Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:
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Legend

Issuer =

City =

State =

Organization =

Laboratory =

Agency 1 =

Agency 2 =

Institute =

Bonds =

Date 1 =

Date 2 =

Date 3 =

Dear :

This is in response to your request on behalf of the Issuer for the following rulings:

1. The Organization's contracts with Agency 1 and Agency 2, both of which are agencies of the United States, will not result in private business use of the Facility (hereinafter defined) to be financed with the proceeds of the Bonds for purposes of sections 141(b) and 145 of the Internal Revenue Code (the "Code").

2. Payments to the Organization under the contracts with Agency 1 and Agency 2 will not cause the Bonds to be federally guaranteed within the meaning of section 149(b) of the Code.

FACTS AND REPRESENTATIONS

The Issuer is a public, non-profit corporation created by the City under State law to induce various economic enterprises to locate or remain in State.

The Organization is a non-profit, membership corporation organized under State law and is recognized as a section 501(c)(3) organization. The Organization's members consist of numerous national and regional colleges and universities in the Unites States. The Organization is administered by a board of directors elected by its members.

The Organization was founded to promote access by faculty and students at colleges and universities to the scientific equipment and experience available at the federal government's national laboratories and, in particular, the Laboratory in the City. Other purposes specified in the Organization's charter include assisting in the development of research and educational programs at universities and colleges, as well as supporting local, state, and federal governments.

In furtherance of its exempt purposes, the Organization contracts with certain federal government agencies, including Agency 1 and Agency 2 (collectively, the "Agencies"), to perform various activities for such agencies. A significant amount of these activities are performed at its campus-style complex (the "Campus") located in the City. The Campus is owned by the Organization. Agency 1 has facilities located in the City near the Campus.

From a revenue standpoint, two of the Organization's most significant contracts are with the Agencies. The contract with Agency 1 (the "Agency 1 Contract") provides that the Organization will perform various activities for Institute, an organization affiliated with Agency 1 that maintains and advances Agency 1's science and education capabilities. The Agency 1 Contract has a three-year term ending on Date 1. Agency 1

has an option to extend the contract for two years through Date 2. Prior to Date 2, the Organization intends to pursue renewals or extensions of the Agency 1 Contract on similar terms and expects that the contract will be renewed.

The Agency 1 Contract is a cost-reimbursement contract. Reimbursable costs include the real-estate costs the Organization incurs performing activities under the Agency 1 Contract. The amount that the Organization is reimbursed for such real-estate costs is determined by federal cost accounting standards. The Organization also receives a fixed fee that is payable monthly over the term of the Agency 1 Contract and can annually earn an award based upon its performance. Agency 1 has no obligation to make payments under the Agency 1 Contract if the Organization does not fulfill its obligations under the contract. Payments to the Organization under the Agency 1 Contract are subject to Agency 1's receipt of funds pursuant to annual appropriations.

Under the Agency 1 Contract, the Organization is required to perform certain activities in specific facilities of Agency 1, the Institute, or the Organization. Certain other activities, however, may be performed at any location. Agency 1 has no leasehold or possessory rights to the Organization’s facilities under the Agency 1 Contract. Likewise, Agency 1 has no right to occupy or otherwise control any of the Organization’s facilities pursuant to the Agency 1 Contract.

Under the contract with Agency 2 (the “Agency 2 Contract”), the Organization performs activities in furtherance of Agency 2's graduate research program. The original term of the Agency 2 Contract was two years, ending on Date 3. Agency 2 has exercised an option to renew the contract for three years. Prior to the end of this three-year period, the Organization intends to pursue additional renewals or extensions of the Agency 2 Contract on similar terms and expects that the contract will be renewed.

As with the Agency 1 Contract, the Agency 2 Contract is a cost-reimbursement contract. The Organization is reimbursed for the real-estate costs incurred in performing the Agency 2 Contract. Such costs are reimbursed according to federal cost accounting standards. The Organization is also paid a fixed fee annually. Agency 2 has no obligation to make payments if the Organization does not fulfill its obligations under the Agency 2 Contract. Payments to the Organization under the Agency 2 Contract are subject to Agency 2's receipt of funds pursuant to annual appropriations.

The Organization may perform its obligations under the Agency 2 Contract at any location. Agency 2 has no leasehold or other possessory interest in the Organization’s facilities and has no right to occupy or otherwise control any of the Organization’s facilities under the Agency 2 Contract.

The Organization has determined that it has a need for additional office space on the Campus. To meet this need, the Organization intends to construct an additional building on the Campus (the “Facility”). Because the Facility will be located on the

Campus, it will also be located near property of Agency 1 located in the City. The Facility will be owned by the Organization and, accordingly, will not be depreciable by either of the Agencies.

The Issuer expects to issue the Bonds and loan the proceeds to the Organization to finance the cost of constructing and equipping the Facility. The Bonds will be payable in part from the revenues of the Facility. However, the payments the Organization receives under the Contracts that relate to activities performed at the Facility are not determined based on the debt service on the Bonds.

The Organization expects to use a substantial amount of the space in the Facility to perform its activities under the Agency 1 Contract and the Agency 2 Contract (collectively, the "Contracts"), as well as to perform general corporate work of the Organization. The Organization expects that substantially more than 5 percent of the Facility will be used to perform activities under each of the Contracts.

Neither of the Contracts require that the Organization perform any activities at the Facility. In addition, the Organization represents that the activities that it expects to perform under the Contracts at the Facility can be performed at any of the Organization's facilities. The Facility will not be constructed to meet specific needs of the Agencies. Neither Agency 1 nor Agency 2 will occupy any portion of the Facility and all persons occupying the Facility will be employees of the Organization. The Organization will bear any risk of loss with respect to the Facility. The Contracts do not impair the Organization's rights to use the Facility for other purposes or to dispose of the Facility.

The Organization represents that the activities it expects to perform at the Facility under the Contracts are in furtherance of its exempt purposes and none of the activities will constitute an unrelated trade or business of the Organization within the meaning section 513(a). The Organization represents that research (within the meaning of section 1.141-3(b)(6) of the Income Tax Regulations) will not be conducted at the Facility.

LAW:

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

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

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

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

Under section 141(e)(1)(G), the term qualified bond means any private activity bond if such bond is a qualified 501(c)(3) bond.

Section 145(a) provides that the term qualified 501(c)(3) bond means any private activity bond issued as part of an issue if:

(1) all property which is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and

(2) such bond would not be a private activity bond if:

(A) 501(c)(3) organizations were treated as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying section 513(a), and

(B) paragraphs (1) and (2) of section 141(b) are 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(a) provides generally that sections 1.141-0 through 1.141-15 apply to section 145(a). Section 1.145-2(b) provides that in applying sections 1.141-0 through 1.141-15 to section 145(a), (1) references to governmental persons include 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under section 513(a); (2) references to "10 percent" and "proceeds" in the context of the private business use test and the private security or payment test mean "5 percent" and "net proceeds"; and (3) references to the private business use test in sections 1.141-2 and 1.141-12 include the ownership test of section 145(a)(1).

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

Under section 1.141-3(b)(1), both actual and beneficial use by a nongovernmental person may be treated as private business use. A nongovernmental person is defined in section 1.141-1(b) as a person other than a governmental person. A governmental person is a state or local governmental unit (as defined in section 1.103-1) or any instrumentality thereof, but does not include the United States or any agency or instrumentality thereof.

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

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

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

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

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

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

Under section 1.141-3(c)(1), use of financed property by nongovernmental persons in their trades or businesses is treated as general public use only if the property is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade or business. An arrangement that conveys priority rights or other preferential benefits is not use on the same basis as the general public. Section 1.141-3(c)(3) further provides that an arrangement is not treated as general public use if the term of the arrangement is longer than 200 days.

The circumstances under which a special economic benefit may result in private business use are illustrated in examples under section 1.141-3(f). Example 7, for instance, provides as follows:

> City B issues obligations to finance construction of a specialized pollution control facility on land that it owns adjacent to a factory owned by Corporation N. B will own and operate the pollution control facility, and N will have no special legal entitlements to use the facility. B, however, reasonably expects that N will be the only user of the facility. The facility will not be reasonably available for use on the same basis by natural persons not engaged in a trade or business. Under paragraph (b)(7)(ii), because under all the facts and circumstances the facility is functionally related and is physically proximate to property used in N's trade or business, N derives a special economic benefit from the facility. Therefore, N's private business use may be established solely on the basis of that special economic benefit and N's use is treated as private business use of the facility.

Similarly, Example 8(ii) of section 1.141-3(f) illustrates a situation where a bond-financed runway at a city-owned airport used only by private air carriers (*i.e.,* charter and commercial airlines, but not general aviation operators who are natural persons not engaged in a trade or business) may result in private business use, despite the fact that the air carriers do not have special legal entitlements with respect to the runway. Because the runway is not available for use by the general public, based on the facts and circumstances, including whether there are only a small number of lessee private air carriers, the private business use test may be met solely because the private air carriers receive a special economic benefit from the runway.

Section 149(b)(1) provides that section 103(a) does not apply to a State or local bond that is federally guaranteed.

Section 149(b)(2) provides that a bond is federally guaranteed, if:

> (i) the payment of debt service on the bond is guaranteed, in whole or in part, by the United States or any agency or instrumentality thereof;
>
> (ii) 5 percent or more of the proceeds of the issue of which the bond is a part is to be used to make loans, the payment of which is to be guaranteed in whole or

in part by the United States or any agency or instrumentality thereof, or is to be directly or indirectly invested in federally insured deposits or accounts; or

(iii) the payment of debt service on the bond is otherwise indirectly guaranteed in whole or in part by the United States or any agency or instrumentality thereof.

The prohibition under section 149 applies not only to direct guarantees, but also in circumstances where an underlying arrangement may result in the federal government indirectly guaranteeing debt service on an obligation. Congress intended that the determination of whether a federal guarantee exists be based on the underlying economic substance of a transaction, taking into account all facts and circumstances. See H.R. Rep. No. 99-426, at 1013 (1985),1986-3 (Vol. 2) C.B. 538 (the "House Report").

The House Report suggests that an indirect federal guarantee may arise where the federal government contracts to purchase the output of a bond-financed facility. Similarly, where the federal government leases property there may be an indirect guarantee by the United States. A key element in determining whether a prohibited guarantee exists is whether there is a transfer of risk to the federal government. See Staff of Joint Comm. on Taxation, 98th Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 939 (Joint Comm. Print 1985).

ANALYSIS:

Issue One

As agencies of the United States, the Agencies are nongovernmental persons for purposes of the private business use test. Thus, it must be determined whether the Contracts result in private business use of the Facility by either of the Agencies for purposes of sections 141(b) and 145.

The Contracts do not convey special legal entitlements to the Facility to Agency 1 or Agency 2. The terms of the Contracts with the Organization do not provide either of the Agencies with an ownership, leasehold or possessory interest in the Facility. The Agencies will not have the right to occupy or otherwise control the use of the Facility. The Contracts do not impair the Organization's right to use the Facility for other corporate purposes or to dispose of the Facility. Moreover, the Organization is not required to use the Facility to perform its legal obligations under either of the Contracts. In fact, the activities that the Organization expects to perform at the Facility under the Contracts can be performed at any of the Organization's facilities. While the Agencies may have rights with respect to the manner in which the Organization performs certain activities that will be conducted in the Facility, those rights govern the Agencies' contractual relationship with the Organization, rather than rights that relate to the use of the Facility.

Although the Contracts do not convey special legal entitlements to the Facility, it is expected that the entire Facility will be used to perform activities under the Contracts or for other corporate work of the Organization. The Organization expects that if the Contracts are renewed it will continue to use the Facility to perform activities for the Agencies. If the Contracts are not renewed, the Organization will use the Facility for other corporate work and does not expect that the Facility will be available for use on the same basis by natural persons not engaged in a trade or business. Thus, the Facility is not expected to be available for use by the general public and we must determine whether the Agencies receive a special economic benefit from the Facility that gives rise to private business use.

To determine whether either of the Agencies receive a special economic benefit that results in private business use, it is necessary to consider all the facts and circumstances, including whether the Facility is functionally related or physically proximate to property used by the Agencies in their trades or businesses; whether only a small number of nongovernmental persons receive a special economic benefit from the Facility; and whether the cost of the Facility is depreciable by any nongovernmental person.

The examples under section 1.141-3(f) provide additional guidance to determine whether non-governmental persons receive a special economic benefit from bond-financed property that results in private business use. Example 7, for instance, illustrates a scenario where bonds are issued to finance a specialized pollution control facility. The example concludes that the specialized pollution control facility is functionally related to the primary facility, a factory, because it is built to meet the specific needs of the factory and is integrally related to the factory (*i.e.*, the processing and disposal of pollution produced by the factory). When these facts are coupled with the fact that the pollution control facility is on land adjacent to the factory and it is reasonably expected that the factory will be the only user of the pollution control facility, the example concludes that the owner of the factory, a nongovernmental person, derives a special economic benefit from the pollution control facility that results in private business use. Similarly, Example 8(ii) of section 1.141-3(f) illustrates a situation where a bond-financed runway at a city-owned airport used by private air carriers may result in private business use because of the special economic benefit that private air carriers receive from the runway. As in Example 7, the bond-financed property, the runway, is built specifically to meet the needs of the private business users, the air carriers, and is integrally related to the primary facility, the airport. Consequently, there is a functional relationship between the runway and the airport that, when combined with other factors, may result in private business use.

In contrast to the examples provided in the regulations, the Facility is not functionally related to property used in the Agencies' trades or businesses. The Facility will not be constructed to meet specific needs of the Agencies and is not integrally related to any property used in the Agencies' trade or business. Rather, the Facility is

being constructed to meet the Organization's need for additional office space. Further, the Facility will not be constructed in such a manner that would limit the Organization's ability to use the Facility for activities unrelated to the Agencies. The Facility is not specifically needed for the Organization's performance under the Contracts. The activities under the Contracts that are expected to be conducted in the Facility may be performed in any of the Organization's facilities. Thus, based on the facts and circumstances, there is no functional relationship of the Facility to property used in the Agencies' trades or businesses.

The location of the Facility also does not support a finding of private business use. As noted, the Facility will be constructed on the Campus to meet the Organization's need for additional office space. The Facility will not be proximate to other property used by Agency 2. Although the proposed location for the Facility may be near other property used by Agency 1, the decision as to where to construct the Facility is not based on the needs of Agency 1. Moreover, no facts have been presented suggesting that it is necessary for the Facility to be located near Agency 1 in order for the Organization to perform activities under the Agency 1 Contract. This can be contrasted with the examples under section 1.141-3(f) that describe situations where there is a physical need for locating the bond-financed facility (*e.g.*, the pollution control facility or the runway) near the nongovernmental person's property. Therefore, the proximity of the Facility to other property used by Agency 1 is not relevant under the facts and circumstances.

The number of nongovernmental persons benefitting from the Facility also does not support a finding of private business use. Although a significant amount of the Facility is expected to be used to perform activities under the Contracts, the Organization is not limited to using the Facility for activities related to the Agencies. Unlike the bond-financed property described in the examples in section 1.141-3(f), the design of the Facility will not limit it to a specific use and, thus, will not limit the potential types of nongovernmental persons that may benefit from the Facility. Moreover, the terms of the Contracts with the Agencies do not limit the number of nongovernmental persons that may benefit from the Facility because the Contracts do not require any activities to be conducted at the Facility. Thus, the fact that a substantial amount of the Organization's activity at the Facility is with respect to its Contracts with the Agencies is not relevant under the facts and circumstances.

Finally, the cost of the Facility will not be depreciable by any nongovernmental person for purposes of section 1.141-3(b)(7)(ii)(C). The Facility will be owned by the Organization and only the Organization will be eligible to depreciate the cost of the Facility.

Considering all the facts and circumstances, the Agencies do not receive a special economic benefit from the Facility that results in private business use.

Issue Two

The determination of whether a federal guarantee exists is based on the underlying economic substance of the transaction, taking into account all facts and circumstances. An underlying arrangement may result in the federal government indirectly guaranteeing debt service on an obligation.

Based on the facts and circumstances, the payments to the Organization under the Contracts will not cause the Bonds to be federally guaranteed within the meaning of section 149(b). Although the revenues from the Facility will consist primarily of amounts received from the Agencies, the mere fact that federal funds may be available to pay debt service on the Bonds does not result in an indirect federal guarantee. Rather, the question is whether the substance of the transaction (*i.e.*, the contractual relationships between the Organization and the Agencies) results in a transfer of risk to the federal government to pay debt service on the Bonds.

In the instant case, there has been no transfer of risk to the federal government to pay debt service on the Bonds. There is no guaranteed stream of revenues from the Agencies that is available to pay debt service on the Bonds. Unlike a guarantee, the Agencies have no obligation to make payments of debt service upon a default on the Bonds. Rather, any payments from the Agencies are subject to the Organization's fulfillment of its obligations under the Contracts. Moreover, payments under the Contracts are subject to the Agencies' receipt of funds pursuant to annual appropriations. Thus, there is no transfer of risk to the federal government to pay debt service on the Bonds in the event of a default and the Bonds will not be federally guaranteed within the meaning of section 149(b).

CONCLUSIONS

Based on the information submitted and representations made, we conclude that:

1. The Organization's Contracts with the Agencies will not result in private business use of the Facility.

2. Payments to the Organization from the Agencies under the Contracts will not cause the Bonds to be federally guaranteed within the meaning of section 149(b) of the Internal Revenue Code.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings.

Except as specifically ruled above, no opinion is expressed concerning this transaction under any other provision of the Code or regulations thereunder, including sections 103 and 141 through 150. Specifically, no opinion is expressed concerning whether interest on the Bonds is excludable from gross income under section 103(a). In addition, no opinion is expressed concerning whether the activities discussed in this ruling constitute an unrelated trade or business within the meaning section 513(a).

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

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

Sincerely,

Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)

By: _____

Bruce M. Serchuk
Senior Technician Reviewer
Tax Exempt Bond Branch