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September 17, 2014

Internal Revenue Service
CC:PA:LPD:PR (REG-140379-02; REG-142599-02)
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: REG-140379-02; REG-142599-02: Allocation of and Accounting for Tax-Exempt Bond Proceeds for Purposes of the Private Activity Bond Restrictions

Ladies and Gentlemen:

The National Association of Bond Lawyers (NABL) respectfully submits the enclosed supplemental commentary in response to your request for additional input regarding the usefulness of treating a partnership of private businesses and governmental persons (or section 501(c)(3) organizations for qualified 501(c)(3) bonds) as an aggregate of its partners where there is a fixed allocation of all partnership items for the entire measurement period for the bonds or the entire period that the person is a partner. The enclosed comments were prepared by an ad hoc task force comprising those individuals listed in Exhibit B and approved by NABL's Board of Directors. These comments supplement NABL's submissions to the Department of the Treasury and the Internal Revenue Service on December 22, 2006, and February 15, 2008, relating to the proposed allocation and accounting regulations published in the Internal Revenue Bulletin on October 30, 2006 (REG-140379-02; REG-142599-02).

NABL exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the law affecting public finance. We respectfully provide this submission in furtherance of that mission.

If NABL can provide further assistance, please do not hesitate to contact Bill Daly in our Washington, D.C. office at (202) 503-3300.

Sincerely,

Allen K. Robertson

Allen K. Robertson

Enclosure

cc: Vicky Tsilas
James Polfer

SUPPLEMENTAL COMMENTS BY THE NATIONAL ASSOCIATION OF BOND LAWYERS TO THE DEPARTMENT OF THE TREASURY OFFICE OF TAX POLICY AND THE INTERNAL REVENUE SERVICE REGARDING AGGREGATE TREATMENT OF PARTNERSHIPS OF GOVERNMENTAL PERSONS (OR SECTION 501(C)(3) ORGANIZATIONS) AND PRIVATE BUSINESSES

The following comments are submitted on behalf of the National Association of Bond Lawyers ("NABL") and supplement NABL's comments submitted on December 22, 2006, and February 15, 2008 (together, the "Primary Recommendations"). These comments are in response to your request for additional input regarding the usefulness of treating a partnership of private businesses and governmental persons (or section 501(c)(3) organizations for qualified 501(c)(3) bonds) as an aggregate of its partners where there is a fixed allocation of all partnership items for the entire measurement period for the bonds or the entire period that the person is a partner. These comments, in supplementing our prior comments, respond to the solicitation for public comment contained in section VI of the preamble to the proposed regulations published in the Internal Revenue Bulletin on October 30, 2006 (REG-140379-02; REG-142599-02) (the "Proposed Regulations").[1]

Background—The Proposed Regulations and the Primary Recommendations

The Proposed Regulations provide that a partnership generally is treated as a separate entity that is not a governmental person for purposes of analyzing private activity under I.R.C. § 141. This separate entity treatment would not apply under the Proposed Regulations, however, if all of the partners are governmental persons or, for qualified 501(c)(3) bond purposes, if all of the partners are governmental persons or 501(c)(3) organizations.[2] In such situations, each partner would be considered a separate user of bond-financed facilities. This generally means that no private business use would arise solely as a

[1] The solicitation in the preamble to the Proposed Regulations reads as follows:

> One limited circumstance in which the Treasury Department and the IRS are considering favorable aggregate treatment for partnerships (for example, disregarding eligible partnerships as separate private business entities) and are soliciting specific comment is that of a partnership of governmental persons (or section 501(c)(3) organizations for 501(c)(3) bonds) and private businesses in which the respective partners receives the same distributive share of each partnership item for Federal tax purposes (including income, gain, deduction, loss, credit and basis) as their respective interests in the partnership and this share remains the same for the entire measurement period for the bonds or the entire period that the person is a partner. The Treasury Department and the IRS solicit specific public comment regarding whether it would be useful to treat such a partnership as an aggregate in this limited circumstance involving straight-up allocations of all partnership items in accordance with constant percentage interests in the partnership.

[2] Prop. Treas. Reg. §§ 1.141-1(e)(2) and 1.145-2(c)(3).

result of the existence of the partnership.[3] A partnership one or more of the partners of which is a for-profit entity, however, would be treated as a separate entity under the Proposed Regulations, and no allocation of use among the partners would be permitted for purposes of analyzing private activity. In addition, whether or not the partnership includes a for-profit partner, no allocation of ownership would be permitted for purposes of the ownership requirement under I.R.C. § 145(a)(1).[4]

NABL's December 2006 submission stated as follows:

> The Treasury and IRS have asked for comments as to whether the partnership entity should be disregarded where not all partners are governmental entities if all attributes [of ownership] are allocated on a "straight up" basis. NABL strongly believes that the partnership entity should be disregarded for purposes of private activity bond analysis where all attributes of ownership (including contribution, income, and loss) are allocated on the basis of a percentage of ownership.
>
> NABL also notes that the Proposed Regulations only apply the entity rule and not the aggregate rule for purposes of Section 145(a)(1) of the Code. §1.145-2(c)(3). Where there is a "straight-up" allocation of partnership attributes and the 501(c)(3) entity is participating in the partnership in furtherance of its exempt purposes, NABL recommends that the partnership should similarly be disregarded, even for purposes of the Code Section 145(a)(1) rule. In any event, NABL recommends that a partnership solely between 501(c)(3)s and governmental entities should always be disregarded.

NABL continues to support these positions, but wishes to provide further commentary regarding the utility of treating a venture undertaken jointly by a governmental entity or a 501(c)(3) organization and a for-profit entity (a "public-private partnership"[5]) as an aggregate of its partners. Such public-private partnership may take many forms for non-tax purposes, e.g., a partnership, a limited liability company, a joint venture, etc., but would be a partnership for federal income tax purposes.

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3 Private business use may still arise, for example, to the extent the partnership enters into a lease or a management contract or engages in a trade or business activity unrelated to the charitable purpose of one or more of its 501(c)(3) organization partners.

4 Prop. Treas. Reg. §§ 1.141-1(e)(1) and 1.145-2(c)(3).

5 In common parlance, the term "public-private partnership" is often used to describe partnerships where there is not a fixed allocation of all partnership items for the entire measurement period for the bonds or the entire period that the person is a partner. In fact, sometimes the term "public-private partnership" is used in common parlance to describe arrangements that are not even partnerships for federal tax purposes. Such arrangements are beyond the scope of this paper. The term "public-private partnership," as used in this paper, only describes partnerships for federal income tax purposes where there is a fixed allocation of all partnership items for the entire measurement period for the bonds or the entire period that the person is a partner.

General Comments

Public-private partnerships generally are formed to carry out projects that will be optimized by a mix of governmental (or 501(c)(3) in the case of qualified 501(c)(3) bonds) and private business uses. Public-private partnerships permit governments and 501(c)(3) organizations to take advantage of cost and economy of scale efficiencies in terms of project development and can often facilitate the ultimate delivery of services at lower cost than the public sector can achieve alone. The benefits of public-private partnerships have been difficult to realize with tax-advantaged bonds not only because of the lack of guidance under current law concerning allocation of bond proceeds but also because current rules treat such partnerships as separate entities rather than as aggregates of their partners.

NABL believes that public-private partnerships should be treated as aggregates of their partners, including for purposes of the ownership requirement for qualified 501(c)(3) bonds, at least in situations where such partnerships maintain a fixed allocation of partnership items, as suggested in the Proposed Regulations' preamble. As described later in these comments, aggregate treatment has become particularly urgent in recent years because of the need to implement policies of the Patient Protection and Affordable Care Act (Pub. L. 111-148, 124 Stat. 119) (the "Affordable Care Act") that are intended to promote cooperation between public and private sectors to achieve health care objectives. Aggregate treatment continues to be relevant in connection with general governmental and other 501(c)(3) organization projects as well.

Separate Entity vs. Aggregate Treatment

Federal tax rules follow two basic approaches when considering the tax consequences of partnerships – a separate entity approach and an aggregate approach. The separate entity approach treats the partnership and each partner as separate entities, with each partner owning an interest in the partnership rather than in the underlying assets of the partnership. The Proposed Regulations would apply this approach for purposes of the private business use analysis of all public-private partnerships and for purposes of the ownership requirement under I.R.C. § 145(a)(1). In contrast, the aggregate approach disregards the partnership and treats each partner as directly owning an undivided interest in the partnership assets and having a proportionate share of the liabilities. Under the Proposed Regulations, the aggregate approach would apply for purposes of the private business use analysis involving partnerships containing only governmental entities or, for qualified 501(c)(3) bonds, governmental entities and 501(c)(3) organizations. Additionally, as stated above, the Proposed Regulations would not apply the aggregate approach at all for purposes of the ownership requirement of I.R.C. § 145(a)(1).

NABL believes tax policy does not dictate the separate entity approach of the Proposed Regulations. Indeed, as evidenced by the private activity bond rules developed for "output facilities"[6] and

[6] "Output facilities" are defined in Treas. Reg. § 1.141-1(b) as electric and gas generation, transmission, distribution, and related facilities, and water collection, storage, and distribution facilities.

general tax rules concerning the treatment of partnerships, if tax policy seeks not to interfere with efficiencies that may be achieved by public-private ventures, an aggregate approach is consistent with that policy.

In connection with "output facilities," the Internal Revenue Service has determined that an undivided ownership interest in jointly owned property constitutes a separate property interest that is treated as a separate facility. If the undivided ownership interest is owned by a governmental unit and only that portion of the facility is financed with tax-exempt bonds, the ownership interest of any other joint owner is not treated as private business use.[7] A similar approach applies to unrelated business income tax and general exempt organization matters. Pursuant to I.R.C. § 512(c), for example, an exempt organization that is a member of a partnership conducting an unrelated trade or business with respect to the exempt organization must include its share of the partnership income and deductions attributable to that business in computing its unrelated business income. In Rev. Rul. 98-15[8] and Rev. Rul. 2004-51,[9] the Internal Revenue Service applies the aggregate approach in connection with public-private partnerships to determine exempt organization status, including whether the activities of the partnership constitute an unrelated trade or business of the exempt organization,[10] and states that the activities of a partnership must be considered to be the activities of the partners. Moreover, in connection with the Affordable Care Act, the Internal Revenue Service has concluded that activities of partners in an accountable care organization are to be attributed to the organization's partners on an aggregate basis.[11]

By applying a similar approach to that already used by the Treasury Regulations and the Internal Revenue Service for output facilities and the same (aggregate) approach as is used in other general tax situations, a facility owned or otherwise used by a public-private partnership can be analyzed for private activity bond purposes using reasonable allocations. This approach would allow the ownership or other use of a facility by a partnership with a private partner, while permitting a portion of the facility to be financed with tax-advantaged bonds in an amount equal to the governmental or 501(c)(3) organization partner's interest in the venture. For example, if an exempt entity (such as a governmental or 501(c)(3) organization) and a private entity share in the operation of a hospital facility, ownership and use of the facility could be allocated to each partner based on the percentage of assets contributed by each partner, and the portion of the facility treated as owned by the exempt entity would be eligible for financing with tax-advantaged bonds, including qualified 501(c)(3) bonds. Also, the benefit of tax-exempt financing is not being effectively transferred to the private partner when such aggregate treatment is limited to situations involving a fixed allocation of all partnership items in accordance with constant percentage

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[7] Treas. Reg. § 1.141-7(i), Example 1.

[8] 1998-1 C.B. 718.

[9] 2004-1 CB. 974.

[10] To the extent the criteria set forth in these revenue rulings (regarding participation that does not give rise to an unrelated trade or business) are not satisfied, such participation will create the same amount of private use regardless of whether aggregate treatment or separate entity treatment is applied. We believe that, from a policy point of view, the Treasury Department and the Internal Revenue Service should take comfort from this point.

[11] IRS Fact Sheet FS-2011-11 (Oct. 20, 2011).

interests in the partnership for the entire measurement period for the bonds or the entire period that the person is a partner.

The separate entity approach of the Proposed Regulations, however, would cause the entire facility to be owned by the partnership and treated as used in a private trade or business, and would require structuring or restructuring of transactions to use 100 percent taxable financing, which would likely have a substantial impact on financing costs and thereby on the cost of providing services—even though as a matter of economic substance a 501(c)(3) organization would have substantial and permanent ownership stake in the facility. NABL believes that this result is inconsistent with the use of the aggregate approach in other tax-exempt bond circumstances and in many similar situations.[12]

Health Care Considerations

Reconsideration of the separate entity approach is particularly relevant given the federal government's efforts to implement the provisions of the Affordable Care Act. A fundamental objective of the Affordable Care Act is to transform the delivery of health care services from a series of discrete actions by disparate entities to the provision of services along a continuum of care, with communication and coordination among participants. This paradigm shift requires integration of activities between traditional not-for-profit health care providers (such as governmental or 501(c)(3) hospitals and nursing homes) and for-profit participants (including physicians, pharmacies and for-profit healthcare providers).[13] The logical form for many of these cooperative endeavors is a joint venture, a joint operating arrangement or another type of partnership. Attached as Exhibit A is an example of such an endeavor and the potential consequences applicable to tax-advantaged financings.

Recommendation

NABL believes that the policies of I.R.C. §§ 141 and 145, which aim to limit private business uses and ownership of bond-financed property, are not, in the context of economically advantageous public-private partnerships, in any way impaired by permitting aggregate treatment of public-private partnerships in cases where the attributes of ownership in the partnership are fixed for at least as long as any tax-advantaged bonds will remain outstanding. NABL also believes that such policies can be carried out in a manner that complements policies under the Affordable Care Act. This will enable the benefit of tax-advantaged debt to be available for the public portion of such public-private partnerships and relieves governmental persons and 501(c)(3) organizations from choosing between (1) increasing the cost of delivery of health care by issuing taxable instead of tax-advantaged debt, and (2) foregoing joint ventures encouraged by the Affordable Care Act or sound fiscal policy. Accordingly, NABL recommends that any

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[12] Similarly, the inability to apply an aggregate approach in these situations would cause an entity that engages in a public-private partnership post-issuance to take remedial action with respect to bonds in an amount significantly disproportionate to the economic interest the governmental entity (or 501(c)(3) organization) has ceded to the private entity pursuant to the venture.

[13] Such integration may also occur between governmental providers and 501(c)(3) providers. In connection with governmental bonds, 501(c)(3) providers would be considered private business users.

final regulations permit the use of the aggregate approach for arrangements constituting partnerships for federal tax purposes between governmental entities (or 501(c)(3) organizations) and private entities for private business use and ownership purposes. Arrangements constituting partnerships between two or more 501(c)(3) organizations, which currently may use the aggregate approach only for use purposes, should similarly be permitted to apply the aggregate approach for ownership purposes as well.

Exhibit A

A 501(c)(3) hospital organization completed the construction of a replacement hospital facility in 2009. Fifty percent of the project was financed with the proceeds of qualified 501(c)(3) bonds. The hospital paid the remaining project costs and costs of issuance with its own moneys. The hospital is the owner of the replacement facility. As a result of shrinking demand for inpatient services in recent years, approximately ten percent of the facility is vacant. Assume for purposes of this example that this space is treated as 50 percent bond-financed. The hospital is considering the two projects described below to increase utilization of the facility and improve the provision of medical services to the community. As described below, the separate entity approach of the Proposed Regulations severely limits the hospital's ability to implement these projects.

Alternative #1: Mental Health Services. The hospital would like to have its primary care practice designated as a "Patient Centered Medical Home," as defined in section 3502 of the Affordable Care Act. This designation carries with it critical federal and state financial incentives and is expected to improve patient outcomes and experiences. In order to achieve such designation, the hospital's primary care practice will need to offer more mental health resources to its patients. The hospital has determined that such services are in high demand in the community. Under section 2703 of the Affordable Care Act, the hospital also anticipates qualifying for increased Medicaid reimbursement rates for home health services that are available if the hospital provides mental health services.

To acquire the necessary mental health resources, the hospital would like to purchase an existing for-profit medical group that provides these services, but the physician owners of the medical group are not interested in becoming hospital employees. The hospital has also considered entering into a series of management agreements with the medical group. Given the comprehensive and collaborative nature of the intended programs under the Affordable Care Act, however, the parties determine that they need a longer-term arrangement than the safe harbors under Rev. Proc. 97-13 will allow, and a greater degree of clinical and administrative coordination. For these reasons, the hospital and the medical group conclude that a partnership arrangement is needed. Under the partnership arrangement, the hospital is to transfer ownership of the vacant facility space to the partnership. Both partners are to receive the same distributive share of each partnership item for federal tax purposes as their respective interests in the partnership, and the share is anticipated to remain the same for the duration of the partnership. The distributive share of the hospital is at least 50 percent.

Alternative #2: Partnership with Larger Health System. Due to its small size and rural location, the hospital struggles to recruit specialist physicians and to offer certain services to its patients, such as diagnostic cardiac catheterizations, interventional radiology and vascular surgery. The hospital has had discussions with a large area private hospital system concerning a collaborative arrangement that would allow the hospital to provide those services to its patients locally. The creation of an interventional radiology and vascular surgery program will require a substantial investment of resources by both parties, in building out the space, hiring additional physicians and staff, and marketing. For these reasons, the parties need a long-term arrangement, with each party assuming equal risks and benefits. The hospital and the system wish to enter into a joint venture and transfer ownership of the vacant facility space to the partnership for the creation of the heart and vascular center. The distributive share of the hospital is at least 50 percent.

Consequences of Partnership Creation. In each of the cases described above, the partnership structure is important to implementing the objectives of the Affordable Care Act. Under the Proposed Regulations, however, such arrangements would lead to private ownership and private business use of the facilities even though the governmental or 501(c)(3) hospital maintains at least a 50 percent share in the partnership.[14] The ownership of facility space by the partnership would cause bonds issued to finance the space to be private activity bonds that are not qualified 501(c)(3) bonds, and, independently, the partnership's use would be expected to give rise to private payments in amounts that will exceed five percent of the proceeds of the bond issue, causing the bonds to become taxable. In cases such as these, hospitals may ultimately decide not to go forward with joint ventures initiatives due to the difficulty of maintaining the tax status of the bonds under the separate entity treatment imposed by the Proposed Regulations.

In contrast, if the governmental or 501(c)(3) hospital in the examples above were treated as owning and using the bond-financed portion of the facility space based on the hospital's 50 percent interest in the partnership, the bonds would continue to satisfy the ownership requirement of I.R.C. § 145(a)(1), and the partnership would not give rise to any private business use of the bonds.[15] This aggregate treatment for ownership and private business use purposes may enable the hospital to go forward with such initiatives.

[14] Private business use arises in this context under the Proposed Regulations even though, as the Treasury Department has recognized in Rev. Rul. 98-15 and Rev. Rul. 2004-51, such participation generally has no effect on an organization's exempt status and gives rise to no unrelated business income.

[15] NABL recognizes that fact patterns may develop in which, even if aggregate treatment is the applicable law, a public-private partnership will give rise to either (a) private ownership or (b) private business use and private payments in an amount that will meet the private activity tests. Even in such circumstances, however, the aggregate approach will proportionately reduce the amount of private ownership, private business use and private payments and the amount of bonds that must be remediated. This reduction in cost may enable some projects to go forward that otherwise would be deemed to be cost-prohibitive.

Exhibit B

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