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November 24, 2015

VIA EMAIL

Mr. John J. Cross III
Associate Tax Legislative Counsel
United States Department of the Treasury
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Mr. Kent Hiteshew
Director, Office of State and Local Finance
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Mr. James A. Polfer
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Office of the Chief Counsel
Internal Revenue Service
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RE: Recommended Additional Revisions to Revenue Procedure 97-13 and Related Regulations

Dear Mr. Cross, Mr. Hiteshew and Mr. Polfer:

The National Association of Bond Lawyers ("NABL") respectfully submits the attached recommendations for additional revisions to the management and other service contract safe harbors against private business use in Revenue Procedure 97-13 and related federal income tax regulations. NABL generally applauds the amplification to Revenue Procedure 97-13 made by Notice 2014-67 for contracts having a term up to five years. NABL respectfully requests that comparable significant revisions and supplements be made with respect to contracts having a term longer than five years.

We submit these recommendations particularly in light of recent increased emphasis on improving efficiency of State and local government enterprises, and on fostering "public private partnerships." We respectfully submit that the safe harbors for longer-term management and other service contracts are unnecessarily inflexible to accommodate many arrangements that are entirely consistent with the relevant federal tax policies, and in many respects are based on an outdated conceptual framework that merits reconsideration. As a foundation for our specific recommendations, these comments discuss in some detail the history of the development of Rev. Proc. 97-13 and recommend a new framework for establishing more flexible safe harbors.

The enclosed comments were prepared by an ad hoc task force comprising those individuals listed in Appendix C and approved by the NABL Board of Directors.

If NABL can provide further assistance, please do not hesitate to call Bill Daly in our Washington, D.C. office at (202) 503-3303.

Sincerely,

Kenneth R. Artin

RECOMMENDATION BY THE NATIONAL ASSOCIATION OF BOND LAWYERS TO REVISE REVENUE PROCEDURE 97-13 AND RELATED FEDERAL TAX REGULATIONS

EXECUTIVE SUMMARY

The National Association of Bond Lawyers ("NABL") hereby submits its suggested revisions to the safe harbors against private business use in Revenue Procedure 97-13, 1997-1 C.B. 632, as amended by Revenue Procedure 2001-39, 2001-2 C.B. 38, and as amplified by Notice 2014-67.

We offer these comments in response to the request for public comments set forth in Notice 2014-67 and in light of recent initiatives of President Obama to foster the development of public-private collaboration on infrastructure. On July 17, 2014 President Obama released a memorandum titled "Expanding Public-Private Collaboration on Infrastructure Development and Financing" (the "Presidential Memorandum"), which includes the following statements:

> We must use every tool at our disposal to lay the foundation for future prosperity and create new jobs, including better collaboration between the public and private sectors with respect to infrastructure development and financing in areas such as transportation, water, ports, energy and broadband, among others. The Federal Government can play an important role in supporting, promoting and expanding opportunities for public and private partners to work together on developing and financing infrastructure in these areas, thus increasing overall investment while safeguarding the environment and communities and improving project delivery.

In that light, Section 1 of the Presidential Memorandum sets forth the following statement of policy:

> It shall also be the policy of the Federal Government for all agencies to facilitate, as appropriate, greater public and private partnership and collaboration, including with international investors and companies, to develop, improve, and maintain infrastructure across the country where and when economically and environmentally beneficial and in the public interest.

Following up on the Presidential Memorandum, the Treasury Department released a white paper titled "Expanding our Nation's Infrastructure through Innovative Financing" in September 2014. This white paper emphasizes the Administration's directive to the Treasury Department to "analyze how to increase public and private sector collaboration in infrastructure development." As is discussed in the Treasury Department white paper, many public-private partnerships take the form of management or other service contracts between exempt sector owners of infrastructure and private sector service providers.

These comments are also offered in light of the publication of final regulations on October 27, 2015 under Sections 141 and 145 of the Internal Revenue Code on "allocation and

accounting."[1] We applaud the additional flexibility provided by these new regulations for public-private collaboration and in particular the new rule that facilitates reasonable use of tax-exempt financing of projects used by partnerships including a State or local government or 501(c)(3) organization owner.

Even after publication of Notice 2014-67 and the final private activity bond allocation and accounting regulations, however, the current federal tax regulations and published guidance concerning the treatment of these arrangements with respect to property financed with tax-exempt bonds under the "private activity bond rules" of Section 141 of the Internal Revenue Code of 1986, as amended (the "Code"), continue to place significant restrictions on the effectiveness, flexibility and efficiency of public-private collaborations. NABL submits that the current rules are unnecessarily limiting, and that a continued reconsideration of the interpretive published guidance under Section 141 of the Code will significantly further the policies stated in the Presidential Memorandum. NABL applauds the release of Notice 2014-67 relating to management and other service contracts having a term not exceeding five years. NABL observes, however, that many management and other service contracts for infrastructure have terms exceeding five years, and that more flexible interpretive rules are particularly needed for such longer-term contracts. We recommend that the same type of reconsideration of existing limitations that resulted in publication of the final allocation and accounting regulations should also be undertaken for the rules relating to management and other service contracts.

NABL recommends that the existing safe harbors for management and other service contracts should be further expanded as follows. First, safe harbors for contracts having a term greater than five years relying on the "fixed fee" framework should be retained but made more flexible in a manner comparable to the flexibility provided in Notice 2014-67 for five-year contracts, and certain principles developed in private letter rulings should be reflected in published guidance. Second, the Treasury Department and the Internal Revenue Service should consider additional frameworks for safe harbors that are not based on "fixed fee" limitations but nevertheless further the purposes of Section 141. Third, the limitation set forth in the existing private activity bond regulations prohibiting management and other service contracts "based, in whole or in part, on a share of net profits" should be reconsidered, and a more flexible rule focusing on control relationships should be adopted. The following comments address each recommendation. Appendix A to this submission is a summary of NABL's specific recommendations for revising the management contract safe harbors for longer-term arrangements. Appendix B to this submission sets forth two examples illustrating NABL's proposed approach for management contracts based on retention of control.

In this submission, references to "management contracts" generally refer to management and other service contracts as broadly defined in the Treasury regulations.

These comments supplement NABL's submissions to the Department and the Internal Revenue Service on January 22, 2015 relating to Notice 2014-67, on May 2, 2012 relating to Rev. Proc. 97-13, and on December 22, 2006, February 15, 2008 and September 17, 2014 relating to proposed allocation and accounting regulations.

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[1] 80 FR 65637-65646.

DISCUSSION AND RECOMMENDATIONS

1. History and conceptual framework of Rev. Proc. 97-13.

Under Section 141(b)(1) of the Code, an issue generally meets the "private business use test" if more than 10 percent of the proceeds of the issue is to be used for any private business use. Section 141(b) provides for lower limits on the amounts of private business use in certain cases, including a five percent limit on "unrelated" or "disproportionate" private business use.

Section 141(b)(6) of the Code provides that the term "private business use" means "use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit." For purposes of this provision, "use by a member of the general public shall not be taken into account", and "any activity carried on by a person other than a natural person shall be treated as a trade or business."

The Code itself does not otherwise define the meaning of private business use, and does not expressly provide any rules to determine whether service contracts result in private business use.

Section 141 of the Code was enacted as part of the Tax Reform Act of 1986.[2] Section 1301(e) of the Tax Reform Act of 1986 included a statutory directive regarding the treatment of management contracts under the private business use rules:

> The Secretary of the Treasury or his delegate shall modify the Secretary's advance ruling guidelines relating to when use of property pursuant to a management contract is not considered a trade or business use by a private person for purposes of Section 141(a) of the Internal Revenue Code of 1986 to provide that use pursuant to a management contract generally shall not be treated as trade or business use as long as—
>
> (1) the term of such contract (including renewal options) does not exceed 5 years,
>
> (2) the exempt owner has the option to cancel such contract at the end of any 3-year period,
>
> (3) the manager under the contract is not compensated (in whole or in part) on the basis of a share of net profits, and
>
> (4) at least 50 percent of the annual compensation of the manager under such contract is based on a periodic fixed fee.

This statutory provision has been central to the development of published guidance relating to the treatment of management contracts under the private business use rules, as is further discussed in this submission.

[2] Section 1301 of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat 2085.

Under the Tax Reform Act of 1986, the then-current rules for tax-exempt bonds contained in Sections 103 and 103A of the Internal Revenue Code of 1954 were divided, by subject, into Sections 103 and 141 through 150 of the Code. The legislative history to the Tax Reform Act of 1986 generally states that "to the extent not amended, all principles of present law continue to apply under the reorganized provisions."[3] With respect to private business use, the legislative history states generally as follows:

> As under present law, a person may be treated as 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.[4]

The legislative history described the statutory provisions of Section 1301(e) of the Tax Reform Act of 1986 as follows:

> The conference agreement follows the Senate amendment's directive to the Treasury Department to liberalize its advance ruling guidelines on the treatment of nongovernmental use pursuant to certain management contracts, with a modification. Under the agreement Treasury is directed to modify its advance ruling guidelines to provide that use pursuant to management contracts not exceeding five years (including renewal options) is not treated as private trade or business use if –
>
> (1) at least 50 percent of the compensation of any manager other than a governmental unit is on a periodic, fixed-fee basis;
>
> (2) no amount of compensation is based on a share of net profits; and
>
> (3) the governmental unit owning the facility may terminate the contract (without penalty) at the end of any three-year period. (footnote omitted)
>
> Except for the specific changes indicated, the conferees do not intend Treasury to alter the present-law advance ruling guidelines and regulations for determining when nongovernmental use is disregarded for purposes of the trade or business use test *or to limit the Treasury Department's authority to determine what constitutes (or what does not constitute) a use of bond proceeds*.[5] (emphasis added)

Importantly, the legislative history clearly states that Congress intended that the private business rules for the treatment of management contracts to be at least as flexible as set forth in Section 1301(e), but did not constrain the Treasury Department's regulatory authority to adopt other, more flexible rules.

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[3] H.R. Rep. No. 841, 99th Cong, 2d Sess., at II-686 (Conf. Rep.).

[4] H.R. Rep. No. 841, 99th Cong., 2d Sess., at II-687-88 (Conf. Rep.).

[5] H.R. Rep. No. 841, 99th Cong., 2d Sess., at II-689 (Conf. Rep.).

The General Explanation to the Tax Reform Act of 1986 further describes Section 1301(e) in a manner that affirms that additional steps to further public-private partnerships are appropriate:

> Congress recognized that State and local governments can, in certain cases, achieve significant cost efficiencies through joint public-private partnerships that utilize private management skills to assist in the provision of governmental services. Congress believed that properly restricted private management contracts should not prevent qualified governmental units from issuing tax-exempt obligations to finance the provision of these services. The Act accordingly liberalizes prior law by expanding the scope of management contracts that are permitted in conjunction with governmental tax-exempt financing.[6]

Prior to the enactment of the Tax Reform Act of 1986, rules comparable to the private business use test were provided in the "industrial development bond test" in Section 103(b) of the Internal Revenue Code of 1954. This test generally referred to an obligation "which is issued as a part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person." Section 103(b) of the Internal Revenue Code of 1954 did not otherwise define "trade or business" for this purpose.

Treasury Department regulations promulgated under Section 103(b) of the Internal Revenue Code of 1954 are generally much less complete than the subsequent regulations promulgated under Section 141 of the Code. These regulations issued under former Section 103(b) refer to "sales," "leases" and "other arrangements" as causing the "trade or business test" to be met, but do not contain any provisions expressly addressing the treatment of management contracts.

The treatment of service contracts under the "trade or business use test" was, however, addressed in advance ruling position safe harbors set forth in revenue procedures. In particular, Rev. Proc. 82-14[7] and Rev. Proc. 82-15[8] provided safe harbors for different types of service contract arrangements, and were the precursors of current safe harbors. Both of these revenue procedures provided that they were "intended only to inform taxpayers . . . of existing standards for the issuance of private letter rulings," that "they do not define, as a matter of law, the circumstances under which a bond issued by a state or local political subdivision thereof is an industrial development bond" and "are not to be applied in the examination of taxpayer's returns as tests for determining the taxability of bond interest."

Rev. Proc. 82-14, by its terms, applied to a "contract with a nonexempt management company for management services in the operation of facilities." Rev. Proc. 82-14 generally set forth two safe harbors under which a management contract would not cause a facility to be "used in the trade or business of a nonexempt person." Section 3.01 provided for a safe harbor for a contract with a term not exceeding five years if it provided for "compensation for the management

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[6] Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986, JCS-10-87, at 1153 (100th Cong., 1st Sess., 1987).

[7] 1982-1 C.B. 459.

[8] 1982-1 C.B. 460.

services that is based on a periodic flat fee that is reasonable in relation to the services performed" and permitted automatic increases that would "not exceed the percentage increases determined by the particular external standards for computing such increases" in the contract. In addition, the safe harbor stated that if "the term of the contract (including any renewal option) exceeds two years, the owner must be able to cancel the contract without penalty at the end of each two-year period of the contract term."

Section 3.02 of Rev. Proc. 82-14 provided for a safe harbor for a contract with a term not exceeding one year if it provided for "compensation for management services based on a percentage of the gross revenues from the facilities." For this purpose, "gross revenue" is defined as the "total revenue received from the operation of the facilities." Section 3.02 provided that this safe harbor applies if "the facilities financed with bond proceeds have not been operated for a sufficient period to establish with reasonable certainty the amount of the annual gross revenues and expenses" and further provided that at "the end of the one-year term, any management contract must provide for compensation to be based on a periodic flat fee."

Rev. Proc. 82-15, by its terms, applied to circumstances in which facilities are used by physicians, professional corporations or other nonexempt persons who are not employees of the exempt persons, and also sets forth two safe harbors under which a contract would not cause a facility to be "used in the trade or business of a nonexempt person." Section 3.01 established a safe harbor for a contract with a term not exceeding two years if it provided for "compensation based on a percentage of the fees charged for services rendered by the nonexempt person." In addition, the safe harbor stated that "the exempt person must be able to cancel the contract without penalty or cause by giving the nonexempt person 90 days' notice."

Section 3.02 of Rev. Proc. 82-15 established a safe harbor for a contract with a term not exceeding five years, subject to termination by the exempt user without penalty or cause after the end of each two-year contract, that was comparable to the safe harbor set forth in Section 3.01 of Rev. Proc. 82-14. This safe harbor also required that the compensation be reasonable and be "based on a periodic fixed fee" that could be subject to automatic increases not exceeding certain external indices.

Both revenue procedures also provided that, if the governing body of the exempt organization numbers five or more members, one member of the governing body may be the nonexempt person service provider, a related person, an employee of the nonexempt person, or a member of the governing body of the nonexempt person, except that that such persons may not serve as the chief executive of the exempt person.

The apparent interpretive framework underlying both Rev. Proc. 82-14 and Rev. Proc. 82-15 is set forth in General Counsel Memorandum 37641.[9] The analysis set forth in GCM 37641 merits reconsideration in some detail particularly because the analysis appears to have influenced and partially shaped the manner in which existing guidance was framed.

GCM 37641 generally set forth a "proprietary interest" test for determining whether a management contract resulted in noncompliant use of bond-financed facilities:

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[9] August 16, 1978.

> We believe the test to be applied where a manager operates a bond-financed facility is whether the nonexempt person is merely providing a service or commodity to the political subdivision that owns or is responsible for the operation of the facility, or whether the nonexempt person is itself operating the facility as a proprietor. Operation of the facility as a proprietor is regarded as important under the regulations. See Treas. Reg. § 1.103-7(c); Examples (9) and (11). In the obvious and typical situations where the facilities are leased or sold to a nonexempt person, such person "uses" the facility in the capacity of a proprietor, and the role of the political subdivision is passive or intermediary. On the other hand, a nonexempt person that sells a commodity or provides a service to the political subdivision may benefit from the facility in an indirect economic sense, but this does not amount to "use" within the meaning of the "trade or business" test, unless the involvement, whether direct or indirect, amounts to a proprietary use of the facility.

Importantly, the GCM did not cite or discuss any authority supporting the proposition that fixed fee compensation arrangements are inherently less indicative of a "proprietary interest" than variable fee compensation arrangements. The GCM does assert that the "existence of an agreement to share profits should invoke scrutiny because it may give rise to a presumption that the person receiving a share of net profits is a partner", but does not contain a rigorous or thorough discussion of the various other factors relevant to that analysis.

2. History of regulations and other published guidance under Section 141.

a. Rev. Proc. 97-13 was originally framed based on an extrapolation of the safe harbor set forth in Section 1301(e) of the Tax Reform Act of 1986 and was not intended to be a comprehensive consideration of other possible types of management contracts consistent with the purposes of Section 141 of the Code.

In response to Section 1301(e) of the Tax Reform Act of 1986, the Internal Revenue Service substantially revised the prior safe harbors for management contracts, first in Rev. Proc. 93-19,[10] and then in Rev. Proc. 97-13. Both revenue procedures were developed in connection with the drafting and publication of proposed and final Treasury regulations on "private activity bonds," which were published in final form on January 10, 1997.

Rev. Proc. 97-13 adopted the safe harbor set forth in Section 1301(e) for five-year contracts providing for at least 50 percent fixed fee compensation. Importantly, the drafters of Rev. Proc. 97-13 in effect adopted Section 1301(e) as the touchstone for further revisions to the management contract safe harbors. Because then-existing safe harbors permitted 100 percent variable compensation for short-term contracts (one year) and Section 1301(e) provided for a safe harbor for 50 percent fixed fee compensation for intermediate-term contracts (five-year/three-year termination), Rev. Proc. 97-13 adopted the position that safe harbors for longer-term contracts are appropriate to the extent that a greater percentage of compensation is a fixed fee. Accordingly, Rev. Proc. 97-13 provides for a safe harbor for management contracts having a term not greater than 15 years if "at least 95 percent of the compensation for services for each annual period during

[10] 1993-1 C.B. 526.

the term of the contract is based on a periodic fixed fee."[11] Rev. Proc. 97-13 provides for a safe harbor for management contracts having a term not greater than10 years if "at least 80 percent of the annual compensation for services for each annual period is based on a periodic fixed fee."[12] In each case "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." Also, in each case, the safe harbor provides that the term must not exceed 80 percent of the reasonably expected economic life of the property.

In addition, if all of the financed property subject to the contract is a facility or system "consisting primarily of public utility property," a 20-year term is permitted in lieu of the permitted 10-year and 15-year terms.

The approach taken in 1997 was to establish new safe harbors by extrapolating the existing safe harbors and the safe harbor set forth in Section 1301(e). Although this process of extrapolation was and continues to be a reasonable approach, it did not involve a comprehensive consideration of other types of management contract compensation arrangements that could also be consistent with the underlying purposes of Section 141 of the Code, and appears not to have been grounded in significant other case law or published guidance authority.

b. The development of Treas. Reg. § 1.141-3 was informed by Section 1301(e)

Section 1301(e) was not only the touchstone for the development of the safe harbors set forth in Rev. Proc. 97-13, but also was the basis for the key provision in the private activity bond regulations concerning the treatment of management contracts. Treas. Reg. § 1.141-3(b)(4) generally provides that a management contract with respect to financed property "may result in private business use of that property, based on all the facts and circumstances," but also contains the specific rule 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." The specific rule in Treas. Reg. § 1.141-3(b)(4) is taken virtually verbatim from Section 1301(e) of the Tax Reform Act of 1986. We emphasize, however, that Congress enacted Section 1301(e) expressly as a *safe harbor*, with no implication that it should be adopted as the substantive rule for when a management contract necessarily results in private business use.

c. Implications of Notice 2014-67.

In Notice 2014-67 the Treasury Department and the Internal Revenue Service significantly amplified Rev. Proc. 97-13 for management contracts having a term not exceeding five years. While specifically preserving the existing safe harbors set forth in Rev. Proc. 97-13, the additional safe harbor for contracts having a term not exceeding five years is permitted if "[a]ll of the compensation for services is based on a stated amount; periodic fixed fee; a capitation fee; a per-unit fee; or a combination of the preceding. The compensation for services also may include a percentage of gross revenues, adjusted gross revenues, or expenses of the facility (but not both

[11] Section 5.02(1) of Rev. Proc. 97-13.

[12] Section 5.02(2) of Rev. Proc. 97-13.

revenues and expenses)."[13] Moreover, Notice 2014-67 does not require each such arrangement to be cancellable prior to their termination date without penalty or cause. Notice 2014-67 also requests public comments on the treatment of management contracts for purposes of Sections 141 and 145(a)(2)(B) of the Code.[14]

NABL greatly appreciates the additional guidance provided by Notice 2014-67 with respect to the five-year safe harbor and in particular the provisions that permit its retroactive application. The elimination of the early termination requirement is also a positive development. We emphasize that the publication of Notice 2014-67 has significant implications for the development of additional safe harbors for management contracts, particularly including, but not limited to, contracts having a term exceeding five years. First, Notice 2014-67 represents an unequivocal statement that the Treasury Department and the Internal Revenue Service have clear regulatory authority to provide guidance that extends significantly beyond the safe harbor provided by Section 1301(e) of the Tax Reform Act of 1986. Just as importantly, the publication of Notice 2014-67 revised in a more flexible manner the primary limiting touchstone that was crucial in the framing of the safe harbors for longer-term contracts in Rev. Proc. 97-13. Because the safe harbors requiring compensation to be at least 95 percent fixed fee (for 15-year contracts) and 80 percent fixed fee (for 10-year contracts) were based on the statutory safe harbor requiring compensation to be at least 50 percent fixed fee (for five-year contracts), the removal of the 50- percent fixed fee limitation and the termination without penalty or cause requirement for the five-year contract safe harbor invites a fundamental reconsideration of whether more flexible safe harbors for longer-term management contracts are appropriate. The question raised by Notice 2014-67 is what additional frameworks for safe harbors for longer-term non-cancellable management contracts are consistent with the purposes of Section 141 of the Code.

We note that Notice 2014-67 did not revise the standard currently expressed in both the private activity bond regulations and Rev. Proc. 97-13 that a management contract generally results in private business use "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." Because that standard is also based on, and directly drawn from, the safe harbor set forth in Section 1301(e) of the Tax Reform Act of 1986, Notice 2014-67 can also reasonably be read as an invitation to reconsider whether that standard is unnecessarily restrictive.

d. Implications of the final "allocation and accounting" regulations.

Included in the release of final regulations on allocation and accounting on October 27, 2015, by the Treasury Department and the Internal Revenue Service is a new rule that facilitates tax-exempt financing of public-private partnerships in a manner that reflects a rethinking of the prior framework. Although the prior position of the Internal Revenue Service was that a partnership including a person other than a State or local government needed to be treated as an entity (and a nonqualified user) for purposes of the private business use test, the new regulations reverse that position by treating a partnership including a State or local government (or 501(c)(3) organization) as an aggregate of its partners. Among other things, we note that the rule in the existing regulations for management contracts prohibiting the sharing of net profits appears now

[13] Section 3 of Notice 2014-67.

[14] Section 5 of Notice 2014-67.

to be conceptually inconsistent with the framework of the new allocation and accounting regulations. A partnership, by definition, typically includes a sharing of net profits; by providing aggregate treatment of partnerships under the private business use test, the Treasury Department and the Internal Revenue Service have acknowledged that the sharing of net profits of a financed project with a person other than a State or local government does not necessarily result in private business use of the entire bond-financed project. In light of the new final regulations, the key question to be resolved is what alternative framework for management contracts should apply.

Further, although publication of the final regulations on "allocation and accounting" will further public/private partnerships, we emphasize that many structures involving such public/private partnerships include contracts for management services by for-profit participants. Accordingly, further flexibility for management contracts is essential to more fully implement the apparent policy goals of those new final regulations.

3. The Treasury Department has broad regulatory authority to adopt more flexible private business use rules for management contracts.

For the most part, the prior approach of the Treasury Department and the Internal Revenue Service to the treatment of management contracts has implicitly acknowledged the need for flexible rules that can accommodate a wide variety of management contracts entered into for reasons that serve bona fide governmental and exempt purposes. Accordingly, most of the existing and prior authority has been in the form of safe harbors, and those safe harbors have been revised in a series of published revenue procedures to be more flexible over time in a manner taking into account the actual experience of state and local governments and exempt organizations dealing with such safe harbors. A further revision to the rules for management contracts is entirely consistent with this general approach.

We emphasize that the Treasury Department has broad regulatory authority to define when a management contract results in private business use, and to more generally revise the existing regulatory definition of private business use. Indeed, Section 1301(e) of the Tax Reform Act of 1986 itself states that it does not "*limit the Treasury Department's authority to determine what constitutes (or what does not constitute) a use of bond proceeds*." (emphasis added)

4. Increased flexibility is needed and appropriate for long-term management contracts.

Although the safe harbors provided by Rev. Proc. 97-13 represented an improvement over prior safe harbors, the safe harbors for longer-term contracts have proved to be inflexible to accommodate many types of service contracts that further bona fide purposes and are consistent with the purposes of the private activity bond tests. In revising the framework of the safe harbors, we recommend that the Treasury Department and the Internal Revenue Service take into account the types of provisions presented to the Internal Revenue Service in the many private letter ruling requests concerning the treatment of management contracts under the private business use rules since 1997.

The fixed fee limitations of the existing safe harbors presents the following problems: (1) they do not permit sufficient flexibility to accommodate changes in circumstance, (2) they do not

permit sufficient flexibility to accommodate many reasonable types of compensation arrangements that are intended to provide incentives for better performance, and (3) under many circumstances, they make the determination that compensation is reasonable and at fair value more difficult.

We recommend that the Treasury Department and the Internal Revenue Service retain a safe harbor based on the "fixed fee" framework but in a more flexible form. Congress clearly indicated in the Tax Reform Act of 1986 that a safe harbor based on the extent to which compensation is fixed is one reasonable approach. Extrapolating from the benchmark of a safe harbor for contracts having a term not exceeding five years continues to be an appropriate approach. Because the five-year safe harbor has been revised to permit 100 percent variable compensation, a reasonable extrapolation is to permit longer-term management contracts with a greater percentage of variable compensation. We recommend, for example, that a safe harbor for management contracts having a term not exceeding 10 years should be correspondingly revised to permit up to 75 percent variable compensation, and that a safe harbor for management contracts having a term not exceeding 15 years should be correspondingly revised to permit up to 50 percent variable compensation. Also, we recommend that these permitted limits be applied on an average basis over the term of the contract, not only on an annual basis. We also recommend that such longer-term contracts not be limited by early optional termination without penalty or cause requirements. We particularly recommend, however, that other safe harbors should be adopted that are not limited by the fixed fee framework.

The state and local government and exempt organization enterprises and projects customarily financed with tax-exempt bonds often, by their nature, require long-term planning and long-term contractual arrangements. For example, municipal utilities are often required, by regulators and otherwise, to develop long-range plans to provide assurance that the public will continue to be served and regulatory requirements met. The need for long-term contractual arrangements, however, is distinct from the question of whether long-term non-cancellable contracts providing for substantially fixed-rate compensation are necessary, or even workable, in many circumstances.

For example, consider a local government sewer and wastewater district that serves a large portion of a metropolitan area. As a part of its long-range planning, and to obtain greater efficiencies in operation, the district may seek to enter into a contract with a term of 15 years or longer. Over that period, however, the district may reasonably expect that there may be changes in the scope and nature of its operations. For example, the scope of its service area may expand or contract, there may be years of unusual needs for service (such as flood years), the relevant technologies for providing service may change, or the district may seek to adjust services based on the quality of services rendered over time. There is no reason to assume that a long-term contract providing for a fixed fee can reasonably accommodate the legitimate needs of the district. Indeed, in many such circumstances, it may be impracticable for a state or local government to fit within the exact safe harbors of Rev. Proc. 97-13 because the fixed fee framework is insufficiently flexible.

A number of private letter rulings issued by the Internal Revenue Service acknowledge the practical necessity of having contractual provisions that adjust based on changes of circumstance, and hold that such provisions are entirely consistent with the purposes of Section 141 of the Code.

For example, in PLR 200813016,[15] the Internal Revenue Service considered a management contract for a solid waste disposal facility that generally provided for a fixed fee and a variable fee based on solid waste in excess of minimum tonnage generally limited to 20 percent of total compensation. The management contract also provided that the variable fee would not be limited in certain cases of excessive rainfall and other weather events.

In PLR 200330010,[16] the Internal Revenue Service considered a management contract for a water treatment facility not exceeding 20 years generally based on at least 80 percent fixed fees. The contract, however, provided for certain additional payments for "uncontrollable circumstances" and capital modifications necessitated by circumstances such as change in law, contamination of the site, naturally occurring events such as earthquake or landslide, shortfalls in the delivery of raw water, government preemption, labor disputes, subcontractor failures, and failures of the local government to provide related facilities. The Internal Revenue Service held that the management contract did not give rise to private business use, even though it could be reasonably expected that, over the term of the contract, additional payments under the uncontrollable circumstances provision would be required.

NABL believes that the need for provisions accommodating change of circumstance is commonplace, and should be expressly permitted in revised safe harbors.

5. The best way to provide for flexibility for incentive arrangements serving bona fide purposes is to adopt additional safe harbors not limited by the fixed-fee framework.

Private letter rulings concerning the treatment of management contracts under the private business use rules treat favorably a variety of different types of incentive compensation arrangements, even though many of those arrangements do not exactly fit within the Rev. Proc. 97-13 safe harbors. For example, in PLR 201412011,[17] the Internal Revenue Service considered a long-term management contract for an electric transmission and electric distribution system. The Internal Revenue Service concluded that a complex annual incentive compensation component did not cause the contract to result in private business use of the property subject to the contract. The incentive compensation was based on cost management performance, customer satisfaction, technical and regulatory performance and financial performance. A major element of the incentive compensation was based on reducing and controlling operating costs and capital costs.

In PLR 201338031,[18] the Internal Revenue Service considered a 15-year management contract for the operation of a governmentally-owned hotel. The management contract provided for an annual incentive fee based largely on whether the hotel's "achieved revenue per available room" was at least a set percentage of the achieved revenue per available room of a group of comparable hotels. The Internal Revenue Service concluded that this was a permissible incentive compensation arrangement.

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[15] March 28, 2008.

[16] September 25, 2003.

[17] March 21, 2014.

[18] September 20, 2013.

In PLR 201338026,[19] the Internal Revenue Service considered a contract with a medical group for operation of clinical facilities. The service contract provided for base compensation based largely on the number of "work relative value units" produced at the facility. The contract also provided for incentive compensation based on achievement of various performance categories, including cost management, patient access, patient satisfaction and throughput. The Internal Revenue Service concluded this was a permissible incentive compensation arrangement, based largely on a representation that the number of "work relative value units" did not necessarily correspond to gross revenues of the facility.

These, and other examples of management contract compensation arrangements addressed in private letter rulings, highlight that there are many different types of incentive compensation arrangements that further bona fide governmental and exempt purposes. We observe that the fixed-fee framework unnecessarily restricts other types of compensation arrangements that are becoming increasingly common for management arrangements involving infrastructure owned by state and local governments. For example, the Treasury Department's 2014 white paper on "Expanding our Nation's Infrastructure through Innovating Financing" describes in detail the increasing use of "availability payments" relating to public infrastructure projects. In general, such payments are required to be made by a state and local government to the service provider only when the project is available for public use at prescribed operational levels or meets other performance criteria; for that reason, the "availability payment" approach generally is not consistent with the "fixed fee" requirements of the existing Rev. Proc. 97-13 safe harbors as they are currently framed. In addition, the existing limits on contract terms in Rev. Proc. 97-13 may preclude the effective application of the availability payment structure, which may be intended to obligate the service provider to be responsible for the long-term operational viability of the facility. In many current cases under financing structures using availability payments, the private manager may provide the financing for all or a portion of the infrastructure, which is secured by the availability payments. If the rules for when management contracts give rise to private business use are made more flexible in a manner consistent with our recommendations, however, we believe that other structures using availability payments likely would arise that are consistent with preserving the ability to finance governmentally-owned infrastructure with tax-exempt bonds.

We emphasize that certain availability payment and other incentive payment arrangements may reasonably be treated as not resulting in private business use under the existing regulations on the basis that they are "solely incidental to the primary governmental function or functions of the financed facility."[20] For example, a long-term arrangement for maintenance and repair services of a financed facility may reasonably be treated as not resulting as private business use under this exception. Because the examples in the existing regulations for this exception are limited (contracts for janitorial, office equipment repair, hospital billing, or similar services), there is need for clarification regarding its application to a broader range of contracts.

To date, the analysis of the Internal Revenue Service of these various arrangements under the private business use rules has focused on whether the compensation is a fixed-fee and whether it is properly treated as based on both a percentage of gross revenues and a percentage of expenses. One way to amplify Rev. Proc. 97-13 would be to describe and permit certain specific types of

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[19] September 20, 2013.

[20] Treas. Reg. § 1.141-3(b)(4)(iii)(A).

incentive compensation arrangements. Such an amplification would be a welcome step forward, but it would be unlikely to encompass all of the many different types of reasonable incentive compensation structures that are suitable in different contexts.

In many cases, an analysis based on whether compensation is based both on gross revenues and expenses is unduly inflexible and requires an unnecessarily difficult analysis. Indeed, the question of whether revenues and expenses are being shared is inherent in many arrangements in which a service provider is compensated from the operation of the managed facility. As is set forth below, revision of the rule focused primarily on whether compensation is "based, in whole or in part, on a share of net profits" would be a more significant step forward to permit a wider variety of incentive arrangements consistent with the purposes of Section 141.

6. Rules relating to reimbursement of expenses should be clarified, but are not necessary to the application of additional safe harbors.

Section 5.02(1) of Rev. Proc. 97-13 provides that "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."

A number of private letter rulings have in effect, permitted this reimbursement exception to be extended to apply to situations where a service provider is reimbursed for operating costs paid to an affiliate or other related party, provided that the reimbursement is approved by a state or local regulatory body, or there is other adequate assurance that the costs reimbursed reflect fair market value. For example, in PLR 201228029,[21] which considered a long-term management contract for an electric transmission and distribution system, the Internal Revenue Service permitted this exception to be applied to reimbursement of operating costs paid to affiliates, including a mark-up, provided that the costs met applicable requirements of the Federal Energy Regulatory Commission.

NABL believes that the extension of this rule to reimbursed costs paid to affiliates and other related parties in such circumstances is appropriate, and recommends that it should be expressly reflected in revised safe harbors.

A number of other private letter rulings have applied this rule to salaries and other costs paid to employees, provided that such reimbursements do not include amounts paid by the service provider to or for individuals who are part of senior management and who are employed by the service provider. For example, in PLR 201412011[22] the Internal Revenue Service treated reimbursement of wages, salaries, benefits and other labor costs as not being treated as compensation for purposes of Rev. Proc. 97-13, but specifically indicated that such pass-through expenditures did not include amounts paid by the manager "to or for individuals who are part of senior management and who are employed" by the manager.

In at least one other private letter ruling, the Internal Revenue Service has accepted a more flexible, but still limited, approach. In PLR 201338026 (concerning a contract with a medical

[21] July 13, 2012.

[22] March 21, 2014.

group for operation of clinical facilities, as discussed above) the Internal Revenue Service treated reimbursement of the compensation of employees of the service provider as not constituting "compensation" of the manager, including compensation paid to vice presidents and the president of the medical group. The compensation paid by the manager to the president, however, was itself largely variable, and based on the production of "work related value units." The analysis of the Internal Revenue Service in permitting the pass-through arrangement largely depended on a conclusion that the compensation paid to the president was not, itself, compensation based, in whole or in part, on a share of net revenues.

This approach of treating compensation paid to senior management as not necessarily a cost paid to an "unrelated party" within the meaning of Section 5.02 of Rev. Proc. 97-13 has no basis in Rev. Proc. 97-13. In general, NABL recommends that reimbursement of compensation paid by a manager to any of its employees, whether senior management or not, should not be treated as compensation paid to the manager, unless the employee is the owner of a significant equity interest in the manager.

We observe that the difficulties presented by the question of determining what payments constitute "compensation" for purposes of Rev. Proc. 97-13 only arise because the existing safe harbors for long-term contracts are primarily based on whether the compensation paid is a fixed fee. Although we recommend that the existing safe harbors based on percentage fixed fee arrangements be continued in more flexible form, the additional safe harbors recommended in this submission would not depend on such considerations and would in that respect be more readily administrable.

Also, the Internal Revenue Service has indicated a concern applying the "pass-through" compensation rule to compensation paid by the manager to senior employees could be a device to avoid the rule the compensation may not be based in whole or in part on a share of net profits. As is discussed below, however, there is significant authority that permits employees and independent contractors to be compensated in part on the basis of a share of net profits. A more flexible approach would look to that authority, which generally focuses on consideration of control rights.

7. The development of more flexible rules for section 501(c)(3) organizations has focused on control rights.

In our September 17, 2014 submission on "Allocation of and Accounting for Tax-Exempt Bond Proceeds for Purposes of the Private Activity Bond Restrictions" we recommended that the Treasury Department consider the treatment of partnerships of Section 501(c)(3) organizations with non-exempt persons under Rev. Rul. 98-15,[23] Rev. Rul. 2004-51,[24] and related authority as a framework for permitting more flexible public-private partnership arrangements under the private activity bond regulations. We appreciate the favorable response to that submission, as reflected in the aggregate treatment of partnerships provided for in the allocation and accounting regulations published on October 27, 2015. This submission provides a further consideration of that framework in the context of the treatment of management contracts.

[23] 1998-1 C.B. 718.

[24] 2004 C.B. 975.

Prior to 1980 the Internal Revenue Service generally took the position that it was *per se* not permitted for an exempt organization to participate as a partner in a partnership with a non-exempt person. In 1980 the United States Tax Court rendered its landmark decision in *Plumstead Theatre Society v. Commissioner*[25] soundly rejecting that *per se* position. In *Plumstead* a Section 501(c)(3) organization entered into a limited partnership with private investors to raise funds to produce a theater production. The investors made a capital contribution and were entitled to a percentage share of profits and losses from the production. The court held that the arrangement was consistent with the organization's exempt purposes, because the organization retained sufficient control over the production.

In the wake of *Plumstead*, the Internal Revenue Service and the Treasury Department embarked on a long reconsideration and revision of its position. Although a detailed discussion of that reconsideration is beyond the scope of this submission, the important point is that the Treasury Department and Internal Revenue Service abandoned the prior *per se* prohibition and instead focused on identifying and articulating the types of control relationships sufficient to assure that a partnership or joint venture would be consistent with exempt purposes.

Perhaps the most significant product of that reconsideration is Rev. Rul. 98-15, which sets forth the Internal Revenue Service position regarding circumstances under which it is consistent with charitable purposes for a Section 501(c)(3) hospital organization to enter into a "whole hospital" joint venture with a for-profit corporation. Rev. Rul. 98-15 describes a situation in which the hospital organization forms a limited liability company with a for-profit corporation and then contributes its hospital and all operating assets to the LLC. The LLC then operates the hospital. The revenue ruling focuses on circumstances under which the hospital organization retains sufficient substantive control to assure that the hospital facilities will be operated in a manner consistent with exempt purposes. Among other things, in the fact pattern under which the joint venture is permitted, the hospital organization retains majority control of the governing board, the governing board has reserved rights over major operating decisions, and the governing documents give priority to charitable purposes.

In many respects, the position of the Internal Revenue Service regarding the treatment under the private business use rules prior to publication of the 2015 allocation and accounting regulations was analogous to the position of the Internal Revenue Service regarding the treatment of partnerships involving 501(c)(3) organizations and non-exempt persons under the rules for private benefit and private inurement prior to the *Plumstead* decision. Prior to *Plumstead*, the Internal Revenue Service adopted a position that partnerships between exempt organizations were *per se* not permitted. After a careful reconsideration, the Internal Revenue Service eventually abandoned the *per se* position, and instead adopted a more purposive position that focuses on whether the exempt organization retains sufficient control to assure that the partnership will fulfill exempt purposes.

Rev. Rul. 98-15 focuses in particular on whether the exempt organization retains sufficient governing board control to assure that a partnership furthers exempt purposes. For public-private partnerships, the Treasury Department and the Internal Revenue Service have now abandoned the existing *per se* approach, and similarly adopt a more purposive approach focusing on economic

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[25] 74 T.C. 1324 (1980), *aff'd*, 675 F. 2d 244 (9th Cir. 1982).

and financial substance. We acknowledge, however, that the purposes of Section 501(c)(3) are not the same as the purposes of Sections 141 and 145. Accordingly, the essential elements of control to assure that the purposes of the private activity bond rules are furthered in a management contract context are not necessarily identical to the essential elements of control to assure that the purposes of the private benefit and private inurement rules are furthered.

8. The factors of control relevant to the purposes of the private activity bond rules should be considered in light of analogous authority, but take into account the considerations unique to Section 141.

The private activity bond regulations describe the purposes of the private activity bond rules as follows:

> The purpose of the private activity bond tests of section 141 is to limit the volume of tax-exempt bonds that finance the activities of nongovernmental persons, without regard to whether a financing actually transfers benefits of tax-exempt financing to a nongovernmental person. The private activity bond tests serve to identify arrangements that have the potential to transfer benefits of tax-exempt financing, as well as arrangements that actually transfer these benefits.[26]

We recommend that the rules for the treatment of management contracts under the private business use rules be reframed in a manner that focuses on this statement of purpose (or other, more flexible, statement of purpose to be adopted in future regulations). Under such a purposive framework, management contracts should be treated as resulting in private business use only if (1) the management contract actually transfers the benefits of tax-exempt financing to a nongovernmental person; or (2) the management contract does not provide the issuer (or exempt organization) with sufficient controls to reasonably assure that the arrangement does not have significant potential to transfer the benefits of tax-exempt financing to a nongovernmental person. This purpose is in some respects similar to, but distinct from, the purposes of the private benefit and private inurement rules that apply to exempt organizations. In particular, a reasonable interpretation of this statement is that the private activity bond rules are in general more focused on arrangements that transfer (or have significant potential to transfer) a financial benefit derived from favorable tax treatment. By comparison, the rules that apply to exempt organizations focus on more qualitative considerations (in particular, whether an arrangement serves a private benefit even in the absence of any financial benefit).

Accordingly, we recommend that revisions to the management contract rules identify the control relationships that provide sufficient assurances that there is no significant potential for transferring to the manager the benefits of tax-exempt financing.

We note that other analogous federal tax authority concerning management contracts focuses on control relationships. We do not recommend that the Treasury Department and the Internal Revenue Service adopt new safe harbors that exactly follow any of the lines of authority discussed in these comments, but rather that the themes and approaches in that authority inform the development of new safe harbors.

[26] Treas. Reg. § 1.141-2(a).

We first acknowledge that there is substantial basis in federal tax authority distinguishing debt from equity (or other types of instruments) to the effect that the term of an arrangement and whether an arrangement provides for variable compensation can be important factors in determining whether the arrangement is properly treated as equity. For example, in Notice 94-47,[27] the Internal Revenue Service emphasized that one important factor to be considered in determining whether an instrument is debt is whether there is an unconditional promise to pay a sum certain on demand "in the reasonably foreseeable future." In that context the Internal Revenue Service also emphasized that "[n]o particular factor is conclusive in making the determination of whether an instrument constitutes debt or equity. The weight given to any factor depends on all the facts and circumstances and the overall effect of an instrument's debt and equity features must be taken into account." Also, even in that context, the Internal Revenue Service acknowledged that instruments with very long terms can appropriately be treated as debt.[28]

We believe that this line of authority contributes to the underpinnings of the existing framework of the Rev. Proc. 97-13 safe harbors for long-term management contracts. The term of an arrangement and the extent to which an arrangement is variable reasonably can be viewed as important factors in the consideration of whether an arrangement is equity-like. We note, however, that in the development of the rules for when management contracts results in private business use, the Internal Revenue Service has not discussed or explained how these themes from the federal tax authority dealing with debt and equity could have relevance by analogy. In any event, to the extent that reference to debt-equity authority is relevant, that authority highlights that the proper analysis requires a consideration and weighing of multiple factors, and that no one or two factors are necessarily dispositive in contexts in which they are outweighed by other factors. We offer our recommendations for additional safe harbors that emphasize other factors in this light.

Although the federal tax authority dealing with debt-equity considerations has some relevance, we believe that other federal tax authority is more closely analogous, particularly the federal tax authority concerning whether a management contract is properly recharacterized as a lease or partnership, as discussed below, and the authority concerning whether partnership arrangements coupled with management contracts are consistent with the section 501(c)(3) status of an exempt organization, discussed above. Our observation is that such other authority is generally more focused on a consideration of the types of control relationships.

We also emphasize that our recommendations are made in consideration of the particular purposes of the private business use rules and the unique circumstances relating to the affected facilities, which are owned by state or local governments or exempt organizations, and typically are available for general public use. For example, by analogy, the federal income tax authority dealing with the distinction between debt and equity clearly needs to take into account the special considerations that apply to state and local governments, which generally are prohibited by their organizational statutes from having equity holders. We suggest that analogous federal tax authority needs to be considered and imported to Section 141 in light of those special

[27] 1994-1 C.B. 357.

[28] Notice 94-47 cites and discusses *Monon Railroad v. Commissioner,* 55 T.C. 345 (1970), *acq.*, 1973-2 C.B. 3, which involved a debt instrument with a 50-year term.

considerations. We do not request, and do not recommend, that additional safe harbors apply, either directly or by any implication, for any purpose other than Sections 141 and 145 of the Code.

Other analogous authority is set forth in Section 7701(e) of the Code. Section 7701(e) states that the following control factors are relevant for determining when an arrangement in the form of a management contract will be treated as a lease for federal income tax purposes: whether the service recipient is in physical possession of the property or controls the property; whether the provider has a significant economic or possessory interest in the property and whether the provider bears risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract; whether the service provider uses the property concurrently to provide significant services to entities unrelated to the service recipient; and whether the total contract price substantially exceeds the rental value of the property for the contract period.

Section 7701(e) was enacted to address arrangements that are in some respects the "reverse" of the arrangements typically involved in service contracts relating to tax-exempt bond financed property. Section 7701(e) primarily concerns the treatment of property provided by the service provider. The private activity bond rules, by contrast, primarily concern the treatment of property provided by the service recipient. Nonetheless, it is appropriate to consider the implications of Section 7701(e) in framing service contract rules under Section 141.

Case law interpreting Section 7701(e) has taken the view that, of the various factors listed, "control" may be the most significant factor. For example, in *Tidewater Inc. and Subsidiaries v. U.S.*[29] the Fifth Circuit considered whether a contract in the form of a "time charter" of a vessel was properly treated as a lease or a service contract for purposes of Section 927 of the Code. In determining that the arrangement was properly treated as a lease under Section 7701(e), the court stated that it was required to "determine the weight each factor deserves" because Section 7701(e) "does not specify the weight given to its factors." The court concluded that "the crucial issue is whether Tidewater or its customer had control of the vessel." The court emphasized that the "customer directed the movement of the vessel, cargo, and passengers" and that "the master and crew were required to fulfill them."

Other case law distinguishing a lease from a service contract similarly emphasizes the importance of control as a crucial factor. For example, in *Meagher v. Commissioner*[30] the Tax Court held that a management contract for services managing the use and leasing of tank cars would not be recharacterized as a lease for federal income tax purposes. The Tax Court held that "the existence of control over the venture by the property owner and the risk of loss on the property owner are key factors indicating a management contract." In *Meagher*, the Tax Court noted that, although the owner did not exercise day-to-day direct control, the owner in effect exercised substantive control through the terms of the management contract.

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[29] 565 F. 3d 299 (5th Cir. 2009).

[30] 36 T.C.M. 1091 (1977).

Other cases emphasizing the importance of control as a crucial factor for distinguishing a service contract from a lease include *Xerox Corporation v. United States,*[31] *State National Bank of El Paso v. United States,*[32] and *McNabb v. Commissioner.*[33]

Notably, Section 7701(e) does not expressly provide, or directly imply, that fixed fee arrangements are necessarily more indicative of management contract treatment than variable fee arrangements. To the contrary, one factor listed by Section 7701(e) that is indicative of service contract treatment is whether the fees paid to the service provider can vary depending on whether the service is rendered.

Accordingly, the task in reframing additional safe harbors for the private activity bond rules for service contracts should be to focus on the types of control relationships that provide sufficient assurances that the purposes of the private activity bond rules will be met, while still providing state and local governments with flexibility to achieve legitimate governmental and exempt purposes. In the context of the types of projects typically financed with tax-exempt bonds, we recommend that one such control factor should be control of the rates and fees, if any, charged to the users of a financed facility.

We note than an emphasis on who retains the rights to control rates is already reflected in the final private activity bond regulations. The private activity bond regulations provide that arrangements which are "comparable to" arrangements that are specifically listed as resulting in private business use also result in private business use. The main example interpreting this rule focuses in particular on the right to control rates as an important factor in determining whether an arrangement results in private business use:

> *Rights to control use of property treated as private business use – parking lot.* Corporation C and City D enter into a plan to finance the construction of a parking lot adjacent to C's factory. Pursuant to the plan, C conveys the site for the parking lot to D for a nominal amount, subject to a covenant running with the land that the property be used only for a parking lot. In addition, D agrees that C will have the right to approve rates charged by D for use of the parking lot. D issues bonds to finance the construction of the parking lot on the site. The parking lot will be available for use by the general public on the basis of rates that are generally applicable and uniformly applied. The issue meets the private business use test because a nongovernmental person has special legal entitlements for beneficial use of the financed facility that are comparable to an ownership interest.[34]

Further, the existing private activity bond regulations provide that a management contract results in private business use if the service provider is treated as the lessee of the financed property for federal income tax purposes.[35] For this purpose, the regulations state that the following factors

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[31] 656 F.2d 659 (Ct. Cl. 1981).

[32] 509 F.2d 832 (5th Cir. 1975).

[33] 81-1 U.S.T.C. ¶ 9143 (W.D. Wash. 1980).

[34] Treas. Reg. § 1.141-3(f), *Example 5*.

[35] Treas. Reg. § 1.141-3(b)(4)(iv).

are relevant: the degree of control over the property that is exercised by the nongovernmental person; and whether a nongovernmental person bears the risk of loss of the financed property.

In general, NABL concurs that a focus on control relationships is appropriate for the interpretation of when contracts give rise to private business use and is entirely consistent with the legislative purposes underlying the private activity bond requirements. In other words, a focus on control relationships is consistent with identifying, in the most meaningful way, arrangements that further governmental purposes. In order to better facilitate more flexible arrangements that serve bona fide governmental and exempt purposes, however, NABL recommends that published guidance further consider the specific types of control relationships that are most important to furthering the purposes of the private activity bond rules.

We submit that the essential task in reframing the management contract rules is to apply principles of control emphasized in a substantial body of analogous authority to the types of facilities typically financed with tax-exempt bonds under Sections 141 and 145 of the Code. For the most part, these are infrastructure facilities and other facilities that are required to be governmentally owned and that serve the general public. Accordingly, factors of control that are most important to the economic and practical substance of operations in this context are (1) control over rates charged; (2) control to ensure that financed facilities are made available to the general public or other users that further governmental and exempt purposes; and (3) control over major capital expenditures and dispositions. In this regard, we also highlight that neither the term of the arrangement nor the extent to which compensation is variable is necessarily an essential factor in distinguishing a management contract from other types of arrangements (other than, in the case of contract term, tax ownership).

We recommend that control over rates charged, within reasonable constraints, should be the basis of one additional safe harbor. As is discussed above, the purposes of the private activity bond rules is focused on whether arrangements have the potential to transfer financial benefit, and control over rates is the factor most directly related to the financial operation of a facility. Also, the existing regulations indicate that control over rates may be a particularly important factor.

9. Additional safe harbors should consider providing more flexible treatment for facilities available for use by the general public.

The existing regulations provide for more flexible private business use rules for facilities "available for use by the general public" in a number of respects. For example, in the case of facilities available for use by the general public, private business use is established only on the basis of contract rights, not on the basis of special economic benefit alone, but provide that special economic benefit alone can give rise to private business use in the case of facilities not available for use by the general public.[36] Also the exceptions for short-term use arrangements are more flexible for facilities available for general public use than for other types of facilities.[37]

We suggest that this general rule be taken into account in the framing of additional management contract safe harbors. First, we expect that the majority of tax-exempt bond facilities

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[36] Treas. Reg. § 1.141-3(b)(7).
[37] Treas. Reg. § 1.141-3(c).

subject to longer-term management contracts under new safe harbors would be facilities available for general public use (such as infrastructure facilities). Second, we recommend that somewhat more flexible control factors should apply to the safe harbors for facilities available for general public use than for other types of facilities.

In this light, we also recommend one or more additional safe harbors be adopted based on control factors that do not necessarily require direct control of rates charged, at least in certain circumstances. One reasonable approach would be to provide that, in the case of a facility available for use by the general public, direct control of rates charged would not be required, provided that the qualified user retains the contractual rights to: (a) control major dispositions and additions to the financed facility; (b) determine the general scope and nature of the use of the project by the general public, in particular to assure the continued availability of the facility for use by the general public; and (c) require that rates charged be within a range that is reasonable and customary and to determine whether the rates charged are generally applicable and uniformly applied within the meaning of the regulations.

10. The current regulatory prohibition on management contract compensation "based, in whole or in part, on a share of net profits" should be reconsidered.

NABL believes that the rule in the existing regulations and Rev. Proc. 97-13 that a management contract generally results in private business use if it provides for "compensation based, in whole or in part, on a share of net profits from operation of the facility" has proven to be unnecessarily restrictive and difficult to apply. We also believe that this rule is conceptually inconsistent, and more restrictive, than the rules for public-private partnerships reflected in the 2015 allocation and accounting regulations. NABL acknowledges that revision of this rule would require revisions to the existing private activity bond regulations, and not only a revision of Rev. Proc. 97-13.

NABL observes that the rule as framed is literally more restrictive than a rule providing that an arrangement that results in a partnership or other "proprietary interest" for federal income tax purposes results in private business use, because the rule prohibits any compensation "based, in whole or in part" on a share of net profits. Accordingly, we emphasize that the final regulations establish a rule that may be regarded as stricter and less flexible than the "proprietary interest" rule that was widely thought to previously apply. Many different types of compensation or other arrangements can have triggers based on a share of net profits, and still not be treated as resulting in a partnership for federal tax purposes. For illustrative purposes, we discuss certain of these authorities in detail.

For example, *Rigas v. U.S.*[38] considered the proper characterization of a "Loan and Management Agreement" for servicing, management, administration and disposition services with respect to an oil and gas industry asset portfolio, including the hiring of necessary environmental

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[38] 746 F. Supp. 2d 778 (S.D. Tex. 2011). This decision was affirmed on other different, procedural grounds by the Fifth Circuit. 2012-2 U.S.T.C. 50,530 (5th Cir. 2012). We include a discussion of this decision in part because it reflects a recent assertion of the Internal Revenue Service's position that a management contract providing for payment of compensation based on a share of net profits is not necessarily, or even presumptively, properly recharacterized as resulting in a partnership or other proprietary interest.

and petroleum consultants and conducting physical inspection of assets within the portfolio between a limited partnership and the owner of the portfolio of assets. The arrangement provided that the owner would pay the limited partnership for its approved overhead expenses through a nonrecourse promissory note. In addition, the arrangement provided that owner would pay the limited partnership 20 percent of net profits as compensation for services. The arrangement took the form of a management contract and related loan arrangement. The owner retained title, ownership and exclusive control of the portfolio of assets. The taxpayers, who were limited partners of the limited partnership, sought to characterize the arrangement as a partnership for federal income tax purposes, and to recognize income from the arrangement as capital gain rather than ordinary income.

The court held that the arrangement was a service contract, not a partnership for federal income tax purposes, and expressly rejected the assertion that a sharing of net profits necessarily results in a partnership. In so holding, the court in particular emphasized the control retained by the owner of the asset portfolio. The court held that "where the putative partner does not possess an ownership interest in capital, title to the assets or the partnership, or no practical ability to control assets, a partnership is unlikely to exist."

The *Rigas* decision hinges primarily on a close consideration of control factors. The court noted that the manager "possessed a great deal of autonomy in managing the day-to-day operations of the assets portfolio."[39] The manager's responsibilities included engineering analysis, title work for assets, structuring hedging agreements, managing loan agreements, servicing bank accounts, preparing financial reports, and negotiating exits from agreements and planning all operating expenses of the venture and investments in a capital asset. The manager did not need to obtain the owner's approval to select particular properties to drill wells, as long as such decisions were within the owner's budget. The manager did not, however, have the right to increase the owner's capital commitment to a particular asset, could not enter into binding agreements in the owner's name, and could not dispose of assets without the owner's approval.

The *Rigas* decision also emphasizes that "the presence of loss sharing among partners" is "more dispositive of a partnership arrangement" than a mere sharing of net profits. Similarly, in *Estate of Smith v. Commissioner,*[40] the Eighth Circuit addressed circumstances in which an investment firm contended it was engaged in a partnership with individual investors possessing trading accounts at the firm. The firm split the profits with individual investors. Only under unusual circumstances, however, would the firm be required to cover losses on the trading accounts. The Eighth Circuit found that "such limited assumption of liability would not conclusively establish a partnership."[41]

The *Rigas* decision also sets forth a detailed discussion of other authority holding that a sharing of net profits is not necessarily indicative of a partnership arrangement. For example, in *Kessler v. Commissioner,*[42] the Tax Court held that a partnership did not result from a real estate

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[39] *Id.*

[40] 313 F.2d 724 (8th Cir. 1963).

[41] 313 F.2d at 732 *affirming* 33 T.C. 465. See also *Meagher*, discussed above, which respects the form of a management contract involving the sharing of net profits.

[42] T.C. Memo 1982-432.

arrangement in which an individual agreed to be paid 15 percent of the net profits in exchange for his management services. The Tax Court stated that the net profits was "contingent compensation" that was relatively common. See also *Kahn v. Commissioner,*[43] holding that a contingent profits interest that was subordinated to a capital owner's expenses in purchasing and liquidating assets was a fee for services.

One of the most frequently cited decisions setting forth the framework for when an arrangement will be deemed to be a partnership for federal tax purposes is *Luna v. Commissioner,*[44] which held that an arrangement under which an insurance salesman's compensation was measured in relationship to profits was not properly treated as a partnership for federal tax purposes. *Luna* sets forth the following statement of the framework:

> The following factors, none of which is conclusive, bear on the issue . . . : The agreement of the parties and their conduct in executing its terms; the contributions, if any, which each party has made to the venture; the parties' control over income and capital and the right of each to make withdrawals; whether each party was a principal and a coproprietor, sharing a mutual property interest in the net profits and having an obligation to share losses, or whether one party was the agent or employee of the other, receiving for his services contingent compensation in the form of a percentage of income; whether business was conducted in the joint names of the parties; whether the parties filed for Federal partnership returns or otherwise represented to respondent or to person with whom they dealt that they were joint venturers; whether separate books of account were maintained for the venture; and whether the parties exercised mutual control over and assumed mutual responsibilities for the enterprise.

Considered in this light, we submit that one of the conceptual problems with the rule in Treas. Reg. § 1.141-3(b)(4)(i) is that it is too exclusively focused on whether compensation is in any part based "on a share of net profits." As the foregoing authorities expressly provide, compensation based "on a share of net profits" is *not* necessarily indicative of a "proprietary interest." A test more consistent with the prevailing analogous authority would rely on a consideration and weighing of multiple factors. We acknowledge that the test for when an arrangement results in a partnership for federal tax purposes should not necessarily be exactly the same as the test for when an arrangement results in private business use. In particular, the authority concerning whether an arrangement results in a partnership for federal tax purposes is in large part concerned with ascertaining intent of the parties, which may be of lesser importance in the circumstances typically involved in the determination of private business use. We submit, however, that at least a very similar approach of weighing multiple factors, including particularly control of the uses of assets, would be more consistent with the purposes of Section 141 of the Code. Framed in this light, it is evident that an approach providing for multiple safe harbors, focusing on different factors, is appropriate.

One of the practical problems with the rule as currently framed is that there is little or no direct authority explaining what "compensation, based in whole or in part, on a share of net profits" means in this context. There is, by contrast, a substantial body of authority defining the

[43] 499 F. 2d 724 (2d Cir. 1974).
[44] 42 T.C. 1067 (1964).

circumstances under which certain types of arrangements in the form of service contracts are treated as partnerships for federal tax purposes, but it is unclear how such authority applies to the particular formulation of the final regulations.

Perhaps the greatest practical problem posed by the rule as stated is that it works to unnecessarily restrict many types of incentive compensation arrangements that serve bona fide governmental purposes. Indeed, because of the lack of clarity in the rule as currently framed, many recent private letter rulings have addressed the question of whether different types of compensation arrangements could be characterized as based, in whole or in part, on a share of net profits.[45]

11. Anti-abuse provisions in the existing regulations provide an acceptable standard for one element of new safe harbors.

As is set forth above, NABL recommends that the rules for management contracts be amplified in a manner that focuses on the underlying purposes of Section 141 of the Code. The general statement of purpose set forth in Treas. Reg. § 1.141-2(a) is further explicated in the "anti-abuse" provisions set forth in Treas. Reg. § 1.141-14. These anti-abuse provisions generally provide that the Commissioner may take any action to reflect the substance of a transaction "[i]f an issuer enters into a transaction or series of transactions with respect to one or more issues with a principal purpose of transferring to nongovernmental persons (other than as members of the general public) significant benefits of tax-exempt financing in a manner that is inconsistent with the purposes of Section 141."

We highlight in particular that the examples to the anti-abuse provisions illustrate that the standard for what is meant by "transferring significant benefits of tax-exempt financing" is entering into an arrangement with a nongovernmental person that provides for payments, or economic benefits, directly based on the actual amounts paid as tax-exempt interest. *Example 1* in Treas. Reg. § 1.141-14(b) describes a situation where a city issues $20 million of bonds intended to be tax-exempt for the stated purpose of financing improvements to roads that it owns. As a part of the same plan of financing, however, the city also agrees to make a loan to a corporation from its general revenues that it otherwise would have used for road improvements. The example states that the "interest rate on the loan corresponds to the interest rate on a portion of the issue." For that reason, the example concludes that $7 million of the proceeds of the bonds may be allocated to the financing of the loan by the Commissioner.

Example 2 in Treas. Reg § 1.141-14(b) describes a situation where a county issues $10 million of bonds intended to be tax-exempt to finance the purchase of land with the reasonable expectation that it will be the sole owner of the land. Subsequent to the date of issuance, the federal government acquires the land for $3 million in a condemnation action. The county then uses the $3 million received in a condemnation action to make a loan to a corporation. The example states that "the interest rate on the loan reflects the tax-exempt rate on the bonds and thus is substantially less than a current market rate." For that reason, the example concludes that the Commissioner may treat the $3 million as proceeds of the bonds, even though such treatment would not otherwise be required by the regulations.

[45] See, e.g., PLR 201338031 and PLR 201338026.

Example 3 of Treas. Reg. § 1.141-14(b) describes a situation where a city issues tax-exempt bonds with a 30-year term to finance the acquisition of an industrial building having a remaining life of 30 years. On the date of issuance of the bonds, the city leases the building to a corporation for three years. It is reasonably expected that the fair rental value of the building will be substantially greater in early years of the term of the bonds rather than in later years. The example states that the "annual rental payments are significantly less than fair market value, reflecting the interest rate on the bonds." The present value of the rental payments is approximately 25 percent of the debt service on the issue. For that reason, the example concludes that the amount of "private business use" may be measured on a different basis than an annual basis averaged over the term of the bond issue.

Examples 5 and 6 of Treas. Reg. § 1.141-14(a) describe a situation where a city acquires an electric generating facility with an economic life of more than 40 years and enters into a 30-year take or pay contract to sell 30 percent of the available output to an investor-owned utility. The city plans to use the remaining 70 percent for its own governmental purposes. To finance the entire cost of the facility, the city issues $30 million of taxable bonds and $70 million of bonds intended to be tax-exempt. The city allocates all of the private business use resulting from the contract with the investor-owned utility to the taxable bonds, and all of its own use of the facility to the $70 million bonds intended to be tax-exempt.

In *Example 5* the taxable bonds have earlier maturities (resulting in a weighted average maturity of 15 years) and the bonds intended to be tax-exempt have later maturities (resulting in a weighted average maturity of 26 years). In that example, the payments of the investor-owned utility under the take or pay contract are "expressly determined by reference to 30 percent of . . . total costs (that is, the sum of debt service required to be paid on both [the taxable bonds and the bonds intended to be tax-exempt] and all other operating costs." Because of the longer-term of the bonds intended to be tax-exempt, the investor-owned utility accordingly would make payments for a substantial period of time based on the tax-exempt rate of the city's bonds. For that reason, the example concludes that the Commissioner could allocate private business use on a pro rata basis, and treat the $70 million bonds as meeting the private business use test.

In *Example 6*, however, the facts are changed in different ways that permit a conclusion that significant benefits of tax-exempt financing are not transferred to the investor-owned utility. No such benefits are treated as transferred if the payments of the investor-owned utility are based only on the debt service on the taxable bonds, or if the payments of the investor-owned utility are based exclusively on fair market value pricing. In addition, the example concludes that significant benefits of tax-exempt financing would not be treated as transferred if the taxable and tax-exempt bonds had equivalent weighted average maturities and the city and the investor-owned utility entered into a customary contract providing for payments based on a ratable share of debt service.

This anti-abuse rule, and these examples, provide an acceptable framework for a standard in a new management contract safe harbor requiring that benefits of tax-exempt financing not be improperly transferred to a service provider. This standard primarily looks to whether the issuer entered into a contract directly based on the tax-exempt interest rate paid by the issuer on its tax-exempt bonds. This standard both furthers the purposes of Section 141 of the Code and would be readily administrable by the Internal Revenue Service. We emphasize that we do not propose that

a new safe harbor rely solely on the standards set forth in this anti-abuse rule; rather, this standard would serve as an additional element of new safe harbors based primarily on control relationships.

APPENDIX A
SUMMARY OF SPECIFIC RECOMMENDATIONS TO REVISE EXISTING REV. PROC. 97-13 SAFE HARBORS FOR LONGER-TERM CONTRACTS

NABL recommends that the existing safe harbors for management contracts be further expanded. NABL recommends first that the existing safe harbors for contracts having a term greater than five years should be made more flexible in a manner comparable to the additional flexibility provided in Notice 2014-67 for management contracts having a term not exceeding five years. Second, NABL recommends that the Treasury Department and the Internal Revenue Service consider additional frameworks for safe harbors that are not based on “fixed fee” limitations; such additional frameworks should be based on a reconsideration of the types of control arrangements that assure that the purposes of Section 141 will be furthered. Third, NABL recommends that the limitation set forth in the existing private activity bond regulations prohibiting management contracts “based, in whole or in part, on a share of net profits” be reconsidered, and a more flexible rule focusing on control relationships be adopted.

Our specific recommendations are as follows:

a. Expand existing safe harbors based on fixed fee compensation arrangements.

    i. Permit the 10-year and 15-year safe harbors to have a greater percentage variable compensation. For example, requiring only 25 percent fixed fee compensation for management contracts having a term not exceeding 10 years and 50 percent fixed fee compensation (not only on an annual basis) for management contracts having a term not exceeding 15 years would be a reasonable extrapolation from the new safe harbors for contracts having a term not exceeding five years set forth in Notice 2014-67.

    ii. Expressly permit contractual provisions that accommodate changes in underlying circumstances (e.g., unusual weather, significant changes in population served).

    iii. Expressly permit provisions that contemplate periodic resetting of fixed fee compensation to reflect fair market value.

    iv. Clarify and expand the rule that treats reimbursement of expenses paid by the service provider as not included in compensation; for example, clarify that this rule may be applied to reimbursement of administrative overhead expenses paid to third parties, if that reimbursement is approved by a state or federal regulatory body.

b. Establish additional more flexible safe harbors based on contractual provisions providing sufficient control by the qualified user which are not based on the “fixed fee” compensation framework.

i. Permit any management contract, without regard to length of contract term, meeting the following standards:

(1) The qualified user is treated as the "owner" of the facility for federal tax purposes, for that purpose permitting a safe harbor similar to Section 142(b)(1)(B) (lease term not more than 80 percent of reasonably expected life; service contract provider makes an irrevocable election not to claim depreciation or investment credit);

(2) The qualified user retains the right to set rates for the facility, subject to customary rate covenants to bondholders; for this purpose, covenants by the qualified user to charge reasonable and customary rates should be consistent with retention of control; and

(3) The compensation of the service provider is not based, directly or indirectly, on the tax-exempt bond interest rates paid by the qualified user. For this purpose, reference to the standard for transferring benefits of tax-exempt financing in the private activity bond anti-abuse rules should apply.

ii. Permit any management contract, without regard to length of contract term, meeting the following standards:

(1) The qualified user is treated as the "owner" of the facility for federal tax purposes (applying the safe harbor described in (i) above);

(2) The financed facility is available for general public use within the meaning of Treas. Reg. § 1.141-3;

(3) The qualified user retains the rights to control major dispositions and additions to the financed facility and determine the general scope and nature of the use of the project by the general public, and in particular to assure the continued availability of the facility for use by the general public;

(4) The qualified user retains the rights to require that rates charged be within a range that is reasonable and customary and to determine whether the rates charged are generally applicable and uniformly applied within the meaning of the regulations; and

(5) The compensation of the service provider is not based, directly or indirectly, on the tax-exempt bond interest rates paid by the qualified user. For this purpose, reference to the standard for transferring benefits of tax-exempt financing in the private activity bond anti-abuse rules should apply.

c. Establish a new safe harbor to the effect that a management contract will not be treated as a "lease" if one of the revised safe harbors for management

contracts is met and the contract does not convey to the service provider rights of a lessee under applicable state law.

Each of the foregoing recommendations could be implemented without any revision to the final regulations. NABL recommends that the standard for when management contracts give rise to private business use be reconsidered and revised, but we recommend that the implementation of the foregoing safe harbors be adopted even without revisions to the final regulations. If a revision of the final regulations is considered, NABL recommends that the private activity bond regulations and Rev. Proc. 97-13 be revised to delete the rule that a management contract generally results in private business use if compensation is based, in whole or in part, on a share of net profits, and instead substitute a rule that focuses on contractual control rights.

APPENDIX B
EXAMPLES OF MANAGEMENT CONTRACTS

Long-term service contract for sewer and wastewater district. A sewer and wastewater district serving a major portion of a metropolitan area has a governmental need for long-term planning, particularly in light of the long forward-looking planning requirements of environmental regulations. In that light, and to achieve greater efficiencies in operation, the district seeks to enter into a contract with a private corporation to operate its wastewater system. The district has financed, and expects to continue to finance, most of the capital improvements of the system with tax-exempt bonds. The operator will expend significant amounts to review, analyze and make recommendations to improve operations, and will bear the cost of restructuring of management and workforce to improve operations. The service contract has a 25-year term, and is terminable by the district, but only for cause, including failure to meet certain standards of quality of service to the public. The operator will be responsible for hiring all employees and for entering into many contracts related to operations, including contracts for electricity for the system. The district will have rights to control rates charged by the public for use of the system, the area served by the system and major capital expenditures, and to approve major contracts with vendors. The scale of operations of the system may vary from year to year depending on such factors as weather events, changes in population, and changes in industry in the area served. The district reasonably believes that a method of compensation that reasonably reflects fair market value of services is a management fee based on a fixed percentage of gross revenues of the system. The district also reasonably believes that the governmental purposes of the system are best served by providing for certain incentive payments to the service provider based on customer satisfaction. The district negotiates the service contract compensation in a manner that does not take into account the tax-exempt interest rates on its bonds.

This service contract should not be treated as giving rise to private business use of any of the district's bond-financed property, because the district retains control of the system. The results should also be the same if the service provider is entitled to obtain incentives to reduce the costs of electricity to operate the system.

Long-term management contract for operation of a hospital. A county owns and operates a hospital that is in financial distress. Major portions of the hospital have been financed with tax-exempt bonds of the county. Particularly in light of increased regulatory complexity and other significant changes in the health care industry, the county determines that it does not have the requisite expertise to operate the hospital efficiently with its own employees, and seeks to enter into a long-term contract with a private management corporation with particular expertise in the health care area. The operator will bear the cost of certain software systems to improve revenue cycle operations. The county seeks to enter into a management contract with a 25-year term. The contract is subject to termination by the county, but only for cause, including failure to meet certain quality measures relating to provision of health care. The contract provides for annual compensation to the manager which is generally based on the number of patient days served and procedures performed. In addition, the contract provides for additional compensation to the manager for providing certain services at a lower cost. The county negotiates the contract in a manner that does not take into account the tax-exempt interest rates on the county's bonds.

Under the terms of the management contract, the county retains control of rates charged to patients, provided that they are within a reasonable range of prevailing rates, and retains the right to require that certain specified health care services be provided to the public and that the hospital be available to serve the general public.

The hospital currently operates at a loss, but the county and the manager reasonably expect that, after the implementation of improved operating systems and controls, the revenues of certain departments of the hospital will exceed allocable operating expenses starting in the third year of the management contract. Because of the financial distress of the county and the hospital, a substantial percentage of the manager's management fee will be deferred, and will only be paid when and to the extent that those departments have revenues that exceed allocable expenses. The county has obtained a feasibility study based on reasonable assumptions that indicates that it is reasonably expected that all management contract fees, including deferred fees, will be paid during the 25-year term of the management contract.

This management contract should not be treated as giving rise to private business use of hospital because the county retains control of the hospital.

APPENDIX C

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