prior to August 18, 2017 that have not been materially modified or extended, please see Exhibit 3 under Tab 1.**

OVERVIEW:

The Board of County Commissioners ("Board") periodically considers the issuance of tax-exempt governmental bonds and tax-exempt qualified private activity bonds to finance the construction or acquisition of infrastructure, facilities and other assets. Section 141 of the Internal Revenue Code of 1986, as amended (the "Code") provides that interest on the County's bonds is exempt from tax to the extent that bond proceeds are used for governmental purposes. Section 142 and 145 of the Code provide that interest on the County's bonds is exempt from tax to the extent that bond proceeds are used for certain government-encouraged private uses.

The regulations contain specific constraints concerning the use of bond proceeds directly or indirectly in an unrelated trade or business or other private use. The County must carefully monitor the use of bond proceeds to ensure the County complies with tax law requirements while the bonds are outstanding.

RESPONSIBILITY:

The County Debt Manager will act as the tax compliance officer who will have the primary responsibility to monitor the County's compliance with federal tax requirements for the County's bonds. The County Debt Manager will establish procedures to monitor the anticipated private use of facilities financed with tax-exempt bonds ("Bond-Financed Property") at the time the bonds are issued and any changes in that private use while the bonds are outstanding. Additionally, any payments received with respect to privately used Bond-Financed Property must be monitored over the life of the bond issue. These responsibilities shall include, but not be limited to, communication of monitoring procedures to applicable County Departments, confirming consistent application and monitoring the completeness of documentation of these procedures.

It is the responsibility of each County Department that oversees the construction and operation of facilities financed with tax-exempt bond proceeds to track the planned and actual use of the facilities on an annual basis while the bonds are outstanding. The Department Head or their Designee (collectively, the "Department Designee") will maintain an updated list of bond issues outstanding, the uses of bond proceeds, the uses of facilities financed by bond proceeds and monies collected with respect to the use of Bond-Financed Property that is privately used. A copy of the updated list shall be sent to the County Debt Manager annually. The County Debt Manager shall review all private uses and work with each department and Bond Counsel to make certain that no private use is undertaken which might adversely affect the tax-exempt status of each bond issue. A further breakdown of the procedures to carry out these responsibilities is detailed in the policy and procedures below. For purposes hereof, references to "Bond Counsel" shall mean, to the extent practicable, the bond counsel firm that served as the County's Bond Counsel in connection with the specific issue of Bonds that financed Bond-Financed Property that is the subject of review.

POLICY:

It is the policy of the County to monitor the use of Bond-Financed Property from the time the facilities are put into service until after the bonds have been paid off to ensure that the facilities are used for governmental purposes and to limit the amount of tax-exempt bonds that finance private activities of non-governmental entities.

Bond-Financed Property

The first step in undertaking a review of private use limitations is to identify all of the property that was financed by a particular issue of Bonds. In many cases a particular property or project may have been partially financed with multiple issues and a change in the use of that property or project could affect all those issues. The County Debt Manager will identify all outstanding Bonds of the County by reference to the audited financial statement for the fiscal year and any interim unaudited financial statements. The County Debt Manager will establish and maintain books and records that reflect the actual expenditure of proceeds of particular Bonds on Bond-Financed Property.

Private Activity Review

Reference should be made to the Private Activity Restrictions on Private Business Use and accompanying attachments, attached as Tab I, for further guidance on the Private Activity Limitations of Section 141 of the Code, including certain exceptions to private business use.

In order to demonstrate compliance with the private activity limitations of the Code, the County Debt Manager will inquire of each Department Designee as to the use of Bond-Financed Property by any non-governmental persons on a periodic basis. The County Debt Manager will seek to identify the potential occurrence of any of the events set forth below (a "Tax Event") with respect to any Bond-Financed Property, as more fully set forth in the procedures below.

Tax Events

A. **Change of ownership of the Bond-Financed Property** - the ownership of any portion of the Bond-Financed Property is transferred to anyone, prior to the earlier of the end of the expected economic life of the property, or the latest maturity date of any obligation of the issue financing (or refinancing) the property.

B. **Private Business Use of the Bond-Financed Property** - any portion of the Bond-Financed Property will be used by anyone other than a State or local governmental unit or members of the general public who are not using the property in the conduct of a trade or business, including the federal government and non-profit 501(c)(3) organizations,. Examples of uses that can give rise to private business use include, but are not limited to, use by the federal government of bond financed facilities including jail facilities holding federal prisoners, use by a person as an owner, lessee, purchaser of the output of facilities under a "take" or "take or pay" contract, use pursuant to a reservation of capacity agreement with respect to a wastewater facility, purchaser or licensee of research, a manager or independent contractor under certain management or professional service contracts or any other arrangement that conveys special legal entitlements (e.g., arrangement that conveys priority rights to the use or capacity of the financed property) for beneficial use of the property financed with proceeds of tax exempt debt or special economic benefit.

C. **Private Leases of the Bond Financed Property** - any portion of the Bond-Financed Property that is to be leased, or otherwise subject to an agreement that gives possession of any portion of the Bond-Financed Property to anyone, other than a state or local governmental unit.

D. **Management Agreement or Service Agreement** - any portion of the Bond-Financed Property is to be used under a management contract or professional service contract (e.g., medical group), other than a contract for services that are solely incidental to the primary function of Bond-Financed Property, such as janitorial services or office equipment repair.

E. **Sale of Output from Bond-Financed Facility** - any output of the Bond-Financed Facility is to be sold to or otherwise used by any person other than a state or local governmental unit or a member of the general public.

F. **Naming Rights Agreements for the Bond-Financed Property** - any portion of the Bond-Financed Property will become subject to a naming rights or sponsorship agreement, other than a "brass plaque" dedication.

G. **Research using the Bond-Financed Property** - any portion of the Bond-Financed Property will be used for the conduct of research under the sponsorship, or for the benefit of, any organization other than a state or local governmental unit.

H. **Private Loan of Bond Proceeds** - any portion of the proceeds of the Bonds (including any investment earnings thereon) that are to be loaned by the Issuer.

The existence of private uses will trigger a need to review the extent to which there have been payments received by the County either from the private party, such as lease payments, or payments with respect to the Bond-Financed Property. If at any time there is a question, or a potential problem arises with respect to private payments, it should be brought to the attention of the County Debt Manager as soon as possible and Bond Counsel should be consulted on the application of the private payment test. In this regard, it is best practice to consult with Bond Counsel prior to taking any action or entering into any agreement that potentially gives rise to private use or private party payments with respect to Bond-Financed Property.

MONITORING PROCEDURES:

1. **Designation of Responsibilities**

   The County Debt Manager is responsible for monitoring compliance with all issues relating to Bonds. The County Debt Manager monitors each bond issue to enforce the policies and procedures relating to private use, private payments and economic life of the projects. The general responsibilities of the County Debt Manager with respect to bond compliance shall include, but not be limited to, communication of monitoring procedures for Governmental Bonds to applicable County Departments, confirming consistent application of these procedures, monitoring the completeness of documentation required by these procedures, and conferring with Bond Counsel as necessary.

The County Department responsible for overseeing the construction and operation of the projects financed with tax-exempt bond proceeds is responsible for tracking the planned and actual use of projects, including expenditures of bond proceeds. The Department Head Director or his Designee will maintain an updated list of bond issuances outstanding, the uses of proceeds and the percentage determinations with respect to private uses. At the time of issuance, the County Debt Manager and the Department Designee will complete the appropriate documentation to understand the planned use of the proceeds. Additionally, each Department should keep track of any moneys ("Equity") not derived from bond proceeds contributed to project costs. Treasury Regulations (Treasury Regulation §1.141-6) generally permit private use to be allocated first to Equity and then to bond proceeds. If possible, such Equity contribution should be identified in the tax certificate at the time of issuance of the related bonds, and all Equity contributions should be allocated to a Bond-Financed Property by no later than the date such project is placed in service.

2. Identifying Bond Issues and Planned Use of Proceeds

The Department Designee shall complete the following steps in order to properly identify new Bond issues (and certain Bond issues outstanding at the time of adoption of this policy and procedure) and understand the planned use of Bond proceeds for each issue under his/her management and control:

A. At the time of issuance, complete a summary of Bond Issuance, Construction and Use Plan, which documents the planned usage of the bond proceeds, detail understanding of the physical projects and the planned use of these projects. The Department Designee and Debt Manager will work with operating personnel to determine and document planned uses of projects financed with bond proceeds.

B. In conjunction with completing the Bond Construction and Use Plan, the Department Designee shall complete a Physical Project Details Summary outlining uses both public and private.

   A copy of any service or management contracts or agreements associated with each facility should be maintained in a file attached to each Summary. This planned use information may be necessary for safe harbor protection upon a change in use to show that the change was not planned at time of issuance.

   On completion of the Bond-Financed Projects and final expenditure of proceeds, the Department Designee and Debt Manager will review and document the allocation of proceeds of the Bonds to particular costs. A final allocation of proceeds to expenditures will be made and retained with the records of each related issue of Bonds not later than 18 months after the later of the expenditure of the proceeds of the bonds or the placed in service date for the Bond-Financed Property. To the extent possible, non-Bond proceeds (Equity) will be allocated to the financing of any property or project expected to have significant private use and such allocation will be documented at the time of final allocation of the proceeds of Bonds.

3. Periodic Tax Event Review

The County Debt Manager will disseminate to, and discuss with Department Designees, the list of Tax Events described above and will attempt to identify any potential Tax Event before it occurs. The County Debt Manager should work closely on a regular basis with each department involved with the operations involving Bond-Financed Projects to learn about potential and actual changes as they are contemplated.

Once a potential change in use has been identified, the County Debt Manager shall work with the Department Designee and user to determine the parameters for the new use. Some of the parameters to consider include whether the use will be available to other organizations or the public, rents or compensation for use, costs of use to the County and square footage to be used, management contracts, leases, service, etc. These use parameters will determine if the use constitutes a non-qualified use and/or new private use of the facilities. The Department Designee shall update the schedule summarizing Changes in Use.

Upon a change in use in a management or service contract, the Debt Manager will direct Bond Counsel to review the contract to determine if a safe harbor applies that would avoid private use from occurring. These types of agreements are typical in courthouse and jail facility contracts or agreements. Departments should submit these contracts to the Debt Manager (and the County's Bond Counsel) in the early stages of discussions prior to going to the Board for approval. Early Bond Counsel review of the contracts may help avoid private use problems.

On or prior to the occurrence of any contemplated Tax Event, the County Debt Manager will consult with Bond Counsel for the relevant bonds to ascertain what effect, if any, a contemplated Tax Event may have on the tax-exemption of interest on the bonds. Bond Counsel also should be consulted regarding questions of measurement of private use. In certain circumstances, if the private use causes a limitation on the overall issue to be exceeded, it may be necessary for the County to take a remedial action under Treasury Regulation Section 1.141-12 to preserve the tax-exempt status of interest on the Bonds. See Tab II regarding available remedial actions. Timely identification of a Tax Event is necessary to take a remedial action. In certain cases, remedial action may not be available and the County may need to consider a voluntary closing agreement with the Internal Revenue Service (IRS).

4. Annual Review

The County Debt Manager and Department Designees shall be responsible for reviewing the County's bond issues on an annual basis. This review will involve analyzing the planned uses for the physical properties, as documented on the summaries and schedules indicated above, and determining whether any changes in use are contemplated and or have occurred. This review shall include information and/or documentation concerning users of the facility for any proposed or actual changes identified within the past year (e.g. changes in square footage, increased public or private uses, changes in activities including additions/deletions of specific activities). Such information and/or documentation may include, but is not limited to, the factual details of the proposed or actual change in use, policies and procedures related to use, expenses related to use, improvements made, etc.

On an annual basis, the Department Designee will review the actual use of each Bond issue to determine whether the actual use has changed from the plan and will file an annual report to the County Debt Manager. Where the actual use is different, the Department Designee will document how it is different and the effects of the differences on the private use calculations. The County Debt Manager shall review all new private uses and work with each department and the County's Bond Counsel to make certain that no private use has been undertaken that might affect the qualified status of each tax-exempt bond issue.

Additionally, on an annual basis, the Department Designee will confirm the actual use of any Grant moneys to determine whether the actual use has changed from the authorized use under the related Grant agreement and will file an annual report to the County Debt Manager. Where the actual use is different, the Department Designee will document how it is different and contact the County Debt Manager. The County Debt Manager shall work with each department and the County's Bond Counsel to make certain that any change in the expected use of Grant proceeds will not affect the qualified status of the related tax-exempt bond issue.

Each Department shall be responsible for completing and maintaining the documentation required in this procedure for the bond issues under its control including: a) List of tax-exempt bond issues and development/project plan; b) Project Detail by project at the time on new issuance and again on a yearly basis to update actual use; c) Grants; d) Qualified Private Use, at the time of new issuance and again on a yearly basis to update actual use; and e) Economic Life of Property, at time of issuance and potentially annually to update any changes in use of the proceeds that are expected to change the economic life of the property.

The County Debt Manager will prepare an annual report summarizing current Bond issues outstanding and the status of each based on the data provided in the annual departmental update reports. The County Debt Manager will report to the Director of OFMB any potential problems that may arise that could threaten the tax-exempt status of a bond issue and the steps being taken to resolve the potential problem. Discussions will be held with Bond Counsel as to the steps required to be taken.

QUALIFIED PRIVATE ACTIVITY BONDS:

The County is periodically an issuer of qualified private activity bonds, the tax-exemption of which is dependent on compliance with various use requirements, depending on the type of bonds issued. Set forth below are procedures to be followed with respect to these.

Non-Conduit Airport Facility Bond Issues

The County periodically issues tax-exempt bonds for airport facilities, which may be issued as either Governmental Bonds under Section 141 of the Code or Qualified Private Activity Bonds under Section 142 or Section 146 of the Code. To the extent the Bonds are issued as Governmental Bonds, the foregoing procedures apply. To the extent the Bonds are issued as Qualified Private Activity Bonds, separate use of proceeds rules apply to those Bonds and the procedures below apply.

Planned Use of Proceeds

At the time of issuance of a new Bond issue for airport facilities that are expected to be used by private non-governmental person, the Department Designee and Debt Manager will work with operating personnel and Bond Counsel to determine and document planned uses of projects financed with Bond proceeds. The Department Designee and Debt Manager will assure themselves that all Bond-Financed Facilities will be owned by the County and will meet the public use requirement by being used by the general public or by common carriers serving the general public. If any Bond-Financed Facility is to be leased to or managed by anyone other than a state or local governmental unit, the Department Designee and the Debt Manager will assure that any such lease or management agreement meets the following three requirements of Section 142(b)(1)(B) of the Code:

A. The agreement term is not greater than 80% of the economic life of the Bond-Financed Facility subject to that agreement;

B. The lessee or manager has no option to purchase the Bond-Financed Property other than at fair market value determined at the time the option is exercised; and

C. The lessee or manager makes an irrevocable election not to claim depreciation or investment credits with respect to the Bond-Financed Property.

Based on a review of projected costs, the Debt Manager will assure that at least 95% of the net proceeds of the Bonds will be spent on qualified costs of an airport facility and not more than 2% of the proceeds of the Bonds will be spent on costs of issuance. The Debt Manager will consult with Bond Counsel for the Bonds on any questions relating to the eligibility of any project costs for bond financing.

At the completion of the project and final expenditure of the proceeds of the Bonds, the Department Designee and the Debt Manager will review and document the final allocation of proceeds to costs of the Bond-Financed Property. If there remain unexpended proceeds of the Bonds on project completion, the Debt Manager will consult with Bond Counsel for the appropriate remedial action to take.

<u>Periodic and Annual Review</u>

The Department Designee will regularly consult with department operating personnel as to the use of the Bond-Financed Property to assure that all facilities continue to be used as qualifying airport facilities that meet the public use requirement and that all leases or management contracts meet the requirements of Section 142(b)(1)(B) of the Code. In addition, the County Debt Manager and the Department Designee will conduct a similar annual review of the use of the facilities that comprise the Bond-Financed Property. If a facility ceases to be used for a qualifying purpose, the County Debt Manager will consult with Bond Counsel as to appropriate remedial action to be undertaken.

<u>Conduit Bond Issues</u>

The County is occasionally a conduit issuer of qualified private activity bonds for the benefit of conduit borrowers to finance facilities, including facilities owned by qualified 501(c)(3) entities, qualified exempt airport facilities and qualified exempt manufacturing facilities. In the case of

conduit issues, post-issuance tax compliance is generally the responsibility of the conduit borrower (the "Borrower") under tax covenants contained in the loan agreement, other financing documents and/or the tax certificate (collectively, the "Financing Documents"). The County should endeavor to assure that the Borrower is complying with its covenants.
The Department of Housing and Economic Sustainability is responsible for administering the County's program for conduit bond issues.

MAINTAINING FILES AND RECORDS:

The IRS has its own record retention requirements as per Section 1.6001-1(e) of the Income Tax Regulations; additionally, the State of Florida's General Records Schedule GS1-SL requires bond resolutions to be retained as permanent records. See also IRS FAQs on Record Retention, attached as Attachment D. Set forth below are recordkeeping obligations necessary to demonstrate compliance with the private activity limitations.

The Debt Manager shall maintain a file for each Bond issue. The file shall include a copy of the bond documents, Detailed Project Schedule, Qualified Private Use by project, and Economic Life of the Project. The file shall contain a copy of all contracts, leases, agreements and documentation that any private use or private payment does not exceed permissible limits. The file shall contain annual reports from Departments managing Bond projects summarizing all recalculations of private use percentage and private payment summaries. This file must be maintained for each Bond issue for the life of the issue (including any issue which subsequently refunds that issue) plus three years.

Verdenia C. Baker
VERDENIA C. BAKER
COUNTY ADMINISTRATOR

Attachments:
Attachment A: Definitions
Attachment B: Private Activity Restrictions on Private Business Use
Attachment C: Remedial Actions Governmental Bonds
Attachment D: Tax-Exempt Bonds FAQs Regarding Record Retention Requirements
Attachment E: Private Business Use Questionnaire

Supersession History:
1. PPM# CW-F-077, effective 08/31/2009
2. PPM# CW-F-077, effective 12/17/2012
3. PPM# CW-F-077, effective 04/17/2018

ATTACHMENT A
DEFINITIONS

GOVERNMENTAL BONDS

Bonds – Includes bonds, notes, certificates of participation, installment sale or financing lease arrangements issued on a tax-exempt basis.

Governmental Bonds – Governmental Bonds are bonds that are not Private Activity Bonds.

Grant – A transfer of County bond proceeds for a governmental purpose to an entity that is not related to, or an agent of the County, where repayment by the grantee is not expected. Obligations or conditions intended solely to assure expenditure of the transferred County bond proceeds in accordance with the governmental purpose of the transfer do not prevent a transfer from being considered a Grant.

Management Contract – A management, service or incentive payment contract between a governmental unit and a non-governmental service provider under which the service provider provides services involving all, a portion of, or any function of a facility. A management contract with respect to financed property generally results in a private business use if the contract provides for compensation of services rendered with compensation based, in whole or in part, on a share of net profits from the operation of the facility. Revenue Procedure 2017-13 provides safe harbors pursuant to which qualifying management contracts would not be treated as constituting private use of a financed facility.

Private Activity Bonds - A bond is a private activity bond if the bond issue meets: (i) **both** the private business use test **and** the private payment or security test; **or** (ii) the private loan financing test. The tests are applied on a basis of reasonable expectations of the County on the date of the issue and by taking into account deliberate actions of the County while the bonds are outstanding. In many cases, a deliberate action that causes bonds to become private activity bonds can be cured by taking remedial actions.

Private Business Use Test - The private business use test is met if the amount of proceeds of bonds that are used in a private business use is more than 10% of total proceeds. A 5% limit is used in lieu of a 10% limit if the private use is unrelated to a governmental use or related but disproportionate to a governmental use. Private Business Use means use, directly or indirectly, in a trade or business carried on by any person other than the County or another state or local governmental unit, including a use by a 501(c)(3) organization or the federal government. All private business uses over the life of the bonds are aggregated in determining whether the limitations are met.

Private Loan Financing Test - The Private Loan Financing Test is met if the issuer uses bond proceeds to make total loans to private persons exceeding the lesser of 5% of the proceeds or $5 million.

Private Payment or Security Test - The private security or payment test is met if the payment of debt service on more than 10% of the issue and is directly or indirectly (i) secured by any interest in property used for a private business use or payments in respect of such property or (ii) derived from payments in respect of property or borrowed money used for a private business use. A 5% limit is used in lieu of a 10% limit if the private use is unrelated to a governmental use or related but disproportionate to a governmental use. Private payments are not taken into account to the extent properly allocated to ordinary and necessary expenses directly attributable to the operation and maintenance of the Bond-Financed Property used by the private user.

Qualified Private Activity Bonds – Any Bond described in Section 141(e) of the Code, including exempt facility bonds under Section 142 of the Code, qualified 501(c)(3) bonds under Section 145 of the Code and qualified manufacturing bonds under Section 146 of the Code.

Research Agreement – An agreement for any original investigation for the advancement of scientific knowledge not having a specific commercial objective, including such research in the social sciences, arts and humanities. A Research Agreement will result in private business use if it conveys priority rights to the use or capacity of a facility. Rev. Proc. 2007-47 provides safe harbors for determining whether corporate sponsored research and industry or federally-sponsored agreements result in private business use.

{Revised 12/2023}

ATTACHMENT B
PRIVATE ACTIVITY RESTRICTIONS ON PRIVATE BUSINESS USE GOVERNMENTAL BONDS

Introduction

The Internal Revenue Code of 1986, as amended (the "Code") limits the amount of proceeds of tax-exempt governmental bonds (including short term obligations such as notes) that can be used for the benefit of private businesses. Section 141 of the Code treats as a taxable private activity bond a bond issued as part of an issue that meets the private business use test and the private security or payment test, or the private loan test. The private business use test is met if the amount of proceeds of bonds that are used in a private business use is more than ten percent of total proceeds. The private security or payment test is met if the payment of debt service on more than 10 percent of the issue is directly or indirectly (i) secured by any interest in property used for a private business use or payments in respect of such property or (ii) derived from payments in respect of property or borrowed money used for a private business use. A five percent limit is used in lieu of a ten percent limit if the private use is unrelated to a governmental use or related but disproportionate to a governmental use. For purposes of Section 141, the term private business includes nonprofit, 501(c)(3) organizations as well as the federal government.

Private business use generally

Private business use can arise from almost any use of tax-exempt bond-financed property by anyone other than a state or local governmental unit ("Governmental Unit") or members of the general public who are not using the property in the conduct of a trade or business. Examples of uses which can give rise to private business use include use (a) by a person as (i) an owner, (ii) a lessee, (iii) a purchaser of the output of facilities under a "take and pay" or "take or pay" contract, (iv) a purchaser, sponsor or licensee of research and (v) a manager, operator, or independent contractor under certain management or professional service contracts, (b) pursuant to an arrangement that conveys (i) special legal entitlements (e.g., an arrangement that conveys priority rights to the use or capacity of the financed property) for beneficial use of the property financed with proceeds of tax exempt debt or (ii) other special economic benefits, (c) use by the United States government and its agencies and instrumentalities and (d) use by nonprofit corporations.

The purpose of this Summary is to assist employees of a Governmental Unit in recognizing uses, actions or other arrangements with respect to tax-exempt bond-financed property which may not comply with the requirements of the Internal Revenue Code of 1986, as amended, and which could jeopardize the tax exempt status of bonds issued to finance such property. It is not exhaustive and may not be relied upon as legal advice. Before any use, action or other arrangement described herein is commenced, such use, action or other arrangement should be reviewed by bond counsel to the Governmental Unit.

Leases of the Financed Property. Leases and certain other agreements which transfer possession of tax exempt financed property will result in a private business use if the party to whom the property is leased is not a Governmental Unit. Examples include leases of space for book stores and cafeterias.

Priority Rights. Arrangements that convey special legal entitlements (e.g., arrangements that convey priority rights to the use or capacity of the financed property) for control or beneficial use of property financed with proceeds of tax exempt debt are treated as private business uses. Examples of such arrangements are contracts with research companies to set aside space for the testing of new products or arrangements pursuant to which a person which is not a Governmental Unit is entitled to limit, or control charges for, access to all or a portion of tax-exempt bond financed property.

Naming Rights and Sponsorship Payments. Agreements which permit a private company or organization to make payments for the right to have its name or logo used in connection with property financed with tax exempt debt may result in private business use. The rules in this area continue to evolve but "qualified sponsorship payments" should not give rise to a private business use. A qualified sponsorship payment means any payment made by any person engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgement of the sponsor's name or logo in connection with the activities of the Governmental Unit. Such use or acknowledgement may not include advertising such person's products or services. The qualified sponsorship payment would not include (a) any payment that is contingent upon attendance at events or (b) any payment that entitles the payor to the use or acknowledgement of the payor's name or logo in regularly scheduled and printed material published by or on behalf of the Governmental Unit. This would allow donations in exchange for the usual "brass plaque" but call into question arrangements such as the right to name a facility of the Governmental Unit and control how that facility is referred to in publications and press releases.

Research Arrangements. Research conducted under the sponsorship or for the benefit of organizations other than Governmental Units, including research sponsored by any branch of the Federal government, can result in the private business use of any property financed with tax exempt debt which is used in the conduct of the research. The Internal Revenue Service has published guidance on the circumstances under which a research agreement does not result in private business use. The guidance for safe harbor research arrangements is set forth in Rev. Proc. 2007-47 (2007 IRB LEXIS 570; 2007-29 I.R.B. 108) attached hereto as Exhibit 1.

Management and Service Contracts. Both contracts for the management of property financed with tax exempt debt and certain contracts for the provision of services in connection with property financed with tax exempt debt can result in private business use. Contracts which may result in a private business use include management, service, or incentive payment contracts between the Governmental Unit and a service provider under which the service provider provides services involving all, a portion of, or any function of, a facility financed with tax exempt debt. For example, a contract for the provision of management services for an entire facility, and a contract for management services for a specific portion of a facility, such as a cafeteria are each treated as a management contract. However, contracts for services that are solely incidental to the primary function of the property financed with tax exempt debt, such as janitorial services or office equipment repair, are not regarded as management or service contracts for this purpose. The Internal Revenue Service has published safe harbor guidance on the circumstances under which a management or service agreement does not result in private business use. The guidance is set forth in Rev. Proc. 2017-13[2] (2017-6 I.R.B. 787) attached hereto as Exhibit 2;

[2] Revenue Procedure 2017-13 superseded Revenue Procedure 97-13, as amended. Revenue Procedure 2017-13 allows the use of all of the Rev. Proc. 97-13 rules for management contracts executed prior to August 18, 2017. The provisions of Rev. Proc. 2017-13 may be applied to management contracts executed on or after January 17, 2017 and must be applied to (i) new management contracts executed on or after August 18, 2017 or (ii) existing management contract materially modified on or after August 18, 2017. **For**

Rev. Proc. 2017-13 sets forth, or incorporates by reference to other Treasury Regulations, some key definitions and provides a set of general principles under which a Management Contract can find a "safe harbor," and not give rise to private use.

Those key definitions are:

(1) *Capitation Fee* – means a periodic fixed amount for each person for whom the Service Provider or Qualified User assumes the responsibility to provide all needed service for a specified period of time. An example of a capitation fee is a fixed dollar amount payable each month to a medical service provider for each member of a health maintenance organization. A periodic fixed amount can include an automatic increase based on a specified, objective, external standard such as the Consumer Price Index. A Capitation Fee can include a variable component of up to 20% of the total Capitation Fee.

(2) *Controlled Group* – means a group of entities controlled directly or indirectly by the same entity or group of entities where (i) direct control is evidenced by the right or power to (a) approve and remove without cause a controlling portion of the governing body of the controlled entity or (b) to require the use of funds or assets of the controlled entity for any purpose of the controlling entity, and (ii) indirect control arises when the controlled entity controls another entity or entities.

(3) *Eligible Expense Reimbursement Arrangement* – means a Management Contract under which the only compensation consists of reimbursements of actual and direct expenses paid by the Service Provider to Unrelated Parties.

(4) *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 for a Managed Property. A Management Contract does not include a contract or a portion of a contract for the provision of services prior to the Managed Property being placed in service, such as a construction design or construction management contract.

(5) *Managed Property* – means the portion of a Project with respect to which the Service Provider provides services. Note: The Managed Property may consist of only a portion of the Project and the Managed Property may include facilities that were not financed with the proceeds of tax-exempt bonds.

(6) *Periodic Fixed Fee* – means a stated dollar amount for services rendered for a specified period of time such as a stated dollar amount per month. The stated dollar amount can automatically increase according to a specified, objective, external standard that is not linked to the output or efficiency of the Managed Property such as the Consumer Price Index.

(7) *Per Unit Fee* – means a fee based on a unit of service such as a stated dollar amount for a specified medical procedure or car parked. Just like Capitation Fees and Periodic Fixed Fees, the amount may increase according to a specified, objective external standard.

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management contracts in effect prior to August 18, 2017 that have not been materially modified or extended, please see Exhibit 3.

(8) *Project* – means one or more facilities or capital projects, including land, buildings, equipment, or other property, financed in whole or in part with proceeds of the issue. Note: The Project may include facilities that have not been financed with the proceeds of tax-exempt bonds.

(9) *Qualified User* – means a governmental person (a state or local governmental unit) and, for qualified 501(c)(3) bonds, a governmental person or a 501(c)(3) organization.

(10) *Related Party* – means any member of the same Controlled Group.

(11) *Service Provider* – means any person other than a Qualified User that provides services to, or for the benefit of, a Qualified User under a Management Contract.

(12) *Unrelated Parties* – means a person other than (1) a Related Party or (2) a Service Provider's employee.

The set of principles are:

(1) **In General**. If a Management Contract meets all of the applicable conditions of Rev. Proc. 2017-13, or is an Eligible Expense Reimbursement Arrangement, the Management Contract does not result in private business use. Use of the Managed Property by the Service Provider that is functionally related and subordinate to the performance of services under the Management Contract, such as use of storage areas or office space, does not result in private business use.

(2) **General Financial Requirements**.

(a) The payments to the Service Provider must be reasonable compensation for services rendered during the term of the Management Contract. Compensation includes payments to reimburse actual and direct expenses paid by the Service Provider and related administrative overhead expenses of the Service Provider.

(b) The Management Contract must not provide to the Service Provider a share of the net profits from the operation of the Managed Property. Incentive compensation will not be treated as providing a share of net profits if the eligibility for the incentive compensation is determined by the Service Provider's performance in meeting standards that measure quality of service, performance, or productivity.

(c) The Management Contract must not impose on the Service Provider a burden of bearing any net losses from the operation of the Managed Property.

(d) The Management Contract will not be treated as providing a share of net profits or requiring the Service Provider to bear net losses if the compensation is (i) based solely on a Capitation Fee, a Periodic Fixed Fee, or a Per Unit Fee, (ii) incentive compensation, or (iii) a combination of these types of compensation.

(e) Deferral of the payment of compensation to the Service Provider is permitted, and will not be treated as contingent on net profits and losses if (i) the compensation is payable at least annually, (ii) the contract imposes reasonable consequences for late payment such as late interest or late payment fees, and (iii) any deferred compensation is payable no later than the end of five years after the original due date.

(3) **Term of the Management Contract.**

(a) The term of the Management Contract cannot exceed the lesser of (i) 30 years or (ii) 80% of the weighted average reasonably expected economic life of the Managed Property. Economic life is determined as of the beginning of the term of the Management Contract. Land is not included in determining the life of the Managed Property unless 25% or more of the proceeds of the relevant bonds were used to purchase the land. Note: These requirements may make it difficult to enter into a Management Contract near the end of the life of the Managed Property.

(b) A contract that is materially modified must be retested under this rule as of the date of the material modification.

(c) Contract renewal term options are counted against the contract term limitation only if and to the extent held by the Service Provider. Automatic renewal provisions subject to cancellation by either party (also referred to as "evergreen" provisions) are not counted against the contract term limitation.

(4) **Control of the Managed Property**. The Qualified User must exercise a significant degree of control of the Managed Property. This control requirement is met if the Management Contract requires the Qualified User to approve (i) the annual budget for the Managed Property, (ii) capital expenditures for the Managed Property, (iii) disposition of any property that is part of the Managed Property, (iv) the rates charged for the use of the Managed Property, and (v) the general nature and type of use of the Managed Property. Note: The approval of rates may be done by (I) specific approval, (II) approving a methodology for setting the rates, or (III) requiring the rates to be reasonable and customary as specifically determined by or negotiated with an independent third party (such as a medical insurance company).

(5) **Risk of Loss**. The Qualified User must bear the risk of loss of the Managed Property by damage or destruction. However, the Qualified User can insure against this loss through a third party (insurer).

(6) **No Inconsistent Tax Position**. The Management Contract must require that the Service Provider will not take any tax position inconsistent with being a service provider to the Qualified User. Thus a Service Provider cannot claim depreciation of the Managed Property or an investment tax credit with respect to the Managed Property.

(7) **Service Provider Relationship with the Qualified User**. The Service Provider or any related party to the Service Provider cannot have a role or relationship with the Qualified User that limits the Qualified User's ability to exercise its rights under the Management Contract. A Service Provider may be treated as having a prohibited role or relationship with the Qualified User if (i) more than 20% of the voting power of the governing body of the Qualified User is vested in the directors, officers, shareholders,

partners, members and employees of the Service Provider, (ii) the governing body of the Qualified User includes the chief executive office or chairperson (or equivalent) of the Service Provider, or (iii) the chief executive officer of the Service Provider is the chief executive officer of the Qualified User or any related party to the Qualified User.

Output Facilities. Occasionally a Governmental Unit will acquire facilities such as co-generation facilities. The sale of output (as distinguished from consumption of the output by the Governmental Unit) from an output type facility can result in a private business use.

Joint Ventures. Joint venture arrangements between a Governmental Unit and persons other than a Governmental Unit may result in private business use. These arrangements need to be examined to see if they are viewed as partnerships for federal tax purposes.

Exclusions from Private Business Use

Incidental Uses. A very limited spectrum of incidental uses are not treated as private business uses if certain conditions are met. Those conditions are: (a) except for vending machines, pay telephones, kiosks and similar uses, the use must not involve the transfer to the private user of possession and control of space that is separated from the other areas of the facility by a physical barrier; (b) the use must not be functionally related to another use of the facility by the same private user; and (c) such incidental uses may not, in the aggregate involve more that 2.5 percent of the facility. Examples of incidental uses include pay telephones, vending machines and advertising displays.

General Public Use. Use of facilities intended for general public use is not considered "use" by nongovernmental persons in a trade or business if such persons use the facilities in their trade or business on the same basis as other members of the public. Use of the financed facilities by organizations such as school groups, church groups, and fraternal organizations and numerous commercial organizations for a short period of time on a rate scale basis will not be considered use by nongovernmental persons in a trade or business if the rights of such a user are only those of a transient occupant rather than the full legal possessory interests of a lessee. Any arrangement that conveys priority rights to the use or capacity of the financed property will be treated as a private business use.

Reimbursement for public utility property management. Contracts for the operation of a facility or system of facilities consisting predominately of "public utility property", will not be considered management contracts if the only compensation is reimbursement to the Service Provider of actual and direct out-of-pocket costs paid to unrelated third parties and reasonable administrative overhead expenses of the Service Provider.

Expense reimbursement for other property. Contracts to provide services under which the only compensation is reimbursement to the Service Provider of actual and direct out-of-pocket costs paid to unrelated third parties are not considered to be management contracts.

Short Term Uses. Certain short term uses will not be treated as private use. Use by a nongovernmental person is not private use if either:

> (i) (A) the term of the use under the arrangement, including all renewal options is not longer than 200 days, and (B) the use of the financed property under the same or similar arrangements is predominantly by natural persons who are not engaged in a trade or business; or
>
> (ii) (A) the term of the use under the arrangement, including all renewal options, is not longer than 100 days, and (B) the arrangement would be treated as general public use, except that it is not available for use on the same basis by natural persons not engaged in a trade or business because generally applicable and uniformly applied rates are not reasonably available to natural persons not engaged in a trade or business; or
>
> (iii) (A) the term of the use under the arrangement, including all renewal options, is not longer than 50 days; and (B) the arrangement is a negotiated arm's-length arrangement, and compensation under the arrangement is at fair market value.

In addition, in each case the property must not be financed for the principal purpose of providing that property for use by that non-Governmental Unit. Furthermore, if a management contract gives the Qualified User the right to terminate without cause and without penalty upon 50 days' notice to the vendor, that management contract may, under certain circumstances, be deemed to have a term of 50 days, regardless of its nominal term, and, hence, not result in private business use.

Qualified improvements. Proceeds of tax exempt bonds that provide a governmentally owned improvement to a governmentally owned building (including its structural components and land functionally related and subordinate to the building) are not used for a private business use if

(i) The building was placed in service more than 1 year before the construction or acquisition of the improvement is begun;

(ii) The improvement is not an enlargement of the building or an improvement of interior space occupied exclusively for any private business use;

(iii) No portion of the improved building or any payments in respect of the improved building secures payment of the tax exempt bonds; and

(iv) No more than 15 percent of the improved building is used for a private business use.

(v) Measurement of Private Business Use

All private business uses of property financed by a bond issue are aggregated to determine if the limitations have been exceeded. Private business use of property is measured on an average basis over a measurement period that runs from the later of the issue date of the bonds or the date property is placed in service, through the earlier of the last date of the expected economic life of the property or the maturity date of the bonds or refunding bonds. The average percentage of private business use is the average of the percentages of private business during one-year periods within the measurement period. The percentage of private business use for any one-year period is the average private business use for that year, determined by comparing the amount of private business use during that year to the total amount of private business use and governmental use.

EXHIBIT 1

RESEARCH CONTRACT GUIDELINES

Rev. Proc. 2007-47—Operating Guidelines for Research Agreements

(Also Part I, § § 103, 141, 145; 1.141-3, 1.145-2.)

June 26, 2007

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 § 1.1031 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).

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EXHIBIT 2

MANAGEMENT CONTRACT GUIDELINES

(Applicable to Management Contracts entered into on and after August 18, 2017)

Rev. Proc. **2017**-13, **2017-6 I.R.B. 787-** Management Contract Guidelines[3]

Released: January 18, 2017

Published: February 6, 2017

26 CFR 601.601: Rules and regulations.(Also: §§ 141, 145, 1.141-3, 1.145-2)

SECTION 1. PURPOSE

This revenue procedure provides safe harbor conditions under which a management contract does not result in private business use under § 141(b) of the Internal Revenue Code or cause the modified private business use test for property financed with qualified 501(c)(3) bonds under § 145(a)(2)(B) to be met. This revenue procedure modifies, amplifies, and supersedes Rev. Proc. 2016-44, 2016-36 IRB 316, to address certain types of compensation, the timing of payment of compensation, the treatment of land, and methods of approval of rates. Sections 2.11 through 2.14 of this revenue procedure generally describe the modifications and amplifications made to Rev. Proc. 2016-44 by this revenue procedure.

SECTION 2. BACKGROUND

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

.02 Section 141(b)(1) provides generally 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. Section 141(b)(6) defines "private business use" as use (directly or indirectly) in a trade or business carried on by any

[3] Revenue Procedure 2017-13 superseded Revenue Procedure 97-13, as amended. Revenue Procedure 2017-13 allows the use of all of the Rev. Proc. 97-13 rules for management contracts executed prior to August 18, 2017. The provisions of Rev. Proc. 2017-13 may be applied to management contracts executed on or after January 17, 2017 and must be applied to (i) new management contracts executed on or after August 18, 2017 or (ii) existing management contract materially modified on or after August 18, 2017. **For management contracts in effect prior to August 18, 2017 that have not been materially modified or extended, please see Exhibit 3 under Tab 1.**

person other than a governmental unit. For this purpose, any activity carried on by a person other than a natural person must be treated as a trade or business.

.03 Section 1.141-3(a)(1) of the Income Tax Regulations provides, in part, that the 10 percent private business use 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. Section 1.141-3(a)(2) provides that, in determining whether an issue meets the private business use test, it is necessary to look at both indirect and direct use of proceeds. 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.

.04 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 as a result of ownership; actual or beneficial use of property pursuant to a lease, a management contract, or an incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

.05 Section 1.141-3(b)(3) provides generally that the lease of financed property to a nongovernmental person is private business 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)(3) further provides that, in determining whether a management contract is properly characterized as a lease, it is necessary to consider all the facts and circumstances, including the following factors: (1) the degree of control over the property that is exercised by a nongovernmental person; and (2) whether a nongovernmental person bears the risk of loss of the financed property.

.06 Section 1.141-3(b)(4)(i) provides generally 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 operations of the facility. Section 1.141-3(b)(4)(iv) provides generally that a management contract with respect to financed property results in private business use of that property if the service provider is treated as the lessee or owner of financed property for federal income tax purposes.

.07 Section 1.141-3(b)(4)(ii) defines “management contract” 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, 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.

.08 Section 1.141-3(b)(4)(iii) provides that the following arrangements generally are not treated as management contracts that give rise to private business use: (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 the hospital's facilities; (C) a contract to provide for the operation of a facility or system of facilities that consists primarily of public utility property, 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.

.09 Section 141(e) provides, in part, that the term "qualified bond" includes a qualified 501(c)(3) bond if certain requirements stated therein are met. Section 145(a) provides generally that "qualified 501(c)(3) bond" means any private activity bond issued as part of an issue if (1) all 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 (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 that 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 1.145-2 provides that, with certain exceptions and modifications, §§ 1.141-0 through 1.141-15 apply to § 145(a).

.10 Rev. Proc. 2016-44 provides safe harbor conditions under which a management contract does not result in private business use of property financed with governmental tax-exempt bonds under § 141(b) or cause the modified private business use test for property financed with qualified 501(c)(3) bonds under § 145(a)(2)(B) to be met. Rev. Proc. 2016-44 modified and superseded Rev. Proc. 97-13, 1997-1 C.B. 632; Rev. Proc. 2001-39, 2001-2 C.B. 38; and section 3.02 of Notice 2014-67, 2014-46 I.R.B. 822.

.11 Section 5.02 of Rev. Proc. 2016-44 sets forth general financial requirements for management compensation arrangements eligible for the safe harbor. Sections 5.02(2) and 5.02(3) of Rev. Proc. 2016-44 provide that the contract must neither provide to the service provider a share of net profits nor impose on the service provider the burden of bearing any share of net losses from the operation of the managed property. Before the publication of Rev. Proc. 2016-44, previously applicable revenue procedures expressly treated certain types of compensation, including capitation fees, periodic fixed fees, and per-unit fees (as defined therein), as not providing a share of net profits. Questions have arisen regarding whether these common types of compensation continue to be treated in a similar manner under Rev. Proc. 2016-44. Related questions have arisen about whether a service provider's payment of expenses of the operation of the managed property without reimbursement from the qualified user (as defined in section 4.04 of Rev. Proc. 2016-44) affects the treatment of these types of compensation. To provide continuity with the previous safe harbors, this revenue procedure clarifies that these types of compensation and certain incentive compensation will not be treated as providing a share of net profits or requiring the service provider to bear a share of net losses.

.12 Sections 5.02(2) and 5.02(3) of Rev. Proc. 2016-44 also provide that the timing of payment of compensation cannot be contingent upon net profits or net losses from the operation of the managed property. Questions have arisen about the effect of these restrictions on the timing of payment of compensation. This revenue procedure clarifies that compensation subject to an annual payment requirement and reasonable consequences for late payment (such as interest charges or late payment fees) will not be treated as contingent upon net profits or net losses if the contract includes a requirement that the qualified user will pay the deferred compensation within five years of the original due date of the payment.

.13 Section 5.03 of Rev. Proc. 2016-44 provides that the term of the contract, including all renewal options (as defined in § 1.141-1(b)), must be no greater than the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property. For this purpose, under Rev. Proc. 2016-44, economic life is determined in the same manner as under § 147(b), but without regard to § 147(b)(3)(B)(ii), as of the beginning of the term of contract. Section 147(b)(3)(B)(i) provides that generally land is not taken into account, but § 147(b)(3)(B)(ii) provides that if 25 percent or more of the net proceeds of any issue is to be used to finance the acquisition of land, such land shall be taken into account and treated as having an economic life of 30 years. Questions have arisen about excluding land when the cost of the land accounts for a significant portion of the managed property. This revenue procedure provides that economic life is determined in the same manner as under § 147(b) as of the beginning of the term of the contract. Thus, land will be treated as having an economic life of 30 years if 25 percent or more of the net proceeds of the issue that finances the managed property is to be used to finance the costs of such land.

.14 Section 5.04 of Rev. Proc. 2016-44 provides that the qualified user must exercise a significant degree of control over the use of the managed property. Section 5.04 of Rev. Proc. 2016-44 further provides that this requirement is met if the contract requires the qualified user to approve, among other things, the rates charged for use of the managed property. Section 5.04 of Rev. Proc. 2016-44 also provides that a qualified user may show approval of rates charged for use of the managed property by either expressly approving such rates (or the methodology for setting such rates) or by including in the contract a requirement that service provider charge rates that are reasonable and customary as specifically determined by an independent third party. Questions have arisen about the requirement to approve the rates in various circumstances in which it may not be feasible to approve each specific rate charged, such as for a physician's professional services at a § 501(c)(3) hospital or hotel room rates at a governmentally-owned hotel. This revenue procedure clarifies that a qualified user may satisfy the approval of rates requirement by approving a reasonable general description of the method used to set the rates or by requiring that the service provider charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party.

SECTION 3. SCOPE

This revenue procedure applies to a management contract (as defined in section 4.03 of this revenue procedure) involving managed property (as defined in section 4.04 of this revenue procedure) financed with the proceeds of an issue of governmental bonds (as defined in § 1.141-1(b)) or qualified 501(c)(3) bonds (as defined in § 145).

SECTION 4. DEFINITIONS

For purposes of this revenue procedure, the following definitions apply:

.01 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 such 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 fixed periodic amount may include an automatic increase according to a specified, objective, external standard that is not linked to the output or efficiency of the managed property. 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. 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 risk such as risk of catastrophic loss.

.02 Eligible expense reimbursement arrangement means a management contract under which the only compensation consists of reimbursements of actual and direct expenses paid by the service provider to unrelated parties and reasonable related administrative overhead expenses of the service provider.

.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 for a managed property. A management contract does not include a contract or portion of a contract for the provision of services before a managed property is placed in service (for example, pre-operating services for construction design or construction management).

.04 Managed property means the portion of a project (as defined in § 1.141-6(a)(3)) with respect to which a service provider provides services.

.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 the managed property. 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 are treated as per-unit fee arrangements. A fee that is a stated dollar amount specified in the contract does not fail to be a per-unit fee as a result of a provision under which the fee may automatically increase according to a specified, objective, external standard that is not linked to the output or efficiency of the managed property. 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.

.07 Qualified user means, for projects (as defined in § 1.141-6(a)(3)) financed with governmental bonds, any governmental person (as defined in § 1.141-1(b)) or, for projects financed with qualified 501(c)(3) bonds, any governmental person or any 501(c)(3) organization with respect to its activities which do not constitute an unrelated trade or business, determined by applying § 513(a).

.08 Service provider means any person other than a qualified user that provides services to, or for the benefit of, a qualified user under a management contract.

.09 Unrelated parties means persons other than either: (1) a related party (as defined in § 1.150-1(b)) to the service provider or (2) a service provider's employee.

SECTION 5. SAFE HARBOR CONDITIONS UNDER WHICH MANAGEMENT CONTRACTS DO NOT RESULT IN PRIVATE BUSINESS USE

.01 In general. If a management contract meets all of the applicable conditions of sections 5.02 through section 5.07 of this revenue procedure, or is an eligible expense reimbursement arrangement, the management contract does not result in private business use under § 141(b) or 145(a)(2)(B). Further, under section 5.08 of this revenue procedure, use functionally related and subordinate to a management contract that meets these conditions does not result in private business use.

.02 General financial requirements.

(1) In general. The payments to the service provider under the contract must be reasonable compensation for services rendered during the term of the contract. Compensation includes payments to reimburse actual and direct expenses paid by the service provider and related administrative overhead expenses of the service provider.

(2) No net profits arrangements. The contract must not provide to the service provider a share of net profits from the operation of the managed property. Compensation to the service provider will not be treated as providing a share of net profits if no element of the compensation takes into account, or is contingent upon, either the managed property's net profits or both the managed property's revenues and expenses (other than any reimbursements of direct and actual expenses paid by the service provider to unrelated third parties) for any fiscal period. For this purpose, the elements of the compensation are the eligibility for, the amount of, and the timing of the payment of the compensation. Incentive compensation will not be treated as providing a share of net profits if the eligibility for the incentive compensation is determined by the service provider's performance in meeting one or more standards that measure quality of services, performance, or productivity, and the amount and the timing of the payment of the compensation meet the requirements of this section 5.02(2).

(3) No bearing of net losses of the managed property.

(a) The contract must not, in substance, impose upon the service provider the burden of bearing any share of net losses from the operation of the managed property. An arrangement will not be treated as requiring the service provider to bear a share of net losses if:

(i) The determination of the amount of the service provider's compensation and the amount of any expenses to be paid by the service provider (and not reimbursed), separately and collectively, do not take into account either the managed property's net losses or both the managed property's revenues and expenses for any fiscal period; and

(ii) The timing of the payment of compensation is not contingent upon the managed property's net losses.

(b) For example, a service provider whose compensation is reduced by a stated dollar amount (or one of multiple stated dollar amounts) for failure to keep the managed property's expenses below a specified target (or one of multiple specified targets) will not be treated as bearing a share of net losses as a result of this reduction.

(4) Treatment of certain types of compensation. Without regard to whether the service provider pays expenses with respect to the operation of the managed property without reimbursement by the qualified user, compensation for services will not be treated as providing a share of net profits or requiring the service provider to bear a share of net losses under sections 5.02(2) and 5.02(3) of this revenue procedure if the compensation for services is: (a) based solely on a capitation fee, a periodic fixed fee, or a per-unit fee; (b) incentive compensation described in the last sentence of section 5.02(2) of this revenue procedure; or (c) a combination of these types of compensation.

(5) Treatment of timing of payment of compensation. Deferral due to insufficient net cash flows from the operation of the managed property of the payment of compensation that otherwise meets the requirements of sections 5.02(2) and 5.02(3) of this revenue procedure will not cause the deferred compensation to be treated as contingent upon net profits or net losses under sections 5.02(2) and 5.02(3) of this revenue procedure if the contract includes requirements that:

(a) The compensation is payable at least annually;

(b) The qualified user is subject to reasonable consequences for late payment, such as reasonable interest charges or late payment fees; and

(c) The qualified user will pay such deferred compensation (with interest or late payment fees) no later than the end of five years after the original due date of the payment.

.03 Term of the contract and revisions. The term of the contract, including all renewal options (as defined in § 1.141-1(b)), must not be greater than the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property. For this purpose, economic life is determined in the same manner as under § 147(b) as of the beginning of the term of the contract. A contract that is materially modified with respect to any matters relevant to this section 5 is retested under this section 5 as a new contract as of the date of the material modification.

.04 Control over use of the managed property. The qualified user must exercise a significant degree of control over the use of the managed property. This control requirement is met if the contract requires the qualified user to approve the annual budget of the managed property, capital expenditures with respect to the managed property, each disposition of property that is part of the managed property, rates charged for the use of the managed property, and the general nature and type of use of the managed property (for example, the type of services). For this purpose, for example, a qualified user may show approval of capital expenditures for a managed property by approving an annual budget for capital expenditures described by functional purpose and specific maximum amounts; and a qualified user may show approval of dispositions of property that is part of the managed property in a similar manner. Further, for example, a qualified user may show approval of rates charged for use of the managed property by expressly approving such rates or a general description of the methodology for setting such rates (such as a method that establishes hotel room rates using specified revenue goals based on comparable properties), or by requiring that the service provider charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party (such as a medical insurance company).

.05 Risk of loss of the managed property. The qualified user must bear the risk of loss upon damage or destruction of the managed property (for example, due to force majeure). A qualified user does not fail to meet this risk of loss requirement as a result of insuring against risk of loss through a third party or imposing upon the service provider a penalty for failure to operate the managed property in accordance with the standards set forth in the management contract.

.06 No inconsistent tax position. The service provider must agree that it is not entitled to and will not take any tax position that is inconsistent with being a service provider to the qualified user with respect to the managed property. For example, the service provider must agree not to claim any depreciation or amortization deduction, investment tax credit, or deduction for any payment as rent with respect to the managed property.

.07 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 under the contract, based on all the facts and circumstances.

(2) Safe harbor. A service provider will not be treated as having a role or relationship prohibited under section 5.07(1) of this revenue procedure if:

(a) No more than 20 percent of the voting power of the governing body of the qualified user is vested in the directors, officers, shareholders, partners, members, and employees of the service provider, in the aggregate;

(b) The governing body of the qualified user does not include the chief executive officer of the service provider or the chairperson (or equivalent executive) of the service provider's governing body; and

(c) The chief executive officer of the service provider is not the chief executive officer of the qualified user or any of the qualified user's related parties (as de fined in § 1.150-1(b)).

(3) For purposes of section 5.07(2) of this revenue procedure, the phrase “service provider” includes the service provider’s related parties (as defined in § 1.150-1(b)) and the phrase “chief executive officer” includes a person with equivalent management responsibilities.

.08 Functionally related and subordinate use. A service provider’s use of a project (as defined in § 1.141-6(a)(3)) that is functionally related and subordinate to performance of its services under a management contract for managed property that meets the conditions of this section 5 does not result in private business use of that project. For example, use of storage areas to store equipment used to perform activities required under a management contract that meets the requirements of this section 5 does not result in private business use.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2016-44 is modified, amplified, and superseded.

SECTION 7. DATE OF APPLICABILITY

This revenue procedure applies to any management contract that is entered into on or after January 17, 2017, and an issuer may apply this revenue procedure to any management contract that was entered into before January 17, 2017. In addition, an issuer may apply the safe harbors in Rev. Proc. 97-13, as modified by Rev. Proc. 2001-39 and amplified by Notice 2014-67, to a management contract that is entered into before August 18, 2017 and that is not materially modified or extended on or after August 18, 2017 (other than pursuant to a renewal option as defined in § 1.141-1(b)).

SECTION 8. DRAFTING INFORMATION

The principal authors of this revenue procedure are Johanna Som de Cerff and David White of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact David White on (202) 317-6980 (not a toll-free number).

EXHIBIT 3

APPLICABLE TO MANAGEMENT CONTRACTS EXISTING PRIOR TO AUGUST 18, 2017 THAT HAVE NOT BEEN MATERIALLY MODIFIED OR EXTENDED

For management contracts in effect prior to August 18, 2017 that have **not** been materially modified or extended, the guidance forth in Rev. Proc. 97-13 (1997-1 C.B. 632; 1997 IRB LEXIS 14; 1997-5 I.R.B. 18, as modified by Rev. Proc. 2001-39, 2001 IRB LEXIS 229; 2001-28 I.R.B. 38) would be applicable and is set forth below after the following chart. The chart below summarizes the Rev. Proc. 97-13 safe harbor guidance:

Maximum Length of Contract[1]	Permitted Fee Arrangement[2]
Lesser of 15 years or 80% of the economic life of the property	95% periodic fixed fee with single, one time (stated dollar amount) incentive payment)
Lesser of 10 years or 80% of property life 5 years–cancelable by Governmental Unit upon reasonable notice at end of the third year	80% periodic fixed fee (i) at least 50% must be a periodic fixed fee, (ii) 100% capitation fee[3] or (iii) mixed capitation and periodic fixed fee
3 years cancelable upon reasonable notice by Governmental Unit at end of the second year	100% per unit fee or combination of per unit and periodic fixed fee
2 years cancelable upon reasonable notice by Governmental Unit at end of the first year	Percentage of fees charged or a combination of a per unit fee and a percentage of revenue or expense fee[4]

[1]Contract term includes any legally enforceable renewal right.
[2]No portion of the fee may be a net profits interest.
[3]A fixed amount per person for a given period of time.
[4]This option is restricted to contracts to provide services to third parties or contracts during an initial startup period of a facility.

Rev. Proc. 97-13, 1997-1 C.B. 632--Management Contract Guidelines (Supersedes Rev. Proc. 93-19), as amended by Rev. Proc. 2001-39, 2001-2 C.B. 38

1997-1 C.B. 632; 1997 IRB LEXIS 14; 1997-5 I.R.B. 18; REV. PROV 97-13

(Also Part I, §§ 103, 141, 145; 1.141-3, 1.145-2.)

February 3, 1997, amended July 9, 2001.

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 governmental 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 businesses 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 fixed periodic amount may include an automatic 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*[4]. 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. *A fee that is a stated dollar amount specified in the contract does not fail to be a per-unit fee as a result of a*

4 Added by Rev. Proc. 2001-39, section 4.01.

provision under which the fee 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.[5]

.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.

5 Added by Rev. Proc. 2001-39, section 4.02.

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).

{Revised 12/2023}

ATTACHMENT C
REMEDIAL ACTIONS GOVERNMENTAL BONDS

Introduction

The Internal Revenue Code of 1986, as amended (the "Code") limits the amount of proceeds of tax-exempt governmental bonds (including short-term obligations such as notes) that can be used for the benefit of private businesses. Section 141 of the Code treats as a taxable private activity bond a bond issued as part of an issue that meets the private business use test and the private security or payment test, or the private loan test. The private business use test is met if the amount of proceeds of bonds that are used in a private business use is more than ten percent of total proceeds. The private security or payment test is met if the payment of debt service on more than 10 percent of the issue is directly or indirectly (i) secured by any interest in property used for a private business use or payments in respect of such property or (ii) derived from payments in respect of property or borrowed money used for a private business use. A five percent limit is used in lieu of a ten percent limit if the private use is unrelated to a governmental use or related but disproportionate to a governmental use. For purposes of Section 141, the term private business includes nonprofit, 501(c)(3) organizations as well as the federal government.

Deliberate Action

The Regulations promulgated by the Internal Revenue Service ("IRS") under Section 141 of the Code, specifically provide that bonds will be treated as private activity bonds if the issuer takes a deliberate action subsequent to the issue date that causes the tests for a private activity bond to be met. An issuer cannot rely merely on its expectations on the date of issuance to avoid jeopardizing the status of its bonds as governmental bonds. A deliberate action is any action taken by an issuer, but not including an action, such as a condemnation, that would be treated as an involuntary or compulsory conversion under Section 1033 of the Code, or an action that is taken in response to a regulatory directive made by the federal government. A deliberate action is deemed to occur when the issuer enters into a binding contract with a nongovernmental person for use of the financed property that is not subject to any material contingencies. In most cases, material conditions to closing a transaction will be treated as material contingencies so that the date of deliberate action will be the date disposition proceeds are received.

Conditions to Remedial Action

Under the Regulations, in order to take a remedial action to preserve the tax-exempt status of interest on bonds, the following conditions must be met:

(1) *Reasonable expectations test.* The issuer must reasonably have expected on the issue date that neither the private business test nor the private loan test would be met. The period of time that has elapsed since the bonds were issued will be a factor in evaluating the reasonableness of expectations. Under certain conditions an expectation on the issue date to take a deliberate action that would cause one of the tests to be met (e.g., a sale of the project) will be disregarded if the issuer expected on the issue date that the financed property would be used for a qualified purpose for a substantial period before such action, the issuer is required to redeem all nonqualifying bonds (without regard to the amount of disposition proceeds) within 6 months of the action, the redemption meets all the remedial

action conditions (described below) and there was no arrangement on the date of issue with a nongovernmental person or a non-501 (c)(3) organization with respect to the activity;

(2) *Maturity not unreasonably long.* The term of the bond *issue* must not be longer than is reasonably necessary for the governmental purpose of the issue. This requirement is met under a safe harbor if the weighted average maturity of the bonds is not greater than 120 percent of the average reasonably expected economic life of the financed property as of the issue date.

(3) *Fair market value consideration.* The terms of any change in use or loan arrangement are bona fide and arms-length and the new user pays fair market value for the use of the financed property. For this purpose, fair market value may take 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. Any disposition proceeds must be treated as gross proceeds for arbitrage purposes. This will require that the issuer meet yield restriction or rebate requirements with respect to these funds. The issuer may treat the date of receipt of the proceeds as an issue date for purposes of eligibility for temporary periods and exemptions from rebate.

(5) Proceeds expended on a governmental purpose. Except where a redemption or defeasance remedial action is taken, the proceeds must have been expended on a governmental purpose before the date of the deliberate action.

Effect of Remedial Action

A remedial action is treated as curing a change in ownership or a private use or private loan of proceeds, thereby preserving the tax-exempt status of existing bonds. It does not cure a failure to meet the private payment or security interest limitation. In the case of advance refunding bonds, remedial action taken with respect to the refunding bonds proportionally reduces the amount of proceeds of the refunded bonds that is taken into account under the private business use or loan test. In other words, the remedial action taken with respect to the refunding bonds proportionally "cures" the refunded bonds.

Disposition Proceeds and Nonqualified Bonds

Generally, in order to take one of the remedial actions it is necessary to know what the disposition proceeds are and how much of the disposition proceeds are allocated to particular issues. Disposition proceeds arise in a sale, exchange or other disposition of bond-financed property. Disposition proceeds do not arise, however, in an installment sale arrangement and the bond proceeds remain allocated to the transferred property in that case. This distinction becomes important when determining what remedial action is appropriate.

In the case of property financed from different sources of funding, the disposition proceeds are first allocated to the outstanding bonds (both taxable and tax-exempt) that financed the property in proportion to the principal amount of the outstanding bonds. Disposition proceeds may not be allocated to bonds that are no longer outstanding or to revenues if the disposition proceeds are not greater than the total principal amount of the outstanding bonds allocable to that property. Only amounts in excess of that total may be allocated to another source.

Under the Regulations, the amount of nonqualified bonds that arise from a deliberate action is a percentage of the outstanding bonds equal to the highest percentage of private business use in any one-year period commencing with the deliberate action. Allocations to nonqualified bonds must be made on a pro-rata basis except that for purposes of the redemption or defeasance remedial action the issuer may treat bonds with longer maturities as the nonqualified bonds. This treatment would be necessary, for example, where the bonds are required to be called in inverse order of maturity rather than pro rata.

Permitted Remedial Actions

Redemptions or Defeasance

The first remedial action is redemption or defeasance which is available in the case of a deliberate action taking the form of a sale, lease or nonqualified management contract or other action. This remedial action probably will be the most frequently used remedial action in sale transactions. Under this remedial action, other than in the case of an exclusively cash disposition, all nonqualified bonds must be redeemed within 90 days of the deliberate action. Proceeds of tax-exempt bonds may not be used to effect the redemption unless they are proceeds of qualified private activity bonds (e.g., exempt facility bonds) taking into account the purchaser's use. If the bonds are not currently redeemable, a defeasance escrow must be established for all nonqualified bonds within 90 days of the deliberate action and notice of defeasance must be furnished to the Commissioner of Internal Revenue within 90 days of the escrow establishment. Defeasance is only available as a remedial action, however, if the period between the issue date and the first call date is not more than 10½ years. Thus, for example, if a bond-financed building is leased to a private for-profit entity, all tax-exempt bonds that financed that building would have to be redeemed or defeased within 90 days.

In the case of a disposition, a sale, exclusively for cash, if the disposition proceeds are less than the amount of the nonqualified bonds, only an amount equal to the disposition proceeds must be used to redeem or defease a pro rata portion of the nonqualified bonds.

Alternative Use of Disposition Proceeds

In the case of a disposition exclusively for cash, the issuer may, in lieu of redeeming or defeasing bonds, expend the disposition proceeds on other qualifying facilities. The issuer must reasonably expect to expend the disposition proceeds within two years of the deliberate action and must treat the disposition proceeds as bond proceeds for purposes of Section 141. The issuer must not use such proceeds in a manner that would cause the private business tests or the private loan test to be met. Furthermore, the issuer must not take any action subsequent to the date of deliberate action to cause either of these tests to be met. This requirement precludes the issuer from repeatedly taking advantage of the remedial action provisions with respect to the same bond issue. If the issuer does not use all of the disposition proceeds for an alternative use it must use, the remaining proceeds to redeem or defease bonds as described above.

If the disposition proceeds are to be used by a 501(c)(3*)* organization, the nonqualified bonds must, in addition, be treated as reissued and must, beginning on the date of the deliberate action, meet all the requirements for qualified 501(c)(3) bonds. For example, this requires that a TEFRA hearing be held and approval obtained with respect to the new uses of proceeds before the date of the deliberate action.

Alternative Use of Facility

The third remedial action, alternative use of a facility, permits the bonds to remain outstanding if the facility is now used for a qualifying purpose and the nonqualified bonds are treated as reissued as of the date of deliberate action as qualified bonds, e.g., qualified 501(c)(3) bonds or qualified exempt facility bonds. The nonqualified bonds must satisfy all the requirements for that particular type of issue from the date of deliberate action, including the volume cap limitation of Section 146 of the Code, if applicable. The Regulations specifically provide, however, that the used property limitation of Section 147 will not apply. In the case of exempt facility bonds, and other non-501(c)(3) qualified bonds, the interest will be treated *as* a preference item for alternative minimum tax ("AMT") purposes (see discussion below). This remedial action is not available if the deliberate action involves a disposition to a purchaser who finances the purchase with tax-exempt bonds.

The Regulations provide that any disposition proceeds, including proceeds from an installment sale, must be used to pay debt service on the bonds on the next available payment date or within 90 days of receipt, be deposited into a defeasance escrow, yield restricted and used to pay debt service on the bonds on the next available payment date. The Regulations do not address under this remedial action alternative how to deal with the change in status of interest from non-AMT to AMT. This is addressed, however, in *Rev.* Proc. *97-15,* discussed below.

Rev. Proc. 97-15

Rev. Proc. 97-15 provides a program under which an issuer may request a closing agreement as a remedial action to prevent interest on outstanding bonds from being included in gross income or to prevent interest from being treated as an item of tax preference for AMT purposes as a result of a subsequent action. Closing agreements under this program will not resolve any other issue, nor will they preclude an examination by the IRS of any matters not addressed in the closing agreement. These closing agreements are not available with respect to an issue of outstanding bonds that is under examination by the IRS.

Closing Agreement as to Exclusion from Gross Income

A number of procedural and substantive conditions to obtaining a closing agreement are set forth in Rev. Proc. 97-15. In addition, in the case of a closing agreement that provides that interest will not be included in gross income, the issuer must agree to redeem the outstanding bonds at the next redemption date. The issuer also must pay a closing agreement amount equal to the sum of the present value amounts determined by multiplying the amount of interest accruing on the nonqualified bonds in each year by .29 and present valuing each such number from April 15 of the year after the interest accrues to the date on which the payment is sent to the IRS, using as the discount rate, the taxable applicable federal rate for a term equal to the period from the subsequent action to the redemption date.

Alternative Minimum Tax Closing Agreement

In the case of a closing agreement that provides that the interest will not be treated as an item of tax preference, among other conditions, the issuer must pay an amount equal to the sum of certain present value amounts. These amounts are determined by multiplying the principal amount of the nonqualified bonds that will be outstanding on January 1 in each calendar year beginning in the year of the subsequent action and ending the first calendar year in which the bonds will no longer be outstanding, by .0014 and present valuing each such number from April 15 of the year following each such calendar year to the date of payment to the IRS, using the applicable federal rate for the period specified in the closing agreement as the discount rate.

VCAP

The IRS has adopted procedures for its Voluntary Closing Agreement Program ("VCAP") under which issuers of tax exempt bonds can voluntarily resolve violations of the Code or Regulations on behalf of their bondholders or themselves through closing agreements with the IRS. These procedures are set forth in Internal Revenue Manual 7.2.3. If a deliberate action has occurred that cannot be remedied with a remedial action, a VCAP should be considered.

{Revised 12/2023}

ATTACHMENT D
TAX EXEMPT BOND FAQs REGARDING RECORD RETENTION REQUIREMENTS

During the course of an examination, IRS Tax Exempt Bonds (TEB) agents will request all material records and information necessary to support a municipal bond issue's compliance with section 103 of the Internal Revenue Code. The following information is intended solely to answer frequently asked questions concerning how the broad record retention requirements under section 6001 of the Code apply to tax-exempt bond transactions. Although this document provides information with respect to many of the concerns raised by members of the municipal finance industry about record retention, it is not to be cited as an authoritative source on these requirements. TEB recommends that issuers and other parties to tax-exempt bond transactions review section 6001 of the Code and the corresponding Income Tax Regulations in consultation with their counsel.

These frequently asked questions and answers are provided for general information only and should not be cited as any type of legal authority. They are designed to provide the user with information required to respond to general inquiries. Due to the uniqueness and complexities of Federal tax law, it is imperative to ensure a full understanding of the specific question presented, and to perform the requisite research to ensure a correct response is provided.

The freely available Adobe Acrobat Reader software is required to view, print, and search the questions and answers listed below.

1. Why keep records with respect to tax-exempt bond transactions?
2. Who may maintain records?
3. What are the basic records that should be retained?
4. Are these the only records that need to be maintained?
5. In what format must the records be kept?
6. How long should records be kept?
7. How does this general rule apply to bond refundings?
8. What happens if records aren't maintained?
9. Can a failure to properly maintain records be corrected?
10. Are there exceptions to the general rule regarding record retention for certain types of records?

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 information 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 bond 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.

Who may maintain records?

Read together, section 6001 of the Code and section 1.6001-1(a) of the Regulations apply to taxpayers and persons filing tax returns, including returns related to tax-exempt bond transactions (i.e., Forms 8038, 8038-G, 8038-GC, 8038-T, 8038-R, 8328, 8703). This encompasses several parties to the bond transaction including:

1. issuers as the party responsible for satisfying the filing requirements under section 149(e) of the Code;

2. conduit borrowers for deductions taken for payment of interest on outstanding bonds or depreciation of bond-financed facilities; and

3. bondholders, lenders, and lessors as recipients of exempt income from the interest paid on the bonds.

Since many of the same records may be examined to verify, for example, both the tax-exempt status of the bonds and the interest deductions of the conduit borrower, it is advisable for the bond documents to specify which party will bear the responsibility for maintaining the basic records relating to a bond transaction. Additional parties may also be responsible for maintaining records under contract with any of the parties named above. For example, a trustee may agree to maintain certain records pursuant to the trust indenture.

What are the basic records that should be retained?

Although the records required 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 from the investment of proceeds, guaranteed investment contracts, and rebate calculations).

Are these the only records that need to be maintained?

No, the list above is very general and only highlights the basic records that are typically material to many types of tax-exempt bond financings. Each transaction is unique and may, accordingly, have other records that are material to the requirements applicable to that financing. The decision as to whether any particular record is material must be made on a case-by-case basis and could take into account a number of factors, including, for instance, the various expenditure exceptions. Moreover, certain records may be necessary to support information related to certain requirements applicable to specific types of qualified private activity bonds. With respect to single and multifamily housing bonds as well as small issue industrial development bonds, examples of such additional material records include:

Single Family Housing Bonds	Documents evidencing that at least 20% of proceeds were available for owner financing of targeted area residences.
	Documentation evidencing proper notification of each mortgagor of potential liability of the mortgage subsidy recapture tax.
Multi-Family Housing Bonds	Documentation evidencing that the facility is not used on a transient basis.
	Documentation evidencing compliance with the income set-aside requirements.
	Documentation evidencing timely correction, if any, of noncompliance with the income set-aside requirements.
Small Issue Industrial Development Bonds	Documentation evidencing compliance with the $10,000,000 limitation on the aggregate face amount of the issue.
	Documentation evidencing that no test-period beneficiary has been allocated more than $40,000,000 in bond proceeds.

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:

1. 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.

2. 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.

3. 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).

4. 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.

5. 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.

6. 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.

7. 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 long should records be kept?

Section 1.6001-1(e) of the Regulations provides that records should be retained for so long as the contents thereof are material in the administration of any internal revenue law. With respect to a tax-exempt bond transaction, the information contained in certain records support the exclusion from gross income taken at the bondholder level for both past and future tax years. Therefore, as long as the bondholders are excluding from gross income the interest received on account of their ownership of the tax-exempt bonds, certain bond records will be material. Similarly, in a conduit financing, the information contained in the bond records is necessary to support the interest deduction taken by the conduit borrower for both past and future tax years for its payment of interest on the bonds.

To support these tax positions, material records should *generally* be kept for as long as the bonds are outstanding, plus 3 years after the final redemption date of the bonds. This rule is consistent with the specific record retention requirements under section 1.148-5(d)(6)(iii)(E) of the arbitrage regulations.

Certain federal, state, or local record retention requirements may also apply.

How does this general rule apply to bond 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 3 years after the final redemption of both bond issues.

What happens if records aren't maintained?

During the course of an examination, TEB agents will request material records and information in order to determine whether a tax-exempt bond transaction meets the requirements of the Code and regulations. If these records have not been maintained, then the issuer, conduit borrower or other party may have difficulty demonstrating compliance with all federal tax law requirements applicable to that transaction. A determination of noncompliance by the IRS with respect to a bond issue can have various outcomes, including a determination that the interest paid on the bonds should be treated as taxable, that additional arbitrage rebate may be owed, or that the conduit borrower is not entitled to certain deductions.

Additionally, a conduit borrower who fails to keep adequate records may also be subject to an accuracy-related penalty under section 6662 of the Code on the underpayment of tax attributable to any denied deductions. Section 6662 of the Code imposes a penalty on any portion of an underpayment of tax required to be shown on a return that is attributable to one of several factors, including negligence or disregard of rules or regulations. Section 1.6662-3(b)(1) of the Regulations provides that negligence includes any failure by the taxpayer to keep adequate books and records or to substantiate items properly. Under section 6662(a) of the Code, the penalty is equal to 20 percent of the portion of the underpayment of tax attributable to the negligence. Section 6664(c)(1) provides an exception to the imposition of accuracy-related penalties if the taxpayer shows that there was reasonable cause for the underpayment and that the taxpayer acted in good faith.

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 Compliance and Program Management 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.

Are there exceptions to the general rule regarding record retention for certain types of records?

No, but TEB encourages members of the municipal finance industry to submit comments and suggestions for developing record retention limitation programs for specific types of bond records, for specific classes of tax-exempt bond issues, or for specific segments of the bond industry. Comments can be submitted in writing to TEB and sent by e-mail to TEGE TEB Questions.

{Revised 12/2023}

ATTACHMENT E
PRIVATE BUSINESS USE QUESTIONNAIRE GOVERNMENTAL BONDS

TO: [NAME]
[TITLE]

FROM: Debt Manager, Palm Beach County Office of Financial Management & Budget

DATE: [CURRENT DATE]

RE: Use of Tax-Exempt Bond-Financed Property

In order to maintain the tax-exempt status of bonds (including any short-term obligations such as notes) which have been issued to finance facilities or equipment for the benefit of Palm Beach County (the "Issuer"), the ownership and certain uses of the Bond-Financed Property must be monitored and recorded. In general, the ownership and use of the Bond-Financed Property must be monitored and recorded from the date of issue of the bonds until the earlier of the end of the expected life of the property, or the final maturity date of any bonds issued to finance the property. Because it is the Internal Revenue Service's position that records be maintained until 3 years after the final maturity date of any bonds issued to finance (or refinance) the property, staff will be asked to update these records for changes in the use or ownership of the property.

Attached is a schedule with a brief description of property financed with proceeds of tax exempt bonds. Our records indicate the property is located at [NAME OF FACILITY]. Please review your records and respond to each of the questions for the Bond-Financed Property listed, including both the present use of the property and any past uses of it. Please do not skip questions. If you are uncertain how to respond to a particular question, please provide a brief explanation in the space immediately following the question. If necessary, I will contact you for clarification. Please refer to Tab I-A, Private Activity Restrictions on Private Business Use, of the Post-Issuance Compliance Guide, for a brief description of types of private use.

We recognize that some of the requested information and records may not be available. However, your cooperation is necessary in order to collect as much of this information as possible.

SCHEDULE

USE OF TAX EXEMPT BOND BOND-FINANCED PROPERTY

Description of property: [Description] (the “Bond-Financed Property”)

Location: [facility name]

Bond or Note Issue: [name of bonds or notes]

Amount of Tax-Exempt Bond Proceeds Applied to Project:

Survey Date: [current date]

PLEASE REVIEW APPENDIX A FOR APPLICABLE RULES ON PRIVATE USE

I. Ownership and Use of the Bond-Financed Property and Equity.

1.1 When was the Bond-Financed Property placed in service?

____

1.2 Is the Bond-Financed Property still being used for its original purpose?

Yes ☐ No ☐ If No, please explain how it is being used.

II. Leases of the Bond-Financed Property.

2.1 Has any portion of the Bond-Financed Property been leased to or been the subject of a possessory interest, such as a license in, any person, including the federal government?

Yes ☐ No ☐

III. Priority Rights

3.1 Has any portion of the Bond-Financed Property been the subject of an arrangement with a person other than the Government of Palm Beach County for priority use or for use of certain capacity of the Bond-Financed Property?

Yes ☐ No ☐

IV. Naming Rights or Sponsorship Agreements.

4.1 Has any portion of the Bond-Financed Property been the subject of a contract or other arrangement with anyone pursuant to which that person will make a payment to the Issuer in return for the right to have its name or logo used in connection with the Issuer or any portion thereof?

Yes ☐ No ☐ If Yes, please provide details of the arrangement.

V. Research.

5.1 Has any portion of the Bond-Financed Property been used in research sponsored by anyone other than a Governmental Unit? (Note that the federal government is not a Governmental Unit.)

Yes ☐ No ☐

VI. Management Agreements, Operating Contracts, and Service Agreements.

6.1 Has any portion of the Bond-Financed Property been used in connection with any type of service contract, operating contract, or management contract described below?

(a) A contract with a non-employee group, other than a Governmental Unit, to provide services to, operate, or manage any function of, the Issuer?

Yes ☐ No ☐ If Yes, identify the person or organization that is a party to the contract. Please note that in responding to this question, the federal government is not a Governmental Unit and any such arrangement with the federal government should be reported.

(b) A contract with an employee to provide services to, or manage any function of, the Issuer, where such contract contains an incentive compensation arrangement?

Yes ☐ No ☐ If Yes, identify the person or organization that is a party to the contract.

(c) A contract with a person other than a Governmental Unit to provide services, such as food services to the Issuer?

Yes ☐ No ☐ If Yes, identify the person or organization that is a party to the contract.

VII. Output Facilities.

7.1 Is any portion of the Bond-Financed Property an output type facility? (An example of an output type facility would be a water plant or sewage treatment facility.)

Yes ☐ No ☐

VIII. Joint Ventures.

8.1 Has any portion of the Bond-Financed Property been used in any joint venture arrangement with any person other than a Governmental Unit?

Yes ☐ No ☐ If Yes, please provide details of the arrangement.

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Date: ______________

By: _________________________________

Name: _________________________________

Title: _________________________________

{Revised 12/2023}