NABL: TEB Adds Exam Resolution Method.

The Internal Revenue Service (IRS) Office of Tax Exempt Bonds (TEB) has announced it will amend Internal Revenue Manual (IRM) 4.81.5 to include an additional resolution method. The additional method is available when, during an exam of a tax-exempt or tax-credit bond issue, an issuer redeems 100 percent of the outstanding principal amount of the bonds. In that case, the examiner and group manager should consider whether to close the exam without further TEB action, although there may be a referral to another IRS business unit. The memorandum communicating the new method sets out factors to be considered in making the determination to close the exam. The new resolution method is available as of October 18, 2016.

The memorandum is available here.

TAX - KENTUCKY

Wilgreens, LLC v. O'Neill

Court of Appeals of Kentucky - September 23, 2016 - S.W.3d - 2016 WL 5319593

Taxpayer appealed determination of the Board of Tax Appeals upholding county property valuation administrator's property tax assessment on commercial real property, asserting administrator overvalued property under income generation approach by including income generated under commercial lease.

The Circuit Court affirmed. Taxpayer appealed.

The Court of Appeals held that:

- Taxpayer failed to present evidence demonstrating that property tax assessment overvalued property, and
- Property tax assessment under income generation approach, which included rental payments, was reasonable and did not overvalue property.

Taxpayer failed to present evidence demonstrating that property tax assessment by county property valuation administrator overvalued property by using income generation approach for estimating fair cash value, which required consideration of present value of all future benefits, including net rental income generated under triple net lease for retail pharmacy that encumbered property, and thus assessment's prima facie validity was required to be upheld, though taxpayer asserted income from lease was above-the-market. Taxpayer attempted to show property was overvalued by relying on properties very different from the subject property, as none of the allegedly comparable properties were located on same major throughway or anywhere similar.

Property tax assessment of commercial property by county property valuation administrator under

income generation approach for estimating fair cash value, which required consideration of present value of all future benefits, including net rental income generated under triple net lease for retail pharmacy that encumbered property, was reasonable and did not overvalue property, though taxpayer asserted lease was above-the-market; lease was part of property, property was capable of generating kind of income derived under lease with or without retail pharmacy by virtue of its location on major throughway, several properties located in same area, such as national grocery store chain, generated similar benefits for their owners, and fact that property was able to generate such income made it more valuable.

Muni Pros Bemoan Lack of Detail in Tax Plans for Infrastructure, Muni Exemption.

WASHINGTON – As the presidential campaigns have become increasingly focused on personality and name calling, municipal finance pros are begging for more defined infrastructure spending plans and clarity on how the muni tax exemption will fare in the event of tax reform.

The Tax Foundation, in what may be its final evaluation] before Election Day, released its latest report, estimating Hillary Clinton's proposed tax plan would increase federal tax revenue by $1.4 trillion over the next decade.

But in the eight-page report, the think tank said that Clinton proposed several tax policies without indicating exactly how they would work, a criticism that has been made of both candidates.

"Because campaigns are not in the business of crafting legislative language, it is often the case that many proposals are too vague to model precisely," the report read. "As a result, it is necessary to make assumptions about how campaign proposals would operate."

In its report released on Oct. 12, the Tax Foundation said Clinton's plan would increase federal tax revenue by $1.4 trillion over the next decade on a static basis and $663 billion after accounting for the smaller economy and narrower tax base it would create.

The report is an update from the group's January analysis of the Clinton plan. The most recent report accounted for new policies the Democratic nominee introduced, which the Tax Foundation said "significantly" impacted its growth and revenue estimates. These included a 28% limit on the tax benefit from specified deductions and exclusions, leaving the muni exemption standing in question.

The Tax Foundation's January analysis assumed the 28% cap would only apply to itemized deductions but that the limitation would be identical to the cap President Obama has proposed in his last several budget requests.

Mike Nicholas, chief executive officer of Bond Dealers of America, stressed the importance of tax-exempts for infrastructure as uncertainty over the muni exemption lingers.

"If a concern of either candidate is in reducing fiscal burdens on localities, while simultaneously rebuilding the nation's infrastructure and putting people back to work, then maintaining the tax exemption should be of paramount importance," Nicholas said. "It is our hope that this tool is not compromised by placing any cap or limit on the value of the tax exemption."

Tax Foundation director of federal projects Kyle Pomerleau, who compiled the report, said most of

the revenue gain is due to increased individual income tax revenue that the group projected to create roughly $817 billion over the next decade. Clinton's proposed estate tax changes will raise an additional $310 billion over the next decade, while increased corporate and payroll taxes would account for $300 billion in revenue, the group said.

The $1.4 trillion projection is in line with a Clinton plan estimate released this month by the Tax Policy Center, which also projected an additional $2.7 trillion in raised revenue over years 11-to-20 of implementation.

TPC also estimated that Donald Trump's plan would increase the federal debt by $7.2 trillion, which the Republican took exception to, calling it a "fraudulent analysis."

Trump's revised plan included reduced marginal tax rates and increased standard deduction amounts but lacked many "important details," TPC said, leaving analysts to make many assumptions.

Late last month, the Tax Foundation released an updated analysis of Trump's plan – which would reduce the current individual income tax brackets to three from seven with a 33% top rate. The planwould also reduce the corporate rate to 15% from 35%. The Tax Foundation analysis estimated Trump's plan would reduce federal revenues by $11.98 trillion over the next decade.

Many muni participants have pegged 2017 as the year for long-awaited tax reform legislation, leaving some eager for more detailed proposals as the presidential election nears.

Frank Shafroth, the director of the Center for State and Local Government Leadership at George Mason University, said Monday that estimates can be made with the plans in their current forms, but more detail would be welcome.

"It clearly makes it harder," Shafroth said. "But you get a general idea. The mainstream organizations that have evaluated Trumps plan have said would it would increase the debt and deficit. There's some consensus that the Clinton plan would modestly reduce the deficit."

He called the Trump plan a "double whammy" in its current form due to the fact that it would substantially lower rates and enhancing the benefits from capital gains. This could discourage investment in munis, he said.

The U.S. Conference of Mayors earlier this month called on both candidates to maintain the tax-exempt standing of munis in their tax plans or risk costing cities billions of dollars. Should the incoming president cap the muni exemption at 28%, as President Obama has proposed in his last several budget requests, cities would see roughly $200 billion in additional costs.

Should the exemption be removed entirely, the group said that figure could balloon to $500 billion and prohibit cities from making much-needed investments in infrastructure. Nicholas also stressed the economic effects of any limit or removal.

"We would hope that [Trump] views tax-exempt municipal bonds as a proven, economically efficient solution to the U.S. infrastructure problem," Nicholas said. "BDA urges both candidates to avoid eliminating or placing an unnecessary limit or cap on the value of the municipal bond interest exemption and we look forward to learning more about their individual tax plans in the coming days leading up to the election."

Using figures provided by the Tax Foundation and the Tax Policy Center, the Committee for a Responsible Federal Budget (CRFB) estimated that Clinton's infrastructure spending could cost up to $300 billion, while Trump's could cost between $500 and $600 billion.

Clinton has proposed allocating $25 billion to direct public investment as well as $25 billion to a new national infrastructure bank that would be leveraged to support additional loans as well as Build America Bonds, which would be renewed and expanded under her plan.

Still, CRFB said that both proposals lack the infrastructure spending details needed to make anything beyond a preliminary cost estimate, especially Trump's, which it said is "assumed to be insignificant." Trump's estimate was based on statements he made planning to double the cost of Clinton's infrastructure plan.

The Bond Buyer

By Evan Fallor

October 17, 2016

More on Rev. Proc. 2016-44: What Light Is Shed on Net Profits Compensation?

As reported several times in this blog (here, here, and here), Rev. Proc. 2016-44 significantly expands the opportunities for management/service contracts that don't result in private business use. One such post was Joel Swearingen's very thoughtful piece on the future of the facts and circumstances test as applied to these contracts (here). Of course, Rev. Proc. 2016-44 retains the prohibition against any portion of the manager's compensation being based on net profits, as that rule is set forth in the Treasury Regulations (specifically Treas. Reg. 1.141-3(b)(4)(iv)), so the IRS cannot override that rule through a Revenue Procedure. Unfortunately, in restating this prohibition, the IRS has muddied the water as to its boundaries, creating potential need for application of the facts and circumstances test. Please read on for a discussion of the questions that have been created.

Rev. Proc. 97-13 states the net profits prohibition very simply: "The contract must provide for reasonable compensation for services rendered with no compensation based, in whole or in part, on a share of net profits from the operation of the facility." Section 5.02(1). It then states that the compensation arrangements specifically authorized in 97-13 – percentage of gross revenues or expenses, capitation fee and per-unit fee – are not based on net profits.

In contrast, Rev. Proc. 2016-44 expands the discussion of a net profits arrangement, including the following:

> The contract must not provide to the service provider a share of net profits from the operation of the managed property. Compensation to the service provider will not be treated as providing a share of net profits if no element of the compensation takes into account, or is contingent upon, either the managed property's net profits or both the managed property's revenues and expenses for any fiscal period. For this purpose, the elements of the compensation are ***the eligibility for, the amount of, and the timing of the payment of the compensation."***

Section 5.02(2) (emphasis added).

Prior to the issuance of 2016-44, the IRS issued several private letter rulings applying the facts and circumstances test to conclude that the management fee described in the ruling did not violate the net profits prohibition. In one such ruling, the contract permitted the qualified user to defer paying a stated dollar amount of a fixed periodic management fee and the full amount of a productivity reward to the service provider if net cash flow was insufficient, after taking into account a payment to the qualified user, to pay those fees. Ltr. Rul. 200222006 (Feb. 19, 2002). Any deferred compensation was payable when cash flow was sufficient to make the payment or, at the latest, upon expiration or earlier termination of the contract. In ruling that the contract did not create private business use, based on the facts and circumstances test, the IRS reasoned as follows:

> The Owner's right to defer a stated dollar amount that represents a portion of the management fee and the full amount of the productivity reward (the 'deferred fees') under the circumstances presented raises the issue of whether the these fees are based on a share of Hotel net profits. Although the timing of payment of the deferred fees is based on Hotel net profits and, therefore, indicates private business use of the Hotel by Manager, we think that the circumstances support a conclusion otherwise. The full amount of all deferred fees will be payable regardless of the existence and amount of net profits when the Management Contract expires or is terminated. In addition, the deferrable portion of the management fee is a stated dollar amount and is not, itself, a percentage of Hotel net profits. The productivity reward is analogous to the productivity reward approved by Rev. Proc. 97-13, 5.02(3) because it is to be made only once and is based on an increase in gross revenues for a period specified in the Management Contract. Finally, the feasibility study projects that no deferrals will occur. Thus, although the deferred elements of the Manager's compensation do not satisfy the requirements of Rev. Proc. 97-13, 5.03(1), on balance, these deferred elements do not indicate private business use under 1.141-3(b)(4)."

In a later ruling, the IRS addressed a compensation arrangement that included an incentive fee that was payable only if three tests were met, one of which required that the manager "meet a stated net operating surplus/deficit level for the applicable fiscal year that is established in advance of each fiscal year of the term of the Management Contract in the approved budget for such fiscal year." Ltr. Rul. 201145005 (Aug. 4, 2011). Only if all three tests were met, the manager was entitled to a set incentive fee; the fee did not vary based on the level of the surplus/deficit. In its analysis, the IRS first stated that the contract did not meet the requirements of 97-13. However, it then applied a facts and circumstances analysis to conclude that the contract did not result in private business use. While its reasoning isn't entirely clear, the IRS appears to have concluded that the provision described above did not result in compensation based on net profits because the incentive payment did not vary based on the level of surplus or deficit.

While these rulings provide authoritative guidance only to the issuers receiving them, bond counsel regularly study these rulings and interpret the underlying law and regulations with these rulings in mind. As a practical matter, bond counsel have no choice but to place some importance on letter rulings given the dearth of authority in the tax-exempt bond area.

The question that bond counsel now face is whether Rev. Proc. 2016-44 backtracks from these favorable conclusions. As quoted above, 2016-44 states that a compensation arrangement does not violate the net profits prohibition if no "element" of the compensation takes into account, or is contingent upon, the managed property's net profits. And for this purpose, 2016-44 states that the elements of the compensation are the ***eligibility for*** (arguably violated in Ltr. Rul. 201145005), the amount of, and the ***timing of*** (almost certainly violated in Ltr. Rul. 200222006) the payment of the

compensation.

Was it the IRS's intent in Rev. Proc. 2016-44 to signal a reversal of the above letter rulings? While this would be a plausible conclusion, I do not believe it is warranted. It appears that Treasury was reflecting its knowledge and experience gained in addressing various compensation arrangements in the ruling context, and that it sought in 2016-44 to make clear, if it was not clear already, that provisions of the sort addressed in the above rulings disqualify the contract from the safe harbor. Exclusion from the safe harbor of contracts where eligibility for, or timing of, compensation is contingent upon sufficient net cash flow is consistent with the position of the IRS expressed in these rulings, where the IRS applied a facts and circumstances test. Whether those contracts give rise to private business use depends now, as it did before, on the facts and circumstances test. So, just as the compensation provisions addressed in the above pre-2016-44 rulings, taken in the overall context of the respective contract, did not violate the net profits prohibition under a facts and circumstances analysis, the same conclusion should be reached under the facts and circumstances test of Rev. Proc. 2016-44.

Squire Patton Boggs

by Robert J. Eidnier

USA October 7 2016

TAX - CALIFORNIA

Covarrubias v. Cohen

Court of Appeal, Third District, California - October 7, 2016 - Cal.Rptr.3d - 2016 WL 5864578

City residents petitioned for writ of mandate to compel Director of the Department of Finance, the state Controller, city, and county auditor-controller to continue payments of set-asides from "tax increment" to city's subsidized housing fund.

The Superior Court denied petition. Residents appealed.

The Court of Appeal held that:

- City's set-asides for future affordable housing payments were not "deferred" payments that remained enforceable after the dissolution of the redevelopment agency, and
- City's set-asides for future affordable housing payments were not "obligations imposed by state law" that remained enforceable after the dissolution of the redevelopment agency.

TAX - CALIFORNIA

City of San Diego v. San Diegans for Open Government

Court of Appeal, Fourth District, Division 1, California - September 22, 2016 - Cal.Rptr.3d - 2016 WL 5231822

City filed validation action regarding the city's plan to levy a special tax. A suspended corporation filed a verified answer. After the corporation was revived, the Superior Court issued a ruling validating the special tax.

Corporation appealed, and the Court of Appeal reversed and remanded with directions to enter judgment in favor of the corporation. The Superior Court denied validation and partially granted corporation's attorney fee motion. City appealed.

The Court of Appeal held that on issue of first impression, private attorney general fees could not be awarded to a suspended corporation that was not revived before the expiration of the deadline to appear in the validation action.

Private attorney general fees could not be awarded to a corporation that was suspended when it filed an answer in a validation action, where both the corporation and its attorney knew the corporation was suspended, the corporation was not revived before the expiration of the deadline to appear in the validation action, and the corporation did not explain what additional benefit it provided in the matter in light of the fact that another objector had already appeared and was protecting the public interest.

IRS Requests Comments on Tax-Exempt Bond Forms.

The IRS has requested public comment on Forms 8038, 8038-G, and 8038-GC, information returns for tax-exempt bond issues; comments are due by December 12, 2016.

Read the RFC.

IRS PLR: Organization Is Instrumentality of State Political Subdivisons.

The IRS ruled that an organization that is a consolidated department of all incorporated cities in a state is a wholly owned instrumentality of political subdivisions of the state and, thus, contributions to the organization may be deductible under section 170(c)(1).

Read the Private Letter Ruling.

California Cities Seek Record Tax Hikes as Boom Passes By.

California's booming, yet many of its cities aren't feeling it.

From Yreka, near the Oregon border, to El Centro, just north of Mexico, more than 80 local governments are asking voters next month to approve sales-tax increases, the most on record. While some aim to boost spending on roads or other projects, most measures would just provide extra cash. In Ridgecrest, Fairfax, and Fountain Valley, officials say the revenue would eliminate budget deficits or prevent cuts to police and fire departments.

The governments' revenues aren't keeping up with rising expenses, including for employee pensions, despite the thriving technology industry, home-price gains and rapid economic growth in much of the state. That's due in part to the landmark property-tax limits California voters approved almost four decades ago that have prevented municipalities from reaping windfalls as the housing market rebounded from last decade's crash.

“Like a lot of mid-sized communities in California, we are struggling with staffing our essential services,” said Brent Weaver, vice mayor of Redding, which is seeking an increase in the sales tax so it can hire more police. “We have been really struggling the last several years trying to grow our economy.”

The proposals are timed to coincide with the presidential election, which will increase voter turnout in a state divided between the Democrat-heavy coast and the less-populous Republican interior. On Nov. 8, Californians will decide 427 local measures authorizing taxes and bond issues, almost twice the 240 on ballots four years ago, according to a report by Michael Coleman, the fiscal policy adviser for the League of California Cities.

California’s local governments have turned increasingly to sales taxes since the passage of Proposition 13 in 1978 capped how much they can raise from homeowners. At the same time, services — which have helped drive the economy — generally aren’t taxed. Another impediment: the state in 2012 dissolved redevelopment agencies that cities had previously used to finance infrastructure projects.

The lingering financial pressure stands in contrast to the overall state, whose government has seen once chronic deficits disappear as the economy revived. California’s gross domestic product grew by 4.1 percent in 2015, more than any other state but Oregon, which expanded at the same pace, according to the U.S. Bureau of Economic Analysis.

Welcoming the fiscal turnaround, investors have pushed the yield on California’s 10-year bonds to just 0.22 percentage point more than top-rated debt, down from as much as 0.67 percentage point in 2013, according to data compiled by Bloomberg.

Localities “can’t fully enjoy the benefits of economic growth because they’re limited in one of their major sources of revenue,” said Howard Cure, head of municipal research in New York at Evercore Wealth Management, which oversees $6.3 billion of investments. “They’re feeling a certain pinch.”

Los Angeles County, Orange County, San Francisco and 60 other cities are among the local governments pushing for higher sales taxes, according to a report by the California Taxpayers Association. Nine cities are seeking the cash for a specific function, which require the approval of two-thirds of the electorate. The rest need support of a majority because the money isn’t being tied to a particular goal. Some campaigns say the effect on taxpayers will be softened because the state’s sales tax will decline by 0.25 percentage points in January, when a temporary increase is set to expire.

Retirement costs are a major reason for rising expenses. Among the cities with tax-increase measures, almost four dozen are expected to see double-digit percentage jumps in their annual pension bills by 2020, according to data compiled by Marc Joffe, research director at the California Policy Center, a nonprofit that has criticized public pensions. That’s assuming the state’s investments return 7.5 percent annually, a target it hasn’t hit in the past two years.

In Redding, pension bills are just one of the burdens facing the community with 92,000 residents more than 200 miles north of San Francisco. Its retirement contributions are slated to rise by almost 55 percent to $25.5 million by fiscal 2019-2020.

The city has reduced its police force to about 98 officers from more than 120 before the recession, said Weaver, the vice mayor. That has led to an increase in emergency call response times, he said. If voters sign off, the additional proceeds would be used to hire 33 officers and 10 firefighters, he said.

For Colusa, a farming community of about 6,000 residents 100 miles to the south, a sales-tax increase could help stave off insolvency. The city has drawn down its savings, said Randy Dunn, fire chief and interim city manager, and employment costs are rising. Federal grants are disappearing, as well as revenue tied to Indian casinos. Its projected 2020 pension contribution will rise 62 percent to $636,000.

“At this rate, we’re going to deplete reserves,” he said. “In about four years, we’re looking at a serious possibility of a bankruptcy.”

Bloomberg Markets

by Romy Varghese

October 13, 2016 — 2:00 AM PDT Updated on October 13, 2016 — 11:03 AM PDT

TAX - WASHINGTON

City of Spokane v. Horton

Court of Appeals of Washington, Division 3 - September 22, 2016 - P.3d - 2016 WL 5342591

City brought mandamus action against county assessor, county treasurer, and Department of Revenue (DOR), seeking to compel county to implement ordinance which would provide certain disabled or low-income citizens with real property tax exemption.

The Spokane Superior Court granted mandamus relief. Assessor, treasurer, and DOR appealed.

The Court of Appeals held that:

- Section of state constitution allowing legislature to grant property tax exemption to retired property owners does not grant authority to legislature to confer authority on municipal corporations to grant same exception, and
- City’s statutory power to assess and collect taxes did not provide authority for ordinance.

City’s statutory power to assess and collect taxes did not provide authority for city ordinance granting real property tax exemption to low-income seniors, persons with permanent disabilities, and disabled veterans. State constitution prohibited municipalities from assessing and collecting nonuniform taxes, and legislature explicitly qualified statutory taxing power with the caveat that such power was subject to constitutional limitations.

TAX - NORTH CAROLINA

Henkel v. Triangle Homes, Inc.

Court of Appeals of North Carolina - September 20, 2016 - S.E.2d - 2016 WL 5076152

Purchaser at federal tax lien foreclosure sale brought action to quiet title to the property after upset bidder at village’s prior tax foreclosure sale recorded commissioner’s deed to the property.

The Superior Court quiet title in purchaser, and upset bidder appealed.

The Court of Appeals held that federal tax lien foreclosure sale purchaser had title to property.

Claim to parcel by holder of quitclaim deed issued following upset bid at village's tax sale was subordinate to federal tax sale purchaser's claim to the property based on superior federal tax lien such that recordation statute did not apply and federal tax sale purchaser had title to property. As village's foreclosure action and sale violated federal law by failing to provide notice to United States or join it as a party and occurred prior to the federal tax lien foreclosure sale, quitclaim deed was conveyed subject to the federal tax lien, and quitclaim deed holder was put on notice of the federal tax lien foreclosure sale but failed to redeem the parcel from the federal tax foreclosure sale within 180 days.

NABL: TEB Releases Work Plan for FY 2017.

The Internal Revenue Service (IRS) Tax Exempt and Government Entities (TE/GE) Division, including the Office of Tax-Exempt Bonds (TEB), has released its work plan for fiscal year (FY) 2017. TEB's highest priority examination cases are claims and returns that have been identified because of evidence of noncompliance, such as referrals. TEB receives two types of claims: claims for a return of an overpayment of rebate and claims for direct pay bonds. In FY 2016, TEB revised its direct pay bond refund process, and as a result, in FY 2017, TEB expects to receive fewer direct pay bond referrals, but these referrals will be returns that likely have a higher risk of noncompliance than found generally in returns referred under the prior process. The next priority is returns having issues for which past information, including past examinations and VCAPs, indicate a higher risk of noncompliance. This initiative began in FY 2016 and includes examinations of returns for prison financings and small issue bonds. TEB will also devote resources to identifying new issues and fact patterns with a higher risk of noncompliance, and developing methods to find these new issues. TEB will use methods, including market scans and data analytics, to identify new areas of noncompliance for examination.

The IRS TE/GE work plan is available here (note that the TEB section begins on page 21).

NABL: Ohio Senators Oppose Political Subdivision Regs.

Senators Rob Portman (R-OH) and Sherrod Brown (D-OH) sent a letter to Internal Revenue Service (IRS) Commissioner Koskinen, opposing the current form of the IRS proposed political subdivision regulations (REG-129067-15). The senators expressed concern that the definition is overly broad and risks denying tax exempt financing to "valid and vital political subdivisions" such as sewer districts, port authorities and airport authorities. The senators specifically point to the government control test's application to multi-jurisdictional entities and to the replacement of the private activity tests in section 141 with a "vague and malleable public purpose standard."

The letter is available here.

Just in Case You Didn't Notice – Rev. Proc. 2016-44 Treats as Compensation under a Management Contract the Reimbursement of Amounts Paid by the Manager to its Employees.

Revenue Procedure 2016-44 is laudable because it significantly expands the scope of management contracts that can satisfy the safe harbor from private business use of facilities financed with proceeds of tax-advantaged bonds. It also makes much more feasible the use of tax-advantaged bonds in public-private partnership arrangements. Revenue Procedure 2016-44 does, however, effect one curious change of uncertain implication from its predecessor, Revenue Procedure 97-13.

The management contract safe harbors set forth in Revenue Procedure 97-13 provide that the reimbursement by the "qualified user"[1] of direct expenses paid by the manager to unrelated parties is not treated as compensation of the manager under the management contract. Consequently, such expense reimbursement is not taken into account in determining whether the management contract satisfies a Revenue Procedure 97-13 safe harbor from private business use. The Internal Revenue Service held in Private Letter Ruling 200222006 (Feb. 19, 2002) and Private Letter Ruling 201145005 (Aug. 4, 2011) that the payment of compensation by the manager to its non-executive employees (in the case of the former private letter ruling) and to its employees that do not have an ownership interest in the manager entity (in the case of the latter ruling) was the payment of direct expenses to unrelated parties, the reimbursement of which would not be considered compensation under Revenue Procedure 97-13.

Revenue Procedure 2016-44 changes this result. The reasons for, and implications of, this change are not immediately evident.

Under Revenue Procedure 2016-44, a manager is treated as receiving compensation from the qualified user if the qualified user reimburses the actual and direct expenses (and related administrative overhead expenses) paid by the manager. Revenue Procedure 2016-44 further provides that the reimbursement of actual and direct expenses paid by the manager to unrelated parties is disregarded as compensation for purposes of determining whether the management contract attempts an impermissible sharing of net profits of the bond-financed facility through the payment of compensation that takes into account both the revenues and expenses of the managed facility. However, in direct contrast to Revenue Procedure 97-13, as interpreted by Private Letter Rulings 200222006 and 201145005, Revenue Procedure 2016-44 expressly provides that an employee of the manager is not an unrelated party to the manager.

If the reimbursement of the manager's employee compensation expenses constitutes compensation under the management contract, does this mean that in the not-uncommon arrangement where a manager receives a percentage of the managed facility's gross revenues and is reimbursed for its employee expenses the manager obtains a share of the net profits of the managed facility, which would result in private business use of the tax-advantaged bonds that financed the managed facility? This would be a bizarre result, as illustrated by the following examples.

Assume that a manager contracts with a qualified user to provide counseling services in the qualified user's tax-advantaged bond-financed facility. Assume further that (i) employee compensation is the sole variable expense of the managed facility, (ii) the manager is paid 100% of the facility's gross revenues and is reimbursed for the compensation it pays its employees, and (iii) the management contract otherwise satisfies the elements of Revenue Procedure 2016-44. Under this arrangement, the manager ultimately realizes only the gross revenues, not the net profit or loss, of the managed facility. If gross revenues in a given year are $1,000,000 and the compensation paid to the manager's employees is $500,000, the manager realizes only the $1,000,000 of gross revenues, because the $500,000 of employee compensation expense reimbursement offsets the amounts paid by the manager to its employees. The same is true if the gross revenues of the managed facility are $1,000,000 and the compensation paid to the manager's employees is $1,500,000 – the reimbursement of the manager's employee compensation expense leaves the manager with the gross revenues of the managed facility and with no portion of the $500,000 loss.

Now let's assume that we are dealing with the same management contract, except that the qualified user does not reimburse the manager for the manager's employee compensation expenses. This agreement at least facially complies with Revenue Procedure 2016-44, because the only element of compensation paid to the manager is the gross revenues of the managed facility. Unlike the arrangement where the qualified user reimburses the manager's employee compensation expenses, however, the lack of such reimbursement causes the manager ultimately to realize something other than the gross revenues of the managed facility. Where the gross revenues of the facility exceed the manager's employee compensation expenses, the manager is left with the surplus (which will by definition be less than the facility's gross revenues), and where the manager's employee compensation expenses exceed the facility's gross revenues, the manager will bear the loss.

This is not to say that a management contract results in the impermissible sharing of net profits and losses of the managed facility where the manager is paid a percentage of the facility's gross revenues and is not reimbursed for its employee compensation expenses. This is instead meant to highlight the absurdity of a literal application of Revenue Procedure 2016-44 where the manager is paid a percentage of the gross revenues of the managed facility and is reimbursed for its employee compensation expenses. In such a case, the manager ultimately receives only its percentage of the gross revenues, and the cost of operating the managed facility (in other words, the entrepreneurial risk associated with the facility) remains where it should – with the qualified user.

To avoid unwarranted confusion, the IRS should amend Revenue Procedure 2016-44 so that it accords with Revenue Procedure 97-13, as interpreted by Private Letter Rulings 200222006 and 201145005, to make clear that the reimbursement of a manager's direct and actual employee compensation expense is disregarded as compensation in determining whether the manager and qualified user have entered into an arrangement to share the net profits and losses of the tax-advantaged bond-financed facility.

[1] A qualified user of tax-advantaged bond-financed facilities is any state or local governmental unit or instrumentality thereof, and, in the case of qualified 501(c)(3) bonds, a 501(c)(3) organization if the bond-financed property is not used in an unrelated trade or business of such an organization.

Squire Patton Boggs

The Public Finance Tax Blog

By Michael Cullers on September 27, 2016

Following Revenue Procedure 2016-44, Is There Still a 'Facts and Circumstances' Test for Private Business Use?

As we have discussed in previous posts (here), most practitioners treat a management contract for services at bond-financed property that does not fit within a safe harbor from private business use as giving rise to private business use of the bonds for tax purposes. However, the Treasury Regulations provide that whether or not a management contract gives rise to private business use is based on all the facts and circumstances surrounding the contract.[1] A number of IRS private letter rulings, though they technically cannot be relied on as precedent, rule that various management contracts that don't fit within a safe harbor do not give rise to private business use (discussed here).[2]

In Revenue Procedure 2016-44 (discussed here) the IRS replaced the longstanding safe harbors for

management contracts under Rev. Proc. 97-13[3] with a "one-size-fits-all" type safe harbor for all management contracts. This post will discuss the evolution of the policy behind the private business use rules and show that the relevance of the "facts and circumstances" analysis following Rev. Proc. 2016-44 may be diminished. The cause of the diminished value is attributable to the fact that Rev. Proc. 2016-44 has, in effect, imported many of the considerations that previously existed in the facts and circumstances test in the Treasury Regulations into the new safe harbor. As a result, many agreements that fail to qualify for the new safe harbor will no longer be eligible for the facts and circumstances test because the agreements convey a leasehold or ownership interest in bond-financed property (and are therefore not management contracts).

History

Prior to the first appearance of private business use safe harbors for management contracts in Rev. Proc. 82-14, , in 1978, the IRS released General Counsel Memoranda 37641 (the "**1978 Memo**") which includes a thorough discussion of the facts and circumstances that the IRS considered to be necessary for a management contract to be excluded from private business use.[4] Specifically, the 1978 Memo says the following:

> "The regulations are not clear as to the result where a bond-financed facility is owned by the political subdivision or exempt person but is operated by a nonexempt person under a contract. Obviously, the mere fact that a nonexempt person makes a profit, in his trade or business, with respect to certain aspects of bond-financed facilities, is not fatal. The architect who designs a state office building, and the contractor who constructs it, no doubt make a profit, but their activity ordinarily does not constitute a 'use' of the facility that will satisfy the 'trade or business' test. Often, bonds are issued to enable a political subdivision or exempt person to finance aspects of their governmental or exempt function. Sometimes the governmental or exempt function is carried out by way of contract with a nonexempt person who provides a commodity or service. Such arrangements do not necessarily amount to a 'use' of bond proceeds within the meaning of the 'trade or business' test. **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** . . . . 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 . . . . On the other hand, a nonexempt person that . . . 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."[5]

To determine whether a service provider is merely providing a service, or is instead operating a bond-financed facility in a proprietary capacity, the 1978 Memo instructs taxpayers to consider (i) which party controls the use of the bond-financed facility, (ii) the term of the agreement, and (iii) compensation to the provider. Look familiar?

The 1978 Memo acknowledged that a management contract could convey a proprietary interest in a bond-financed facility if, for example, the service provider uses a bond-financed facility for its own

benefit and not for the benefit of the owner of the facility. Unfortunately, there is no discussion of how to determine whether a service provider uses a bond-financed facility for its own benefit. In any event, the 1978 Memo strongly suggests that a proprietary interest is necessary for an agreement to result in private business use.

In Revenue Procedure 93-19, the IRS backed away from some of its assertions in the 1978 Memo. Likely emboldened by a 1986 acknowledgement by Congress that a management contract (as well as a lease) could result in private business use,[6] in Rev. Proc. 93-19 the IRS said that "[a] management or other service contract that gives a nongovernmental service provider a proprietary interest in the operation of a facility is not the only situation in which a contract may result in private business use of the facility."

In response to proposed private business use regulations promulgated in 1994,[7] commentators requested that the Treasury Department backtrack from the pronouncement in Rev. Proc. 93-19 and promulgate final regulations that conclude that a management contract should only give rise to private business use if it transfers a proprietary interest in financed property to the service provider. When Treasury finalized these regulations in 1997, the preamble explicitly rejected that request:

> "The final regulations . . . continue to reflect the view that Congress intended that a management contract can give rise to private business use even if it does not in substance transfer a leasehold or ownership interest to a nongovernmental person for general federal income tax purposes. Thus, the final regulations do not adopt the rule that a management contract gives rise to private business use only if it transfers a proprietary interest to a nongovernmental service provider. The final regulations provide that the determination of whether a management contract that does not meet the qualified management contract safe harbors gives rise to private business use is based on all the facts and circumstances."[8]

These 1997 regulations, read together with the 1978 Memo, make clear that a management contract can result in private business use based on all the facts and circumstances even if it (a) does not convey a proprietary interest to the service provider and (b) is not properly characterized as a lease.

Prior to Rev. Proc. 2016-44, it was much easier to identify certain management contracts that did not result in private business use based on all the facts and circumstances even though the contract did not qualify for one of the private business use safe harbors in Rev. Proc. 97-13.[9] Following Rev. Proc. 2016-44, the application of the facts and circumstances standard is significantly limited because contracts that do not fit within the Rev. Proc. 2016-44 safe harbor will often be characterized as lease agreements, which are not eligible for the fall-back facts and circumstances analysis.

Rev. Proc. 2016-44

A more comprehensive analysis of Rev. Proc. 2016-44 is here. Under Rev. Proc. 2016-44, a management contract fits within a private business use safe harbor if it meets the following criteria:

- The service provider's compensation is reasonable, and it isn't based on net losses or net profits of the bond-financed facility.
- The term of the contract is within permitted time limits.
- Control over the managed property generally remains with the owner.

- Risk of loss of the managed property generally remains with the owner.
- The service provider must take tax positions consistent with it being a manager and not a lessee of the bond-financed facility.
- There are no circumstances substantially limiting the qualified user's ability to exercise its rights.

Certain of these criteria should look familiar. For example, control over managed property and risk of loss are two of the criteria explicitly mentioned in the 1997 private business use regulations as factors that distinguish management contracts from lease agreements.[10] Put another way, a management contract that conveyed too much control or the risk of loss to the service provider is not eligible to meet the "facts and circumstances" test because it is not a management contract. Furthermore, the ability to substantially limit a qualified user's ability to exercise its rights is another form of control, so arguably failing that requirement could also cause the agreement to be considered a lease.[11]

That leaves the following facts and circumstances criteria that are not already encapsulated by Rev. Proc. 2016-44:

- Reasonable compensation (incl. no net profits or net losses)
- Term of the contract
- Consistent tax positions

Although not drafted with tax-exempt bonds in mind, Section 7701(e) provides certain relevant criteria to distinguish a lease from a management contract. One of those criteria is whether the service provider has a significant economic interest in the property. In a 2015 letter to the IRS discussing the impact of Section 141 of the Code on public/private arrangements, the ABA Taxation Section interpreted Section 7701(e) and relevant case law as standing for the proposition that a "contract should be treated as a lease (as contrasted with a mere service contract), based upon . . . the operator's ability to share in both the combined revenues and expenses of the applicable enterprise."[12]

That leaves the following facts and circumstances criteria that are not already encapsulated by Rev. Proc. 2016-44:

- Term of the contract
- Consistent tax positions

The 1978 Memo indicates that when the term of a contract is "unreasonable," the continued possession and operation of the bond-financed facility may amount to de facto control and virtual ownership regardless of any provisions in the contract that give the qualified user supervisory control. Furthermore, long-term contracts that exceed the permitted length in Rev. Proc. 2016-44 may raise an inference that the contract conveys an ownership interest in the bond-financed facility which results in private business use without regard to any facts and circumstances.[13] In addition, for qualified 501(c)(3) bonds, another byproduct of a contract term in excess of the permitted length in Rev. Proc. 2016-44 is the possibility that the contract results in a violation of the ownership requirement in Section 145(a)(1).

Finally, a management contract will not run afoul of the consistent tax position requirement if the manager agrees "not to take any depreciation or amortization, investment tax credit, or deduction for any payment as rent with respect to the managed property." To the extent that the manager fails this requirement, it is very likely that the provider's interest in the bond-financed facility is greater than that of a service provider and that the contract is not properly treated as a management contract.

In sum, Rev. Proc. 2016-44 has, in effect, swallowed up many of the considerations that previously existed in the facts and circumstances test in the Treasury Regulations, and they have been instead imported into Rev. Proc. 2016-44's bigger safe harbor.

Conclusion

Following the release of Rev. Proc. 2016-44, many of the contracts that fail to qualify for the new safe harbor will likely be considered to convey a leasehold or ownership interest in the bond-financed facility for federal income tax purposes. Because agreements that convey a leasehold interest or an ownership interest may not be excluded from private business use based on all facts and circumstances, the relevance of the facts and circumstances test is diminished (maybe significantly) by Rev. Proc. 2016-44.

[1] Treas. Reg. § 1.141-3(b)(4)(i).

[2] PLR 201228029 (although compensation was not within Original Safe Harbors, it was not based on net profits so, based on facts and circumstances, the management contract did not result in Private Business Use); PLR 201145005 (although the term of the agreement exceeded what was permitted to qualify for the Original Safe Harbors, based on facts and circumstances, the management contract did not result in Private Business Use); PLR 200813016 (although compensation was not within Original Safe Harbors, it was not based on net profits so, based on facts and circumstances, the management contract did not result in Private Business Use); PLR 200330010; PLR 200222006

[3] As amplified by Rev. Proc. 2001-39 and Notice 2014-67 discussed here and here.

[4] The "facts and circumstances" test was not included in the Treasury Regulations until the Final Regulations (defined herein) were promulgated in 1997. Practically speaking, as illustrated in the detailed factual analysis in the 1978 Memo, even before the facts and circumstances test appeared in the Treasury Regulations, the IRS has always applied it.

[5] Emphasis added.

[6] Conference Report for the Tax Reform Act of 1986, H.R. Conf. Rep. No. 841, 99th Cong. 2d Sess. II-687, 1986-3 (Vol. 4) C.B. 687-88.

[7] 59 FR 67658.

[8] 62 FR 2275.

[9] See footnote 2.

[10] Treas. Reg. 1.141-3(b)(3)(i) and (ii).

[11] A valid argument could be made that the ability to "substantially limit" the exercise of the owner's rights and the "control" requirement are two separate requirements; however, consider the following language in the 1978 Memo: "[This control] requirement will be met if the [qualified user] retains control or a veto power over the decisions of the management company. To effectuate this requirement there should be no common or related members of the governing body or board of directors of the [qualified user] and the manager."

[12] Available here.

[13] Treas. Reg. § 1.141-3(b)(2).

Squire Patton Boggs

The Public Finance Tax Blog

By Joel Swearingen on September 23, 2016

IRS Says Florida Jail Bonds May Be Taxable.

WASHINGTON – The Internal Revenue Service has informally advised the Baker Correctional Development Corp. in Florida that $45 million of first mortgage revenue bonds it issued in 2008 are taxable.

BCDC disclosed the IRS' stance in a material event notice posted on the Municipal Securities Rulemaking Board's EMMA website this week.

Jeffrey Cox, finance director for the Baker County Sheriff's Office, said Thursday that the IRS audit found the bonds failed to meet the private payment use test due to the jail's large federal inmate population.

"From what I can gather from speaking with the IRS and our attorneys, it's a revenue problem," Cox said.

BCDC is currently exploring options to refinance the tax-exempt bonds ahead of an IRS potential adverse determination, according to the event notice.

Because BCDC has not received anything in writing from the IRS, Cox said it does not have any definitive plans on how and when it will refinance the bonds. It is relying on communication between its attorneys and the IRS.

"From those conversations, the IRS is wanting us to pull the bonds off the market as quickly as we can," Cox said. "We've interpreted that to be 60-90 days."

As of Thursday, the Baker County Detention Center, located in Macclenny, Fla., has 480 inmates, roughly 350 of which are federal.

The detention center, which opened in Sept. 2009 and is roughly 30 miles west of Jacksonville, is owned by BCDC and operated by the Baker County Sheriff's Office. BCDC was formed as a nonprofit in 2006 to acquire, construct, maintain and/or operate one or more jails in Baker County.

Jails in border states often have contracts to house inmates from the U.S. Citizenship and Immigration Service or the U.S. Marshals Service. The U.S. Immigration and Customs Enforcement's (ICE) enforcement and removal operations division began housing detainees at Baker County Detention Center in 2009 under an intergovernmental service agreement with Baker County, according to ICE.

Tax-exempt bonds become private activity bonds if more than 10% of the proceeds are used for private use and more than 10% of the debt service payments are from or secured by private parties. Under the federal tax code, PABs are only exempt if they are issued for "qualified" purposes; jails do not fall under a qualified category.

On average, the jail is comprised of roughly 60-70% federal inmates, Cox said, making it more than six times as high as the private payment test allows. That ratio has been relatively consistent over the past six years. The federal government pays BCDC $84.72 per day for each federal inmate it houses, Cox said.

The IRS opened its audit of BCDC's bonds a little over a year ago, according to Cox.

The IRS began a widespread audit of tax-exempt bond-financed jails about three years ago, especially those that housed a large amount of federal inmates. The federal government is deemed a private entity in under the federal tax code, while state and local governments are classified as governments.

BCDC's material event notice said that the jail has cooperated in the audit and is in discussions to resolve the issues raised, but added there "can be no assurance as to the ultimate outcome."

Peter Dame, a partner at Akerman, tax counsel for BCDC, told the bondholders Tuesday in a conference call that he and the IRS have set a "joint target date" to wrap up the audit by the end of October.

"The IRS has not been confrontational about this but obviously something needs to get done to resolve their audit. I think at this point they have all the information they need," he said.

Dame said Baker is considering refunding the jail bonds with a bank loan, but no letters of interest have been sought yet. PFM has been hired to advise the issuer on the refinancing.

According to the bonds' official statement, the Series 2008 first mortgage revenue bonds were issued to finance the acquisition of roughly 90 acres of land to use as the jail site, as well as the construction of a 512-bed jail facility to house inmates, administrative offices for the Baker County Sheriff's Office. Sell & Melton in Macon, Ga., served as bond counsel for the issue and Bergen Capital, a division of Scott & Stringfellow in Hasbrouck Heights, N.J., served as underwriter.

In 2011, BCDC entered a forbearance agreement for principal payments on the $45 million bond issuance in 2008. The move came after the jail had lower-than-projected inmate counts and higher-than-expected startup costs.

The 508-bed jail was constructed after the county's existing 132-bed jail reached its capacity and was in need of replacement, according to the OS for the bonds.

The Bond Buyer

By Evan Fallor

September 29, 2016

Shelly Sigo contributed to this story.

Fitch on Dedicated Tax Bonds.

Palomar Health, CA – Impact of Pledged Special Revenue Analysis on GO Bonds

Amy Laskey, Jim LeBuhn and Tom McCormick on Monday, September 26th discussed Palomar

Health and Fitch’s views on dedicated tax bonds.

Listen to the Audio.

S&P U.S. Not-For-Profit Health Care Stand-Alone Hospital Median Financial Ratios - 2015 vs. 2014

Similar to the overall medians for stand-alone hospitals and health care systems combined, we saw stronger operating margins for stand-alone hospitals in 2015 at each rating category, offset by consistently softer non-operating revenue compared to 2014.

Continue reading.

Sep. 21, 2016

S&P U.S. Not-For-Profit Health Care System Median Financial Ratios - 2015 vs. 2014

System medians, similar to the stand-alone medians, demonstrated operating margin improvement in 2015, which when combined with softer non-operating income produced modest coverage gains in the higher rating categories, with slight declines in the lower rating categories.

Continue reading.

Sep. 21, 2016

S&P U.S. Not-For-Profit Acute Health Care Speculative Grade Median Financial Ratios.

Speculative grade ratings are defined as those rated ‘BB+’ or below. Within speculative grade, a majority of the health care organizations are rated in the ‘BB’ category with fewer in the ‘B’ and ‘CCC’ categories.

Continue reading.

Sep. 21, 2016

S&P U.S. Not-For-Profit Health Care Small Stand-Alone Hospital Median Financial Ratios.

S&P Global Ratings defines a small stand-alone acute care hospital, which is a subset of our stand-alone hospital universe, as one having net patient service revenue below $125 million.

Continue reading.

Sep. 21, 2016

S&P: U.S. Not-For-Profit Acute Health Care Ratios Are Calm On The Surface But Turbulent Underneath.

The overall financial performance of U.S. not-for-profit acute health care organizations rated by S&P Global Ratings continued the improvement we saw last year when we returned the sector outlook to stable from negative, albeit at a more reserved pace.

Continue reading.

Sep. 21, 2016

S&P U.S. Not-For-Profit Health Care Children's Hospital Median Financial Ratios.

Children’s hospital ratios are generally rated higher on the rating spectrum than stand-alone hospitals and more in line with health care systems even though most are stand-alone providers.

Continue reading.

Sep. 21, 2016

NABL: Minnesota Delegation Sends Letter to IRS on Political Subdivisions.

The members of the Minnesota congressional delegation from both parties sent a letter to Treasury Secretary Lew and Internal Revenue Service (IRS) Commissioner Koskinen, criticizing the IRS’s proposed rule on the definition of political subdivision (REG-129067-15). The delegation expressed concern that the proposed rule would affect the diverse array of entities that provide essential services to Minnesota communities. The delegation specifically pointed to the “incidental private benefit” portion of the proposed rule and the unclear provisions regarding voter control of a political subdivision, saying those provisions could bar many entities from accessing tax-exempt financing for community projects.

The letter is available here.

TAX - VIRGINIA

Miller & Rhoads Building, L.L.C. v. City of Richmond

Supreme Court of Virginia - September 15, 2016 - S.E.2d - 2016 WL 4864888

Property owner brought action against city, claiming city failed to properly calculate and apply real estate tax exemption.

The Circuit Court determined that the exemption did not apply to the special district tax. Owner appealed.

The Supreme Court of Virginia held that the special district tax was not subject to the exemption.

City's annual special district tax on building was not subject to city's real estate tax exemption, under maxim of expressio unius est exclusio alterius, where city code provision regarding special district tax made tax subject to specifically mentioned sections, and sections providing for exemption were omitted.

Try These Weird Tricks to Split a Bond Issue Into Separate Portions: Squire Patton Boggs

Many of the tax-exempt bond rules apply to an "issue" of bonds. With a few exceptions, an issue of bonds includes all bonds sold by an issuer less than 15 days apart under the same plan of financing, if the debt service on those bonds is reasonably expected to be paid from the same source of funds. If an issuer wants to keep two sets of bonds separate, the usual technique is to sell them 15 days apart. But this can expose the bonds to market movements. Where an issuer does not want to take these risks, if bonds are treated as part of the same issue under this rule, what can be done to separate them?

Issuers may want to divide a bond issue into separate portions for many reasons. The most frequently encountered reason is to allow issuers to divide an issue into bonds that have been part of an advance refunding and bonds that haven't, to simplify how the one-advance-refunding rule applies to the issue and allow the issuer to advance refund complete maturities or complete portions of maturities, as opposed to advance refunding only a portion of all of the maturities.

Issuers can use several techniques by themselves or in combination to separate an issue into separate portions for many, if not all, purposes.

First, two important notes:

1. **Designating the bonds as separate series ("Series A" and "Series B") is neither necessary nor sufficient to separate a bond issue into separate portions for tax purposes.** Giving separate names to the separate series will help everyone track the separate purposes, and will make it easier for everyone to explain the separate purposes to people (like an IRS agent) who take an interest in the bond issue after it is issued. But the tax law – not the series designation – governs whether or not an issuer can separate the bonds of the issue into different portions.
2. We're **not** talking about the question of "allocating" different sources of funds to various expenditures for a bond-financed project. Different question, different rules, different consequences.

Separate Issue Treatment under Reg. 1.150-1(c)(3). The first technique for separating an issue of bonds is contained in Reg. 1.150-1(c)(3) (incidentally the same subsection of the regulations that defines an "issue" of bonds in the first place). The issuer can allocate bonds, proceeds, and investments to "separate purposes" of the issue, which means separate loans to conduit borrowers,

refunding separate prior issues, truly separate capital projects, etc. This allocation must be made in writing on or before the issue date. (One common reason to make the separate issue election under Reg. 1.150-1(c)(3) is to facilitate compliance with the $150 million nonhospital bond limitation imposed on qualified 501(c)(3) bonds.)

Unfortunately, the Reg. 1.150-1(c)(3) election does not apply for purposes of many of the big-ticket tax-exempt bond requirements. Specifically, it does not apply for purposes of the private business use rules, the arbitrage yield restriction and rebate rules, the advance refunding rules, the rules in Code Section 144(a) regarding small issue industrial development bonds, and the hedge bond rules. For those purposes, we use another technique.

Multipurpose Issue Allocation. If an issuer needs to separate an issue of bonds into separate purposes for certain arbitrage purposes (or, more often, for purposes of the one-advance-refunding rules), then the issuer can allocate those bonds (and their proceeds and investments of those proceeds) under the terms of Reg. 1.148-9. These rules allow an issuer to split the issue into separate portions for almost all purposes of the arbitrage rules, except for calculating the yield on the bonds (with limited exceptions), calculating the rebate amount, determining the minor portion and determining the portion of the issue eligible for investment in investments that can earn arbitrage as part of a reserve fund. The separate portions must, as in the technique under Reg. 1.150-1(c)(3), correspond to truly separate purposes of the issue. The most common example is separating an issue into new money and refunding portions (typically with a separate refunding portion for each refunded prior issue), but an issuer can further subdivide the new money portion of an issue into separate new money portions if, generally, the new money projects financed are not integrated or functionally related. The multipurpose issue allocation rules generally apply for purposes of the private business use rules (see Reg. 1.141-13(d) and Reg. 1.141-13(g), Example 5) and, most importantly, the one advance refunding rule (see Reg. 1.149(d)-1).

Unlike the election under Reg. 1.150-1(c)(3), a multipurpose issue allocation "may be made at any time, but once made may not be changed." Reg. 1.148-9(h)(2)(i). But, the rule always applies, although it has no effect until the issuer/borrower makes the allocation. This is why you will often see language regarding the multipurpose issue allocation in a tax certificate that says something to the effect of "no allocation is being made at this time, but at the future option of the issuer, the issuer can make an allocation according to [x]."

Special rules apply to the refunding portion of the issue. If an issuer wants to specify certain bonds of the issue as the refunding bonds (and avoid a pro rata piece of each bond being treated as a refunding bond), then those bonds must meet one of the following requirements. First, the refunding portion must reflect aggregate debt service that is "less than, equal to, or proportionate to" the debt service on the prior issue in each bond year. This is often called the "debt service savings" test, although, as the quoted language shows, you don't have to show savings. The rationale for this requirement is not abundantly clear from the regulations or their history, but it appears to be that refunding bonds are usually issued to capture debt service savings, and, "if it looks like a duck and sounds like a duck," then it must be a duck/refunding bond.

If the "debt service savings" test cannot be met, then an issuer can specify certain bonds as the refunding bonds if the weighted average maturity of the refunding bonds has the same ratio to the remaining economic life of the refunded assets as the ratio of the weighted average maturity of the new money bonds has to the remaining economic life of the new money assets. (As you can tell from reading the previous sentence, it's difficult to rely on this test, and it's basically impossible to meet this requirement by happenstance.) Finally, if the bonds that the issuer wants to specify as the refunding bonds can't meet either of these tests, the issuer must be able to show that it cannot meet these tests because of a state law prohibition or that the bonds were issued under certain old

indentures; not that it will likely matter, but the regulations say that this one is "strictly construed." Failing that, the issuer is stuck with the conclusion that each group of substantially identical bonds (for example, bonds having the same maturity date) has a pro rata flavor swirl of the various portions of the issue. A number of other detailed rules apply to figure out the precise amount of proceeds allocated to each of the portions and to allocate common costs of the various portions among the portions.

To emphasize again, when an issuer wants to separate a bond issue into various portions, the issuer must meet the above requirements, whether or not it designates the refunding bonds as a separate series for securities purposes.

Other separation techniques exist. For example, an issuer of bonds to finance facilities that will be used in part by governmental entities and in part by 501(c)(3) organizations that are technically part of a single issue can treat them as separate issues of governmental use bonds and 501(c)(3) bonds if the separate portions, treated as separate issues, satisfy the tax-exempt bond requirements separately. The Conference Report for the Tax Reform Act of 1986 states that "the conferees intend that, where an issue consists of two components – governmental financing and qualified 501(c)(3) financing – and the two components, **viewed as separate issues**, satisfy all requirements for tax-exemption. . . ." Conf. Rpt. 99-841, at II-726. (Emphasis added.)

Below is a diagram to illustrate how some of these rules overlap, using a simple example of an issue of bonds that an issuer wants to separate into a new money portion and a refunding portion.

Click here to view the image.

Squire Patton Boggs – John W. Hutchinson

USA September 15 2016

Tax Incentive Evaluation in 2016 - in Law and Practice.

Many states have made progress in recent years toward regular, rigorous evaluations of their economic development tax incentives. In the 2016 legislative session, Alabama, Colorado, Hawaii, Virginia, and Utah enacted laws requiring regular evaluation, while several other states made progress to implement evaluation laws passed in previous years. As a result, lawmakers in numerous states will soon have evidence on the results of their incentives—information that they can use to improve the effectiveness of the programs.

Continue reading.

The Pew Charitable Trusts

September 14, 2016 | Economic Development Tax Incentives | By Josh Goodman and John Hamman

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Hawkins Advisory (Modifications to Qualified Management Contract Rules)

This issue of the Hawkins Advisory summarizes IRS Revenue Procedure 2016-44, issued on August 22, 2016. The Revenue Procedure purports to modify and supersede existing IRS safe harbors for

management contracts involving property financed with tax-exempt bond proceeds.

Read the Advisory.

9/22/2016

NASACT Responds to IRS Proposal on Amending the Definition of Political Subdivision for Municipal Bond Purposes.

Read the NASACT's letter.

IRS Requests Comments on Private Activity Bond Election Form 8328.

The IRS has asked for public comment on Form 8328, "Carryforward Election of Unused Private Activity Bond Volume Cap."

Comments are due by November 14.

Brookings Stadium Study Draws Criticisms.

WASHINGTON – A Brookings Institution study claiming professional sports stadiums built or renovated with tax-exempt bonds during the last 16 years have cost the federal government $3.7 billion has drawn some criticism from a sports consultant and municipal market participants.

The 28-page study – Tax-Exempt Municipal Bonds and the Financing of Professional Sports Stadiums – recommends that tax-exempt financing be prohibited or limited for professional sports stadiums.

The study, authored by Brookings economists Ted Gayer and Austin Drukker, as well as researcher Alexander Gold, focuses on professional football, baseball, basketball and hockey stadiums built, significantly renovated, or under construction since 2000. Of the 45 stadiums that fit this description, 36 were funded, at least in part, by tax-exempt bonds.

The total principal amount of the tax-exempt bonds used for the stadiums was $13.0 billion, according to the study.

The authors found the federal subsidies to issuers totaled $3.2 billion, based on interest rate spreads between tax-exempt and taxable bonds, at present value using a 3% discount rate and 2014 dollars. They said the federal government suffered additional revenue losses of $500 million due the "windfall tax break[s]" from the bonds for high-income earners, also assuming a 3% discount rate and 2014 dollars.

The authors claim there are no studies that provide evidence that such stadiums benefit local economies.

"The evidence for these spillover gains is weak," they said. "Academic studies consistently find no

discernible positive relationship between sports facility construction and local economic development, income growth or job creation."

But Bob Boland, with Boland Sports Practice who is also executive-in-residence and director, Master of Sports Administration and MBA/MSA dual-degree programs at Ohio University, suggested the study is flawed because it's impossible to paint sports facilities with a broad brush. Stadiums should instead be examined on a case-by-case basis, he said.

Boland said the Brookings study fails to take into account the economic development that has occurred in areas surrounding some professional sports stadiums.

He cited as an example the Verizon Center sports and entertainment arena used by the National Basketball Association's Wizards and the National Hockey League's Capitals that revitalized the Gallery Place and Chinatown areas of D.C. with many new restaurants and retail stores.

In Indianapolis, the Lucas Oil Stadium used by the National Football League's Colts and the Bankers Life Fieldhouse used by the NBA's Pacers have spurred economic development in that city's downtown area. Also, the new Yankee Stadium in New York City supported a neighborhood in the south Bronx that was starting to deteriorate, he said.

Jessica Giroux, general counsel and managing director of federal regulatory policy at Bond Dealers of America said the report ignores some of the benefits munis provide to states and localities.

"One of the most important aspects of tax-exempt bonds is that state and local governments have the ability to prioritize which projects to spend their revenue and tax dollars on without having to go through the federal process," she said. "The report ignores this aspect of tax-exempt financing and also misses the point that the true beneficiaries of the tax exemption, which are the local taxpayers who benefit from the financed projects and reduced borrowing costs associated with the usage of tax-exempt bonds to finance necessary infrastructure projects."

George Friedlander, managing director, Municipal Macro Policy and Strategy at Citigroup, Inc., said the study authors note the federal government can't control what projects get done. "They're calling that an evil, but state and local governments would call that a benefit."

Because state and local governments are spending their own money, they are more likely to finance good, he said.

Friedlander, who stressed he doesn't have a view on tax-exempt financing of stadiums, said that in his view the study is flawed in making the case for eliminating or limiting tax exemption.

"One of the things they do wrong," he said, is that they base their findings in part on the interest rate spreads between munis and corporates.

"Everyone else in the entire world, including [the Joint Committee on Taxation] has done it on a ratio basis," he said. They compare muni bond yields as a percentage of corporate bond yields.

He said that in his view the Brookings researchers should not have merely compared Moody's Investors Service's muni and corporate indices. "That doesn't tell you what a muni yield would have to be if it were taxable," he said.

The researchers, in addition to using a ratio, should have figured in at least three other factors to get an "apples-to-apples comparison," he said.

First, he said, the authors should have realized that the corporate bonds in the corporate index are typically a very large size, extremely liquid and show narrow bid/offer spreads. In contrast, the munis in the muni index, tend to be small and less liquid, with larger bid/offer spreads.

Second, "the call right has to be priced in," he said. The study looks at 20-year or longer munis and corporates. Corporates typically have "make whole calls," which discourage issuers from calling them. Munis, in contrast, have 10-year call dates, and issuers often benefit from calling the bonds.

Finally, there are more stringent disclosure requirements for corporate bonds. Investors would want a little extra yield for munis, which don't have as stringent disclosure requirements.

"In an apples-to-apples comparison the ratio would be about 71% for large issuers and 68% for small issuers," showing munis are "vastly more efficient than what [Brookings] is showing," Friedlander said. A smaller ratio means that a larger part of the benefit is going to issuers not investors, he said.

The study recommends that tax-exempt financing be prohibited or limited for professional sports stadiums.

Bonds can be eliminated, the authors said, by removing the so-called "private use test" for stadium financings, as proposed by President Obama in recent budget proposals.

"The simplest and most direct way to address this inefficient federal subsidy would be to eliminate the private payment test for sports stadiums," the study's authors said. Stadiums would never be able to meet the private use test, they said.

"An alternative approach would limit the federal tax subsidy by classifying stadium bonds as qualified private activity bonds, which would make them subject to a state-wide volume cap, place additional restrictions on their use, and allow financing of the bonds through taxes directed at the beneficiaries of the stadiums," the study said.

Currently these state volume caps equal $100 per capita or $302.88 million, whichever is greater, for each state and the District of Columbia.

According to the study, for the first half of the twentieth century, local professional sports franchises funded the construction of most stadiums, it said. The Revenue and Expenditure Control Act of 1958 restricted the projects involving private parties that could be financed with tax-exempt bonds. Under that law, bonds would be taxable if more than 25% of the proceeds were used by a private party and more than 25% of the debt was paid for or secured by a private party. But the law exempted sports stadiums from those restrictions.

The Tax Reform Act of 1986 eliminated sports stadiums from being exempt from the private use and payment tests, while also reducing those tests to 10% from 25%. But this backfired, according to the study. To be eligible for tax-exempt financing, stadium bond issues had to be structured so that no more than 10% of their debt was used or secured by private sports franchises.

"This sets up a kind of matching incentive, an 'artificial financing structure' whereby federal tax exemption is granted if the state or local government is willing to finance at least 90% of the debt service for the bonds," the study said. "Additionally, since this 90% of financing cannot come even indirectly from private activity if tax exemption is to be maintained, the state or local government cannot rely on stadium generated revenue, such as a tax on entry tickets to the stadium or event, or even rent collected from the team as tenants."

The Tax Reform Act of 1986 "effectively requires that, in order to receive the federal subsidy, a state

or local government must finance the bulk of the stadium, and it must rely on tax revenue unrelated to the stadium for the financing, such as general sales taxes, property taxes, income taxes, lotteries, or taxes on alcohol or cigarettes," the study said.

The Bond Buyer

By Lynn Hume and Evan Fallor

September 14, 2016

TAX - VERMONT

TransCanada Hydro Northeast Inc. v. Town of Rockingham

Supreme Court of Vermont - September 9, 2016 - A.3d - 2016 WL 4718020 - 2016 VT 100

Taxpayer, which was an independent wholesale power producer, sought judicial review of town board of civil authority's valuation of hydroelectric facility for property taxation purposes.

State intervened on behalf of town. Following a bench trial, the Superior Court entered judgment setting value of facility at $130,000,000. Taxpayer appealed.

The Supreme Court of Vermont held that:

- Trial court did not err in relying on debt rate proffered by town's expert appraiser, as element of discounted cash flow (DCF) method for determining fair market value of facility;
- Trial court acted within its discretion in relying on calculation of capital expenses proffered by town's expert appraiser, as element of DCF method for determining fair market value of facility;
- Trial court acted within its discretion in relying on estimate of cost of federal relicensing for facility, as element of DCF method for determining fair market value of facility;
- Record supported trial court's finding that three upward adjustments from computed average values were warranted under comparable sale method for determining fair market value of facility; and
- Offer and sale announcement of other hydroelectric facilities were not reliable evidence of fair market value, and thus could not be used in comparable sale method for determining fair market value of facility.

Trial court did not err in relying on 6% debt rate proffered by town's expert appraiser as appropriate calculation of debt-rate element of discounted cash flow method for determining fair market value of taxpayer's hydroelectric facility for property tax purposes, though taxpayer asserted 6% rate was below-market debt rate. Expert calculated 6% debt rate based on taxpayer's own reported debt payments as well as those made by similar corporations, taxpayer did not demonstrate that expert's debt rate was invalid and failed to produce data to contradict calculation, and trial court found that expert was able to demonstrate market basis for his debt rate, which it found to represent sound estimates and valid inputs.

Trial court acted within its discretion in relying on calculation of capital expenses proffered by town's expert appraiser, as part of projected expenses for net revenue element of discounted cash flow method for determining fair market value of taxpayer's hydroelectric facility for property tax purposes, and rejecting approach by taxpayer's expert, though taxpayer asserted calculation by town's expert, including assignment of 1% of value of facility per year to long-term capital improvements, ignored future capital costs for necessary and planned capital improvements,

including overhaul of turbines; town's expert explained his analysis and treatment of capital expenditures, and trial court carefully explained its decision process and how it was influenced by parties' expert testimony.

Trial court acted within its discretion in relying on estimate by town's expert appraiser of cost of federal relicensing for taxpayer's hydroelectric facility, and rejecting approach by taxpayer's expert appraiser, as part of projected expenses for net revenue element of discounted cash flow method for determining fair market value of facility for property tax purposes. Trial court considered both parties' estimates for cost of relicensing, finding taxpayer's expert offered little support for its estimates and calculations and that town's expert offered more plausible estimate of likely costs and risks associated with relicensing, and trial court explained its decision-making process and how it was influenced by experts' testimony.

Record supported trial court's findings that three upward adjustments from computed average values for other hydroelectric facilities, based on-peak and off-peak power generation, ancillary revenue, and premium for taxpayer's facility, were warranted under comparable sale method for determining fair market value of taxpayer's facility for property tax purposes, where town's expert appraiser explained basis for his adjustments, including features of river and taxpayer's facility that elevated it above the average hydroelectric facility, such as amount of water on river, taxpayer's control over that water, ability of facility to use water, and river head and marketplace which taxpayer could sell into.

Sale announcement and offer for other hydroelectric facilities could not be relied upon in determining fair market value of taxpayer's hydroelectric facility for property tax purposes under comparable sales method of valuation, since announcement reflected mere hope rather than price which property would bring when offered for sale, and, though offer represented what property would bring in market if sale was completed, it did not rise to level of reliability demanded to estimate fair market value.

TAX - OHIO

Evans v. Avon

Court of Appeals of Ohio, Ninth District, Lorain County - August 22, 2016 - N.E.3d - 2016 WL 4426407 - 2016 -Ohio- 5460

Hotel patron brought action against city and its finance director, asserting additional 3% lodging tax in ordinance was illegal, and seeking to enjoin city or its agents from collecting the tax.

The Court of Common Pleas entered judgment declaring ordinance illegal, and granting patron injunctive relief. Defendants appealed.

The Court of Appeals held that:

- City ordinance that imposed an additional 3% excise tax to fund a newly established visitors bureau was illegal, and could not be collected by the city or its finance director, and
- City ordinance was not a lawful exercise of city's home rule authority.

Statutory provision that only allowed the levying of an additional 3% excise tax on all hotel and motel lodging when the county had not yet enacted its own lodging tax applied to both corporate municipalities and townships located within the county, and thus, city ordinance that imposed an additional 3% excise tax to fund a newly established visitors bureau was illegal, and could not be

collected by the city or its finance director, where county had already enacted its own lodging tax.

Statute governing which subdivisions may levy an excise tax on lodging of transient guests preempted city ordinance that purported to impose an additional 3% lodging tax, and thus, city ordinance was not a lawful exercise of city's home rule authority. The statute specifically stated that a municipal corporation or township could only levy a lodging tax if it was not located in a county that had in effect a resolution that already levied an excise tax.

State constitution's grant of authority to exercise all powers of local government includes the power of taxation. However, while municipal governments have plenary taxing power, the General Assembly has the authority to impose specific limits on that power.

TAX - OREGON

Falls Apartments, LLC v. Multnomah County Assessor

Oregon Tax Court, Magistrate Division, Property Tax - August 4, 2016 - 2016 WL 4167515

Plaintiff appealed the real market value of its property for the 2015–16 tax year.

The subject property is part of a Construction In Process ('CIP') exemption in which the improvements on the subject property are not subject to taxation. Therefore, only the land valuation is being taxed for the 2015/2016 tax year. The subject property's 2015–16 tax roll real market value was $3,917,000. Plaintiff requested that the subject property's 2015–16 real market value be reduced to $3,773,655, based on the its actual cost.

The County Assessor moved for dismissal because Plaintiff's 2015–16 requested real market value would not provide any sort of tax savings as a result of the CIP.

The issue presented was whether Plaintiff is aggrieved under ORS 305.275(1)(a) for the 2015–16 tax year. Under ORS 305.275(1)(a), a taxpayer "must be aggrieved by and affected by an act, omission, order or determination of" a county board of property tax appeals or a county assessor, among others. Generally, so long as the property's maximum assessed value is less than its real market value, a taxpayer is not aggrieved.

Plaintiff conceded that it's requested 2015-16 real market value would not result in a reduction of the subject property's 2015-16 assessed value or property taxes because the subject property is under the CIP exemption. Plaintiff argued that it is nevertheless aggrieved for the 2015–16 tax year because of a protection afforded taxpayers under Article XI, section 11(2) of the Oregon Constitution, which states in part:

> "After disqualification from partial exemption or special assessment, any additional taxes authorized by law may be imposed, but in the aggregate may not exceed the amount that would have been imposed under this section had the property not been partially exempt or specially assessed for the years for which the additional taxes are being collected."

Under Plaintiff's reading of that constitutional provision, Plaintiff had the right to 'lock in' the assessed value for 2015–16 as it would have been if it had been valued correctly without the exemption.

The Tax Court ruled that Plaintiff was not aggrieved under ORS 305.275(1)(a) for the 2015–16 tax year.

The Court agreed with the County Assessor that Plaintiff may assert a claim when the subject property is no longer exempt under the CIP program. At that point, the subject property's maximum assessed value will be determined taking into account the new improvements and Plaintiff may appeal if it disagrees with the assessment.

GFOA, NABL Issue Guidance on Post-Issuance Tax-Compliance.

The Government Finance Officers Association ("GFOA") and the National Association of Bond Lawyers ("NABL") have issued guidance to issuers and their counsel on developing policies to maximize continuing compliance with the tax-exempt bond rules after the issuance of tax-advantaged bonds. The two organizations cooperated on the issuance of separate but complementary guidance to their respective members.

Post-issuance tax compliance procedures describe the courses of action to be taken by an organization to maximize the likelihood that tax rules applicable to tax-advantaged bonds – tax-exempt bonds, tax credit bonds and direct pay bonds – are followed after the bonds are issued and while the bonds remain outstanding. Post-issuance tax compliance procedures have two fundamental purposes: to enhance the likelihood of compliance with rules and to facilitate and streamline the organization's administrative functions.

Broadly speaking, the tax rules applicable to tax-advantaged bonds address four principal categories: (1) expenditure of proceeds; (2) use of financed assets; (3) investment of proceeds; and (4) recordkeeping.

GFOA's alert, *Developing and Implementing Procedures for Post-Issuance Tax Compliance for Issuers of Governmental Bonds*, is available here. NABL's *Considerations for Developing Post-Issuance Tax Compliance Procedures* is available here.

For more information, contact Emily Brock of GFOA at ebrock@gfoa.org or Bill Daly of NABL at bdaly@nabl.org.

Developing and Implementing Procedures for Post-Issuance Tax Compliance for Issuers of Governmental Bonds.

Introduction

State and local government issuers of tax-exempt bonds must comply with federal tax rules both at the time the bonds are issued and during the entire period the bonds are outstanding in order for the bonds to maintain tax-exempt status.1 For the last decade, the Internal Revenue Service (IRS) has engaged in extensive enforcement of these rules for tax-exempt bonds through a variety of activities including random audits. If an issuer fails to meet applicable federal tax rules, the IRS can declare the interest on the bonds to be taxable, although the IRS has not frequently done so.2 In connection with these enforcement efforts, the IRS has encouraged issuers to develop post-issuance

compliance policies and procedures to help detect and correct potential violations of federal tax law on a timely basis.

The National Association of Bond Lawyers (NABL) released together with this GFOA Alert a white paper entitled "Considerations For Developing Post-Issuance Tax Compliance Procedures" (the "NABL Considerations"), which presents an in-depth discussion of post-issuance tax compliance and the applicable tax requirements that must be satisfied. This Alert provides a general overview of post-issuance tax compliance and highlights points that may be discussed in greater detail in the NABL Considerations or other publications.3 The Alert focuses on compliance for "governmental bonds," (i.e., bonds issued for governmental use and purposes) but can be helpful for complying with qualified 501(c)(3) or other types of private activity bonds.

What is Post-Issuance Compliance?

Post-issuance compliance consists of practices and procedures designed to assist an issuer of governmental bonds in complying with the federal tax requirements that apply from the date the bonds are issued until the date the bonds, or any refunding bonds, are no longer outstanding. The substantive rules can be categorized as: (a) arbitrage and rebate; and (b) use of bond proceeds and of bond financed facilities. Compliance with these rules must be documented by records that meet IRS requirements.

Why Implement Post-Issuance Compliance?

The IRS has encouraged issuers to adopt post-issuance compliance procedures in order to assist in preventing, identifying and correcting possible tax violations that may occur during the term that tax-exempt bonds are outstanding. These procedures help an issuer prevent or correct violations so the IRS does not have a reason to either declare the bonds taxable or negotiate a settlement. The IRS Forms 8038 that must be filed when bonds are issued ask whether the issuer had written procedures and the IRS previously offered issuers with written procedures the possibility of a lower settlement amount in connection tax violations discovered by the issuer for which the issuer sought a closing agreement pursuant to the IRS's Voluntary Closing Agreement Program (VCAP). More recently, the IRS is offering a lower settlement amount if the issuer has "effective" procedures (whether or not written).4 Procedures may also prove helpful in providing information and documentation in the event that the IRS audits an issue. See "Why are Post-Issuance Tax Compliance Procedures Important" in the NABL Considerations.

What Rules Need To Be Monitored?

For governmental bonds, i.e., bonds issued by state and local governments to finance public purpose projects, in the broadest terms, the tax requirements can be grouped into two categories: (a) arbitrage and rebate; and (b) use of bond proceeds and of bond-financed facilities. Each of these categories involve many rules that make it advisable for an issuer to adopt practices that track how bond proceeds are invested and how and when bond proceeds are spent.

Arbitrage and Rebate

Federal tax law and regulations restrict the amount of "arbitrage" an issuer can earn and retain from investing proceeds of a tax-exempt bond.5 As applied to tax-exempt bonds, "arbitrage" generally refers to the profit earned from taxable investments purchased with proceeds of bonds bearing interest at tax-exempt rates. There are two main categories of requirements – yield restriction and rebate. If ***either*** the yield restriction requirements ***or*** the rebate requirements are not satisfied, tax-exempt bonds become "arbitrage bonds" and lose their tax-exempt status.*6*

Yield Restriction

The general rule of "yield restriction" is that bond proceeds may not be invested at a "materially higher" yield than the yield on the bonds.7 Exceptions to this rule apply during "temporary periods" such as the 3-year temporary period that is available for proceeds that an issuer expects to spend on construction or acquisition of capital projects under certain circumstances.8 Additional exceptions including other temporary periods of varying length may apply.9 If there is no exception or a temporary period ends and proceeds remain unspent, either the investments must be yield restricted or a "yield reduction payment" must be made to the federal government.

Rebate

The general rule is that any actual earnings in excess of the yield on the bonds must be paid as "rebate" to the federal government. There are a number of possible exceptions including the $5,000,000 "small issuer" exception for issuers with general taxing powers who do not issue more than $5,000,000 in bonds during a calendar year, and limited exceptions for earnings on a reasonably required debt service reserve fund and on a bona fide debt service fund. There is also an exception for tax and revenue anticipation notes, for proceeds invested in other tax-exempt obligations and exceptions that apply if proceeds are spent within 6-months, 18-months or 2 years for construction.10 Rebate, if any, is due every 5 years or when bonds are paid off, either at maturity or redemption. If there is no rebate exception, it is necessary to determine whether any rebate is due. The calculation depends on a number of factors including whether the bonds are fixed or variable rate and whether there are any hedges (e.g., interest rate swaps) that must be taken into account.

To comply with both the yield restriction and rebate rules an issuer needs to have procedures that identify the type of, and return on, investments made with bond proceeds and when proceeds are spent.

Use of Proceeds and of Bond-Financed Facilities

The general rule for governmental bonds is that no more than 10% of bond proceeds may be used in a private business use and no more than 10% of debt service on the bonds may be paid or secured by payments arising from or related to private business use. The 10% limit is reduced to 5% in the case of unrelated private business use or related business use which is disproportionate. No more than 5% of bond proceeds may be used for and no more than 5% of debt service on the bonds may be paid or secured by payments in respect of, unrelated private business use or disproportionate related business use. In addition, with certain exceptions, no more than the lesser of 5% of bond proceeds or $5,000,000 may be used to finance direct or indirect loans to non-governmental persons.11

To monitor compliance with this requirement, an issuer needs to have procedures to identify who is a private "nonqualified user" and what constitutes private business use. For governmental bonds, any user other than a state or local government is a "nonqualified user". This means that individuals, for-profit entities, non-profits including section 501(c)(3) organizations and the federal government are "nonqualified users," and use by users in any of these categories must be analyzed to determine whether it is "private business use". Use in the trade or business of any non-qualified user is "private business use". Use by the general public is not typically business use. "Private business use" can be created by a lease or license of a bond financed facility. It can also be created through a management or service contract between the issuer (or other qualified user) and a non-qualified user on terms that do not meet a safe-harbor recognized by the IRS12 that gives the non-qualified user a share in the net profits from the use of the facility. Research agreements or special arrangements that give a non-qualified user priority or a benefit not available to the general public

may also create private business use.

When are Procedures Effective?

To be effective, procedures should address the substantive issues necessary to assure tax and other legal and contractual compliance. Procedures should also be implementable, manageable, and diligently followed by the issuer. The design and implementation should take into account the issuer's size, organizational structure, frequency of bond issuance and budget/staffing resources.

If implemented properly, the following elements should assist an issuer with effective oversight of tax rules relating to tax-exempt bonds: (1) identify the individual or individuals responsible for coordinating activities; (2) provide for due diligence review at regular intervals; (3) facilitate training for responsible individuals; (4) describe retention of adequate records to substantiate compliance; (5) accommodate review that identifies areas that are most susceptible to noncompliance; and (6) include procedures to correct identified noncompliance in a timely manner.

Designing a Post-Issuance Compliance Program

General Considerations

A post-issuance compliance program should reflect an issuer's size, resources and borrowing pattern. An issuer may decide to handle compliance in-house or to engage bond counsel or other third-party provider for some or all compliance activities including arbitrage, rebate and monitoring of private business use and payments. In either case, the post-issuance compliance program should have the following elements. The following is a summary of the considerations for designing a post-issuance compliance program. More detail is provided under the heading "Characteristics of Effective Procedures" in the NABL Considerations.

Responsible Staff Should Be Assigned

Whether an issuer will conduct compliance in-house or will engage providers, a "chief compliance officer" with overall responsibility for implementation of the program should be assigned. In a large organization, there may be staff in addition to the chief compliance officer that can be assigned specific responsibilities or the chief compliance officer can have authority to delegate where appropriate. If third-party providers will be engaged to perform some or all of the activities, the program should specify how the providers will be engaged and monitored. The chief compliance officer or officers should be designated by job title rather than name to assure continuity.

Identify the Source of the Tax Requirements Being Monitored

It will be helpful to identify the documents that set forth the tax requirements being monitored so that the compliance officer(s) can find details if necessary.

Identify the Frequency of the Actions to Be Undertaken

The IRS has recommended at least an annual review as a general matter. However, it may be advisable to provide for a review when specific events occur, such as renewal of management contracts, or other events that may result in private business use. A program should also provide for a final allocation of bond proceeds as required by tax regulations.13

Establish a Deadline Reminder System

Where deadlines exist, a reminder system should be established and a back-up reminder is helpful in

avoiding an oversight. Examples of deadlines include ending of temporary periods for yield restriction and deadlines for meeting spend down exceptions for rebate compliance, paying rebate if applicable, and making final allocations.

Identify Records to be Maintained and the Record Retention Period

Records necessary to assure and document compliance should be maintained for the required time periods. The issuer should list the records being maintained and where or by whom. Tax records must be maintained until full payment of the bonds and any refunding bonds plus three years. In addition, state or local record retention requirements need to be considered. In some cases, an issuer may need to seek approval for changes in its record retention policy in order to keep tax or other records for periods longer than otherwise permitted under state law.

Specific to tax-exemption compliance, the following records should be maintained.

1. The bond transcript for each bond issue (which includes among other documents, the trust indenture, loan, lease, or other financing agreement, the relevant IRS Form 8038 (including Forms 8038-G or 8038, as applicable) with proof of filing, the bond counsel opinion and the tax agreement including all attachments, exhibits and any verification report).
2. Records of debt service payments for each issue of bonds.
3. Documentation evidencing the expenditure of bond proceeds, such as construction or contractor invoices and receipts for equipment and furnishings, bond trustee requisitions and project completion certificates, as well as records of any special allocations made for tax purposes including post-issuance changes in allocations.
4. Documentation evidencing the lease or use of bond-financed property by public and private sources, including, but not limited to, service, vendor, and management contracts, research agreements, licenses to use bond-financed property, or naming rights agreements.
5. Documentation pertaining to investment of bond proceeds, including the yield calculations for each class of investments, actual investment income received from the investment of proceeds, investment agreements, payments made pursuant to investment agreements and rebate calculations and copies of any 8038-T or 8038-R filed with respect to the bonds.
6. Documentation pertaining to remedial action and other change-of-use records.
7. Amendments and other changes to the bond Documents (including interest rate conversions and defeasances).
8. Letters of credit and other guarantees for bond issues.
9. Interest rate swaps and other derivatives that are related to bond issues.

Require Training for Responsible Officers

Periodic training for compliance officers should be identified and documented. The issuer should also determine whether the training can be done in-house or whether third-party conferences, courses or providers are appropriate.

Describe Procedures to Identify and Correct Violations

The policy should describe the review process to assure compliance and describe what actions will be taken to correct any non-compliance. Corrective strategies may require engaging counsel or third-party advisors to assist in the remedial action.

Address Other Substantive Issues for Tax-Advantaged Bond Compliance

The policy should also consider other substantive matters that should be included in a post-issuance

compliance program for tax-advantaged bonds such as yield restriction, rebate and tracking possible private business use.

How Should A Post-Issuance Program Be Adopted and Reflected?

An issuer's post-issuance compliance procedures can be included in its general debt management policies or be stated separately. Procedures may be adopted by formal action of the issuer's governing board or be developed independently by management.

Conclusion

GFOA recommends that state and local governments adopt comprehensive written debt management policies, in so doing, the GFOA and NABL work together to provide tools for the state and local government to use in managing these policies, such as the Post Issuance Compliance Checklist. This Alert provides a general overview of the NABL white paper "*Considerations for Developing Post-Issuance Tax Compliance Procedures*" and in so doing, this Alert brings additional awareness to post-issuance tax compliance for issuers within the parameters of federal tax rules. Compliance with federal tax rules both at the time a state or local government issues bonds and during the entire period the bonds are outstanding is necessary in order for the bonds to maintain their tax-exempt status is enforced through current federal tax rules.

Footnotes

1. State and local governments may also issue tax-credit and taxable direct-pay bonds that must satisfy federal tax rules on a continuing basis to retain tax-advantaged status. References herein to tax-exempt bonds also refer to tax-advantaged bonds.
2. If bonds are declared taxable, the tax must be collected from bondholders. The IRS has chosen in most instances to negotiate settlements with the issuers.
3. This Alert together with the NABL Considerations updates information about this topic previously provided through the joint publication with the National Association of Bond Lawyers (NABL) in 2007 of the NABL/GFOA Post-Issuance Compliance Checklist (the "Checklist") and in GFOA's best practices for debt management policies released in 2012. The debt management policies best practices publication is available online.
4. See Internal Revenue Manual ("IRM") 7.2.3.4.4 relating to the IRS's Voluntary Closing Agreement Program (VCAP), which was released in September 2015. This IRM states: "Under this revision of the IRM, post issuance compliance procedures are not required to be in any other pre-specified format. To obtain a TEB VCAP, however, an issuer is required to provide evidence that it has implemented a change to its procedures that is reasonably expected to prevent the same type of violation from happening in any of its bond issues. This change to the procedures is being made to allow issuers to develop their own best practices for post-issuance compliance procedures and to measure the benefit of those procedures by their effectiveness, that is, whether they enable the issuer to capture a violation quickly. TEB continues to strongly encourage issuers to have post-issuance compliance procedures that effectively monitor compliance with all of the IRC and Regulations requirements applicable to the bonds." (Emphasis added).
5. Internal Revenue Code §148 and regulations thereunder.
6. See "Tax Exempt Bonds: A Roadmap to Arbitrage Requirements for Tax-Exempt Governmental Bonds and Qualified Section 501(c)(3) Bonds of Smaller Issuers and Conduit Borrowers", 2013 Report of the Advisory Committee to Tax-Exempt and Governmental Entities (referred to herein as "Twelfth ACT Report").
7. For "new money" bonds, as a general rule, "materially higher" means 1/8 of 1% and for advance refunding bonds, "materially higher" is 1/1000 of 1%. Treas. Reg. §§1.148-2(d)(2)(i) and (ii).

8. This exception applies if, at the time of bond issuance, the issuer reasonably expects to become obligated to spend at least 5% of bond proceeds within 6 months, to allocate at least 85% of proceeds on the financed project within 3 years and to complete the project with due diligence. Treas. Reg. §1.148-2(e)(2)(i)(A)(B) and (C).
9. Temporary period exceptions of varying lengths are also available for bona fide debt service funds, investment proceeds, working capital and refundings. See Treas. Reg. §1.148 -2 (2 and 1.148-9 (d). In addition, there are exceptions for a reasonably required debt service reserve fund and a "minor portion" of the lesser of $100,000 or 5% and for investments in other tax-exempt obligations. Treas. Reg. §1.148-2(d)(2)(v), (f) and (g).
10. See "Exceptions to Rebate", Section VC of the Twelfth ACT Report, supra for a discussion of the exceptions to rebate.
11. Issuers should consult bond counsel for detailed information about the rules that apply to private business use and payments in respect of private business use.
12. Rev. Proc. 97-13 as modified by Rev. Proc. 2001-39 and as amplified by Notice 2014-67, and Rev. Proc. 97-14 as modified by 2007-47 provide safe harbors against "private business use" for management contracts and research agreements
13. Treas. Reg. §1.148-6(d) requires that expenditures be allocated to bond proceeds no later than 18 months after the later of the date the expenditure is made or the project is placed in service and in no event later than 60 days after the 5th anniversary of the date the bonds are issued or retired, if earlier.

IRS Publishes New Management Contract Safe Harbors For Property Financed With Tax-Exempt Bonds: Foley & Lardner

On August 22, 2016, the Internal Revenue Service (IRS) released Rev. Proc. 2016-44, which provides new guidance on the treatment of "management contracts" for purposes of the restrictions on use of property financed with tax-exempt bonds. This published guidance provides for new safe harbors under which the IRS will not treat management contracts as giving rise to private business use.

The new guidance applies to tax-exempt bonds that are governmental bonds issued for the benefit of state and local governments and to qualified 501(c)(3) bonds issued for the benefit of section 501(c)(3) organizations. This guidance also applies to certain qualified tax credit bonds, such as Build America Bonds, that are subject to the same private business use rules. Although the guidance nominally refers to "management contracts," it applies to most types of service contracts. The new guidance is a significant development for those types of bond issues.

Highlights

- The new guidance establishes new safe harbors that are in some ways much more liberal and flexible than the Rev. Proc. 97-13 safe harbors, but in other respects stricter.
- The new safe harbors reflect a reconceived framework and will replace the Rev. Proc. 97-13 safe harbors. Issuers and borrowers generally may continue to rely on the Rev. Proc. 97-13 safe harbors for management contracts entered into before February 18, 2017, and certain extensions of those contracts pursuant to their term.
- The new safe harbors permit almost any type of variable or fixed compensation and abandon the Rev. Proc. 97-13 framework focusing on fixed fees.
- The new safe harbors rely much more heavily on the rule that "net profits arrangements" are not permitted under the safe harbors.
- The new guidance permits management contracts having a term up to 30 years, but retain a rule

limiting the term to no more than 80 percent of the weighted economic life of the managed property.
- The new guidance establishes new safe harbor requirements relating to control of the managed property, bearing of net losses, risk of loss and consistency of tax positions.
- In general, the new safe harbors are more "principles-based," and provide fewer bright lines than the Rev. Proc. 97-13 safe harbors. Accordingly, more interpretive questions may arise than under the Rev. Proc. 97-13 safe harbors, particularly with respect to the new requirements. Also, the question of whether a management contract that does not exactly meet all of safe harbor requirements should still be treated as not resulting in private business use may arise more commonly than under the Rev. Proc. 97-13 standards.
- Many management contracts that have been customarily treated as within the Rev. Proc. 97-13 safe harbors may not exactly meet the new safe harbors.
- In general, the new safe harbors may be particularly helpful for certain long-term management contracts for infrastructure. Certain shorter term management contracts in particular, however, will be subject to new standards that may involve compliance burdens.
- Many issuers and borrowers may need to consider implementing new practices to review management contracts relating to tax-exempt bond financed property that are entered into, materially modified, or in certain cases renewed after February 17, 2017.

Description of the New Safe Harbors

"Safe Harbor" Guidance. The new guidance provides for revised "safe harbors" in the form of a new revenue procedure. It does not change the substantive rules in the IRS regulations for when a management contract gives rise to private business use. Accordingly, the new guidance would not properly be used adversely against issuers and borrowers by the IRS in examinations, but rather sets forth standards that are intended to provide a basis for conservative tax positions of issuers and borrowers.

Immediate Permissive Application. The new guidance may be applied immediately to either new or existing management contracts.

Relationship to IRS Rev. Proc. 97-13, As Amended. The new guidance supersedes Rev. Proc. 97-13, including the portions of Notice 2014-67 that amend Rev. Proc. 97-13. Issuers and borrowers may continue to rely on Rev. Proc. 97-13, as amended, to a management contract that is entered into before February 18, 2017, unless it is materially modified or in certain cases extended on or after that date. An additional effective date rule also grandfathers extensions of a management contract entered into before February 18, 2017 if the extension is pursuant to a "renewal option" provided in the contract. A renewal option is defined as a provision under which either party has a legally enforceable right to renew the contract. Accordingly, during a long transitional period, an important consideration in reviewing certain management contract extensions likely will be whether the extension is pursuant to the terms of the contract.

Because Rev. Proc. 97-13 is superseded, "Rev. Proc. 97-13 compliance" will now be referred to as "Rev. Proc. 2016-44 compliance."

The new guidance is in response to public comment requests for more flexible safe harbors for management contracts having a term greater than five years. It states that it builds upon the amplifications in IRS Notice 2014-67 that provide for flexible safe harbors for contracts having a term up to five years.

Notably, however, the new guidance reframes and in many respects reconceives the safe harbors for management contracts. Although the new guidance responds to industry calls for more flexible safe

harbors, one important question raised is whether certain management contracts that currently qualify for safe harbor treatment will no longer so qualify, as is discussed further below. In general, public comments to the IRS requested additional safe harbors, not new safe harbors that displaced the existing ones; the IRS and Treasury Department did not adopt that approach.

Safe Harbor Framework Restated. The new guidance states that it provides for a "more flexible and less formulaic approach toward variable compensation for longer-term management contracts" and "applies a more principles-based approach focusing on governmental control over projects, governmental bearing of risk of loss, economic lives of managed projects, and consistency of tax positions taken by the service provider."

The new guidance provides a general safe harbor and another safe harbor for "eligible expense reimbursement arrangements." The references in this description to the "new safe harbor" refer to the new general safe harbor when context requires.

Term Up to 30 Years Permitted. If a management contract meets the other requirements for the new safe harbor, the term of the contract may have a term that is no greater than the lesser of 30 years or 80% of the "weighted average reasonably expected economic life of the managed property." By comparison, the existing Rev. Proc. 97-13 establishes separate safe harbors for management contracts with terms not exceeding five years, 10 years, 15 years, and, in some cases, 20 years. The new safe harbor applies the 80 percent limit to contracts with any term, although Rev. Proc. 97-13 does not apply the 80 percent limit to contracts having a term not exceeding five years.

The Rev. Proc. 97-13 safe harbors also generally limit the term of longer-term contract to not more than 80 percent of the useful life of the "financed property." The reference to the "managed property" rather than the "financed property" possibly signals a helpful clarification, because the new safe harbor possibly can be read as focusing on the economic life of the property that is managed, and not the assets that are financed by a particular bond issue. New provisions that describe in more detail how the 80 percent limit applies may raise additional questions.

Variable and Fixed Compensation Permitted. If a management contract meets the other requirements of the new safe harbor, almost any type of variable or fixed compensation is permitted. The Rev. Proc. 97-13 safe harbors are based on the extent to which compensation is fixed. That fixed fee framework will no longer apply under Rev. Proc. 2016-44.

No "Net Profits Arrangements." The new guidance relies more heavily on the rule in the IRS regulations that states that a management contract with respect to financed property generally results in private business use of that property if the contract provides for compensation based, in whole or in part, on a share of net profits from the operation of the facility. The new guidance provides an additional gloss on this continuing standard, which may or may not be helpful to issuers and borrowers.

The new guidance states that compensation to the service provider will not be treated as providing a share of net profits if "no element of the compensation takes into account, or is contingent upon, either the managed property's net profits or both the managed property's revenues or expenses for any fiscal period." For this purpose, the elements of compensation are "the eligibility for, the amount of, and the timing of the payment of the compensation."

In general, this appears to be a somewhat strict interpretation of the no "net profits" standard. Because a contract will not qualify for the safe harbor if the "eligibility for" or "timing of" a payment is based on a net profits standard, it appears that any trigger for a payment based on net profits will not qualify. By comparison, in a recently released private letter ruling (PLR 20162203), the IRS

concluded that a hotel management contract did not give rise to private business use, even though the contract provided for additional compensation triggered by a benchmark that was "a variant of net profits." In that case, the IRS permitted favorable treatment of the contract, in part because the amount of the payment was not based on net profits. Such a private letter ruling only applies to the specific issuer that requested it, and it is unclear whether its favorable conclusion would still apply under the reframed standards of Rev. Proc. 2016-44.

The new guidance also states that "incentive compensation will not be treated as providing a share of net profits if the eligibility for incentive compensation is determined by the service provider's performance in meeting one or more standards that measure quality of services, performance or productivity," but only if the amount and timing of the payment meets the requirements set forth above.
In general, this reframed "net profits" standard will be one of the most important considerations in reviewing management contracts for private business use compliance. One important point, however, is it appears that the somewhat strict interpretation of the no "net profits" rule in the new guidance applies only for the purposes of the safe harbor, and is not necessarily an interpretation of the substantive rule in the IRS regulations for when a management contract is noncompliant.

No Bearing of Net Losses of the Managed Property. The new guidance provides that a management contract will not meet the safe harbor if it, in substance, imposes on the service provider "the burden of bearing any share of net losses from the operation of the managed property." For this purpose, an arrangement will not be treated as requiring the service provider to bear a share of net losses if: (1) the determination of the amount of the service provider's compensation and the amount of any expenses paid by the service provider (and not reimbursed), separately and collectively, do not take into account either the managed property's net losses or both the managed property's revenues and expenses for any fiscal period; and (2) the timing of the payment of compensation is not contingent upon the managed property's net losses.

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

This new requirement is not set forth in Rev. Proc. 97-13. In general, it is framed in a manner similar to the provision concerning net profits arrangements.

Control Over Use of the Managed Property. Perhaps the core provision of the new guidance is a requirement that the qualified user "must exercise a significant degree of control over use of the managed property." This new requirement is not set forth in the current Rev. Proc. 97-13, although certain provisions relating to control were set forth in prior versions.

The "qualified user" is the term used in the safe harbors for the state or local government or 501(c)(3) organization that uses the bond-financed property. The qualified user is usually the issuer or the borrower, and may include other users, such as affiliates.

The new guidance states that this control requirement is met if "the contract requires the qualified user to approve the annual budget of the managed property, capital expenditures with respect to the managed property, each disposition of property that is part of the managed property, rates charged for the use of the managed property, and general nature and type of use of the managed property (for example, the type of services)." It is unclear whether the "significant degree of control" requirement can be established in other ways. For example, it is unclear whether a contract including most of this list of control rights, but not all, can still meet the safe harbor.

The new guidance provides some clarification of what is meant by certain of the listed control rights. As an example, a qualified user may show approval of capital expenditures for a managed property by approving an annual budget for capital expenditures described by functional purpose and specific amounts, and may show approval of dispositions of property in a similar manner. Further, a qualified user may show approval of rates charged for use by either expressly approving such rates (or the methodology for setting such rates) or by including in the contract a requirement that the service provider "charge rates that are reasonable and customary as specifically determined by an independent third party."

These new control rights requirements, and in particular the requirement that the qualified user control rates, may raise many questions and require a change in practices for management contracts entered into, materially modified, or in certain cases extended after February 17, 2017. For example, in the case of physician contracts for hospitals financed with tax-exempt bonds, many existing "separate billing" arrangements that have been treated as within the Rev. Proc. 97-13 safe harbors may not be within the new safe harbors, unless the contracts are reframed to reflect these new requirements.

Risk of Loss of the Managed Property. In order to meet the new safe harbor, the qualified user must bear the risk of loss of the managed property (for example, upon force majeure). A qualified user does not fail to meet this risk of loss requirement as a result of insuring against risk of loss through a third party or imposing on the service provider a penalty for failure to operate the managed property in accordance with standards set forth in the management contract. This is another new requirement.

No Inconsistent Tax Position. Another new requirement is that the service provider must agree "that it is not entitled to and will not take any tax position that is inconsistent with being a service provider to the qualified user with respect to the managed property." As an example, the service provider must agree not to take any depreciation or amortization, investment tax credit, or deduction for any payment as rent with respect to the managed property. It appears that this express agreement will need to be included in contracts under the new safe harbor.

This new requirement is another provision that will likely require a change from current prevailing practices for management contracts entered into, materially modified, or in certain cases extended after February 17, 2017. Many existing contracts that are treated as within the Rev. Proc. 97-13 safe harbors do not contain such an express agreement. Specific agreements regarding tax treatment of the type required by the new safe harbor as a matter of prevailing practice may have been included in long-term management contracts, but have been less common in shorter-term contracts because the tax treatment has been regarded as implicit.

No Circumstances Substantially Limiting Exercise of Rights. The new guidance continues the general requirement in Rev. Proc. 97-13 that the service provider must not have any role or relationship with the qualified user that, in effect, substantially limits the qualified user's ability to exercise its rights under the contract.

Like Rev. Proc. 97-13, the new guidance contains a "safe harbor within a safe harbor" for establishing that the service provider has no such role or relationship. This safe harbor continues the general approach of Rev. Proc. 97-13, but is in some respects stricter. The new guidance requires as a safe harbor that (1) no more than 20 percent of the governing body of the qualified user is vested in persons having a role with the service provider; and (2) that the governing body of the qualified user not include the chief executive officer of the service provider (or a person with equivalent management responsibilities) or the chairperson (or equivalent executive) of the service provider's governing body. For the purpose of this safe harbor, "service provider" now expressly

includes related parties to the service provider.

Because the specific requirements concerning overlapping board members continue to be framed as a "safe harbor within a safe harbor," it appears that issuers and borrowers could reasonably meet the substantive requirement based on other factors.

Functionally Related and Subordinate Use. The new guidance contains a new helpful provision relating to "functionally related and subordinate use." Under this new rule, a service provider's use of a project that is functionally related and subordinate to performance of its services under a management contract does not result in private business use, if the contract meets all of the requirements of the new guidance. An example is use of storage areas to store equipment used to perform activities under a management contract.

Eligible Expense Reimbursement Arrangements. A separate safe harbor is established for "eligible expense reimbursement arrangements." An "eligible expense reimbursement arrangement" is defined as a management contract under which the only compensation consists of reimbursements of actual and direct expenses paid by the service provider to unrelated parties and reasonable related administrative overhead expenses of the service provider. An eligible expense reimbursement arrangement does not result in private business use, regardless of whether the other requirements of the new guidance are met.

This separate safe harbor is an expansion of an exception set forth in the IRS regulations from private business use that previously applied only to management contracts for public utility property.

Contracts Properly Characterized as Leases. The new guidance recites a rule in the IRS regulations that provides that a lease generally results in private business use and that any arrangement that is properly characterized as a lease for federal income tax purposes is treated as a lease (even if the arrangement is in form a management contract). The new guidance further recites a provision in the IRS regulations to the effect that, in determining whether a management contract is properly characterized as a lease, it is necessary to consider all the facts and circumstances, including (1) the degree of control over the property that is exercised by the service provider; and (2) whether the service provider bears the risk of loss of the financed property.

The new guidance does not otherwise expressly address the question of when a management contract is properly characterized as a lease. As a practical matter, however, it would appear that any management contract meeting the new safe harbor should not ordinarily be subject to characterization as a lease, because many of the new requirements (including requirements relating to control and risk of loss) are also factors relevant to determining whether an arrangement is in substance a lease.

Anti-Abuse Rules. The new guidance does not override any of the provisions of the IRS regulations. Accordingly, it is important to continue to interpret the new guidance in the context of the rules of the IRS regulations. In particular, the anti-abuse rules in the IRS regulations provide that, in certain circumstances, an arrangement that directly or indirectly passes through to private persons the financial benefit of tax-exempt interest rates may result in private business use, even if the arrangement would not otherwise result in private business use under the regulations. This anti-abuse rule will continue to be an important consideration in the consideration of certain management contracts.

Expected Future Developments. The new guidance does not request any further public comments. We expect that public comments may be submitted, however, particularly in light of the

reconceived nature of the new safe harbor and its many new requirements. One likely request will be to permit issuers and borrowers to continue to rely on the Rev. Proc. 97-13 safe harbors, at least for a period longer than six months. There is no current indication, however, that the IRS and the Treasury Department would respond to any such public comments. We expect, however, that officials of the IRS and the Treasury Department will make clarifying public statements before February 18, 2017.

Last Updated: September 2 2016

Article by Michael G. Bailey, David Y. Bannard, Dana M. Lach, Chauncey W. Lever and Mark T. Schieble

Foley & Lardner

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

GFOA, NABL Publish Guidance on PostIssuance Tax Compliance.

WASHINGTON – The National Association of Bond Lawyers and the Government Finance Officers Association on Thursday each issued guidance to issuers and counsel on how to comply with tax-exempt bond rules after the issuance of tax-advantaged bonds.

The guidance came after three years of research, according to Matthias Edrich, an attorney with Kutak Rock in Denver and chair of NABL's tax law committee.

Edrich, who authored NABL's 14-page publication, said the groups issued the guidance because of the Internal Revenue Service's focus on the need for issuers to have good policies and procedures in recent years.

"The IRS is telling them today we hope you have effective policies in place, but what means effective is up to you," Edrich said. "We recommend policies that contain certain elements, but they are not penalized if they don't have these elements."

NABL cited several suggestions that the IRS had for issuers in March, including that they: identify those responsible for coordinating post-issuance tax compliance; provide for due diligence reviews at regular intervals; address the timely identification of noncompliance; and promote the retention of adequate records.

"Procedures assist the entity in complying with tax and document covenants, in the transfer of knowledge and to streamline the entity's financing operations, all for the purpose of maintaining the tax benefits associated with the bonds," NABL officials wrote.

The IRS oversees and enforces the post-issuance compliance of tax-advantaged bonds, and NABL said the agency has increased its efforts to encourage issuers and conduit borrowers to adopt effective procedures.

Though it provides oversight, the agency does not dictate to an issuer what elements need to be in a policy, Edrich said. The guidance was written as tips for what an issuer could consider without proposing best practices, he said.

“It’s written fairly broad and supposed to be a guide for issuer boards to be able to think about what are best practices,” Edrich said. “It’s a paper that I hope will be useful for years to come.”

Procedures suggest courses of action an entity can take to maximize the likelihood that rules applicable to tax-advantaged bonds are followed after the bonds are issued and remain outstanding.

A bond is considered tax-advantaged if it is tax-exempt and interest on the bond is excluded from gross income to the bondholder, if it is a taxable tax credit bond and the holder receives federal tax credits, or if it is a direct-pay, taxable bond and the issuer receives federal subsidies from the Treasury Department.

The four principal categories that tax compliance rules address, according to NABL, are the expenditure of bond proceeds, the use of bond-financed assets, the investment of bond proceeds, and the gathering and maintenance of records relating to the bonds.

The two groups added that issuers should consult with bond counsel and other professionals on post-issuance tax compliance as tax laws, rules and practices continue to change.

Emily Brock, director of GFOA’s federal liaison center, said the guidance stems from enforcement actions and settlements, including those reached under the IRS Office of TaxExempt Bonds’ Voluntary Closing Agreement Program (VCAP) as well as other IRS settlements. The IRS has said if such procedures are in place, then it will consider them when issuing orders, she added.

“It’s so important that issuers know and understand all of these compliance procedures so that they can prevent and correct any tax violations while tax-exempt bonds are outstanding,” Brock said. “We just really wanted to make sure the issuer and counsel are informed of the procedures.”

GFOA and NABL issued separate publications, though they were produced as complementary guidance to their respective members.

The guidance was published separately because GFOA wanted to glean those things most important to issuers, while issuers can share the “significantly comprehensive” NABL publication with counsel, Brock said.

“The project taken together is a way for NABL and GFOA to reach an even broader community,” she said.

As of Thursday afternoon, Edrich said he had not received any feedback from NABL members or IRS officials.

NABL officials also said that Congress may develop new types of tax-advantaged bonds in the future that will be subject to additional special tax rules. This could need to be addressed in revisions to the entity’s post-issuance tax compliance procedures, they said.

The Bond Buyer

By Evan Fallor

September 8, 2016

Study Shows Broncos' Mile High Stadium Cost Federal Taxpayers $54 Million.

Sports Authority Field at Mile High, the home of the Super Bowl 50 champions, has shortchanged federal tax collectors by $54 million, a Brookings Institution analysis says.

In the first-of-its-kind study, Brookings looked at 36 professional football, baseball, basketball and hockey stadiums built or renovated since 2000 using $13 billion in tax-exempt municipal bonds and concluded the work resulted in a $3.2 billion federal subsidy, and $3.7 billion loss in federal tax revenue.

It's one thing when local taxpayers pay for stadiums in their hometowns. Front Range residents in 2002 assumed about $300 million of the $400 million cost to build the Broncos' new stadium in the parking lot of the old Mile High Stadium. The tax-free municipal bonds that funded the new stadium were paid off in 2012.

If those bonds had not been not tax-exempt, the federal government would have collected $49 million in taxes. Then taxpayers who held those bonds got a federal income tax break that saved them estimated $5 million, adding up to a $54 million total loss to the federal taxpayers since 2002, according to the Brookings study.

"I love sports. If I want to pay for sports in my town, I have a weak-but-plausible argument that my local community should subsidize a stadium," said Brookings senior fellow Ted Gayer, who co-wrote the study. "But the weakest and most implausible argument is that someone in Montana should be subsidizing whether or not a football team relocates from St. Louis to Los Angeles. A federal subsidy should have federal benefits. There is no benefit to me whether the Broncos play in Denver or Austin."

The Broncos are hardly the largest beneficiaries of tax-exempt municipal bonds. That crown belongs to the New York Yankees, which spent $2.5 billion on Yankee Stadium in 2009, $1.7 billion of which was financed by tax-exempt municipal bonds issued by New York City. The interest earned on those bonds is tax-exempt, resulting in a federal subsidy of $431 million. Bondholders who used the bonds to lower their tax liability received $61 million in tax breaks, creating a total revenue loss of $492 million.

The researchers at Brookings concluded that beyond some hard-to-measure local benefits, federal taxpayers saw no economic benefit for their tax dollars spent on stadiums in Indianapolis, Chicago, Cincinnati, Houston, Miami, Milwaukee, Washington, D.C. and Seattle.

It didn't used to be that way. Stadiums once were private affairs. But in 1953, the era of public financing for stadiums began when Milwaukee lured the Boston Braves with a new stadium built with tax dollars. In the mid-1980s, Congress passed the Tax Reform Act, which meant to curtail federal subsidies by tying them to municipal financing deals.

That legislation required that municipalities finance a large chunk of the stadium and said governments can't pay for that financing with taxes harvested from the stadium. Instead, cities typically rely on taxes on hotels, rental cars and "tourist taxes" to support new stadiums and still qualify for federal subsidies in the form of tax-free bonds. Taxing visitors is a good way to convince local taxpayers they won't be alone in shouldering the burden of paying off the new stadium.

"That doesn't make sense," Gayer said. "If you want to collect revenue, you should collect from the people who are gaining the most from the new stadium: the people who are actually using the stadium, not my aunt across town who doesn't care about football."

Gayer and his fellow researchers conclude that Congress should end tax-exempt financing for private businesses like professional sports stadiums. Or, at least, the researchers said, limit tax subsidies by offering "qualified private activity bonds" that are subject to statewide caps. A state cap would mean that New York would not get $860 million federal subsidies for homes for its Yankees, Mets, Nets and Islanders and Texas could not get $446 million in federal subsidies for its Astros, Texans, Cowboys, Rockets, Spurs and Stars.

The researchers say the evidence of economic benefits of new stadiums spilling into local communities is "weak."

"Academic studies consistently find no discernible positive relationship between sports facility construction and local economic development, income growth or job creation," reads the study.

Jon Caldara, the Independence Institute chief who has long railed against stadium financing schemes he calls "corporate welfare," said booing a new stadium in Bronco Country does not bolster his popularity. But he does it anyway.

"As much as sports fans might be grateful, I don't think they realize they are on the hook for other people's entertainment. Even if everything the economic development guys say is true — that for every dollar spent it spurs $20 or something in spending in the community, which, by that logic, we should be building five stadiums — it's still wrong because you have the government picking winners and losers," Caldara said. "The money they are playing with is our money, and they are taking chances with our money. We need to recognize we are subsidizing private-sector entertainment.

"At what point do the teams belong to the city?" Caldara asked. "If we are going into debt, and our kids are taking on all this long-term risk, at what point does the mayor get to choose the starting lineup?"

THE DENVER POST

By JASON BLEVINS | jblevins@denverpost.com

PUBLISHED: September 9, 2016 at 12:01 am | UPDATED: September 9, 2016 at 2:03 pm

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Study Shows Stadiums and Arenas Received $3.2B in Federal Tax Breaks.

A new study from the Brookings Institution, which looked at 45 stadiums and arenas in the four major sports leagues that have been built or renovated in that time, reveals the those stadiums and arenas received $3.2 billion in federal tax breaks.

Those stadiums were financed in part with municipal bonds, which are issued by local governments. Interest on those bonds is exempt from federal taxes. Brookings calculates that the federal government lost $3.2 billion in tax revenue – and $3.7 billion if you count the windfall that high-income bondholders get.

Yankee Stadium, which opened in 2009 and cost $2.5 billion to build, topped the list of those entities getting the tax breaks. It received a federal subsidy of $431 million, and the federal government lost a total of $492 million in possible revenue.

The NFL has built or renovated 13 stadiums using tax-exempt bonds since 2000. Major League

Baseball has used bonds for 12 stadiums. The NBA has built seven arenas with them, and the NHL has built four.

Brookings says that stadiums and arenas provide few economic benefits – undercutting a main argument that teams use to persuade cities to finance stadiums.

Because the tax breaks are federal, taxpayers in other states helped fund construction of the stadiums and arenas in other parts of the country. That means that people who live near teams are paying for stadium construction whether they're fans or not.

In order to qualify for federal tax exemption, cities and states can pay back only 10% of the bonds with money that comes from the stadium, such as ticket sales or the rent that the team pays to use the stadium.

Stadiums were largely built without federal funding until 1953. When baseball's Boston Braves moved to Milwaukee, they received a new publicly funded stadium. Using federal money for construction became a trend, despite attempts by Congress to stop it.

More on the effort to build a 65,000-seat Las Vegas-area stadium to house the proposed LV Raiders in Tuesday's print edition and on line at GamingToday.com.

September 10, 2016 9:48 AM

by Robert Mann

TAX - NEW YORK

Joon Management One Corp. v. Town of Ramapo

Supreme Court, Appellate Division, Second Department, New York - August 17, 2016 - N.Y.S.3d - 2016 WL 4371715 - 2016 N.Y. Slip Op. 05795

Property owner brought action against town seeking a judgment declaring that property's tax assessment was overstated and erroneous.

The Supreme Court, Rockland County, granted town's motion for summary judgment and denied property's owner's motion for leave to amend or to enforce settlement agreement. Property owner appealed.

The Supreme Court, Appellate Division, held that:

- Statute of limitations for tax certiorari proceedings applied to action;
- Town's motion for summary judgment was not premature;
- Supreme Court properly denied property owner's motion for leave to amend; and
- Supreme Court properly denied property owner's cross-motion to enforce alleged settlement agreement.

Statute of limitations for tax certiorari proceedings, which required such proceedings to be commenced after exhaustion of administrative grievance remedies and within 30 days after filing of the final assessment roll, applied to property owner's against town seeking judgment declaring that its property's tax assessment was overstated and erroneous, where gravamen of property owner's claim was that its property was overtaxed.

Town's motion for summary judgment on property owner's claim that its property tax assessment was overstated and erroneous was not premature, despite property owner's assertion to the contrary, where property owner failed to demonstrate how discovery might have lead to relevant evidence or that the facts essential to justify opposition to the motion were exclusively within the knowledge and control of the town.

Supreme Court properly denied property owner's motion for leave to amend its complaint against town challenging tax assessment, where property owner's proposed amendments, which were to add causes of action to recover money had and received and to recover damages pursuant to § 1983 for violation of constitutional rights, were devoid of merit.

Supreme Court properly denied property owner's cross-motion to enforce alleged settlement agreement between owner and town with regard to owner's action against town challenging its property tax assessment, where stipulation of settlement was never approved by town board, thus never becoming binding upon town.

TAX - NEW YORK

Nearpass v. Seneca County Indus. Development Agency

Supreme Court, Seneca County, New York - August 18, 2016 - N.Y.S.3d - 2016 WL 4419135 - 2016 N.Y. Slip Op. 26264

Property owners commenced Article 78 proceeding claiming that resolution by county industrial development agency (IDA) to provide tax benefits to developer of casino being built in county was void under New York State Industrial Development Act (IDA Act), impermissibly provided public assistance for private purpose, unlawfully failed to specify amount of tax benefit, materially miscalculated and misstated amount of tax benefit, and was null due to attorney conflicts of interest, and that IDA usurped town assessor's authority to value property improvements.

The Supreme Court, Seneca County, held that:

- Casino was a commercial project and recreation facility within the meaning of the IDA;
- IDA's decision to grant tax benefits to casino was not arbitrary and capricious;
- IDA was not required to specify amount of tax abatement;
- IDA's failure to adopt critique of appraisal report on casino's value was not arbitrary and capricious; and
- Powers of town assessor were not preempted by tax agreement.

IRS Releases Updated Safe Harbors For Management Contracts In Tax-Exempt Bond-Financed Projects: Thompson Coburn

On August 22, 2016, the Internal Revenue Service released Revenue Procedure 2016-44. The purpose of this revenue procedure is to provide revised and broader "safe harbors" under which certain private management contracts will not result in private business use of projects that were financed with the proceeds of tax-exempt governmental or qualified 501(c)(3) bonds.

Potentially impacted issuers and conduit borrowers include governmental and nonprofit healthcare, higher educational and other entities. Market participants have expressed the belief that the more

flexible safe harbor provisions may also help facilitate the structuring of public-private partnership (P3) transactions.

The revised safe harbors set forth in the revenue procedure build upon the existing safe harbors originally set forth in Revenue Procedure 97-13, which were in turn modified by Revenue Procedure 2001-39, and amplified by Notice 2014-67. The existing guidance sets forth conditions under which a management contract does not result in private business use, which conditions include constraints on net profits arrangements, the permitted term of the management contract, the types of compensation provided under the arrangement, and the relationship between the parties. Under such existing guidance, the extent to which the compensation to the private party is a fixed amount is key, in that the greater the percentage of fixed compensation, the longer the term of the management contract is permitted to be. Notice 2014-67 provided additional flexibility within the safe harbors by allowing a broader range of variable compensation arrangements for shorter-term (i.e., up to five year) management contracts.

Continue reading.

Last Updated: August 31 2016

Article by Steve Mitchell and Henry Bettendorf

Thompson Coburn LLP

Baltimore Project Would Include Largest TIF District in City History.

WASHINGTON – The proposed $6.9 billion Port Covington development project in Baltimore would include the largest tax increment financing district in the city's history and would be financed in part with $660 million of bonds backed by the increased property tax revenues.

The project, proposed by Under Armour CEO Kevin Plank, would include a new global headquarters for the sports apparel company as well as residential and retail facilities within a development district.

A new 50-acre, 3.9 million-square-foot headquarters for Under Armour would serve as the project's anchor, and would be flanked by roughly 11 million square feet of mixed-use development.

The project would be owned by Sagamore Development Company, a Baltimore-based real estate firm founded in 2013 by Plank and developer Marc Weller. Development would take place on Port Covington, a 260-acre industrial area roughly two miles south of downtown Baltimore between I-95 and the Middle Branch of the Patapsco River.

The project would be partly financed by $535 million of increased property tax revenue to be collected within a tax increment financing district. Those funds would go toward the construction of infrastructure, including roads and public spaces. None of the TIF revenues would go toward the Under Armour headquarters.

The total bond cost would be $660 million including issuance costs and other costs not associated with construction, according to Baltimore Deputy Finance Director Stephen Kraus.

Kraus said the bonds would be issued by the city of Baltimore Department of Finance in four-to-five

phases over the next 12 years. Construction is expected to be developed in phases over roughly 25 years, according to plans.

The $535 million of expected increased property tax revenue, combined with an additional $349.5 million from the state and $224.2 from the federal government would total almost $1.2 billion in city, state and federal subsidies. Private funding provided by Sagamore is roughly $327.8 million. Of the private and governmental funding of roughly $1.4 billion, $115 million would go toward land acquisition costs, $138 million would go toward site work and $1.2 billion would be used for infrastructure.

The bonds would be paid back by incremental tax revenue generated by the development, as is customary in TIF districts. Tax increment financing secures tax-exempt borrowing by anticipated increases in tax revenues within a defined development district.

The Baltimore Development Corporation, the private nonprofit that grants TIFs for the city, approved the TIF application in March, and it is now before the City Council's Taxation, Finance and Economic Development Committee. The committee has held three hearings regarding the project, but moved a work session originally scheduled for Monday to Sept. 8.

At the time of the application, Baltimore had 14 TIF districts with outstanding debt of $147.2 million.

"One risk is that the developer may not move forward with the development once the tax increment financing district and documents authorizing the issuance of bonds have been approved by the city," officials wrote in the TIF application. "Provided that is the case, the tax increment financing district would remain in place but the bonds would not be issued and debt would not be incurred."

According to plans, the first tranche of TIF bonds would be issued in June 2017 for $62 million, followed by a second tranche of $208.3 million in 2018. A third tranche of $169.7 million would be issued in 2023, and a fourth tranche of $218.7 million would be issued in 2028.

The developer would initially purchase the bonds, which are projected to be outstanding between 2046 and 2058.

Proponents claim the project will bring roughly 8,000 jobs to Baltimore and will revitalize a largely vacant three-mile section of waterfront.

"An area essentially cut off from Baltimore's downtown neighborhoods by the elevated structure of I-95 and the adjacent CSX rail yard will become a dynamic, innovative, mixed-use experience and destination," officials wrote in the application. "As one of the largest urban revitalization projects in the United States, the redevelopment of Port Covington will provide extraordinary economic growth and job opportunities for both the city and the greater region."

Mark Pollak, a partner with Ballard Spahr in Baltimore who is serving as counsel for the developers, said project officials hope to have the initial financing occur in early 2017. Pollak, who described the project as "one of the greatest opportunities the city has ever had," said TIF funding would be phased in over an initial period. He did not comment on what the length of that period may be, and said it was dependent on the growth of Under Armour among other factors.

As among the largest TIF deals in U.S. history, the process could take a while, he said.

"I think everybody recognizes it as a potential transformative project for the city because of the scope," Pollak said, adding that Baltimore Mayor Stephanie Rawlings-Blake has expressed support for the proposed plan. "Clearly Under Armour has the opportunity to grow in many places and we

and the city would hope that they can keep the growth in this city."

Still, he said there has been discussion in regards to the TIF size and negotiations to provide benefits to other parts of the city.

Some of those concerns have been expressed by Baltimoreans United in Leadership Development (BUILD), which in July called for a TIF agreement to include local hiring mandates of 51% for all future businesses in the TIF district. Should that mandate not be met, BUILD officials said the city should invoke "substantial financial penalties" on the parties responsible.

"BUILD calls on the City Council, Sagamore Development, and Mr. Plank to not agree to any city-wide benefits agreement without the city conducting a comprehensive independent analysis of the deal," said BUILD co-chair Rev. Andrew Foster Connors. "If after the analysis the city concludes that the costs associated with the development can be managed, then any agreement must treat the city of Baltimore as a 'first in' investor."

Pollak said the cost of the project is $5.5 billion, but rises to $6.9 billion when accounting for infrastructure costs. Estimates have placed Port Covington's assessed value after construction at $2.6 billion.

In addition to the new Under Armour headquarters, the completed Port Covington project as proposed would include: 1.5 million square feet of retail and entertainment space, more than 7,500 rental and for-sale residential units, 500,000 square feet of industrial/light manufacturing space, 200 hotel rooms, 1.5 million square feet of office space, and 41 acres of public parks and waterfront space, according to the TIF application.

BDC president and CEO William Cole said the group's TIF recommendation was contingent on five factors, which are that: returns to the city exceed the city's hurdle rate, a profit-sharing agreement is negotiated, there is federal and state participation in infrastructure, there is no adverse effect on school funding, and there is no adverse effect on the city's bonding capacity.

If and when the proposal clears the City Council's Taxation, Finance and Economic Development Committee, it will then go before the full City Council for consideration.

Under Armour's headquarters is expected to be built over 15-plus years, according to plans. The Baltimore-based company currently has headquarters in the Tide Point neighborhood of Baltimore, where it has been for 18 years.

In January, Under Armour completed a $40 million office space that houses more than 600 employees, marking the first new building to be opened on the Port Covington campus. Plank's Sagamore Development Company has also completed a reuse of a city garage in Port Covington and the construction of the Sagamore Spirit Distillery in the same neighborhood.

The Bond Buyer

By Evan Fallor

August 30, 2016

Big-Box Stores Battle Local Governments Over Property Taxes.

The retailers are deploying a 'dark store' strategy that's hurting cities and counties around the country.

On Michigan's sparsely populated Upper Peninsula, big-box stores are a modern necessity. Where towns are spaced far apart and winters are long, one-stop shopping to load up on supplies adds a crucial convenience to what can be — at least for many — a rugged existence.

Landing one large retailer is a coup. Having more than one can make a city or town a regional shopping destination. Marquette Township, a small community adjacent to the larger city of Marquette, is in the unique position of having a handful of big-box chain stores. Taking advantage of the fact that the city of Marquette was mostly built out, the township began encouraging large-scale commercial development on its western edge early in the 2000s.

The town now boasts the only Lowe's on the Upper Peninsula, and the only PetSmart, Target and Best Buy. A Menards home improvement store and a Walmart Superstore are there as well. The flurry of new building and retail was so great that the township's tax revenue never took a hit during the Great Recession, even at a time when most small towns on the peninsula and elsewhere in Michigan were struggling.

But recently, the township suffered a dramatic drop in its property tax revenue. It had to cut back on spending, trim employee benefits and reduce library hours. The impact has reached up to surrounding Marquette County, which earlier this year closed a youth home to save money. The reason for the lost revenue isn't declining consumer demand. It's a series of rulings by the Michigan Tax Tribunal that have allowed large retailers to reduce their property tax assessments, in many cases by as much as half.

Big-box retailers argue that the market value of their commercial property should be the sale price of similarly sized but vacant retail buildings. They point out that these buildings are extremely hard to sell as-is once the retailer moves out. They tend to sit empty for long periods. Thus, the assertion is, they aren't worth nearly as much as local tax assessors have traditionally assumed in valuing the property.

This appeals approach was first largely successful in the Detroit area following the recession, when nearly all retailers were dealing with depressed property values. But since then, it has spread across otherwise thriving areas in Michigan to the point where it is difficult to find a county that hasn't been challenged on the issue. The assessment community has even given it a name, dubbing it the "dark-store" strategy.

Local governments, needless to say, aren't buying this. "When you get your house appraised, they're going to look at properties that are occupied," says Steve Currie of the Michigan Association of Counties. "They're not going to look at the foreclosed one because that's not an equitable property. It's the same case here."

Michigan is far from alone in seeing localities take dark-store hits to their property tax base. Counties in Alabama, Florida and Indiana are seeing widespread challenges that make use of the dark-store method. The National Association of Counties says it's an emerging issue in Iowa, North Carolina, Ohio, Tennessee, Washington and Wisconsin.

Still, while these cases have been proceeding for the better part of a decade, it's only been recently that county organizations and public officials have realized the geographical magnitude of the

challenge. County assessors forced to respond to it aren't always aware of similar controversies outside their jurisdiction. This is particularly true in places that are geographically isolated and where assessors are part-time employees.

Getting policymakers clued in to the problem has also been tricky. The world of property tax assessments is loaded with definitions and methodology that, to the average outsider, can seem overwhelming. Property appraisal laws vary by state, and arguments that hold water in one state might not in the next. So it's not always clear to lawmakers what — if anything — they can do legislatively to help counties respond to the threat.

Even in places where counties have pieced together a coordinated effort to fend off challenges, response on the state level has varied. The Indiana General Assembly took arguably the strong-est action, passing two laws last year that essentially banned the dark-store tactic. But those laws were repealed and replaced with a weaker law this year. Alabama passed a law that amounted to an administrative change giving counties more legal resources. The Michigan Legislature has considered but not approved bills dealing with how the Tax Tribunal hears assessment challenges. In these places and elsewhere, many are concerned that the longer it takes for a concerted state response, the more money counties and local governments will lose.

Big-box retail stores aren't the first to complain that their property's uniqueness should afford them special consideration when it comes to their taxable value. Nearly a century ago, the owners of the New York Stock Exchange tried to get the building's appraisal value lowered by arguing that the building's unusual — and expensive — design would be of no value to any future buyer. In fact, the argument went, the building actually lowered the value of the land itself because a future buyer would be forced to shell out the money for demolition costs. While the court rejected that argument in 1928, it has become a popular case to make ever since, with varying levels of success.

There are different nuances and different case law in every state, but it can be generally said that appraisers look at three factors in determining the taxable value of property: the sale price of comparable properties, the current cost to build minus depreciation and the income generated by rents charged to tenants. Appraisers can apply a blend of these approaches to arrive at a property's value, or place most of the weight on just a single approach.

When it comes to unique properties like big boxes, finding comparable sales is difficult. Property values differ by market and it's simply not often that an oversized retailer in a market area sells its property. For this reason, appraisers prefer giving more weight to building costs.

But big-box retailers say using the construction costs of a building to determine the assessment artificially inflates the value. And they insist it's unfair to value their retail properties based on their worth to the current user (referred to as "value-in-use") instead of the value the property would have on the open market (called "value-in-exchange"). The appropriate use of the competing valuation methods is a topic of seething debate in the appraisal world. Retail representatives fall decidedly on value-in-exchange. "It's easy to be confused by the presence of a business," says Florida real estate broker Sheila Anderson, whose firm Commercial Property Services has represented owners in scores of appeals. "But a business is not [what needs to be] assessed." In her view, it's only the resale value of the empty building that matters for taxation. And that is nearly always a much smaller amount.

Complicating the matter are deed restrictions the big-box retailers place on the properties they do sell. Typically, a retailer closes a location to open up another store close by, or leaves because the market isn't viable anymore. But just to be sure a competitor doesn't move in and fare better, the deed bars the new owner from operating a similar business. Assessors say this limitation artificially depresses the market value of the property. The retailers consider it insignificant.

The debate leads to real questions about the fairest way to value these prolific but unique properties, says Allen Booth, a former city assessor in Rhode Island without any affiliation to a dark-store case. “The reality is there are very few tenants that will move into the custom building when you’re dealing with these big-box situations,” he says. But, he adds, officials are leery of retail attorneys’ motives because they can profit greatly from the challenges by taking a cut of the tax refund if they win. “You have to wonder,” Booth says, “are these people just being obnoxious or are the properties really overvalued and it’s just that now someone’s looking at it?”

Tax courts in Michigan have generally agreed with retailers that properties were being overvalued. In Marquette Township, Lowe’s successfully used this argument in a 2012 challenge to its property assessment and succeeded in reducing its taxable value from $5.2 million to less than $2 million, even though the store alone cost $10 million to build. The township spent several hundred thousand dollars in legal costs but failed to win in the appeals process. As a result, the ruling applied to other pending challenges. All told, the township’s total property tax collections have fallen nearly 22 percent in just a few years.

Statewide, the results have been similar. According to the International Association of Assessing Officers, the valuation on large retailers across the country is anywhere from $45 to $75 per square foot, depending on the market. After five years of litigation in Michigan, says tax attorney Jack Van Coevering, the average per-square-foot value in the state is $20.

The big-box retailer Meijer brought a case at one of its most successful Indiana locations, in Marion County, after winning reduced assessments in Michigan. The attorney for Meijer went so far as to tell the Indianapolis Business Journal that the appeal in Marion County was a test case because “whatever the value is there would be the upper limit of the value across the state.” The retailer won in late 2014 and got its assessment slashed from $83 per square foot to $30 per square foot. The decision applied retroactively, requiring Marion County to refund Meijer $2.4 million for nine years of back taxes. Indiana county officials estimated that if the decision were to be extended to the more than 17,000 commercial properties across the state, it would mean a loss of $120 million in property tax revenue statewide.

Indiana lawmakers responded quickly. In 2015, the legislature passed two bills: One effectively banned using the dark-store method to value existing businesses, and the other required using the cost method for properties over a certain square footage. But those laws were repealed this year under concerns they violated the uniformity clause in the state’s constitution, which requires all property to be assessed on an equal basis. The Indiana General Assembly then passed a new law that requires assessments to be based on the value of properties that are “similarly situated in the marketplace.”

Other states have tried other tactics. Alabama passed a law this year that allows counties to remove these cases from their district attorney’s jurisdiction and hire outside attorneys to fight them. In Michigan, a bill passed the House that would require the Tax Tribunal to consider all three valuation methods (rather than just the one the retailer is arguing for). It will be considered in the Senate later this fall.

In short, the legislative authority of lawmakers to intervene is murky. “It’s always appropriate for the legislature to try to clarify and remedy a situation when appropriate,” says Joan Youngman, a property tax expert with the Lincoln Institute of Land Policy. “But you want to be sure this is a problem with the existing law.”

In the end, the best way to beat back the challenges is to win in court. But that’s a tough task for counties that don’t have a lot of resources. In Tampa, Fla., Hillsborough County’s director of

valuation, Tim Wilmath, says counties in his state have caught on early to the dark-store challenge and have for the most part been able to mount successful defenses. Wilmath co-authored an article in an industry magazine last year advising county assessors on how to challenge the tactic, which has made him a de facto adviser to smaller counties across the country. “They’re looking for advice on how best to go at it,” he says of the calls from outside Florida. “But even when they know all the right things to do, they still settle because they just don’t have the money.”

In Michigan, a recent Court of Appeals ruling may prove to be a turning point. In May, the court overturned a 2015 decision by the Michigan Tax Tribunal that had favored the retailer Menard against the city of Escanaba in a property tax dispute. The court found that Escanaba’s cost-based approach was more reasonable than the retailer’s comparable sales method, which included using dark stores. The case was remanded back to the tribunal with directions to consider all the assessment methods. It may end up setting a precedent for cases in Michigan that are currently open.

Still, for counties and townships that have already lost or settled cases, the damage has been done. And because of limits on how much localities can increase the property tax each year, the previous losses in tax revenue will never be made up. In Marquette Township, that means officials will have to figure out how to replenish the reserves that were drained to pay back Lowe’s, at the same time adjusting permanently to a shrunken tax base.

“The long and short of it,” says Marquette Township Manager Randy Girard, “is that we will not recover.”

GOVERNING.COM

BY LIZ FARMER | SEPTEMBER 2016

NABL: IRS Modifies Rev. Proc. 2016-44 Transition Date.

The IRS has modified the effective date of Rev. Proc. 2016-44 to extend the transition period by 6 months.

The revision allows an issuer to apply the safe harbors in Rev. Proc. 97-13, as modified and amplified, to a management contract entered into before August 18, 2017 and that is not materially modified or extended on or after August 18, 2017 (other than pursuant to a renewal option as defined in sec. 1.141-1(b)).

The August 18, 2017 date is 6 months later than previously announced.

The updated version will be printed in next week’s Internal Revenue Bulletin.

The revised version of Rev. Proc. 2016-44 is available here.

An Obscure, Outrageous Reason Your Property Taxes Are So High.

In many parts of the country, they supply our water, fight our fires and help us get to work, but “special districts” are a form of government that receives very little attention. The lack of media

scrutiny and public interest in special districts provides opportunities for insiders to feast on the billions of tax dollars these entities collect each year. One such group of insiders are the intermediaries who help districts issue their bonds.

The Census Bureau counted over 38,000 special districts in its 2012 enumeration of local governments (the next count will be in 2017). The Census also found that these districts had aggregate revenue of $206 billion and debt of $370 billion, representing about 10 percent of the municipal bond market.

In an amusing and informative piece in March, HBO's John Oliver showed viewers the ups and downs of these special districts. One inspiring scene in Oliver's report shows two officials of a New Hampshire mosquito control district conducting a fully by-the-book public meeting with precisely zero members of the public attending.

Less inspiring was the case of a Texas special district formed when a company wheeled a mobile home onto a vacant plot of land and then rented it to a married couple for $150 per month short term. Those two individuals held the entire voting power of the special district – a power they used to authorize $500 million in new bonds to be issued by the district. Those bonds will finance water, sewer and other infrastructure for a new subdivision to be built on the vacant land.

But an electorate of two short-timers lacks the ability and incentive to ensure that the new bonds are issued in a cost-efficient manner. And it appears that underwriters, lawyers, financial advisors and other service providers are raking in outsized shares of these new bond proceeds.

On Aug. 20, James Drew of the *Houston Chronicle* reported on two special districts in Fort Bend County that paid issuance costs of between 9 percent and 11 percent of the face value of the bonds issued (Drew also reported that one of the special districts, MUD 187, was formed when a Houston developer arranged for two people to move their trailer onto what was then an empty field).

The issuance costs paid by these two special districts is well above the national average of 1.02 percent that I calculated in a 2015 study published by the Haas Institute for a Fair and Inclusive Society at UC Berkeley. Issuance costs are to local governments like points are to a consumer taking out a home mortgage. In both cases, the goal should normally be to minimize them.

Subsequently I looked at several bonds issued by special districts in the Dallas suburbs for the Texas Public Policy Institute. Costs of issuance ranged from 11 percent to 15 percent of the face value of the securities. In a number of the Texas cases (both those near Houston and those around Dallas) underwriting fees alone accounted for 3 percent of face value – compared to a national average of about 0.5 percent reported by Bloomberg.

Late last year, the California State Treasurer's Office released a comprehensive database of bonds issued in the Golden State with cost of issuance details. While my study provides data for a nationwide sample of bonds, the California State Treasurer's Office has now posted issuance cost details for all municipal bonds issued statewide. This impressive data set can be found here. The data were collected by the California Debt and Investment Advisory Commission (CDIAC), a unit of the State Treasurer's Office. Under state law, California local governments must report their debt data to CDIAC. The commission had been publishing some of this data, but Treasurer John Chiang, an advocate for transparency, recently decided to publish everything, including details on issuance costs.

A review of the California data shows numerous issuance cost ratios in excess of 10 percent of the issued amount – and even some exceeding 20 percent. Many of the higher issuance cost levels were

associated with small bond issues from special districts. Since some of the issuance costs don't vary with issuance size, they can hit small issuers relatively hard.

In 2013, San Jacinto special districts (called Community Facilities Districts) issued two special tax bonds totaling $985,000 and $925,000 respectively. In each case, costs of issuance exceeded 20 percent.

According to the Official Statement for the $925,000 bond, the district received a mere $532,066 of the bond proceeds. The Estimated Sources and Uses of Funds on page 6 of the document show $90,428 being deposited into a reserve fund and a total of $295,890 going to the underwriter, attorneys and other service providers. The remaining $6,616 reflected an original issue discount, arising from the bonds being sold below face value.

The debt service schedule on page 10 of the Official Statement shows that the district will pay $1,240,252 in interest on the $925,000 of bonds through 2043. Total debt service of $2,165,252 over the life of the bond issue is four times the net proceeds received by the district.

Whether high-cost bonds are issued in Texas, California or another state, the victims are homeowners living in or moving into the special district; their property taxes must be increased to service the bonds. Higher tax rates must be levied over the life of these securities – often as long as 30 years – and can lead to depressed property values.

While special district voters may be unable or uninterested in protecting themselves from excessive bond fees, other levels of government can. More states can follow California's lead by making issuance cost data public and readily accessible, facilitating the type of research I have reported here (Texas has a similar resource here).

Also, regulators can take action against unscrupulous bond market providers. Earlier this year, the Financial Industry Regulatory Authority (FINRA) fined a securities firm for charging a 4.3 percent underwriting fee to a Colorado school district, concluding that the fee "was inappropriate given the underwriting work performed." Hopefully FINRA will turn its attention to special districts, thereby protecting the property taxpayers of tomorrow.

The Financial Times

By Marc Joffe

September 2, 2016

IRS Issues Final Price Regulations to Be Addressed in Fall.

The IRS priority guidelines released this month include two regulations of importance to many GFOA members: Issue price regulations and proposed rules on the definition of political subdivisions. The priority guidelines specify regulations that the U.S. Department of the Treasury will work on through June 30, 2017.

According to the guidelines, the final regulations on the definition of issue price for tax-exempt bonds will be released this year. GFOA expressed core concerns including safe harbors for competitive sales in testimony before Treasury and IRS officials in 2015. The priority guidelines also include the proposed regulations defining political subdivisions for purposes of the tax exemption,

but are not likely to progress, given the extensive response from the issuer community on the topic. GFOA also spoke in opposition to these proposed rules in 2016, specifically emphasizing that the proposed rules question the legitimacy and authority of the bodies enacting the enabling legislation that created the political subdivisions in the first place.

GFOA's Federal Liaison Center will continue to monitor and report the progress of these projects and communicate GFOA's concerns to IRS and Treasury officials throughout the process.

Government Finance Officers Association

Wednesday, August 31, 2016

TAX - NEW YORK

Joon Management One Corp. v. Town of Ramapo

Supreme Court, Appellate Division, Second Department, New York - August 17, 2016 - N.Y.S.3d - 2016 WL 4371715 - 2016 N.Y. Slip Op. 05795

Property owner brought action against town seeking a judgment declaring that property's tax assessment was overstated and erroneous.

The Supreme Court, Rockland County, granted town's motion for summary judgment and denied property's owner's motion for leave to amend or to enforce settlement agreement. Property owner appealed.

The Supreme Court, Appellate Division, held that:

- Statute of limitations for tax certiorari proceedings applied to action;
- Town's motion for summary judgment was not premature;
- Supreme Court properly denied property owner's motion for leave to amend; and
- Supreme Court properly denied property owner's cross-motion to enforce alleged settlement agreement.

Statute of limitations for tax certiorari proceedings, which required such proceedings to be commenced after exhaustion of administrative grievance remedies and within 30 days after filing of the final assessment roll, applied to property owner's against town seeking judgment declaring that its property's tax assessment was overstated and erroneous, where gravamen of property owner's claim was that its property was overtaxed.

Town's motion for summary judgment on property owner's claim that its property tax assessment was overstated and erroneous was not premature, despite property owner's assertion to the contrary, where property owner failed to demonstrate how discovery might have lead to relevant evidence or that the facts essential to justify opposition to the motion were exclusively within the knowledge and control of the town.

Supreme Court properly denied property owner's motion for leave to amend its complaint against town challenging tax assessment, where property owner's proposed amendments, which were to add causes of action to recover money had and received and to recover damages pursuant to § 1983 for violation of constitutional rights, were devoid of merit.

Supreme Court properly denied property owner's cross-motion to enforce alleged settlement

agreement between owner and town with regard to owner's action against town challenging its property tax assessment, where stipulation of settlement was never approved by town board, thus never becoming binding upon town.

IRS Issues New Safe Harbors for Management Contracts to Facilitate P3s.

WASHINGTON – The Internal Revenue Service on Monday released a revenue procedure containing safe harbors for management contracts that allows them to more easily be used in bond-financed infrastructure and other projects involving public-private partnerships.

Rev. Proc. 2016-44 extends terms of long-term management to up to 30 years from the previous 15 years that market participants had complained was too restrictive. It also removes the formulaic fixed fee requirements for manager compensation, allowing for more incentive compensation.

"These safe harbors aim to give municipalities tools to allow more flexible and efficient incentives for longer-term private management of tax-exempt bond financed projects to facilitate infrastructure initiatives," said John Cross, the Treasury Department's associate tax legislative counsel.

The revenue procedure will be published in an Internal Revenue Bulletin on Sept. 6.

The safe harbors apply to any management contract that is entered into on or after Aug. 22, but issuers can also apply the safe harbors to any management contract that was entered into before that date.

Issuers also have the option of applying the more restrictive safe harbors in Rev. Proc. 97-13, issued in 2013, to a management contract that is entered into before Feb. 18, 2017 and not materially modified or extended after that date.

Rev. Proc. 97-13 established safe harbors for long-term management contracts, providing safe harbors under which a contract of up to 10 years would require at least 80% of the manager's annual compensation to be based on a fixed fee. Fifteen-year contracts would require at least 95% of the annual compensation be based on a fixed fee.

But bond lawyers and other market participants complained that the safe harbors were too restrictive and had not kept pace with recent market practices, such as attempts to use bonds to help finance projects with P3s, where private parties join together with state or local governments to develop, build, and operate infrastructure projects. P3s involve long-term management contracts.

Historically, the IRS has found that bond-financed projects have private business use that may jeopardize the tax-exempt status of bonds if there is private ownership or a private lease of a building or other facility.

This new Rev. Proc. 2016-44 contains three provisions containing limits that ensure there is no private ownership or leases.

The first is that a state or local government "must exercise a significant degree of control of the use of the managed property." Second, the state or local government "must bear the risk loss upon damage or destruction of the managed property."

Third, the private party "must agree that it is not entitled to, and will not take any tax position that is

consistent with the state or local government with respect to the managed property. The private party must not take any depreciation or amortization, investment tax credit, or deduction for any rent payment for the property.

The revenue procedure also carries over some restrictions from the previous one such as that there must be no net profit-sharing arrangements.

The procedure is receiving praise from many bond and tax lawyers, some of whom had submitted suggestions to Treasury and IRS on how to how to liberalize management contract safe harbors and clear up points of confusion.

Stefano Taverna, an attorney with McCall, Parkhurst & Horton in Dallas, and the chair of the American Bar Association's tax-exempt financing committee, called the new safe harbors "very significant," adding that they may help facilitate P3s. "I think Treasury did a terrific job at understanding the industry and what it will require in the future and tried to address these concerns," Taverna said. "All in all, I think the industry will welcome what Treasury put forward. It seems to be a lot more flexible and very reasonable."

Carol Lew, a shareholder at Stradling at Newport Beach, Calif., said the prior time limits and compensation structure for management contracts were "too rigid" and called the new rules "much more practical and pragmatic." The new revenue procedure is more representative of how the municipal bond industry has evolved, she said.

"It looks like Treasury and the IRS listened to comments from the industry on how to make the rules achieve IRS objectives and meet the needs of state and local governments," Lew said.

"I think this a helpful rule that can facilitate more public-private partnerships," she said. "It should be a good thing for issuers."

A management contract is defined by the IRS as a "management, service or incentive payment contract between a qualified user and a service provider under which the service provider provides services for a managed property." The contract term limit does not include the portion of a contract for services before a managed property is placed in service, such as construction design or management.

In Jan. 2015, the IRS released Notice 2014-67, which expanded the type of productivity rewards that could be used in management contracts. The notice also said that a management contract would not result in private business use if it is five years or less and compensation for services is based on a stated amount, periodic fixed fee, capitation fee, per-unit fee or any combination.

David Caprera, an attorney with Kutak Rock in Denver, said that this most recent update to management contracts acknowledges that a property manager is not supposed to be the economic equivalent of an owner of the bond-financed property, which he called a "fundamental principle."

"An owner is one who shares in the profits and losses of the business," Caprera said. "If the manager's compensation is reasonable and not tied to profits or losses, the Rev. Proc. recognizes that the manager is not an owner."

"The new rules allow long-term contracts for long-lived projects, and short-term contracts for short-lived assets so long as the compensation is reasonable and not tied to profits or losses," he added. "In particular, the '4 H's' of housing, healthcare, highways and hotels are going to be the beneficiaries, in that long-term assets can now be managed properly on a long-term basis."

Monday's revised Rev. Proc. comes one week after Treasury and IRS released their 2016-17 priority guidance plan, which included six projects for tax-exempt bonds the agencies plan to allocate resources toward through June. Asked about the plan, Cross had said that the most immediate short-term projects were to update management contract safe harbors and issue final regulations on issue price.

The Bond Buyer

By Evan Fallor

August 22, 2016

TAX - MICHIGAN

United States v. Detroit Medical Center

United States Court of Appeals, Sixth Circuit - August 17, 2016 - F.3d - 2016 WL 4376431

United States brought action against not-for-profit hospital corporation to collect Federal Insurance Contributions Act (FICA) taxes on stipends that hospital corporation paid to medical residents.

The United States District Court for the Eastern District of Michigan granted summary judgment to United States. Hospital corporation appealed. The Court of Appeals affirmed in part, vacated in part, and remanded.

IRS issued administrative ruling that medical residents were students who were exempt from FICA taxes, and issued refunds to hospital corporation.

Hospital corporation sought $9.1 million in additional interest on employer portion refunds, contending it was not "corporation" subject to lower interest rate on refunds.

The District Court granted summary judgment to United States. Hospital corporation appealed.

The Court of Appeals held that hospital corporation was "corporation" subject to lower interest on refund of employer portion of FICA taxes.

Not-for-profit hospital corporation was "corporation" under Internal Revenue Code that was subject to lower interest on refund of employer portion of Federal Insurance Contributions Act (FICA) taxes it paid for medical residents whom IRS subsequently determined were students exempt from FICA taxes. In keeping with common-law definition of "corporation," Internal Revenue Code consistently used "corporation" to include nonprofit corporations organized under state law as well as for-profit corporations, and, contrary to hospital corporation's contention, refund provision's cross-reference to subsection dealing with tax payments by C corporations was to define "taxable period," not corporations subject to lower interest rates on refunds.

Rev. Proc. 2016-44 Greatly Expands Rev. Proc. 97-13 Safe Harbor for Management Contracts, Opening the Door for Long-Term Management Contracts.

The IRS has released new management contract safe harbors that profoundly change the prior rules under Rev. Proc. 97-13. The new revenue procedure, Rev. Proc. 2016-44, which was released August 22 by the IRS, appears on first glance to have brought many favorable changes to the safe harbor rules. Unlike the prior guidance under Rev. Proc. 97-13, Rev. Proc. 2001-39, and Notice 2014-67, the new safe harbor under Rev. Proc. 2016-44 applies more principles-based tests rather than mechanical tests based on the length of the contract.

The new safe harbor takes effect immediately, but during an initial transition period running until February 18, 2017, issuers and borrowers can apply either the prior safe harbors or the new safe harbor. More specifically, the new safe harbor of Rev. Proc. 2016-44 applies to management contracts entered into on or after August 22, 2016. In addition, issuers may elect to apply the new safe harbor to management contracts entered into earlier. The prior safe harbors may continue to be applied to any contract entered into before February 18, 2017, that is not materially amended or modified on or after February 18, 2017, except pursuant to certain renewal options.

The safe harbor provided by Rev. Proc. 2016-44 is generally available to management contracts that satisfy the following six requirements:

1. General financial requirements. A contract (i) must provide only for "reasonable compensation" (ii), must not give the service provider "a share of net profits," and (iii) must not impose the burden of sharing any of the net losses on the service provider. 5.02.
2. Term of the contract. The contract term, including renewal options, must not be longer than the lesser of 30 years or 80% of the weighted average reasonably expected economic life of the "managed property" (the portion of the project to which the services relate). If contract terms relevant to the safe harbor analysis are "materially modified," the contract must be retested as a new contract. § 5.03.
3. Control over the managed property. The "qualified user" (depending on the project, this is either a governmental person or a 501(c)(3) organization) must exercise a "significant degree of control" over the managed property. § 5.04.
4. Risk of loss of the managed property. The qualified user must bear the risk of loss upon damage or destruction of the property. § 5.05.
5. Consistent tax positions. The service provider must agree "not [to] take any tax position that is inconsistent with being a service provider," e.g., by claiming depreciation with respect to (and presumably, ownership of) the managed property, or by claiming a deduction for a payment as rent (and presumably classifying itself as a lessee of some or all of the managed property). § 5.06.
6. No circumstances substantially limiting the qualified user's ability to exercise its rights. The service provider must not have any role or relationship with the qualified user that acts to substantially limit the qualified user's ability to exercise its rights under the contract. This safe harbor requirement may be satisfied by its own mini-safe harbor that requires showing: (i) that certain individuals affiliated with the service provider (e.g., directors and officers) do not control 20% or more of the vote of the qualified user's governing body, (ii) the qualified user's governing body doesn't include the service provider's chief executive officer ("CEO") or its chairperson (or the equivalents), and (iii) the CEO of the service provider is not the CEO of the qualified user (or CEO of any entity related to the qualified user). § 5.07.

Management contracts also do not result in private business use if they are an "eligible expense reimbursement arrangement." § 5.01. An "eligible expense reimbursement arrangement" means "a management contract under which the only compensation consists of reimbursements of actual and direct expenses paid by the service provider to unrelated parties and reasonable related administrative overhead expenses of the service provider." § 4.01.

Also, use by a service provider that is "functionally related and subordinate to" a management

contract that meets the safe harbor requirements does not result in private business use. The functionally related/subordinate use rule is clarified by an example: Storage areas to store equipment used to perform activities required under a management contract that complies with Rev. Proc. 2016-44 does not result in private business use (and presumably would mean that such space would not be treated as leased to the service provider).

A few key points to note:

- The new safe harbor may require certain special provisions that might not otherwise appear in a management contract and might not have been required under 97-13. Where does the service provider have to memorialize its agreement not to take inconsistent tax positions? The logical place is in the text of the management contract itself. Likewise, the qualified user must document its control over the managed property through budgetary control and rate-setting powers – these also may require special contract provisions.
- Under the new safe harbor, we no longer have to examine the termination provisions of a management contract.
- We also no longer have to categorize compensation into various buckets (per unit fee, periodic fixed fee, etc.).
- The greatly expanded permitted term opens the door to tax-exempt financing for a whole new world of P3 projects with long-term concession contracts

The summary above does not include all of the specifics. The summary also does not include the full definitions of various terms in Rev. Proc. 2016-44 (most of which are in Section 4 of Rev. Proc. 2016-44).

Squire Patton Boggs

by Alexios S. Hadji

USA August 24 2016

Some Lawyers Have Questions About New Management Contract Safe Harbors.

WASHINGTON – While the Internal Revenue Service's revenue procedure on management contracts received widespread praise from many bond and tax lawyers who felt it would help facilitate bond financing in public-private partnerships, several attorneys also had questions or concerns about it.

Rev. Proc. 201644, released by the IRS on Monday, contains safe harbors for long-term management contracts of up to 30 years from the previous 15-year limit and also removes the formulaic fixed fee requirements for manager compensation.

The new safe harbor under which a management contract does not result in private business use allows for the contracts to be more accessibly used in funding bond-financed infrastructure projects and public-private partnerships as well as for more incentive-based compensation.

Dave Caprera, an attorney with Kutak Rock in Denver, said the revenue procedure is "simpler, [and] easier to understand and apply" than the prior one. He felt the previous formulaic approach involving fixed fees under Rev. Proc. 9713 released in 2013 was ineffective in addressing compensation and term length. The new safe harbors allow longer-term contracts for long-lived

projects and short-term contracts for short-lived assets as long as the compensation is reasonable and not tied to profits or losses.

“The deal guys in my office are partying in the hallway,” he said.

Still, Caprera wanted to know if the term or economic life of a contract is retested when a contract is modified or a new contract is entered into.

The new revenue procedure adopts the existing tax law that treats a term which exceeds 80% of the reasonably expected economic life of a facility as being the equivalent of ownership.

“So, I have a 40-year property and I entered into a 30-year contract,” Caprera said hypothetically. “But the contract is terminated at the end of 15 years. I want a new contract. Can it be 30 years? 20 years, something else? What if the property is in bad repair and is only going to last 10 more years?”

Section 5.03 of the new revenue procedure under “Term of the Contract and Revisions” states that, “[a] contract that is materially modified with respect to any matters relevant to this section 5 is retested under this section 5 as a new contract as of the date of the material modification.”

The new revenue procedure amends Rev. Proc. 9713, which provided safe harbors under which a contract of up to 10 years would require at least 80% of the manager’s annual compensation to be based on a fixed fee. Fifteen-year contracts under Rev. Proc. 9713 required at least 95% of annual compensation to be based on a fixed fee.

The new guidance will supersede the safe harbors under Rev. Proc. 9713, which Michael Bailey, a partner with Foley and Lardner in Chicago, said will “raise many questions regarding whether certain contracts that were within the Rec. Proc. 9713 safe harbors will continue to be within the new safe harbors.”

The new rules generally require state or local governments to control rates, but many contracts under the existing safe harbors do not have that requirement, Bailey said. A major example of this is the separate billing arrangements that are often used in hospital management contracts.

Section 7 of the revenue procedure states that the new safe harbors apply to any “management contract that is entered into or after Aug. 22, 2016 and an issuer may apply these safe harbors to any management contract that was entered into before Aug. 22, 2016.”

But it adds that issuers also have the option of applying the safe harbors in Rev. Proc. 9713 “to a management contract that is entered into before Feb. 18, 2017 and that is not materially modified or extended on or after [that date].”

“For contracts entered into after that date, there could be problems,” Bailey said.

While the new guidance is more liberal than Rec. Proc. 9713 in some cases, such as long-term management contracts for public infrastructure projects, it is “not necessarily true in many other cases,” Bailey said.

He called this a “major issue” that he said will likely need to be addressed in comments submitted to the IRS and the Treasury Department.

Scott Lilienthal, a partner at Hogan Lovells in Washington, said on Wednesday that the new rules are helpful in allowing longer terms and greater flexibility for variable compensation, but had a similar analysis as Bailey.

“The revenue procedure also introduces some new conditions, such as requiring a certain amount of control over the managed facility by the qualified user, and it may take some time to see whether those new conditions may be problematic when applied to specific types of agreements,” Lilienthal said.

The new revenue procedure includes several requirements that must be met under a safe harbor in order for a management contract to avoid resulting in private business use. Similar to 9713, payments cannot be based on a share of net profits.

But the procedure also includes three new requirements to ensure there is no private ownership or lease of a project. A state or local government “must exercise a significant degree of control of the use of the managed property” and “must bear the risk of loss upon damage or destruction of the managed property.” In addition, the private party “must agree that it is not entitled to, and will not take any tax position that is consistent with the state or local government with respect to the managed property. The private party must not take any depreciation or amortization, investment tax credit, or deduction for any rent payment for the property.

Christie Martin and Maxwell Solet, attorneys with Mintz Levin in Boston, said that Rev. Proc. 2016-44 “substantially increases flexibility” for an issuer to work with private parties without jeopardizing the tax-exempt status of bonds.

In a post published on the firm’s website Wednesday, Martin and Solet wrote, “The overall impact of Rev. Proc. 201644 would seem to be an increase in the ability of bond issuers and tax-exempt users of bond-financed facilities to use for-profit contractors at bond-financed facilities. However, practitioners have already noted that the increased flexibility comes with less certainty and more facts and circumstances analysis with respect to many aspects of the safe harbor.”

“One area in which flexibility may be diminished is in the conditions under which payments may be subordinated or deferred, as the guidance indicates that timing of payment may not be conditioned on tests involving both the managed property’s revenues and expenses for any fiscal period,” they added.

Several other bond attorneys also told The Bond Buyer on Monday that it is clear the IRS and Treasury listened to industry concerns in constructing the new rules, which they said will foster more public-private partnerships.

Many market participants felt the prior rules were too restrictive regarding their ability to use tax-exempt bonds to help finance P3s, where private parties join with state or local governments to develop infrastructure projects under long-term management contracts.

The Bond Buyer

By Evan Fallor

August 24, 2016

Hawkins Advisory: 2016 Final Arbitrage Regulations

Read the Advisory.

Hawkins Delafield & Wood LLP

August 23, 2016

TAX - ILLINOIS

State ex rel. Schad v. National Business Furniture, LLC

Appellate Court of Illinois, First District, First Division - August 1, 2016 - N.E.3d - 2016 IL App (1st) 150526 - 2016 WL 4126773

Relator brought qui tam action under False Claims Act (FCA) against retailer, alleging that retailer knowingly failed to collect and remit use taxes on shipping charges for internet and catalog sales.

Following bench trial, the Circuit Court entered judgment in favor of retailer. Relator appealed.

The Appellate Court held that determination that retailer did not act with reckless disregard in failing to collect and remit tax was not against manifest weight of the evidence.

Trial court's determination that retailer did not act with reckless disregard in failing to collect and remit use taxes on shipping charges for internet and catalog sales was not against manifest weight of evidence in relator's qui tam action under False Claims Act (FCA). Retailer's employees testified regarding their practices in ensuring retailer's compliance with law, audit by Illinois Department of Revenue (IDOR) did not indicate that retailer's policies and practices regarding use taxes were not in compliance with law, and relator presented no evidence to show that retailer's employees were anything other than forthright with auditor.

NABL: IRS Issues New Management Contract Safe Harbors.

The IRS has released Rev. Proc. 2016-44, which provides revised management contract safe harbors under which a private management contract does not result in impermissible private business use of projects financed with tax-exempt bonds. Rev. Proc. 2016-44 will be published in Internal Revenue Bulletin Number 2016-36, dated September 6, 2016.

These revised safe harbors give State and local governments the ability to enter into management contracts with private entities to manage or operate tax-exempt bond financed projects with more flexibility for incentives in reasonable compensation arrangements and longer terms of up to 30 years (subject to an economic life limit). The revised safe harbors remove the previous requirements for prescribed percentages of fixed compensation for management contracts for different time periods.

The revised safe harbors continue a longstanding existing prohibition against sharing of net profits. The revised safe harbors add certain new principles-based constraints (governmental control, governmental risk of loss, and no inconsistent tax positions by private service providers).

The revised safe harbors are effective for any management contract that is entered into on or after August 22, 2016, and an issuer may apply these safe harbors to any management contract that was entered into before August 22, 2016. In addition, an issuer may apply the safe harbors in Rev. Proc. 97-13, as modified by Rev. Proc. 2001-39 and amplified by Notice 2014-67, to a management

contract that is entered into before February 18, 2017 and that is not materially modified or extended on or after February 18, 2017 (other than pursuant to a renewal option as defined in § 1.141-1(b)).

Revenue Procedure 2016-44 is available here.

NABL: IRS Issues Corrections to Final Regulations on Non-Issue Price Arbitrage Regulations.

The Internal Revenue Service (IRS) published today in the Federal Register two documents relating to the final regulations on arbitrage restrictions under section 148 of the Internal Revenue Code that were published July 18, 2016. One document makes two corrections to the preamble and the other corrects two dates in the regulation itself.

The corrections are available here.

Not-For-Profits and the New Revenue Recognition Standard.

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09 – Revenue from Contracts with Customers. The Standard was originally effective for annual reporting periods beginning after December 15, 2016 for public entities, and for annual reporting periods beginning after December 15, 2017 for all other entities. However, during August of 2015, the FASB issued ASU 2015-14, which deferred the effective date by one year. Public business entities, certain not-fo--profit entities and certain employee benefit plans should apply the guidance in Update 2014-09 to annual reporting periods beginning after December 15, 2017. All other entities should apply the guidance in Update 2014-09 to annual reporting periods beginning after December 15, 2018.

Is a not-for-profit organization considered a “public entity?” Possibly. A not-for-profit organization that has issued, or is a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market is considered a public entity and is therefore required to implement the new standard at the earlier implementation date.

Under the new standard, an entity should recognize revenue to reflect the transfer of goods or services to customers in the amount that represents the consideration to which the entity expects to be entitled for those goods or services. An entity should apply a five-step process to determine when revenue should be recognized:

1. Identify the contract(s) with a customer.
2. Identify the performances obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations in the contract.
5. Recognize revenue when (or as) the entity satisfies a performance obligation.

Specific guidance about these steps is outside the scope of this article.

Does the new revenue recognition standard affect not-for-profit organizations? It does, if the not-fo--profit receives revenue or support that is considered to be a contract. A contract is defined as an

agreement between two or more parties that creates enforceable rights and obligations. Based on this definition, donations and contributions are not within the scope of the new standard. However, not-for profit organizations have many other types of revenue and support that may qualify as contracts, such as program service revenue, membership dues and tuition, to name a few examples.

Although specific guidance of how this new standard affects certain types of organizations has not yet been finalized, the AICPA is working towards publishing audit guides for various industries to assist in determining when to recognize revenue.

On June 5, 2016, the AICPA's Financial Reporting Executive Committee (FinREC) published working drafts of interpretive guidance to address specific implementation issues for the FASB's revenue recognition standard. The implementation issues are the result of work performed by 16 industry task forces assigned by the FinREC with the task of developing guidance for a revenue recognition guide the AICPA plans to publish in January 2017. Included in the 16 task forces is the Not-for-Profit Revenue Recognition Task Force, which has issued three exposure drafts to date: 1) tuition and housing revenue, 2) contributions and 3) bifurcation of transactions between contribution and exchanges components. These exposure drafts are out for comment until September 1, 2016. The FinREC is also working on an exposure draft to provide guidance for revenue recognition related to subscriptions and membership dues, which has not yet been released.

Last Updated: August 24 2016
Article by Barbara Miller

Ostrow Reisin Berk & Abrams

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

IRS TE/GE Advisory Committee Requests Applications.

The IRS has requested applications for members to serve on its Advisory Committee on Tax Exempt and Government Entities, which will have vacancies in June 2017; applications are due by September 26, 2016.

Click here to learn more and to apply.

NABL Submits Suggested Revisions to the Internal Revenue Manual.

On August 26, 2016, The National Association of Bond Lawyers submitted comments and recommendations for further revisions to the provisions of the Internal Revenue Manual regarding bond examinations and technical advice in an attempt to make those provisions more clear, efficient and useful both for the Internal Revenue Service and for municipal bond issuers.

The comments were prepared by an ad hoc task force of NABL members, led by Thomas Vander Molen, Dorsey & Whitney LLP, with substantial input from individual members of the NABL Board of Directors.

TAX - MAINE

Petrin v. Town of Scarborough

Supreme Judicial Court of Maine - August 16, 2016 - A.3d - 2016 WL 4367255 - 2016 ME 136

Taxpayers filed a complaint appealing the decision of the town board of assessment review denying taxpayers' applications for abatements.

The Superior Court concluded that taxpayer did not have standing to assert one of their challenges but otherwise affirmed the board's decision. Taxpayers appealed.

The Supreme Judicial Court of Maine held that:

- Taxpayers established sufficient particularized injury for standing;
- Allowing abutting properties to be treated as a single parcel violated equal protection and the state constitution;
- Allowing abutting properties to be treated as a single parcel violated statutory requirement that each parcel of real estate must be assessed separately;
- Assessing portions of larger single lots at a rate that is lower than the rate applied to the "base" portion of the lots did not violate equal protection and the state constitution; and
- Board of assessment acted within its discretion in finding that partial revaluation of waterfront and water-influenced property improved equity of town's assessments.

Sun Burn: Solar Tax Credits Scorch State Budgets.

Solar power can burn a hole in a state's budget, but a well-designed plan can bring benefits

When it comes to solar power policy, the line from "Field of Dreams" is worth taking into account: "Build it, and they will come."

Demand for residential or rooftop solar power, spurred in part by state incentives, is growing rapidly. But if incentives are not well-designed, they can overwhelm a state's budget.

Regulators and utility officials in several states have been surprised – not always in a positive way – by the effects of their solar power policies.

Louisiana is one of the more recent, and more dramatic, examples.

In mid-July, Louisiana's Department of Revenue said it was almost $30 million short of funds to pay already submitted claims for rooftop solar systems and that there were no funds to pay future claims, even though the program is not scheduled to end until Dec. 31, 2017.

A 2015 law capped the state's solar tax credit program at $10 million each for 2015-16 and 2016-17 and at $5 million for 2017-18. The state already has $9.3 million in approved credits and $29.6 million in estimated pending claims for 2015-16.

The credit, put in place in 2008, was one of the more generous among state solar tax credits, covering 50% of system costs and capped at $25,000 for an individual system.

That credit has been one of the drivers of solar power in Louisiana. According to the Solar Energy Industries Association, 32 MW of solar power – almost all of its residential – was installed in Louisiana in 2015, a 3% increase over the previous year, and the trade organization expected another 208 MW of installations over the next five years.

Industry experts say part of the reason Louisiana implemented such a generous 50% tax credit was as an effort to compensate for a residential rate structure that did not make solar power attractive.

Louisiana has a declining block rate structure, meaning that the first increment or tier of power used costs the most, with rates then dropping for customers who use more electricity.

In states like California, which has an inclining block rate structure, customers who use the least electricity pay the lowest rates. That structure creates an incentive for customers in the higher tiers to install solar panels in order to reduce their usage and rates. In states, such as Louisiana, with a declining block rate, that rate reduction strategy is not as compelling.

Louisiana's solar tax credit also had a provision that allowed a cash payment for customers who did not have enough income to use all their credits. The state's incentives were very attractive, but when lawmakers moved to rein them in, they went as far to the other side, reducing the cap while the program was still under way and by making the reduction retroactive.

Those sort of policy decisions, and resulting market disruptions, are becoming increasingly common nationwide.

Tax credits fuel Western solar boom

The sudden removal of Louisiana's tax credits may have made things worse for homeowners there, but it is not the only state where booming solar power is creating problems in the state capital.

New Mexico has also ended its solar tax credit. The state implemented its tax credit in 2008 with a 2016 sunset date. But the state set a $3 million a year cap on the program, and has hit that limit in each of the last four years, according to Mark Gaiser, a clean energy program manager with the state's Energy, Minerals and Natural Resources Department.

"New Mexico's tax credit has been running out of money every year at a faster and faster pace," said Noah Long, western energy project director with the National Resources Defense Council.

There have been two attempts to bring the tax credit back, but both have failed in the legislature. And, with the lower house of the legislature controlled by Republicans and the upper house controlled by Democrats, the chances of passing a new solar tax credit into law are slim, Long said.

In retrospect, it looks like putting a cap on the program "was kind of wise," Gaiser said. "It didn't allow for over reach."

Another western state is facing similar problems, but for now the solar tax credit program is still running in Utah, where solar power is booming.

The state saw 3,000 rooftop solar installations in 2015, and the Governor's Office of Energy Development expects to process 12,000 applications this year. If all those applications turn into installations, it would mean more rooftop solar would be installed in 2016 than in all prior years combined.

The boom has been driven by the falling costs of solar panels, as well as at least three different state

solar incentives. In addition to a state solar tax credit, Utah has a net metering program and the state's largest utility, Rocky Mountain Power, until recently offered a rebate on the cost of installing solar power.

The utility rebate was about 1.5 cents per watt of installed rooftop solar. The program was set up as a lottery under a five year program and was very popular. Over four years, the utility provided $40 million in rebates.

But in March the state legislature signed off on Rocky Mountain Power's proposal to end the program in its fourth year and switch it to a broader initiative, the Sustainable Energy and Transport Program, which includes incentives for transportation and energy storage, as well as for solar power.

"We think the solar industry is no longer an unknown quantity," Rocky Mountain Power spokesman Paul Murphy said. "So, we don't think it needs additional incentives. We would rather use the funds for all customers."

Utah also provides a solar tax credit equal to 25% of the cost of a system, capped at $2,000 per system. But the rapid growth of rooftop solar in the state is raising concerns among lawmakers.

When the tax credit was created in 2012, it was a $1 million program, this year it is going to hit $25 million or $40 million, Jeffrey Barrett, deputy director of the Governor's Office of Energy Development, said. "The word 'exponential growth' was created for this sort of thing."

"The legislature is worried as hell about the fiscal impact," Barrett said. "I think new legislation is being drafted right now."

What form that legislation will take is still unknown, he said. It could be a cap or a cap and a phase out, but "in the future, it will be a completely different program."

By law, Utah's the tax credit comes up for review in 2017.

State funding struggles a trend

Overall, the expiration of state solar tax credits has become a national trend.

"I think that it is due in part to budgetary problems, but also due to solar's increasing maturity," Autumn Proudlove, senior policy analyst at NC Clean Energy Technology Center at North Carolina State University, said.

Many of the tax credit programs were put in place to help solar power get off the ground, but with the growing penetration of solar, some states are letting those programs expire.

At the beginning of 2015, 15 states had residential solar tax credits. Now, 11 states have them, and programs are set to expire in Iowa at the end of 2016, in Louisiana and Oregon at the end of 2017, and in Maryland at the end of 2018, according to the Database of State Incentives for Renewables and Efficiency (DSIRE).

In part this a reflection of the natural life span of a tax credit. Tax credits are often put in place to help a technology transit to commercial viability. In some states, legislators are letting them expire because they believe the technology has advanced far enough that tax credits are no longer necessary.

North Carolina is an interesting example, Proudlove said. The state tax credit really helped develop the state's utility-scale solar market, but the residential and commercial solar markets are still small and have really dropped off since the tax credit expired, she said.

According to a survey conducted by the Utah Solar Energy Association, 80% of the respondent said that the tax credit was "important" of "very important" in their decision to install solar panels on their rooves, Ryan Evans, president of the trade group said.

Reducing or capping Utah's solar tax credit "would not send the right message right now," Evans said. "After all, there are only so many Utahans. The boom can't last forever." Eventually everyone who wants solar power will have it or all the roofs will have solar panels, he said.

The other factor that needs to be considered, Evan said, is that tax credits bring in business. "My guess is that the state gets their money back" through increased sales tax and corporate taxes.

According to a report by the North Carolina Sustainable Energy Association, North Carolina energy projects generated $1.54 of state and local government tax revenue for every $1.00 taken in tax credit.

But, as Evans pointed out, "Not all tax credits are created equal." And there is a fair amount of variety when it comes to solar tax incentives. California uses a tax exemption for solar equipment instead of a credit on a tax return. Other states also give an adjustment or deduction on property taxes, but can lead to problems.

Not only do property values change, they are very local, and "it is difficult for developers to know the value," said Sean Gallagher vice president for state affairs at the Solar Energy Industries Association.

Gallagher noted that most tax credits are designed with sunset dates or budget caps. "It is not unusual for them to have a limit,"

In a well-designed system, there needs to be a recognition of the importance of planning, from the perspective of the state, as well as that of the homeowner and the developer. The simplest way to do that is to have a clear expiration date for the tax credit and clear definitions of qualifying factors such as construction start dates.

Other features, such as reserve funds and triggers, can also be helpful tools. They let consumers know when the credits are close to expiration or near capacity.

It's best to design programs with a budget cap or an expiration date, "people need to be able to plan for it," Gallagher said. The worst thing to do, though, is to change the tax credit or lower the cap retroactively. In those situations people stand to lose their investment, Gallagher said.

Utility Dive

By Peter Maloney | August 17, 2016

Philadelphia Business Taxes: Incentives and Exemptions.

Like many cities, Philadelphia does not regularly evaluate whether tax breaks achieve their goals

Overview

Philadelphia business tax rates are among the highest of any large city in the nation, and the tax structure is frequently cited as one reason for the city's relatively weak job-creation record over the past several decades. A key element of that structure is the business income and receipts tax (BIRT), which taxes profits and revenue of businesses located in the city. Only 11 of the nation's 30 largest cities impose levies on corporate profits or revenue, and only Philadelphia does so on both.

To make these business taxes less onerous, Philadelphia's leaders have created a large and varied group of tax incentives and exemptions. Known as tax expenditures, they constitute an integral but little-understood aspect of the city's business tax policy. Supporters view the expenditures—which do not appear in the city's budget or financial statements—as investments in growing, maintaining, and attracting businesses, thereby enhancing the tax base. Critics see them as drains on public resources that have little accountability, haphazard goals, and scant proof that they pay off in business growth or future tax revenue.

To help policymakers and the public better understand the role that these measures play in Philadelphia's overall tax policy, The Pew Charitable Trusts sought to quantify the city's tax expenditures and compare them with those of other major cities. In Philadelphia, the analysis looked at two types of tax expenditures: incentives to spur companies to take specific actions, such as hiring more workers or investing in neighborhoods; and industrywide exemptions to support particular business sectors deemed by policymakers to merit special treatment. The study covered two periods, 2001-03 and 2010-12, in order to show change over time; the 2010-12 data were the most recent for which information was complete.

The research found that Philadelphia has 21 city-approved business tax reduction programs or provisions, the most among the nation's 30 largest cities. Eight of those reductions took effect after 2012, too late for their impact to be included in this analysis.

The research also found that from 2010 to 2012, the tax incentive programs resulted in an average of $109.6 million per year in forgone revenue for the city and the school district—a 634 percent increase from 2001- 03, when the average annual inflation-adjusted amount was $14.9 million. This report describes revenue as "forgone" rather than "lost," in part because repealing the tax incentives would not necessarily restore an equivalent amount of money to local coffers; businesses probably would alter their operations to reduce their tax liabilities.

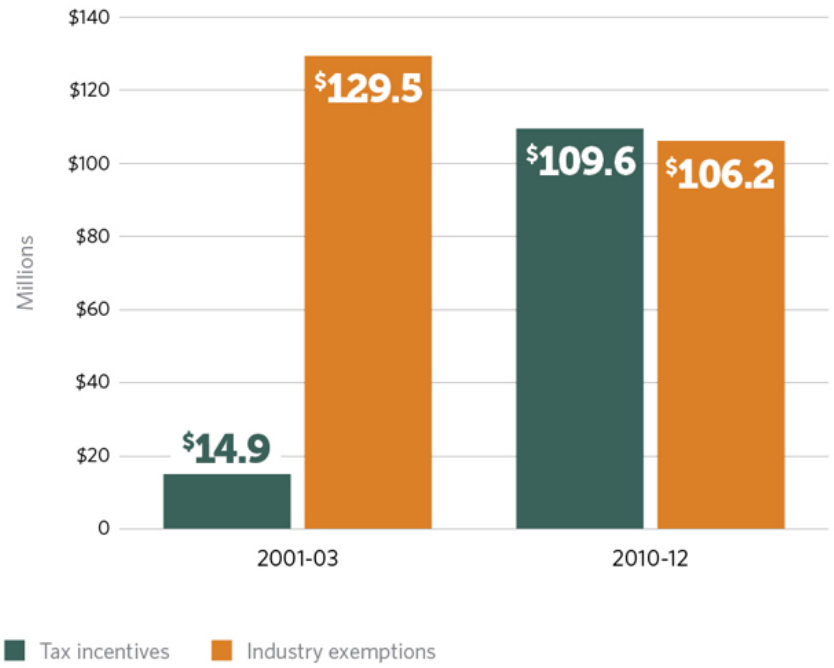
The vast majority of the $109.6 million stemmed from two programs: the 10-year property tax abatement on new construction and building improvements for commercial and industrial property, and the Keystone Opportunity Zone initiative, which exempts businesses within designated areas from state and local business taxation. Like all tax incentives, both of these programs require companies to commit to making new investments in the city and are in effect for limited periods of time.

The other main source of tax expenditures—industrywide exemptions primarily for finance, insurance, utilities, and port-related firms—produced at least $106.2 million in forgone revenue annually from 2010 to 2012. The amount was 18 percent less than in 2001-03, adjusted for inflation. Unlike tax incentives, exceptions are granted to individual companies without any time limits. Companies determine their eligibility in tax filings, which city auditors can challenge. (See Figure 1.)

Figure 1

Forgone Business Tax Revenue in Philadelphia

Annual average, in millions



From 2001-03 to 2010-12, Philadelphia's forgone business taxes grew primarily as the result of expanded use of tax incentives meant to retain and attract businesses and to spur real estate development, hiring, community reinvestment, and other commercial activity. The average annual amount of forgone revenue from tax incentives increased by 634 percent. Industry-specific exemptions declined 18 percent. All figures are inflation-adjusted to 2012 dollars.

Note: See Appendix D for list of credits, abatements, and exceptions.

Source: Pew analysis of Philadelphia Department of Revenue and Office of Property Assessment records

Whether these tax expenditures have paid off for Philadelphia is hard to say. There is no question that there have been benefits, in terms of jobs created and buildings constructed. The issue is whether those benefits outweigh the costs.

Philadelphia reports on some of its smallest tax-expenditure programs but does not conduct comprehensive analyses of how much all the tax expenditures cost or whether they achieve their purposes—and is not required by law to do so. Only a few cities, including New York and Washington, require that kind of reporting. For those reasons, this report does not compare forgone revenue for the city of Philadelphia and the school district with other jurisdictions.

In 2012, the staff of the Pennsylvania Intergovernmental Cooperation Authority (PICA), a state agency that oversees Philadelphia's finances, called on the city to clarify and evaluate specific tax expenditures, concluding: "A lack of detailed accounting prevents a systematic process of evaluating whether the costs of these policies are justified in relation to their benefits."

This study does not attempt to determine whether Philadelphia business tax expenditures have met their goals, but it does look at ways that cities can design programs to include evaluations. According to public finance and policy analysts, measuring the impact of tax benefits and setting clear rules for receiving them are key steps toward an effective and equitable tax system that fosters economic development and generates needed revenue.

Conclusion

For several decades, business leaders and tax experts have called for transformation of the city's

entire tax structure in order to improve Philadelphia's competitiveness with its suburbs and other large cities. The recent overhaul of the city's property tax system, the Actual Value Initiative, was viewed as an important first step in laying the groundwork for comprehensive change.

Given the increase in forgone taxes over the past decade, tax expenditures merit a place in Philadelphia's tax policy discussion. Knowing how much these tax exceptions cost, and whether they are meeting their goals, is a key component of a coherent and equitable city tax policy.

Download the full report.

The Pew Charitable Trusts

TAX - ALASKA

Bingman v. City Of Dillingham

Supreme Court of Alaska - August 12, 2016 - P.3d - 2016 WL 4257176

City petitioned for foreclosure of taxpayer's property. Taxpayer intervened.

The Superior Court entered judgment and decree of foreclosure, and taxpayer appealed.

The Supreme Court of Alaska held that:

- City did not accept taxpayer's proposal to redeem his foreclosed property, and
- Taxpayer did not satisfy statutory requirements for repurchasing his foreclosed property.

City did not accept taxpayer's proposal to redeem his foreclosed property by offering city promissory note for amount due, without interest, that would mature 20 years later, even though proposal stated that silence would be treated as acceptance, and city did not reject offer in manner outlined in taxpayer's proposal, where city sent letter rejecting offer, never recorded taxpayer's redemption, and did not issue certificate indicating that he had redeemed property, but instead published notice of expiration of redemption period, and moved for properties to be transferred by tax deed.

Taxpayer did not satisfy statutory requirements for repurchasing his foreclosed property by offering city promissory note for amount due, without interest, that would mature 20 years later, where offer was made before tax deeds transferred property to city, and failed to meet statutory provisions for calculating purchase price.

Why a Judge Allowed a Challenge to a Private Activity Bond Allocation.

BRADENTON, Fla. — Two Florida counties can move forward with the first lawsuits ever to challenge a private activity bond allocation from the U.S. Department of Transportation.

In a 39-page ruling late Tuesday, U.S. District Judge Christopher R. Cooper sided with Martin and Indian River counties, both of which objected to the USDOT's award of $1.75 billion in private activity bonds for the All Aboard Florida passenger train project.

The planned passenger trains would pass through the two counties on their route between Miami and Orlando.

Cooper said that the counties proved that the bond allocation should have been considered in a federal environmental review process. He denied motions to dismiss the case by the USDOT and All Aboard Florida.

“Martin County is very pleased with the decision and believes that the public will have more information as a result of the court action than they’ve ever had before about the project,” said Stephen Ryan, a partner with McDermott Will & Emery LLP, which represents Martin County.

Cooper said that the counties had legal standing to proceed with their challenges because they demonstrated that the $3.5 billion train project likely will not be built without tax-exempt financing — a reversal from a decision in June 2015.

Cooper said information produced during discovery raised “legitimate questions” about All Aboard Florida’s commitment to completing the second phase of its project, from West Palm Beach to Orlando, without the use of private activity bonds.

“First of all, PAB-based financing is not just the ‘current financing plan’ for the project – it appears to be the only financing plan,” Cooper wrote. “This strikes the court as unusual given the uncertainty surrounding the PAB issue, particularly for a company that has expressed its concern” about keeping the project on schedule and avoiding losses due to delays.

Cooper said the issue “casts some doubt as to whether AAF is truly serious about moving forward with phase 2 of the project regardless of the outcome of this lawsuit.”

“It also indicates that AAF may have simply assumed that alternative financing would be available,” he said.

The ruling is a “really significant victory,” said Indian River County Attorney Dylan Reingold.

He said that information the counties produced in discovery convinced the judge to change his mind about whether AAF needed bond financing for Phase 2 of the project.

“The judge told us we have standing, and we met that burden,” he said.

USDOT referred questions to the U.S. Department of Justice, which did not immediately respond to requests for comment.

All Aboard Florida did not immediately respond to requests for comment.

AAF, which is owned by Fortress Investments Group, is attempting to create a privately funded and operated passenger train service, the nation’s first in decades.

Private financing is in place for its first phase, linking Miami, Fort Lauderdale and West Palm Beach, where stations are under construction, according to court documents.

In Phase 2, Martin and Indian River counties have cited potential harm to public services and archaeological sites from 32 planned high-speed trains daily in separate suits filed in the District of Columbia.

Both cases contended that USDOT’s December 2014 allocation of bonds should have been considered as part of federal agency reviews under the National Environmental Policy Act.

USDOT and All Aboard Florida argued that the approval of private activity bonds was not a major

federal action that would trigger a NEPA review.

The judge disagreed.

Cooper compared the benefits of the $1.75 billion PAB allocation with a $1.6 billion low-interest loan that All Aboard Florida applied for from the Railroad Rehabilitation and Improvement Financing program.

Under federal rules, the RRIF loan is considered a major federal action that triggered a NEPA review, although AAF has not completed the loan process.

“In the court’s view, then, if the amount of federal assistance conferred by the RRIF loan can support a finding of major federal action, so too can the amount of federal assistance conferred by the PAB-allocation decision,” Cooper said.

Cooper also said the fact that USDOT, as a condition of receiving the PAB financing, required All Aboard Florida to comply with an “extensive” list of mitigation measures imposed by the final environmental impact statement indicated that USDOT had “the requisite degree of control called for by NEPA and related statutes so as to implicate major federal action.”

Cooper refused to dismiss claims by the counties that the bond allocation violated NEPA, the National Historic Preservation Act and the Department of Transportation Act.

“I see this as a big game changer as to where this case proceeds,” Reingold said.

Ryan and Reingold said they would confer on the next stage of the litigation, which could be a trial or a ruling on summary judgment.

All Aboard Florida has said it plans to begin the first phase of train service – which it has branded as “Brightline” — next year.

The company tried and failed to privately place the unrated, uninsured bonds after the Florida Development Finance Corp. agreed to be the conduit issuer last year.

The company blamed the tight bond market, as volatility increased and high-yield investor demand dried up in the months before the Fed increased the borrowing rate 25 basis points in December.

The delayed sale led the USDOT in December to grant AAF an extension of time to issue the bonds and agree to allow the debt to be sold in multiple offerings, rather than issuing all $1.75 billion at one time.

In Tuesday’s ruling, Cooper examined difficulties AAF had issuing the PABs as part of his analysis about whether the company could avail itself of other types of financing.

AAF’s first tried to sell the PABs in August at an interest rate of 6% for a single tranche of up to $1.75 billion, Cooper said, adding, “AAF found that it could not sell all its PABs at that rate on the terms it wanted.”

In September, deal was structured at a higher 7.5% interest rate with bonds in two tranches, one for $1.35 billion and the other for $400 million.

“Again, there was insufficient interest from investors for AAF to close on the sales on AAF’s terms,” Cooper said.

In November, after issuing a third supplement to the offering memorandum, AAF kept the projected interest rate at 7.5% but added additional terms "that were arguably more favorable to investors," he wrote.

"Each time [AAF] was either unable to conclude a deal or chose not to do so, depending on whose framing of the issue one prefers," Cooper said. "Either way, the fact remains that the AAF project repeatedly did not generate sufficient interest to result in a sale of all bonds at the 7.5% rate."

All Aboard has argued that it would use other forms of financing for the project, including taxable bonds, but the judge was skeptical of its ability to do so.

"It strikes the court as reasonable that a full sale of the PABs would require an interest rate of at least 8% in the present market, which would bump the interest rate for taxable bonds into the range that AAF acknowledged is unacceptable."

A banker familiar with the PAB deal, who asked not to be identified, said he was told that AAF decided to postpone the offering until all legal issues were cleared up.

All Aboard Florida has until Jan. 1 to issue the bonds, according to the USDOT.

In a statement Wednesday, CARE FL, a local anti-train organization, said that although AAF claims that it is a privately funded project the court ruling proves that AAF is dependent on public support from the tax benefit provided by allowing tax-exemption on its bonds.

The group's steering committee chairman, Brent Hanlon said AAF would travel through heavily populated Treasure Coast areas and require residents to bear additional financial burdens and safety risks.

"We especially applaud the Martin County and Indian River Board of County Commissioners and legal teams for their leadership and steadfast commitment in the fight against AAF," Hanlon said.

The Bond Buyer

By Shelly Sigo

August 17, 2016

An Under-the-Radar Tax Benefit in Muni-Bond Funds.

Funds treated differently from individual munis, allowing investors to claim a tax loss

It's common knowledge among many investors that interest from municipal-bond funds are generally free of income taxes. What is not such common knowledge is that, if used right, muni-bond funds may have a negative tax rate.

That is to say, in addition to tax-free income, investors may be able to take a tax loss without actually incurring an economic loss. Because muni investors are typically in a high tax bracket, this strategy may have broad appeal.

The idea revolves around the fact that interest rates have declined and muni-bond coupon payments are higher than the so-called SEC yield. The SEC yield, created by the Securities and Exchange

Commission to help comparisons among bond funds, represents the fund's true income and carves out any return of capital that is included in the distribution yield. This creates a potential opportunity, according to Joel Dickson, global head of investment research and development at Vanguard Group.

How the Strategy Works

Muni bonds are typically issued at a premium in excess of the face amount of the bond. Because rates have declined, the premiums are now even greater. For example, if you bought a muni bond (not a fund) at $110 that would mature at $100 in five years, roughly $2 a year is just return of your own principal, though the regulator, the Municipal Securities Rulemaking Board, allows it to be called income. After a year, your $110 cost basis would be adjusted to about $108, and you would see that adjusted cost basis on your brokerage statement. Because the cost basis is adjusted down—something known as amortization of premium—you can't sell it a year later at a loss because you were paid back that principal and have no economic loss.

Bond funds, however, are treated differently than owning the bond directly. The amortization of premium doesn't impact the cost basis and thus losses can be claimed even though none were incurred.

Here's how it can work for you or your client, using the example of a muni fund from Mr. Dickson's firm:

Say the Vanguard Intermediate-Term Tax-Exempt Admiral fund has an SEC yield of 1.35%. Though this is the true income, the total distribution yield is 2.79%, meaning 1.44 percentage points is return of principal from an economic perspective. If this continued for a year, an estimated loss of the net asset value of 1.44 percentage points could occur.

The Tax Benefits

For a $100,000 investment over a year under this scenario, the investor would have been paid $2,790 in cash, with $1,350 of that in income and $1,440 in return of principal. You could then sell the fund to recognize the $1,440 tax loss and buy a different low-cost muni-bond fund. This capital loss can be used up to the Internal Revenue Service limit of $3,000 a year or an unlimited amount to the extent you have capital gains this loss could offset.

If you have short-term capital gains , you save at an ordinary income-tax rate. Yet even if a long-term capital gain, you may save 25% or more after taking into account the alternative minimum tax and the Medicare tax that affect so many of the higher-taxed investors who typically own munis.

So the tax loss of 1.44 percentage points on a $100,000 investment at a 25% marginal tax rate translates to a 0.36% tax benefit, or a $360 savings. This may not seem like much, but frame the extra 0.36% with the 1.35% SEC yield to give you a 1.71% tax-free benefit.

Pitfalls to Ponder

Tax laws are complex and Mike Piper, author of "Taxes Made Simple," points out that the fund must be held for six months or the losses could be disallowed according to IRS rules. 852(b)(4)(B).

Also, the actual loss is going to vary based on other factors, such as the direction of interest rates, what investor perceptions are of muni-bond risks, and the muni-bond fund used to execute the strategy.

While these factors will result in the loss being either more or less than estimated, the same factors are also likely to be present if an investor owned the muni bonds directly rather than through a fund. And, of course, muni bonds also have risks of real losses whether owned directly or through a fund. But if you decide munis are right for part of a portfolio, the low-cost muni-bond fund can be superior to bonds from a tax perspective.

And beyond a tax perspective, there are 5 other reasons bond funds are superior to owning the bonds directly. When it comes to muni bonds, there are now 6 reasons funds are superior.

THE WALL STREET JOURNAL

By ALLAN S. ROTH

Aug. 19, 2016 10:54 a.m. ET

—Allan S. Roth is the founder of Wealth Logic, an hourly-based financial-planning firm in Colorado Springs, Colo. His contributions aren't meant to convey specific investment advice.

IL Taxpayers Can Sue to Block Business Tax Credit Program Costing the State Too Much: Panel

An Illinois appeals panel in Springfield, in overturning a lower court decision, has ruled taxpayers have the right to try to block a state commerce agency from administering a business development tax credit program the group of taxpayers has argued is actually an alleged illegal state tax improperly eating up public funds.

The Aug. 2 opinion was penned by Justice Thomas Appleton, of the Illinois Fourth District Appellate Court in Springfield, with concurrence from justices Thomas Harris and Robert Steigmann. The decision upset a ruling by Sangamon County Circuit Court Judge John Madonia, who had tossed a suit by 10 taxpayers against the Illinois Department of Commerce and Economic Opportunity. The case was sent back to circuit court for further proceedings.

The taxpayers brought the action in January 2015, alleging the department overstepped the boundaries of a state law, called the Economic Development for a Growing Economy Tax Credit Act. The Act gives tax breaks to businesses that create new jobs, by giving a tax credit in the amount of the income tax withheld from new employees' paychecks. However, plaintiffs alleged the department is allowing credits in the amount withheld for both new and retained employees.

Plaintiffs argued that as a result, these overindulgent tax credits could diminish the public treasury, with taxpayers having to make up the difference. Apart from that alleged damage, plaintiffs contended they are harmed by the department's misapplication of their tax dollars to administer an illegal regulation. They sought an injunction to halt the tax breaks.

Circuit Judge Madonia ruled plaintiffs lacked standing to pursue the case, because the state had the only interest in the matter and taxpayers suffered no harm. Madonia said the only way plaintiffs could have a stake was for them to claim the tax statute was unconstitutional, not to challenge how the statute was interpreted or how funds were spent. Plaintiffs appealed.

Justice Appleton was not impressed with plaintiffs' contention taxpayers might have to make good the deficiency in tax revenue caused by the excessive tax credits, saying the argument was

“speculative and simplistic.”

“Can one really predict the legislature will probably raise taxes because of the excessively generous tax credits that defendant will grant?” Appleton asked.

However, Appleton was persuaded by plaintiffs’ other argument that “collecting it (an illegal tax) will be a misuse of taxpayer-funded salaries and offices and, as such, a misuse of public funds.”

The state maintained, as it did in circuit court, that the suit was improper, because plaintiffs were trying to exercise a right that belonged to the state alone. The state pointed to federal rulings to bolster its position, but Appleton noted Illinois courts are “more generous” in granting legitimacy to citizens bringing tax suits.

“Unless the administration of an illegal regulation is cost-free (and it is difficult to see how it ever would be), the taxpayer has standing to seek an injunction, regardless of whether the regulation would bring a net profit to the state and regardless of whether the cost of administration is small,” Appleton observed. “It will always cost something to administer a regulation, including an illegal one. The machinery of the State never runs cost-free.”

Appleton cautioned that although taxpayers can challenge the legality of a regulation in court, they cannot attack the regulation on the ground it is “unwise,” “inefficient” or “improvident.”

Plaintiffs are represented by lawyer Jacob Huebert, of the Liberty Justice Center in Chicago, which says its mission is to “revitalize constitutional restraints on government power.” The Illinois Department of Commerce and Economic Opportunity is defended by Illinois Attorney General Lisa Madigan’s office.

The Cook County Record

by Dan Churney

Aug. 8, 2016, 4:42pm

TAX - GEORGIA

Columbus, Georgia Board of Tax Assessors v. Medical Center Hospital Authority

Court of Appeals of Georgia - July 7, 2016 - S.E.2d - 2016 WL 3654495

Hospital authority filed action against board of tax assessors, city, and county tax commissioner, seeking a declaration that its leasehold interest in a continuing care retirement facility was public property exempt from ad valorem taxation.

The Superior Court granted summary judgment for the authority. Tax board appealed.

The Court of Appeals held that hospital authority’s leasehold interest was public property exempt from ad valorem taxation.

Hospital authority’s leasehold interest in a continuing care retirement facility was public property exempt from ad valorem taxation. Revenue bond validation proceedings had conclusively established that the retirement facility furthered a legitimate function of the hospital authority.

Under state constitution, a judgment in a revenue bond validation proceeding is conclusive as to all questions which could and should have been asserted and adjudicated during the bond validation proceedings.

Even the Giants Are Complaining About San Francisco Real Estate.

A prominent tenant with a gorgeous waterfront location in the nation's most expensive city wants a big break on its property tax bill. It may have a case for getting one.

The tenant is the San Francisco Giants, who hold the lease at AT&T Park, where they play baseball. The stadium's location is prime real estate, with stunning bay views and close proximity to downtown, light rail and the Bay Bridge. Home prices have more than doubled in the city since the team built the park 16 years ago. Even though city assessment increases are limited under California law, the land value is expected to rise another 7 percent this year.

Assessor-Recorder Carmen Chu argues that it's only right for the Giants to pay their fair share of the increased worth, just like any homeowner or office building. "At the end of the day," Chu says, "we're talking about real estate values, which fundamentally come down to location. San Francisco and particularly the area of the city that the stadium is in is highly desirable," Chu says. "It's one of the fastest-growing areas."

But the Giants say Chu is asking for way too much. Two years ago, she retroactively doubled the team's property tax bill going back to 2011. The Giants have taken their case to the San Francisco's assessment appeals board. The team argues that its lease on the land is decreasing in value the longer they are tenants. The lease still has 66 years left to go, but the Giants seem to believe the value of the stadium itself is depreciating in the same way a car does.

That argument prevailed a decade ago, when the Giants won an earlier dispute over their property tax bill. But it's a debatable point, says Victor Matheson, a sports economist at College of the Holy Cross. Under income tax rules, the value of a property can depreciate over time. But that's not true under property tax rules. No one could argue that a 100-year-old house in good shape in an upscale neighborhood has no value.

The case for depreciation is undercut by the fact that AT&T Park not only still sparkles but is clearly bringing in lots of money for the team. "It's not like it's now generating half the money that it did when it opened," Matheson says.

The two sides are far apart. But regardless of the appeal's outcome, Chu should take heart from one thing. The Giants may not be paying as much as the assessor thinks is right, but anything at all is more than most sports franchises pay in property taxes. Usually, they're either playing in a municipally owned stadium or they've gotten a break on taxes as part of the initial deal. "They avoid paying taxes almost all over the country," Matheson says.

GOVERNING.COM

BY ALAN GREENBLATT | AUGUST 2016

IRS Ends Eight-Year Audit of Florida's Villages Without Penalty.

The U.S. Internal Revenue Service has closed an eight-year exam of about $300 million of tax-exempt bonds issued for The Villages, one of the world's largest retirement communities, without imposing a penalty, according to a filing by the development districts that issued the debt.

The Village Center Community Development District and the Sumter Landing Community Development District, located about 60 miles (97 kilometers) northwest of Orlando, said the IRS notified them on July 14.

"We were steadfast in maintaining that the districts had followed the law and that there was no factual basis for the IRS examination," wrote district manager Janet Tutt in a July 18 memo listed Wednesday on the Municipal Securities Rulemaking Board's disclosure website. "To have this examination finally closed without penalty is a tremendous victory for our community and vindication of our supervisors and district staff who do a tremendous job serving our residents."

The districts, created by the late billionaire developer H. Gary Morse, issued the bonds to purchase golf courses, recreational centers and other amenities that Morse build. The IRS said that the bonds shouldn't have received tax-exempt status because the boards were appointed by Morse and the majority of the members worked for him. The IRS also maintained the bonds were issued for private, not public, purposes.

"We have concluded that closing this examination without further IRS action supports sound tax administration," wrote Allyson Belsome, an IRS field operations manager for tax-exempt bonds in a July 11 letter to the development districts.

"Federal law prohibits the IRS from discussing specific taxpayers," said IRS spokesman Dean Patterson.

During the course of the audits the district refinanced the bonds in 2014 with taxable bonds to take advantage of lower interest rates.

Bloomberg Business

by Martin Z Braun

August 10, 2016 — 1:50 PM PDT

Ignore the Rules (If They Don't Apply): Squire Patton Boggs

We are rather fond (because you are rather fond) of discussing Rev. Proc. 97-13 and related authorities that address private business use from management contracts. Back in 2014, when the IRS amplified Rev. Proc. 97-13 in Notice 2014-67 (collectively, "97-13"), we even made a holiday present of it. Now more than ever, 97-13 is an essential tool that allows issuers and borrowers to use managers in their facilities and still stay within the private business use limitations. But 97-13 is not a panacea, nor do you always need it to avoid private business use. So, to mix things up, we'll now discuss when you can ignore 97-13, either because you don't need it, or because it can't help you anyway. Many people fall into the habit of thinking that the 97-13 rules apply to any arrangement in bond-financed facilities. However, that's not the case.

Let's start with a key definition from 97-13: a "management contract" is "a management, service, or incentive payment contract between a qualified user and a service provider under which the service provider provides services involving all, a portion of, or any function of, a facility."

From the definition alone, it is clear that some contracts are not "management contracts." Only contracts with "service providers" are included, which means that private parties that have more significant rights to the actual or beneficial use of the bond-financed property (such as lessees of the bond-financed property) will cause private business use of the bond-financed facilities even if the terms of the arrangement technically fall within a safe harbor. In other words, 97-13 cannot help you escape the private business use that may arise from a lease of bond-financed property. (Other exceptions may apply, though, including those in Reg. 1.141-3(d).)

In addition, not all service contracts rise to the level of a "management contract" that must be scrutizined under 97-13. These contracts fall outside of what the regulations and 97-13 say when they refer to a "management contract" that can give rise to private business use. Four notable exceptions from the definition of "management contract" are provided by the Treasury Regulations and referenced in the 97-13. We include these below, along with comments on each:

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

The "solely incidental" language allows certain minor contracts to be excluded. If the particular contract you are reviewing is one of those that is contained within the parenthesis, even better. However, those are only examples, which means that other contracts may also qualify. To date, despite repeated requests from professionals to provide more guidance regarding the scope of "similar services," we have not gotten any.

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

Similarly, "mere" admitting privileges do not fall within 97-13. This exception, like the prior exception, focuses on the economically insignificant and incidental nature of such agreements. What about if you aren't considering a contract with a hospital? Don't forget that this exception may also help by analogy to establish an exception from 97-13 based on facts and circumstances, although one should tread lightly in doing so.

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

We lumped these two together because they are quite similar. The third and fourth exception each depend on reimbursement consisting only of "actual and direct expenses." Like the prior exceptions, these two also focus on the economic insignificance of such agreements.

The fourth exception is particularly helpful because it is not tied to any particular type of services. An important limit to the exception is that it is limited to actual and direct expenses; therefore, if a contract involves a payment to compensate a service provider for projected expenses, it would not

qualify for the fourth exception from being treated as a management contract.

Note that this fourth exception dovetails with the provision of 97-13 that reimbursement of actual and direct expenses is not treated as "compensation" that factors into 97-13's list of safe harbors that link permitted compensation to permitted length. So, even if a contract doesn't meet an exception from the definition of a "management contract," to the extent that compensation involves reimbursement of actual and direct expenses, that compensation is ignored for purposes of the safe harbor. In sum, it may be tempting to treat 97-13 as a one-size-fits-all tool that either fixes (or doesn't) every private business use issue. But remember that 97-13 applies only to "management contracts," and that this term has a specific definition.

Squire Patton Boggs

by Alexios S. Hadji

USA August 11 2016

CDFA Releases Annual Volume Cap Report.

—An Analysis of 2015 Private Activity Bond & Volume Cap Trends—

Columbus, OH — The Council of Development Finance Agencies (CDFA) is thrilled to announce the release of the Annual Volume Cap Report: An Analysis of 2015 Private Activity Bond & Volume Cap Trends. The report provides comprehensive data of the use of volume cap and the issuance of cap-subject private activity bonds nationwide.

Cap-subject private activity bond issuance reported to CDFA increase for the second consecutive year. The change in issuance seen in the past two years mirrors the change seen in the two years prior to hitting a low of $8.8 billion in 2013.

The Annual Volume Cap Report is available online along with CDFA's interactive and searchable National Volume Cap Map.

CDFA collected the information for the report from surveys and interviews with the allocating authority in each state. As a leader in the development finance industry, CDFA serves as the leading source of private-activity bond volume cap data, reporting, and trends. CDFA advocates for the preservation of this critical, catalytic financing tool and encourages interested parties to learn more about the Council's efforts online.

The Council of Development Finance Agencies is a national association dedicated to the advancement of development finance concerns and interests. CDFA is comprised of the nation's leading and most knowledgeable members of the development finance community representing public, private and non-profit entities alike. For more information about CDFA, visit www.cdfa.net.

New Rules for Lessees of Investment Tax Credit Property: Baker Botts

On July 22, 2016, the Internal Revenue Service (the "IRS") and the Department of the Treasury ("Treasury") released proposed and temporary regulations under Section 50 of the Internal Revenue

Code of 1986, as amended (the "Code"), setting forth certain operating rules on the calculation of the investment tax credit (the "ITC") where the lessor has elected to treat the investment tax credit property ("ITC Property") as having been acquired by the lessee. In such case, the lessee, rather than the lessor, is entitled to claim the ITC in respect of the property that is the subject of such election. Of particular note, these rules change the way partners and shareholders of such lessees who are partnerships or S corporations must report the gross income inclusion that applies in lieu of a tax basis adjustment.

I. Background

In general, a 30% ITC is available under current law for certain types of renewable energy property placed in service by a taxpayer during a taxable year. Under the Code and the Treasury Regulations applicable to the ITC, the taxpayer receiving the ITC must reduce its basis in the ITC Property by 50 percent of the credit (or 100 percent for certain rehabilitation expenditure credits) (the "Basis Adjustment Rule"). A recapture rule also requires the taxpayer to increase its tax liability by a recapture amount that decreases over time for the taxable year in which the ITC Property is transferred or otherwise ceases to be ITC Property (or upon disposition of interests in the taxpayer, in the case of partnerships claiming the ITC) if such transfer or cessation occurs within five years of being placed in service (the "Recapture Rule").

A lessor of ITC Property may elect to effectively pass through the ITC to its lessee by treating the lessee as having purchased the property for purposes of computing the ITC (the "Lessor Election"). Because a lessee generally does not obtain a tax basis in leased ITC Property, the lessee cannot, if the Lessor Election were made, take a reduction in tax basis as required under the Basis Adjustment Rule. Instead, the lessee must include in gross income an amount equal to 50 percent of the credit (or 100 percent if the credit was for certain rehabilitation expenditures) ratably over the shortest recovery period applicable to the ITC Property under section 168 of the Code (the "Income Inclusion Rule").

When the lessee taxpayer is an entity taxed as a partnership or an S corporation, the Income Inclusion Rule potentially could have the odd effect of increasing the "outside" tax basis in the interests of partners of the partnership or shareholders of the S corporation under Code Sections 705(a) and 1367(a), respectively. Whether this result was authorized or permitted by existing tax law has been an area of uncertainty. With the issuance of these new regulations, however, the IRS and Treasury have stated their belief that such a benefit, not available to other lessees of ITC Property, is inappropriate and is inconsistent with the purposes of Sections 48, 705 and 1367 of the Code.

II. The Temporary and Proposed Regulations

The proposed and temporary regulations cement the application of the Income Inclusion Rule and provide rules coordinating the Income Inclusion Rule with the Recapture Rule for ITC Property subject to a Lessor Election. Therefore, in lieu of the Basis Adjustment Rule, the lessee must include in gross income an amount equal to the amount of the credit (or, in the case of an energy credit under section 48 of the Code, 50 percent of the credit) ratably over the shortest recovery period applicable to the ITC Property.

In addition, the proposed and temporary regulations provide special rules for lessees that are entities classified as partnerships or S corporations if the Lessor Election has been made. Under these rules, any income resulting from the application of the Income Inclusion Rule is not a partnership item or an S corporation item subject to the tax basis adjustment rules applicable to those entities. Rather, the proposed and temporary regulations generally provide that each partner or shareholder that is the "ultimate credit claimant" is treated as the lessee of the ITC Property and

must include its share of the income under the Income Inclusion Rule. Because the income inclusion under this approach does not flow through the entity, there is no tax basis increase in the equityholder's interest in the entity. An "ultimate credit claimant" is any partner or S corporation shareholder that files an IRS Form 3468, Investment Credit, with its income tax return to claim the ITC.

The proposed and temporary regulations also allow taxpayers to elect to accelerate the income inclusion upon a termination or other disposition of a lease. For partnerships and S corporations, the election is available to the ultimate credit claimant. Furthermore, partners and S corporation shareholders can elect to accelerate the income inclusion when they dispose of their entire interest, direct or indirect, in the partnership or S corporation. The election is available only if the recapture period has ended, and the taxpayer must make the election by including in gross income the relevant amount on the tax return for the taxable year of the termination or other disposition of the lease or the disposition of the taxpayer's entire interest in the partnership or S corporation.

These regulations are prospective and apply to ITC Properties that are placed in service on or after September 19, 2016. Taxpayers wishing to comment on the proposed regulations have until October 20, 2016, to submit such comments or to request a public hearing.

Baker Botts LLP

Peter Farrell, Don J. Lonczak, and Jon Nelsen

USA July 29 2016

Final Arbitrage Regulations Require "Look Through" to a Grantee's Use of Bond Proceeds: A Big "So What?": Squire Patton Boggs

From time to time, issuers will use bond proceeds to make grants to accomplish a governmental purpose. For example, a State bond issuer may make grants to various counties and cities to help with the cost of local transportation improvements. Under the arbitrage regulations (Reg. 1.148-6(d)(4)), the bond proceeds are treated as spent once an issuer makes a grant of bond proceeds to an unrelated party, so long as it is truly a grant (and not an advance that must be repaid). This means that the issuer can stop monitoring the investment yield that it receives from those proceeds once it makes the grant.`

Contrast this with the case in which an issuer transfers bond proceeds to a recipient in the form of a loan. In that case, the loan will be treated as an investment of bond proceeds. This means that the issuer must continue to monitor the investment yield that it receives on the loan, in the form of debt service payments from the recipient. In addition, in the case of a loan, it is clear under other provisions that apply to tax-exempt bonds that the issuer must look through to examine what the loan recipient does with the proceeds that it receives. For example, the issuer must look through to the status of the loan recipient as a governmental person or a private person for purposes of the private business use rules. However, once the loan recipient then spends the bond proceeds on something that counts as an expenditure under the arbitrage rules (for example, by paying them to a construction company in exchange for the company's services in building capital assets of the bond-financed project), at that point the bond proceeds are treated as spent for the purpose to which the loan recipient applied them. In other words, neither the issuer nor the loan recipient would need to look through to examine how the construction company invested and spent the proceeds that were

transferred.

Prior to 2013 proposed arbitrage regulations covering the point, the Code and Treasury Regulations were silent on how to treat bond proceeds that are used to make a grant for purposes other than when to treat the proceeds as spent for arbitrage purposes. Faced with this silence, issuers or conduit borrowers that made a grant of bond proceeds had basically two choices: (1) treat the arbitrage rule as applying for all tax-exempt bond purposes, so that once the issuer or conduit borrower made the grant, the grant recipient would be treated like the construction company in the above example (for example, its identity as a private person would not affect the private business use analysis, and its further investment and use of the proceeds could not affect the tax status of the bonds that financed the grant), or (2) treat the arbitrage rule as applying for arbitrage purposes relating to the timing of the expenditure of bond proceeds (and any purposes that explicitly tie to that arbitrage treatment, such as the "hedge bond" rules (see Reg. 1.149(g)-1(b)), but look through to the grantee's use for other purposes, such as private business use. (One supposes that a particularly cheeky issuer might have cherrypicked Choice (1) or (2) depending on the tax issue in question, but we will rule that out in the interest of good manners.)

Choice (2) was the predominant choice, both out of conservatism in the face of uncertainty, and because Choice (1) leaves us with an entirely unsatisfying answer on one particular issue: the useful life of the bond-financed assets. Under Choice (1), there is no easy way to determine the useful life to the issuer (which is the grantor) of bond proceeds, without looking to see what the grantee does with the bond proceeds.

Now, in governmental bond financings, the useful life of the bond-financed assets is of some interest, although it is not what Mike likes to call a "third-rail" issue[1] as it is in private activity bond financings, where the bonds become taxable if the weighted average maturity of the bonds exceeds 120% of the useful life of the bond-financed assets.

Nevertheless, it is still in an issuer's interest to ensure that the useful life of the bond-financed assets is not wildly out of sync with the weighted average maturity of the bond issue. Compliance with the 120% useful life test will shelter a governmental bond issue within several safe harbors that protect the bond issue from several anti-abuse type rules (for example, the rule in Reg. 1.148-1(c)(4)(i) that can magically transform "available amounts" of the issuer into replacement proceeds of the bond issue that are therefore subject to yield restriction and rebate where bonds are deemed to be outstanding longer than necessary).

In contrast, because of the way that a "grant" is defined under the arbitrage rules, even prior to the 2013 Proposed Regulations, for private business use purposes, an issuer would be in the same place whether it looked through to the grantee's use of the proceeds or not. Recall that, to raise significant tax problems under the private activity bond rules, an issue must exceed the private loan limit, or **both** of the private business use limit **and** the private payment limit. Because even prior to the 2013 Proposed Regulations, a "grant" is not a "grant" unless the recipient doesn't have to pay it back, it is (a) by definition not a loan, so that it cannot be a private loan, and (b) will not generate a stream of private payments coming back to the issuer. Thus, for private business use purposes, if an issuer chose Choice (1) and didn't look through to the grantee's use for private business purposes (treating the grantee like the construction company in our hypothetical above), then no private business use would result, and if an issuer chose Choice (2) and looked through, then, even though private business use might result, there would be no private payments. In each case, the grant is a grant, and thus is not a loan so that it cannot be a private loan.

The 2016 Final Regulations adopt the position of the 2013 Proposed Regulations and force issuers to choose Choice (2). These regulations confirm that a grantor of bond proceeds must look through to

the grantee's use of proceeds for all purposes other than determining when the bond proceeds are spent for arbitrage purposes and any other purposes (such as hedge bonds) that relate to the timing of the expenditure of bond proceeds. These rules are now in new subsection 1.150-1(f). So in some sense, the rule on grants in the Final Regulations might have been a big "so what."

However, there is value in certainty. Although even under prior law issuers essentially had to look through for useful life purposes and it may not have mattered whether they looked through for private activity bond purposes, the clarification in the 2016 Final Regulations is still helpful because it finally puts to rest any lingering uncertainty about the scope of the rules. In addition, the look-through rule will provide certainty in the case where there are unexpected repayments of a grant from a private person that might be characterized as private payments that could give rise to private activity bond problems.

Moreover, the 2016 Final Regulations also give us answers to some questions lingering at the fringes. (As my grandmother used to tell me, there's more to life than private activity bond tests and the question of when proceeds are spent for arbitrage purposes.) For example – before the proceeds are spent for a grant, can the issuer invest those proceeds at an unrestricted yield during a temporary period? If so, what temporary period applies? Does that depend on the issuer's expectations, or the grantee's expectations? To take a specific case, does the 3-year temporary period in Reg. 1.148-2(e)(2) for bond proceeds to be used for a capital project apply based on when the issuer expects to make the grant of bond proceeds, or does it depend on what the grantee plans to do with the granted bond proceeds (and when it plans to do it)? Based on the phrasing of the Final Regulations ("Except as otherwise provided . . . "), and based on the fact that there is no other Regulation or guidance that answers this question about temporary periods, the answer now seems clear. The three-year temporary period will be available based on the grantee's expectations.

So, even though the choices that issuers made in the face of uncertainty and the interaction of the grant rules and the private activity bond rules may have made the rule for grants in the final regulations a "so what," there are still aspects of the rule that are interesting; this is a phenomenon that someone who writes for a public finance tax blog can relate to.

[1] Mike tells me that, years ago, he saw an interview of Eugene Levy in which Mr. Levy said that he knew that the critically acclaimed SCTV program had become too self-referential, and therefore doomed, when it did a parody of an SCTV cameraman's mother. Could the same fate befall a critically acclaimed legal blog?

Squire Patton Boggs

By Johnny Hutchinson on August 4, 2016

TAX - NEW JERSEY

Savage Mills Enterprises, L.L.C. v. Borough of Little Silver

Tax Court of New Jersey - June 21, 2016 - N.J.Tax - 2016 WL 3440588

Savage Mill Enterprises, LLC brought suit against the Borough of Little Silver, arguing that the subject property was entitled to a partial exemption for the portion being used by its 99–year ground lease tenant, which is an undisputed tax-exempt entity, and which owns and uses the building on that land for undisputed charitable purposes.

Borough sought to dismiss the complaint on grounds this court lacks subject-matter jurisdiction

because Savage Mills, a for-profit entity, is contractually obligated to pay local property taxes on property, and thus could not seek a partial exemption for the same.

The Tax Court held that:

- Savage Mills, as fee owner of the subject property, had standing to challenge the amount and methodology underlying the subject property's assessment, which can include a claim for exemption;
- However, this standing does not equate to a grant of the exemption sought because exemption statutes are strictly construed, thus, require full compliance with the statutorily imposed qualifications for an exemption;
- Savage Mills failed to meet the statutory qualifications for a partial exemption, since the plain language of the statute affords a partial exemption only when the landlord is the non-profit entity and the tenant is the for-profit entity.

TAX - NEW YORK

Town of Rye v. Assessor of City of Rye

Supreme Court, Appellate Division, Second Department, New York - July 27, 2016 - N.Y.S.3d - 2016 WL 4007142 - 2016 N.Y. Slip Op. 05652

Town brought action against city to strike a real property tax assessment for town park from assessment roll of city.

The Supreme Court, Westchester County, granted town's motion for summary judgment and denied city's motion for summary judgment. City appealed.

The Supreme Court, Appellate Division, held that:

- Real Property Tax Law provision that exempted from taxation public parks not within a municipality's corporate limits if the governing board of the municipality in which the park was located agreed in writing to exemption applied to dispute, and
- Town was not entitled to exemption from taxation of town park.

Real Property Tax Law provision that exempted from taxation public parks not within a municipality's corporate limits if the governing board of the municipality in which the park was located agreed in writing to exemption applied to dispute between town and city regarding whether or not town park should be exempt from taxation, rather than Real Property Tax Law provision that automatically exempted real property owned by a municipality, held for public use, and within its corporate limits from taxation, where town park was located within corporate limits of city.

Town was not entitled to exemption from taxation of town park that was located within city's corporate limits, pursuant to Real Property Tax Law provision that exempted from taxation public parks not within a municipality's corporate limits if the governing board of the municipality in which the park was located agreed in writing to exemption, despite fact that city had exempted park from taxation in the past, where city's governing board never agreed in writing to exempt park from taxation.

IRS FY2017 Update: Effect of Sequestration on State & Local Government Filers of Form 8038-CP.

Pursuant to the requirements of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, refund payments to certain state and local government filers claiming refundable credits under section 6431 of the Internal Revenue Code applicable to certain qualified bonds are subject to sequestration. This means that refund payments processed on or after October 1, 2016 and on or before September 30, 2017 will be reduced by the fiscal year 2017 sequestration rate of 6.9 percent, irrespective of when the amounts claimed by an issuer on any Form 8038-CP was filed with the IRS. The sequestration reduction rate will be applied unless and until a law is enacted that cancels or otherwise impacts the sequester, at which time the sequestration reduction rate is subject to change.

These reductions apply to Build America Bonds, Qualified School Construction Bonds, Qualified Zone Academy Bonds, New Clean Renewable Energy Bonds, and Qualified Energy Conservation Bonds for which the issuer elected to receive a direct credit subsidy pursuant to section 6431. Issuers should complete Form 8038-CP in the manner provided by the Form 8038-CP Instructions, and affected issuers will be notified through correspondence that a portion of their requested payment was subject to the sequester reduction. Issuers should use this correspondence to identify the portion(s) of amounts requested that were subject to the sequester reduction.

Issuers with any questions about the status of refunds claimed on Form 8038-CP, including any sequester reduction, should contact IRS Customer Account Services at 1-877-829-5500.

Click here to see the FY2013 article.
Click here to see the FY2014 article.
Click here to see the FY2015 article.
Click here to see the FY2016 article.

TAX - OHIO

Innkeeper Ministries, Inc. v. Testa

Supreme Court of Ohio - July 27, 2016 - N.E.3d - 2016 WL 4009986 - 2016 -Ohio- 5104

Nonprofit corporation filed an application for a charitable-use exemption for property the corporation owned.

The Tax Commissioner denied a charitable-use exemption to property. Corporation appealed. The Board of Tax Appeals reversed. The Tax Commissioner appealed.

The Supreme Court of Ohio held that:

- Corporation’s use of property as a free retreat for religious leaders did not qualify the property as a church retreat, and
- Property caretakers personal and permanent residential use of property militated against a finding of charitable use.

Nonprofit corporation’s use of property as a free retreat for religious leaders did not qualify the property as a church retreat, for the purpose of application for a charitable-use exemption for property. The property was not owned by a church, and the property contained the residence of

caretakers.

Property caretakers personal and permanent residential use of property militated against a finding of charitable use, in action seeking a charitable-use exemption for property owned by nonprofit corporation that was used as a retreat for religious leaders.

The Board of Tax Appeals should have required proof that the primary purpose of the property was charitable hospitality, after evidence established the residential use of the property by property caretakers, before it could determine whether to a grant a charitable-use exemption for property. While there was evidence that the property was offered as a retreat for religious leaders, there was no information as to how many individuals stayed at the property, how many individuals the property could accommodate, and whether individuals were turned away from the property.

IRS Updates Section 118 Safe Harbor For Transfers To Public Utilities: Grant Thornton

The IRS has issued guidance (Notice 2016-36) broadening and modifying the safe harbor election under Section 118(a) that provides that certain transfers of property from energy generators to public utilities are contributions to capital instead of income.

Section 61 generally states that gross income includes all income from all sources, but Section 118(a) provides an exception for contributions to the capital of a corporation. However, Section 118(b) excludes any contributions in aid of construction (CIAC), so CIAC is considered income under Section 61.

To encourage the development of the national power grid and markets for the generation, transmission and distribution of power, the IRS created a safe harbor so that qualified facilities and power generators could transfer property to a public utility to tie into the grid without the transfer's creating income for the public utility. The original guidance and its subsequent modifications (Notices 88-129, 90-60 and 2001-82) focused on traditional energy sources.

Notice 2016-36 broadens the scope of the prior notices to be more accessible for wind and solar generators to tie into the grid without transfers of property creating gross income for the public utility.

Article by David Auclair

Last Updated: July 25 2016

Grant Thornton LLP

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Bondholders of the Lost Ark: Squire Patton Boggs

When most bond advisors think of the types of projects that bond proceeds may be used for, they

think of roads, bridges, hospital or university buildings, etc. I think it is safe to say that very few bond advisors visualize an ark, let alone a replica of Noah's Ark. However, the City Council of Williamstown, Kentucky did just that. I guess that makes them visionary.

On December 23, 2013, the City of Williamstown issued $62,000,000 of Taxable Industrial Building Revenue Bonds (the "Bonds") to finance in part a "biblically-themed educational and entertainment complex, to include a replica of the Ark of Noah and related facilities". Per the Official Statement of the Bonds, which is available on EMMA-MSRB, the Bonds were issued under §§103.200 to 103.285 of the Kentucky Revised Statutes. In general, these provisions of Kentucky law permit cities and counties in Kentucky to issue industrial development bonds for projects that will promote economic development within the Commonwealth. So far so good, because successful theme parks most likely promote economic development in their surrounding communities.

When you delve into the details, however, it becomes a little less clear how the owner of the biblical theme park qualified under Kentucky law as a proper conduit borrower of the proceeds of these types of bonds. For example, the relevant provisions of the Kentucky Revised Statutes provide that a city or county may issue industrial development bonds in order to decrease the cost of purchasing or constructing "any industrial building or pollution control facility". The definition of "industrial building", interestingly, includes both facilities used by a nonprofit educational institution and a recreation or amusement park, which I assume is how the owner of a biblical theme park qualified to borrow the proceeds of the Bonds.

The biblical theme park is called Ark Encounters. Unlike the lost Ark of the Covenant in the well-known movie, "Raiders of the Lost Ark", this ark will not be hard to locate (it's also unlikely to melt the faces of those who peer inside). According to the website of Ark Encounters, the replica of Noah's Ark was built according to the dimensions given in the Bible, making it 510 feet long, 85 feet wide, and 51 feet high. This means it is about five stories high and almost as long as one-and-a-half football fields. According to the website, the ark is the largest timber-framed structure in the world. The ark apparently is full of exhibits, including displays of Noah's family and many cages containing animal replicas. Interestingly, at some point, Ark Encounters must have considered housing live animals in the ark, because one of the risk factors listed in the Official Statement for the Bonds is that the "animals that will be in the borrower's care will be important to the Project, and these animals could be exposed to infectious diseases". This is probably not a risk factor that shows up in too many Official Statements.

One obstacle that the owner of Ark Encounters encountered in building its theme park was uncertain financing. For example, the owner had received approval in May of 2011 for a tourism tax credit from the Kentucky Tourism Sales Tax Credit Program. The Official Statement for the Bonds, however, notes that this decision may be challenged as a violation of the Establishment Clause in the U.S. Constitution. (Although the interest on the Bonds is taxable from a federal income tax standpoint, the interest is exempt from Kentucky income tax.) The owner's concern in this regard was warranted, and on December 10, 2014, the owner's qualification for the tourism tax credit was revoked at a cost of approximately $18 million. Apparently, the Kentucky officials were concerned that Ark Encounters had evolved from a tourism attraction to an extension of the owner's ministry, and had reason to believe that the owner intended to discriminate in hiring based upon religion.

Despite the financial uncertainty that the owner of Ark Encounters encountered, the biblical theme park opened a few weeks ago. That is good news for the bondholders of the lost ark, because the debt service on the Bonds will be paid from park revenues.

Squire Patton Boggs

by Cynthia C. Mog

USA July 27 2016

A Summary of the Final Regulations on Non-Issue Price Arbitrage Restrictions: Squire Patton Boggs

On July 18, 2016, the Treasury Department published final regulations on non-issue price arbitrage restrictions (the "**Final Regulations**") in the Federal Register. The Final Regulations finalize regulations proposed in 2007 and 2013 (collectively, the "**Proposed Regulations**"). Click here for a copy of the Final Regulations, and read below for a high-level summary of them. We will in subsequent posts be publishing more detailed analysis of specific provisions in the Final Regulations.

As discussed in a prior post, the Final Regulations apply to bonds sold on or after October 17, 2016 (the "**Effective Date**"). References in this blog post to "Prior Regulations" are references to the Treasury Regulations in effect prior to the Effective Date of the Final Regulations.

The Final Regulations make changes to a number of rules scattered throughout the arbitrage regulations. Below, we take them in order, progressing through the Treasury Regulations. To facilitate your review, at the end of the blog is a comparison table showing certain provisions of the Final Regulations next to the parallel provisions in the Prior Regulations.

Continue Reading.

by Joel Swearingen

July 22, 2016

The Public Finance Tax Blog

Squire Patton Boggs

Ohio Airport Financing May Depend on New Political Subdivision Rule.

WASHINGTON – Four Ohio Congressmen are raising concerns that the Internal Revenue Service and Treasury Department's proposed definition of a political subdivision would jeopardize funding for a $35 million terminal improvement project planned for Akron-Canton Airport.

The project is in the design phase, and will require bond funding for construction to begin as early as the spring or summer of next year, Rick McQueen, president and CEO of the airport, told The Bond Buyer on Monday. The IRS' new definition of political subdivision could have national implications, he said.

Reps. Jim Renacci, R-Ohio; Bob Gibbs, R-Ohio; Tim Ryan, D-Ohio; and Dave Joyce, R-Ohio, wrote a two-page letter to the IRS during the agency's comment period earlier this year. Should the rules be finalized in their current proposed form, the Congressmen said, Ohio's regional airports – specifically the Akron-Canton Airport – may be hampered in their ability to issue tax-exempt bonds to fund infrastructure improvements.

“If at any time the IRS determines that the issuer is operating in a way that either does not provide a significant public benefit, or that provides more than an incidental benefit to any private party, then the status of all of the issuer’s bonds issued after the effective date of the regulations would be in jeopardy,” the Congressmen wrote.

McQueen said that the airport wrote to the IRS earlier this year asking the agency to clarify its issues with airport authorities under current regulations. The IRS responded roughly a month and a half ago with a standard letter that they would be reviewing the airport’s comments, he said.

“It’s not just airport authorities impacted in the state of Ohio, but also other multi-jurisdictional boards throughout the country,” McQueen said. “There are a lot of people that could be impacted by this. My concern is the organizations that aren’t aware of this potential change.”

Whether an entity qualified as a political subdivision has historically been based on whether it had the right to exercise a substantial amount of at least one of three sovereign powers: eminent domain, taxation and policing.

But the now-controversial regulations the IRS and Treasury proposed in February would add two new requirements: political subdivisions must serve a governmental purpose “with no more than an incidental private benefit” and they must be governmentally controlled.

In their two-page letter to the IRS and Treasury, the Congressmen said they were concerned that the Akron-Canton Airport’s “critical” $35 million terminal improvement project could be “negatively impacted” by the new requirements.

The Akron-Canton Airport, located roughly halfway between the two cities with portions in both Summit and Stark counties, is the only commercial airport in Ohio governed by an airport authority.

Its eight-member board includes four members appointed by the Stark County Commissioners and four appointed by the Summit County Executive and approved by council.

In their letter to the IRS, the Congressmen stress that most of Ohio’s airport authorities, including that of Akron-Canton Airport, control their own budgets rather than the airport’s appointing authorities or the counties they operate in.

It is an independent political subdivision of the state and not a component unity of any other government entity, according to the congressmen. Because both counties the airport lies in appoint an equal number of board members, the authority “does not appear to meet the single entity control requirement,” they added.

They said that many Ohio airport authorities issue tax-exempt bonds for purposes that could be construed as private benefit, such as parking garages that could also benefit the private sector. Under current IRS and Treasury regulations as well as Ohio state law, these types of incidental private benefits satisfy the public purpose requirements, making any related private benefit permissible, the congressmen said.

“We are concerned … with the IRS’s future interpretation of this new ‘limited private benefit’ test, which may also pose a federal question and may not follow state law,” the letter read.

McQueen said the situation is urgent for the Akron-Canton Airport project.

“We’re dealing with a building that is 54 years old,” McQueen said. “We will need to have bond capabilities to fund this. It’s very difficult to come up with that money upfront to build the project.”

The terminal improvement project is part of a 20-year, $240 million master plan approved by the Federal Aviation Administration in 2015. The last bonds issued by the Akron-Canton Regional Airport Authority came in 2007, when $16.2 million in bonds were issued to finance terminal and gate improvements, according to the Municipal Securities Rulemaking Board's EMMA website.

McQueen said he couldn't provide a cost estimate comparing the airport's ability to issue bonds under current regulations versus the proposed rules.

"I can't tell you the difference today if it were to be a tax-exempt versus non tax-exempt funded project, but obviously when you're doing a governmental project you try to be as fiscally responsible as possible," McQueen said. "But it would increase the cost for debt service no doubt."

The proposed rules have largely been met with opposition from groups including the Government Finance Officers Association and the Securities Industry and Financial Markets Association, which have said the rules could potentially upend the muni market. Several port and airport authorities, water and sewer issuers, and utility associations were also among those that submitted written comment to the IRS expressing concerns over what the proposed rules could mean for their tax-exempt status.

The IRS and Treasury received 132 comments during the public input period, which lasted from February through late May. The agencies held a public hearing on June 6, where several market groups called for the withdrawal or re-proposal of what they felt were unnecessary or unfair proposed rules.

During the hearing, Thomas Devine, general counsel for the Airports Council International – North America, said what he called "non-problematic" entities like airport authorities had a "bullseye" on their backs.

John Cross, the Treasury Department's associate legislative tax counsel, has said that the new rules were proposed in response to concerns over who was controlling political subdivisions. Despite IRS audits that found some private entities were wielding significant control over political subdivisions, Cross said that the agency is not targeting airports.

IRS officials could not be reached for comment Monday as to when the proposed regulations could be finalized.

The Bond Buyer

By Evan Fallor

July 25, 2016

The Municipal Bond Industry Responds to Tax Foundation's Recent Paper.

Last week, the Tax Foundation released a paper titled, "Reexamining the Tax Exemption of Municipal Bond Interest," which argued that lawmakers should consider reforming the current tax treatment of municipal bond interest. Apparently, the municipal bond industry is less than thrilled with our report: yesterday, *The Bond Buyer* published an article titled, "Why the Tax Foundation Report on Munis is 'Woolly-Headed,' " which quotes several individuals who take issue with our analysis.

Here are a few selections from the article:

> Advocates for maintaining the tax-exempt status of municipal bonds are firing back after a Tax Foundation report last week concluded lawmakers should consider limiting, reforming or eliminating the muni exemption…
>
> "This is a classic woolly-headed, ivory tower analysis," said Chuck Samuels, a member of Mintz, Levin, Cohn, Ferris, Govsky and Popeo. "Tax exempts might cause state and local governments to over-invest in infrastructure? Does anyone feel like their pot holed, overcrowded roads, mass transit and airports are over-invested?"…
>
> John Vahey, director of federal policy for Bond Dealers of America, also disagreed with the opinion that municipalities may be prone to overinvesting in infrastructure. "We think the notion that there is an overinvestment in infrastructure in the U.S. generally right now is a fallacy," Vahey said. "You just need to point to the glaring need to rebuild roads and bridges as well as grades and reports by engineering organizations that analyze the condition of infrastructure."

Most of the negative reactions in the article seem to be directed at one specific argument in the paper: that the tax exemption of municipal bond interest could lead state and local governments to overinvest in infrastructure. To illustrate this concern: it would be socially wasteful for a state government to spend $10 million on a highway project that delivers only $9 million in economic benefits, but the state government might undertake such an investment if the federal government provided it with a $1.5 million subsidy, in the form of a tax exemption.

As an aside, I'll note that this is not an imaginary, theoretical concern. State and local governments have spent over $6 billion on pro football stadiums since 1995, despite questionable public benefits. There is an entire book about how states and localities spend far too much money building new convention centers.

But the individuals quoted in *The Bond Buyer* article seem entirely unconcerned with the possibility that states and localities might invest in infrastructure projects with high costs and low benefits. Instead, they are worried about the opposite scenario: that state and local governments are currently passing up urgent opportunities to invest in infrastructure projects with high benefits and low costs.

Here's my question: if there's a "glaring need" for more infrastructure investment, why aren't state and local governments already filling that need? If there are urgent infrastructure projects with high potential benefits and low costs, why do state and local governments need a federal subsidy to invest in them?

I suspect that the reason why state and local governments aren't investing as much in infrastructure as Chuck Samuels and John Vahey would like is because *state and local voters aren't willing to foot the bill*. And there's the rub.

Supporters of the federal tax exemption of municipal bond interest are essentially making the case that 1) state and local voters are missing a great opportunity to reap large economic benefits at minimal costs, and that 2) the federal government should step in to nudge their decision-making in the right direction, by continuing to subsidize their infrastructure spending.

This is an entirely valid argument, but it assumes that the federal government has a better understanding of what infrastructure should be built than state and local voters do. If this is the case, why have the federal government subsidize state and local infrastructure projects? Why not

argue for the federal government to increase its own direct spending on infrastructure?

In other words, it is either the case that 1) the federal government has a better idea of what infrastructure should be built, and it should purchase the infrastructure itself, or 2) state and local governments have a better idea of what infrastructure should be built, and the federal government should not subsidize them. Either way, a federal tax exclusion for municipal bond interest seems like an unideal policy.

Notably, no one quoted in *The Bond Buyer* article yesterday took issue with the other central claim in the Tax Foundation's report: that the current tax exemption of municipal bond interest is a poorly designed, inequitable, and inefficient tool for subsidizing state and local infrastructure.

The Tax Foundation

By Scott Greenberg

July 27, 2016

Why IRS Dropped its Challenge to Florida CDD Bonds.

WASHINGTON – The Internal Revenue Service has closed audits and left the tax-exempt status unchanged for $311.28 million of community development district bonds in Florida that started a huge debate about political subdivisions and led the tax agency to propose controversial rules for such districts earlier this year.

More than $246 million of the bonds were issued by the Village Center CDD in 1998, 1999, 2001, 2003 and 2004, but were redeemed in November 2014. Another $65 million of bonds were issued by the Sumter Landing CDD were issued in 2005 but were redeemed in October 2015.

In separate letters to each CDD, the IRS noted the bonds were redeemed and said, "We have concluded that closing this examination without further IRS action supports sound tax administration."

The IRS actions close the book on long standing audits that sparked a huge ongoing debate between the tax agencies and municipal market participants over how to define political subdivisions that can issue tax-exempt bonds. These two CDDs – commercial districts for a retirement community with more than 100,000 residents in two counties — were organized as political subdivisions under Florida law. The IRS challenged their status in audits, but has now dropped the challenges and closed the audits.

Perry Israel, a lawyer with a private practice in Sacramento who is representing the Village Center CDD, and Richard Chirls, a lawyer with Orrick, Herrington & Sutcliffe in New York City who is representing the Sumter Landing CDD, each said they and their clients are pleased the examinations have been closed.

"They're absolutely right," said Israel. "It's a poor use of IRS resources to continue to go after these bonds when they've been paid off for almost two years."

The Village Center "did taxable refundings [of the bonds], but was still able to reduce its borrowing costs," he added.

Israel said that he believes the audit of the Village CDD, which began in January 2008 and took more than 8 ½ years to complete, may have been the longest examination ever done in the muni market. Some of those same bonds had also been the subject of an earlier audit that was closed in January 2003 which would make the examination of them even longer.

The IRS was on a slower track with Sumter Landing, but Chirls said, "This is simply an examination that went on much too long. It was, in the end, a waste of resources, staff, administrative time, and actual dollars by the district and the IRS."

Some muni market participants said the IRS may have been willing to close the audits, realizing they were a drag on resources while the agency was up against a statute of limitations problem. Generally, the IRS can go after taxpayers for payment of taxes due to violations of tax laws or rules three years from the later of the date that taxes are due or the date that taxes are paid.

The Village Center bonds were redeemed in 2014 meaning the latest date a full year of interest would have been 2013, with tax returns to be filed in April 2014. Three years after that would be in April of next year. With this year more than half over, the IRS had still not declared the CDD's bonds taxable and, if it had, the CDD would have had an opportunity to appeal that finding and go through a lengthy appeals process.

It seems odd that the IRS closed the audits without accepting a payment for settlements. The two CDDs earlier this year told the IRS they would settle the tax dispute for $300,000, the amount they estimated would be the legal fees they would have to pay to continue fighting the IRS. The IRS, which had been pushing for a $1.5 million settlement, never took them up on the offer.

Also, the IRS letters sent to the CDDs are odd in two respects. Both letters said the CDDs were sent Forms 5701, Notices of Proposed Adjustments. But these forms, which notify taxpayers of increased tax liabilities, are not used in the municipal market, bond lawyers said. The CDDs actually received Forms 5701-TEB, or Notices of Proposed Issue that notified them the IRS had preliminarily determined the bonds were taxable.

In addition, the IRS letter to the Village Center CDD noted the agency found the CDD was not a "proper issuer of tax-exempt bonds" and the bonds were private-activity bonds that did not fall in any of the categories that qualify for tax-exemption. The one sent to the Sumter Landing CDD said only that the IRS found the bonds were taxable PABs.

The IRS may not have said that Sumter Landing CDD was not a proper issuer, because it was only the Village Center that received a technical advice memorandum from the IRS chief counsel's office in May 2013. That TAM said the CDD was not a proper issuer of tax-exempt bonds because its board was and would always be controlled by a developer rather than by residents or others responsible to a public electorate.

However, after an outcry from issuers and bond lawyers that the IRS was trying to change rules retroactively through enforcement actions, the IRS made the TAM prospectively effective. That means the TAM shouldn't apply to either the Village Center CDD or the Sumter Landing CDD.

The TAM led the Treasury Department and IRS to propose rules in February of this year that would dramatically change the definition of a political subdivision.

Historically, the determination of whether an entity was a political subdivision was based on whether it had the right to exercise a substantial amount of at least one of three sovereign powers: eminent domain, taxation, and policing.

Community development districts in Florida, metropolitan districts in Colorado, rural utility districts in California and districts in other states for years have been set up to issue tax-exempt bonds to finance public infrastructure such as roads, sewer and water systems for a variety of development projects. Initially the districts are controlled by developers, but as homes, business parks or shopping areas are built and irrigation systems are set up, the control of boards is passed onto to residents or users such as homeowners, businesses or farmers.

But IRS officials, through audits, found some developers had created political subdivisions and were in complete control of them of years or indefinitely, sometimes issuing tax-exempt bonds for their own benefit.

The proposed rules would add two new additional requirements, besides the sovereign powers one, to the definition. Political subdivisions would also have to serve a government purpose "with no more than an incidental private benefit" and would have to be governmentally controlled.

"The IRS is now properly addressing the perceived problems through a regulatory process that includes proposals, comments and a prospective effective date," said Chirls.

But the proposed rules have taken a beating from municipal market groups and individuals who have sent the IRS more than 130 comment letters slamming them.

The Bond Buyer

by Lynn Hume

July 19, 2016

TAX - WISCONSIN

Lands' End, Inc. v. City of Dodgeville

Supreme Court of Wisconsin - July 12, 2016 - N.W.2d - 2016 WL 3676935 - 2016 WI 64

Corporation brought action against city challenging property tax assessment, and corporation made offer of settlement.

After the Circuit Court denied corporation's motion for summary judgment and affirmed city's valuation, corporation appealed, and the Court of Appeals reversed. On remand, the Circuit Court awarded corporation interest at 1% plus the prime rate, pursuant to the amended version of the interest statute. Corporation appealed, and city petitioned to bypass the Court of Appeals.

The Supreme Court of Wisconsin held that:

- Applying amended version of statute was not retroactive;
- Applying amended version of statute did not take away or impair corporation's vested rights, overruling *Johnson v. Cintas Corp. No. 2*, 360 Wis.2d 350, 860 N.W.2d 515;
- Corporation's due process rights were not violated;
- Statute providing that actions pending were not defeated by repeal of statute was not implicated; and
- Corporation's equal protection rights were not violated.

It was not retroactive, unfair, unreasonable, or unduly burdensome to plaintiff to apply amended

version of statutory rate of interest, which applied when party recovered judgment greater than or equal to amount of its unaccepted offer of settlement, to plaintiff's judgment. Even though version in effect when plaintiff made offer set interest at 12%, while amended version provided rate of 1% plus prime rate, plaintiff had not recovered judgment before amended version took effect, plaintiff's right under amended version of statute at effective date of statute was inchoate, not perfected, not ripened, nor accrued, and amended interest rate compensated plaintiff for approximately market interest rate had judgment recovered been paid immediately.

Plaintiff did not have vested right to statutory 12% rate of interest applicable when party recovered judgment greater than or equal to amount of its unaccepted offer of settlement, which was in effect when plaintiff made its offer of settlement, and therefore amendment to statute that lowered interest rate did not retroactively take away or impair vested rights acquired by plaintiff under existing laws. Plaintiff's entitlement to interest was contingent on subsequent determination that plaintiff was entitled to judgment for greater than or equal to amount of its offer of settlement, and plaintiff did not obtain such determination while 12% interest rate was in effect; overruling *Johnson v. Cintas Corp. No. 2*, 360 Wis.2d 350, 860 N.W.2d 515.

Plaintiff's due process rights were not violated by applying amended version of statute awarding interest when party recovered judgment greater than or equal to amount of its unaccepted offer of settlement, which had interest rate of 1% plus prime rate at time plaintiff recovered judgment, rather than statutory 12% rate that was in effect when plaintiff made offer of settlement. Awarding interest under amended version of statute was not retroactive, and plaintiff did not acquire vested right to 12% interest rate by making offer of settlement, as plaintiff did not recover judgment until after amendment took effect.

Statute providing that actions pending were not defeated by repeal of statute was not implicated by applying amended version of statute awarding interest when party recovered judgment greater than or equal to amount of its unaccepted offer of settlement, which had interest rate of 1% plus prime rate at time plaintiff recovered judgment, rather than statutory 12% rate that was in effect when plaintiff made offer of settlement. Plaintiff's right to interest did not arise until plaintiff recovered judgment, which occurred after statute was amended, and plaintiff's right to recover 12% interest rate was inchoate and contingent on plaintiff first obtaining judgment for as much or more than amount of its offer of settlement.

Rational basis existed for applying amended version of statute awarding interest when party recovered judgment greater than or equal to amount of its unaccepted offer of settlement, which had interest rate of 1% plus prime rate at time plaintiff recovered judgment, rather than statutory 12% rate that was in effect when plaintiff made offer of settlement, and therefore plaintiff's equal protection rights were not violated. Classes were substantially distinct, as parties that recovered judgment before amendment took effect had vested right to 12% rate while parties that did not recover judgment did not, reducing interest to near-market rates fulfilled various legislative objectives, and tying interest rate to market rates was fair to both plaintiff and defendant.

TAX INCREMENT FINANCING - ILLINOIS

Bank of Commerce v. Hoffman

United States Court of Appeals, Seventh Circuit - July 15, 2016 - F.3d - 2016 WL 3854164

Federal Deposit Insurance Corporation (FDIC), in its capacity as receiver for failed bank, sued mortgagor for breach of $9 million note (including a $1.5 million TIF note) on which mortgagor

defaulted, for foreclosure on property mortgaged as security for note, and for judgment against guarantors on note.

Following entry of summary judgment against mortgagor FDIC and guarantor who had guaranteed up to $900,000 of the $9 million loan filed cross-motions for summary judgment. The United States District Court for the Central District of Illinois granted summary judgment to FDIC and to bank, as successor in interest to FDIC. Guarantor appealed.

The Court of Appeals held that:

- Addressing a matter of first impression for the court, federal jurisdiction is not lost when another party is substituted for the FDIC in FDIC litigation, and
- Under Illinois law, the settlement agreement and release signed by guarantor released him from his obligation on a $157,300 loan obtained by guarantor and his wife, but not from the guarantee at issue here.

In Federal Deposit Insurance Corporation (FDIC) litigation, even though the FDIC assigned its interest to another party which was then substituted for the FDIC in the litigation, the case remains "deemed to arise under the laws of the United States," and federal jurisdiction is not lost.

Under Illinois law, settlement agreement and release signed by guarantor released him from his obligation on $157,300 loan obtained by guarantor and his wife, but not from his separate guarantee of up to $900,000 of $9 million loan obtained by mortgagor. Contract was ambiguous, as it contained conflicting language, on the one hand absolving guarantor and wife from liability arising from "the Loan Documents or the Properties" defined as three parcels securing $157,300 loan and nowhere naming mortgagor, while on the other hand generally releasing guarantor and his wife from all liabilities to the Federal Deposit Insurance Corporation (FDIC), as receiver for failed bank that made loan to mortgagor, and its successors, but both guarantor's own testimony and Illinois rules of construction supported interpretation urged by bank, as successor in interest to FDIC, namely, that the more specific provision controlled and guarantor was only released from obligation on $157,300 loan.

Why Report Suggests Muni Tax Exclusion Be Limited or Eliminated.

WASHINGTON – Lawmakers should consider limiting, reforming or eliminating the tax exclusion for municipal bond interest, the Tax Foundation suggested in a report.

The report, called "Reexamining the Tax Exemption of Municipal Bond Interest" was authored by analyst Scott Greenberg.

The report argues that tax-exempt bonds: can encourage municipalities to over-invest in infrastructure; are inefficient when comparing foregone federal government revenue and state and local borrowing costs; and can unfairly benefit taxpayers in higher income brackets.

"The U.S. tax code is badly in need of reform, and any tax reform effort will need to limit or eliminate tax expenditures in order to broaden the federal tax base," the group said in the report. "As Congress moves forward with discussions about tax reform, it should keep every tax provision on the table, including the exclusion of municipal bond interest."

The report does not make any recommendations for lawmakers, but suggests they consider the

“flaws and drawbacks” of the muni exemption in potential tax reform legislation.

It also asks lawmakers to consider three questions: should the federal government subsidize state and local borrowing; should the subsidy take the form of a tax exclusion; and is the current treatment of muni bond interest efficient and equitable.

Greenberg, who also published analyses on the GOP blueprint for tax reform released in June and the tax reform plan proposed by Rep. Jim Renacci, R-Ohio, earlier this month, said in the 12-page report released on Thursday that the muni exemption is an “unideal policy design” for subsidizing state and local debt because it provides larger benefits for taxpayers in higher income brackets and smaller benefits for those in smaller tax brackets. It also shuts some investors completely out of the muni market such as those who do not pay taxes, foreign investors and pension funds, he added.

Greenberg said that while tax-exempt munis encourage states and localities to invest in infrastructure, they also can cause these governments to over-invest, especially when the tax burdens are placed on nonresidents.

For example, he said if a state is considering spending $10 million on a new highway that will only provide $9 million in economic benefits it may decide not to move forward. But if the state receives a $1.5 million subsidy from the federal government, it may go forward with the project “even though the highway is a socially wasteful investment,” he wrote.

The report also said the “most compelling case” that the tax-exempt standing of munis is inefficient, is that for every dollar of revenue the federal government forgoes because of the muni exemption, state and local governments receive less than a dollar in lower borrowing costs.

Citing a 2015 Treasury Department estimate, the report says the federal government will forgo as much as $617 billion in revenue over the next 10 years by excluding interest on munis. It is one of the largest tax expenditures in the individual income tax code, Greenberg said.

Not all munis are used for public purposes, the report pointed out. State and local governments issued $421 billion in tax-exempt bonds in 2013. Of that figure, $340 billion or 80.6% were governmental bonds and $81 billion of 19.4% were private activity bonds, which benefit private parties. This ratio is fairly typical,” the report said. Between 1991 and 2013 governmental bonds accounted for 75.3% of all tax-exempt bonds issued and the other 24.7% were PABs, it said.

In addition, the report said, the majority of tax-exempt bonds are issued in a few states: California, New York, Texas, Pennsylvania, Illinois, Ohio and New Jersey.

Greenberg told The Bond Buyer that the report stems from the fact that the Tax Foundation researches parts of the tax code that “haven’t been sufficiently researched or discussed,” before compiling reports like this one.

“My personal opinion was that the conversation about the tax exemption of munis was an important one,” he said.

The report was met with opposition from Bond Dealers of America, which warned that even just limiting the muni exemption could increase infrastructure costs by more than 10%. BDA and other muni groups contend munis are cost effective in helping to finance infrastructure projects.

Jessica Giroux, general counsel and managing director of federal regulatory policy for BDA, said that eliminating or limiting the muni exemption would pass increased infrastructure costs onto both those who invest in municipal bonds and taxpayers.

“Stripping the muni tax exemption would have a devastating fiscal impact on local governments and their ability to meet the needs of their citizens,” she said. “When put in the context how to reform the federal tax code, this is not a change in the law that we believe many taxpayers would support.”

Giroux said that munis are crucial to funding better roads, water systems, schools and “other vital components of daily life.”

“There continues to be a tremendous need in every state to repair existing and build new infrastructure,” Giroux said. “Municipal bonds continue to be the primary mechanism state and local governments turn to to finance those infrastructure needs.”

The Tax Foundation report comes less than a week after BDA sent a letter to House Speaker Paul Ryan, R-Wis., and Rep. Kevin Brady, R-Tex., the House Ways and Means Committee chairman, that says any repeal of the tax exemption for munis would cost state and local governments an additional $495 billion in interest over a ten-year period.

The GOP plan does not mention munis directly, but it calls for limiting or eliminating unnamed deductions, exclusions and credits. Several muni groups, including BDA and the Government Finance Officers Association, have expressed concern that munis may be included as the plan is amended before Republicans hope to introduce formal tax legislation next year.

Renacci’s plan, released on July 14, would replace the corporate income tax with a consumption tax but would maintain the muni exemption.

The Tax Foundation report’s suggestions echo those of other reports released in recent years. The Simpson-Bowles Commission on Fiscal Responsibility and Reform in 2010 also called for eliminating the tax-exempt status of all new municipal bonds. The Bipartisan Policy Center’s debt reduction task force had earlier called for eliminating the tax exemption for new private activity bonds.

The Bond Buyer

By Evan Fallor

July 22, 2016

Missouri Legislation Limits Municipal Approval Of Tax Increment Financings And Increases Financial Oversight Of Designated Districts.

Three new measures signed into law by Missouri Governor Jay Nixon on June 29 will have lasting implications for the creation and administration of tax increment financings (TIFs), community improvement districts (CIDs) and transportation development districts (TDDs) alike.

House Bill 1434, the legislation addressing TIFs, is largely aimed at the suburban counties in the St. Louis region—St. Louis County, St. Charles County and Jefferson County. Specifically, the bill limits the power of municipalities in those three counties to approve a TIF if the county-wide TIF board rejects it. For the rest of the state, the bill implements a few clean-up provisions—namely, it exempts sheltered workshop tax districts from both state and municipal TIF projects, specifies a deadline of November 15 for each municipality’s required annual report of TIFs and requires the Missouri Office of Administration to post information from the reports on the Missouri Accountability Portal. If a municipality does not comply with the reporting requirements, it can be prohibited from adopting

any new TIF plan for five years. Gov. Nixon stated that the new legislation "contains the most significant TIF reforms Missouri has passed in more than a decade."

Senate Bill 1002 adds new language to the Missouri statute governing CIDs, thereby granting the state auditor authority to assess the tax and financial records of a district the same way they would audit a public agency. The addition is driven in large part by the government's desire to monitor districts which contain no voting citizens, which up until now have largely been able to avoid state-level scrutiny of their operations. Now, all of Missouri's nearly 360 CIDs are on notice that they may be subject to auditing merely because they collect taxes in the capacity of a public entity.

The new CID policy emphasizes the importance of running districts in strict compliance with the law. The state auditor's core functions are designated by the Missouri Constitution, and the process involves a comprehensive review of an organization's governing details and finances. Open for review is a wide range of information, including "meeting minutes, written policies and procedures, and financial records." An audited area has 30 days to respond to the auditor's findings. Once complete, the report will be presented to the governor and the legislature, and made available to the public online.

The new legislation for TDDs—House Bill 1418—gives teeth to existing penalties concerning financial reporting requirements. A lack of detailed language in the previous statute allowed TDDs to avoid paying fines for not filing annual financial statements with the state. Under the new rules, TDDs which fail to timely file with the state auditor will receive a late notice from the Department of Revenue—and will have 30 days upon receipt of such notice to file their report. After the grace period is up, a fine of US$500 will accrue for each day the report remains delinquent. Exempt from fines are only those TDDs that bring in less than US$5,000 of gross revenue for the fiscal year.

The TDD bill also adds a requirement for districts organized prior to August 28, 2016, to "notify the state auditor's office in writing of the date it was organized and provide contact information for the current board of directors by December 31, 2016." A TDD formed after August 28 must notify the state auditor's office of the same within 30 days of its first board of directors meeting. The bill further adds language clarifying that TDDs would be responsible for paying the cost of an audit, not to exceed three percent of the district's gross revenues, regardless of how the audit was initiated.

To be sure, the new CID and TDD requirements should not pose an issue for those districts that continue to operate in compliance with all laws and regulations. However, there are additional administrative burdens and associated costs in the event of an audit. State Auditor Nicole Galloway states that the reforms seek to promote transparency and accountability, and are part of a broader effort to strengthen government oversight of public projects. But with millions of taxpayer dollars at stake, you can expect to see these new measures being enforced vigorously in the months and years to come—further emphasizing the importance of making sure statutory processes are properly followed and written records are appropriately kept.

Article by John Snyder, Julia A. Taylor and Ryan C. Westhoff

Last Updated: July 15 2016

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

IRS Releases Final Arbitrage Regulations (Unrelated to Issue Price): Squire Patton Boggs

The IRS has released final regulations that make a variety of changes to the arbitrage rules for tax-advantaged bonds. These regulations finalize proposed regulations from 2007 and portions of the infamous 2013 proposed regulations that are unrelated to issue price. To say it again, these final regulations do not change the current issue price rules.

To recap the timeline: Click here to view the image.

Topics Covered: The final regulations change some rules that apply to:

- Working capital financings (including long-term working capital financings)
- The rebate computation credit
- Procedures for recovering rebate overpayments
- Certain rules for computing the yield on an issue of bonds (including, for our underwriter friends, the rules for yield-to-call high-premium bonds)
- Integration of hedges (swaps, etc.) with a bond issue
- Accounting for modifying and terminating hedges
- Yield reduction payments (expanding the circumstances under which you can make them)
- Valuing investments of bond proceeds
- The small issuer exception to rebate
- The arbitrage anti-abuse rules
- The definitions of "tax-advantaged bonds" and "issue"
- The definition and treatement of bond-financed grants
- (Rather randomly) Noting that Rev. Proc. 97-15 (dealing with closing agreements requests) is subsumed by Notice 2008-31 (which announced the Voluntary Closing Agreement Program, or VCAP, for tax-exempt bonds), and providing that Rev. Proc. 97-15 is now obsolete

Effective Dates: The final regulations generally apply to bonds sold on or after 90 days after Treasury publishes the final regulations in the Federal Register. The regulations are scheduled to be officially published on Monday (July 18), and 90 days after that date is October 16, 2016, which is a Sunday, so the regulations will generally apply to bonds sold on or after **October 17, 2016**. You can elect to apply certain provisions of the final regulations to bonds sold before that date. The rules for hedges apply to hedges that are entered into or modified on or after October 17, 2016, and there are specific effective dates for some of the provisions.

by John W. Hutchinson

July 15, 2016

Squire Patton Boggs

IRS PLR: City's Purchase of Interest in Electric Generating Facility Won't Result in Private Business Use of Bonds.

The IRS ruled that a city instrumentality's use of bond proceeds to acquire an undivided ownership interest in an electric generating facility from the company that will build the output facility under an agreement that creates a tax partnership between the instrumentality and the company will not result in private business use of the bonds (as defined in § 141(b)(6) for purposes of § 141(b)(1) of the Internal
Revenue Code.

Read the Private Letter Ruling.

MBFA Sends Letter to House Leadership: Defends Tax Exemption for Municipal Bonds in Response to "Blueprint"

Today, the MBFA Coalition submitted a letter to House Speaker Paul Ryan (R-WI) and Rep. Kevin Brady (R-TX), Chairman of the House Ways & Means Committee in response to the release of the "Blueprint" on tax reform to maintain the tax exemption for municipal bonds. You can view a copy of the letter here.

While the Blueprint did not contain any reference to municipal bonds or the current-law status of municipal securities in particular, the letter outlines the benefits of the tax exemption and how its elimination, in whole or in part, will reduce the amount of infrastructure investments state and local residents can afford.

The MBFA will continue to engage with Members of Congress to advocate for the preservation of the tax-exemption for municipal bonds and stress caution for the implications of proposals that limit or eliminate the tax-exemption.

We hope this information is helpful. For further information on MBFA or issues raised in this update, please contact info@munibondsforamerica.org.

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TAX - VIRGINIA

City of Richmond v. Virginia Electric and Power Company

Supreme Court of Virginia - June 30, 2016 - S.E.2d - 2016 WL 3610425

Power company appealed from the decision of the Tax Commissioner affirming city's ruling that company was subject to tax for natural gas consumed at its electric generation station.

The Circuit Court entered a consolidated letter opinion and order ruling that the company was not subject to the tax. City appealed.

The Supreme Court of Virginia held that city could not impose tax on natural gas consumed solely for purpose of generating electricity.

Statute allowing localities to impose tax on consumption of natural gas provided by "pipeline distribution companies" did not permit city to tax power company for natural gas consumed at electric generation station. Statute defined "pipeline distribution companies" as corporations which transmit natural gas to a purchaser for the purpose of furnishing "heat or light," and legislature's use of the word "power" alongside "heat" and "light" in separate provision of statute defining "commission," while omitting it from the definition of "pipeline distribution companies," reflected that the legislature did not intend to permit localities to impose a tax on natural gas consumed solely for the purpose of generating electricity.

DeFazio's Proposed Financial Transaction Tax Would Apply to Munis.

WASHINGTON – Rep. Peter DeFazio's bill to impose a 0.03% tax on secondary market trades of stocks, bonds and derivatives would include tax-exempt as well as corporate bonds, a spokeswoman for the Democrat from Oregon said on Thursday.

The "Putting Main Street First Act" (H.R. 5745), introduced on Wednesday, is similar to bills that the congressman and former Sen. Tom Harkin, D-Iowa, introduced in 2011 and 2013.

DeFazio told reporters on Wednesday that the tax, which would amount to three cents for every $100 trade, is designed to discourage the same speculative trading that led to the 2008 Wall Street collapse and the 2010 "flash crash." It also would raise revenue to fund national priorities such as the development and repair infrastructure.

The tax would be paid by the purchaser of a bond or stock and collected by a broker or exchange. It would raise $417 billion over 10 years, according to the Joint Committee for Taxation.

For munis, this kind of transaction tax would be on top of a fee of $0.01 per $1,000 of the total par value of bonds imposed by the Municipal Securities Rulemaking Board on interdealer muni sales.

There was some confusion about whether the tax would apply to munis because the text of the bill says the tax would be imposed with respect to "any covered transaction." Covered transactions would include purchase of bonds, stocks or derivatives that occurred or were subject to the rules of "a qualified board" as defined by Section 1256(g)(7) of the Internal Revenue Code, according to the bill.

That section of the tax code says "a qualified board or exchange" means: a national securities exchange which is registered with the Securities and Exchange Commission; a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission; or any other exchange, board of trade, or other market which the [Treasury] Secretary determines has rules adequate to carry out the purposes of this section. None of these seem to apply to munis.

Under the bill, while trades involving tax-advantaged investments, such as college savings accounts, 401(k)s, or health savings accounts would also be taxed, individuals would receive tax credits equal to the transaction tax they paid. Additionally, annuities, insurance products and initial public offerings would not be taxed because they are not traded.

DeFazio conceded to reporters on Wednesday that there is little chance the bill would move forward in a Republican-led Congress. But the measure is in line with the Democratic platform for the presidential election, which warns against "risky financial deals that jeopardize everyone, especially the middle class."

Supporters of the bill include the AFL-CIO, Americans for Financial Reform, the Center for Economic and Policy Research, the Communications Workers of America, and Public Citizen.

But Payson Peabody, managing director and tax counsel for the Securities Industry and Financial Markets Association, said on Thursday that SIFMA "has a long record of opposing FTT [financial transaction tax] laws. He called the proposed tax "a new federal sales tax on Americans saving for retirement" and said it "is a bad idea."

"If the experience of other countries is any guide, an FTT would raise less revenue than promised; it would also reduce liquidity sharply in the affected markets, reducing asset values and increasing borrowing costs for US businesses, consumers, and the federal government itself," Peabody said.

There was some confusion from market participants about whether the bill would apply to tax-exempt bonds.

The Bond Buyer

By Lynn Hume

July 14, 2016

NABL: IRS Issues Final Non-Issue Price Arbitrage Regulations.

The Internal Revenue Service will publish in the Federal Register on Monday, July 18, final regulations on the arbitrage investment restrictions on tax-exempt bonds, finalizing proposals from 2007 and 2013. The final regulations do not include provisions on the determination of issue price. These final regulations amend existing regulations to address certain market developments, simplify certain provisions, address certain technical issues, and make the existing regulations more administrable. Notable topics covered include a new compliance-focused safe harbor for longer-term working capital expenditure financings, integration and significant modifications of qualified hedging transactions (e.g., interest rate swaps), valuation of investments at present value or fair market value in specified circumstances, and the treatment of grants with bond proceeds.

The final regulations are available here.

What's in Treasury's Newly Released Final Arbitrage Rules.

WASHINGTON – The Treasury Department and the Internal Revenue Service released final arbitrage rules on Friday that address issues relating to advance refundings, long-term working capital financings, hedges, investments, and grants among other things.

The 78-page package of rules, which consolidate and finalize arbitrage proposals made in 2013 and 2007, are expected to be published in the Federal Register on Monday and to take effect around Oct. 17.

They are designed to address certain market developments, simplify provisions, address certain technical issues and make existing rules more administrable, the agencies said.

"This basically cleans up the outstanding proposals in the arbitrage area from 2007 and 2013," said John Cross, the Treasury Department's associate tax legislative counsel.

The only arbitrage rules left outstanding are those on issue price, which proved to be so controversial when they were first proposed in 2013, they were separated out into their own regulatory package. Those rules were re-proposed in June 2015 and are awaiting further action.

Bond lawyers generally praised many of these final arbitrage rules, but this was not a surprise since most of the proposals were favorably received years ago.

"Overall they're favorable to the bond community," Matthias Edrich with Kutak Rock in Denver said about these final arbitrage rules. "It will take some time for everyone to put these rules into practice to see how well they work."

Chas Cardell, a lawyer at Orrick Herrington & Sutcliffe in San Francisco said the overall package "is extensive in that it deals with a large number of issues that have been percolating for some time."

"In general, they did a great job of listening to the industry's concerns and coming up with rules to solve those concerns," he said. "There are a few instances in which their solution is not the one I would have chosen and in which there seems to be some clunky-ness in the operation of the new rule, but I do not as yet see anything that I think is unfair or misses the mark. In fact, they really did a nice job on these overall in finding a compromise between the industry requests and their compliance concerns."

"It's a great coup for the IRS to consolidate these" because of the lengthy six year period between the proposals, said Vicky Tsilas, who had Cross' position at Treasury before returning to Ballard Spahr early last year. "There are some great nuggets in there."

Bond lawyers were particularly happy that the rules allow issuers to make yield reduction payments for advance refundings. This will help issuers avoid arbitrage problems when the Treasury Department is forced to stop selling state and local government series securities (SLGS) because the federal government has reached its debt ceiling – something that has happened 11 times since 1995, including four times in the last three years.

SLGS are specially tailored securities that issuers can purchase for advance refunding escrows to ensure their investment yields stay below their bond yields and arbitrage is not generated. When the SLGS window is closed, issuers must buy Treasury securities in the open market and that increases the risk their investment yields will exceed their bond yields. The rules allow issuers to simply make payments to the government to reduce their investment yields when they need to.

The rules also provide a new safe harbor for long-term working capital financings, when bonds are issued to finance operating or other non-construction costs. Currently there are no statutory

prohibitions against long-term working capital financings. But if the issuer can't demonstrate long-term financial stress, the IRS can go after the issuer for having more bonds outstanding than necessary and can find the bonds are taxable under arbitrage abuse rules. The IRS has provided some safe harbors that allow issuers to avoid problems in short-term capital financings, but none exist for long-term deals.

The final rules provide, as Cross said, a "road map" for issuers that need to do long-term working capital financings without running into arbitrage problems.

Under the safe harbor, the issuer must reasonably expect to not have any available amounts of money for working capital for at least five years. For every year after the fifth year, the issuer must determine it has no unrestricted amounts of money it can use for working capital. If it does have available money it can take steps to avoid arbitrage problems by: redeeming some bonds; buying tax-exempt bonds; buying SLGS; or spending the money within 30 days for a governmental purpose.

The rules also contain a section on hedging transactions that provide a significant modification or material change standard for interest rate swap terminations. Termination payments are taken into account in determining whether arbitrage is generated. Under the rules, interest rate swaps won't be treated as terminated unless there is a significant modification of the swap, such as a material change in the interest rates used in the swap.

Cross said this section was spurred in part by the financial crisis when bond insurers were downgraded, Lehmann Brothers filed for bankruptcy and tax lawyers had to restructure or modify thousands of swaps. Under existing rules, modifications forced many of those swaps to be terminated.

The final rules also give issuers 15 instead of three days to identify whether a swap is a "qualified hedge" whose yield can be taken into account with the bond yield in determining whether arbitrage has been generated. They detail how taxable indexes, such as LIBOR, may be used for qualified hedges.

Additionally, the rules clarify that when bond proceeds are used to make grants to unrelated parties, the issuer has to consider whether the grant was used for private business. Existing rules don't require grants to be tracked after awarded to an unrelated party.

The rules also clarify when investments need to be valued at fair market or present value.

Several lawyers said they are still studying the rules. "For the most part, Treasury and the IRS did a good job of addressing comments by making positive changes and clarifications," said Tom Vander Molen with Dorsey & Whitney in Minneapolis. "I am, however, disappointed that Treasury and the IRS did not adopt the suggested changes to the definition of fair market value of qualified hedges on termination. A number of suggestions on other items were described as beyond the scope of the project, but further guidance on some of these should be given in the future. In particular, I would like to see Treasury and the IRS expand the situations in which yield reduction payments may be used."

The Bond Buyer

By Lynn Hume

July 15, 2016

TAX - MASSACHUSETTS

West Beit Olam Cemetery Corp. v. Board of Assessors of Wayland

Appeals Court of Massachusetts, Suffolk - July 7, 2016 - N.E.3d - 2016 WL 3619357

Jewish nonprofit organization applied for tax abatement for lot under exemption from property tax applicable to land dedicated to burial of dead and buildings owned and used exclusively in administration of cemeteries, tombs, and rights of burial.

Town's board of assessors denied application, and nonprofit appealed. The Appellate Tax Board ruled that portion of lot improved with single family home was not eligible for exemption, and nonprofit appealed.

The Appeals Court held that:

- Portion of lot improved with single family home "was not dedicated to burial of dead," as required for nonprofit to claim exemption from property tax allowed to cemeteries, tombs, and rights of burial, and
- Single family home was not "used exclusively in administration of cemeteries, tombs, and rights of burial," as required to be eligible for exemption.

Portion of lot improved with single residence in which resident, under caretaker agreement, lived and was obligated to open and close gates of cemetery on daily basis, in exchange for rent, "was not dedicated to burial of dead," as required for Jewish nonprofit owner of land to claim exemption from property tax applicable to land owned by religious nonprofit corporation dedicated to cemeteries, tombs, and rights of burial. Disputed portion of lot was contractually dedicated to residential use, not burials or other cemetery-related activity, under caretaker agreement that established resident's continuous occupancy of property for "residential purposes," "with no interference" by owner except for reasonable inspection and precluded owner from actively developing that portion of lot for "cemetery purposes" during term of agreement, resident's contractual duties to open and close cemetery gates on daily basis were minimal, and she was in now way full-time cemetery caretaker.

Where no interments have taken place on the subject property, the taxpayer seeking to claim an exemption from property tax applicable to cemeteries, tombs, and rights of burial must demonstrate that the property has been dedicated for burial purposes through planning and substantial actual use of the land to prepare it for burials or other activities necessary for, administration and operation of the cemetery.

Land is not "dedicated to the burial of the dead," as required to claim the exemption from property tax applicable to cemeteries, tombs, and rights of burial by a mere dedication or appropriation on paper. Nor does minor use of the purchased land for activities incidental to a cemetery constitute dedication of such land for a burial place.

Single family home on lot owned by Jewish nonprofit in which resident lived rent free, under caretaker agreement with nonprofit, in exchange for resident's obligation to ensure that adjoining cemetery gates were opened and closed on daily basis, was not "used exclusively in administration of cemeteries, tombs, and rights of burial," as required for home to come under exemption from property tax applicable to buildings on cemetery property owned by religious nonprofit corporations, where home was used primarily for residential purposes and was restricted to such use during tax year in question.

South Carolina Economic Development Incentives: The Negotiated Fee in Lieu of Property Taxes.

South Carolina has some of the highest business property taxes in the Southeast. The state generally taxes land, buildings, machinery and equipment, and furniture and fixtures, but does not tax inventory, pollution control equipment, intellectual property, and other assets.

To reduce the effect of its high business property tax rates, and to make the state a more competitive environment for business, South Carolina offers a property tax incentive and tax savings for those businesses investing at least $2.5 million over a five year period in the state. This incentive is known as the negotiated fee-in-lieu of property taxes, or "FILOT".

Property taxes are calculated by taking the "value" of taxable property and multiplying it by an "assessment ratio" set by state law and then multiplying that product by an applicable "millage rate" set by local government. Real property owned and used by a "commercial enterprise" has an assessment ratio of 6%, and the personal property of the business is assigned an assessment ratio of 10.5%. Manufacturers are assigned an assessment ratio of 10.5% for both real and personal property.

Under a FILOT, the value of land and buildings is generally set at the value of this property at the beginning of the arrangement (typically, the cost or price paid for these assets) and this value remains constant throughout the term of the FILOT. This value may be adjusted to fair market value every five years, through agreement with the county. The value of personal property (e.g. machinery and equipment) begins with its cost and then is depreciated each year under a statutory rate (e.g. 11% per year for manufacturers) until the property is depreciated down to 10% of its cost.

The FILOT permits a business and the county to negotiate a reduction in the assessment ratio for all property, both real and personal, down to 6% (or even lower with larger investment levels), and the county can agree to "freeze" the millage rate at a fixed rate, or to adjust the millage rate every five years, throughout the term of the FILOT.

The term of a FILOT is from 20 – 30 years, from each year of investment. The county may grant an extension of the FILOT term for up to an additional 10 years. The investment period is generally five years, but may be extended for an additional five years.

There are three types of FILOT arrangements: the original FILOT Act (the "Big Fee"); the Streamlined FILOT Act (the "Little Fee"); and the Simplified FILOT Act. Each FILOT arrangement requires approval by the county, and through a local county council ordinance, which requires three county council readings and a public hearing.

Original FILOT Act ("Big Fee")

Under the Big Fee, a business must invest a minimum of $45 million in property. The Big Fee requires the county to own and have title to the property, so the business must transfer its applicable property to the county, but subject to a lease agreement with the county where the county leases the property back to the business for its use during the FILOT term. The business has the right to terminate the FILOT and reacquire its property during the term of the lease, and at the end of the lease, for nominal consideration (e.g. $1.00).

Streamlined FILOT Act ("Little Fee")

The Little Fee is similar to the Big Fee, but the investing business must only invest a minimum of $2.5 million over a five-year investment term. Like the Big Fee, the business will transfer its property to the county and lease it back for the term of the FILOT.

Simplified FILOT Act ("Simplified Fee")

Under the "Simplified Fee" a business must invest a minimum of $2.5 million. However, unlike the Big Fee and Little Fee, title to property may remain with the business, and no lease with the county is required. The business and the county enter into an approved "Fee Agreement" with the property being classified as "economic development property."

Additional FILOT Parties

With county consent, an additional business or party may be added to a FILOT arrangement as a "sponsor affiliate". Provided the sponsor affiliate (or multiple sponsor affiliates) makes a required minimum investment (which can be exempted for certain types of businesses, including manufacturing), all property of the sponsor affiliate potentially qualifies for the FILOT.

Larger FILOT Arrangements

Under each of the FILOT arrangements, there are provisions that allow a business to receive a lower property assessment ratio, a longer investment period, and a lengthier FILOT term in return for a substantially higher minimum investment amount, and which is often coupled with a job creation requirement. For example, if a single business invests at least $150 million and creates 125 new full-time jobs in the state, or invests at least $400 million at a project the business may be able to negotiate a reduction of the assessment ratio from 10.5% to 4.0%, an extension of the FILOT term, and the business would have at least 8 years (if an extension is granted – a total of 13 years) to make the required investment.

by Adam Landy | McNair Law Firm, P.A.

7/8/2016

Orrick: IRS Issues Further Guidance on "Start of Construction" Requirement for Renewable Energy Tax Credits, Including Continuity Requirement.

On May 5, 2016, the IRS released Notice 2016-31, which provides additional guidance on the "start of construction" requirements for the production tax credit (PTC) and investment tax credit (ITC) in lieu of the PTC. Notice 2016-31 does not provide guidance with respect to the ITC for solar facilities. On May 18, 2016, the IRS revised Notice 2016-31. As discussed below, Notice 2016-31 provides additional guidance on satisfying the continuity requirement for beginning construction, satisfying the physical work test, and applying the five percent safe harbor to retrofitted facilities.

Under the Internal Revenue Code, eligible solar facilities currently can benefit from an ITC of 30% of the cost basis. Wind facilities can currently benefit from PTCs related to the quantity of renewable energy produced and sold during a taxable year (and, alternatively, can benefit from an ITC in lieu of PTCs). The ITC for solar and PTCs for wind were recently extended in legislation passed in December 2015.

Prior to the extension, the ITC was scheduled to be reduced to 10% for solar facilities placed in

service after December 31, 2016. Prior to the extension, PTCs were available only for wind facilities for which construction began prior to January 1, 2015.

With the extension, solar facilities are eligible for a 30% ITC if construction begins before January 1, 2020. The 30% ITC for solar is phased down to 26% for facilities for which construction begins in 2020, to 22% for facilities for which construction begins in 2021, and to 10% for facilities for which construction begins after December 31, 2021. Additionally, to be eligible for the 30%, 26%, or 22% ITC, the solar facility must be placed in service before January 1, 2024 (if not, the ITC is reduced to 10%). Notice 2016-31 does not provide guidance with respect to the start of construction requirements for ITC with respect to solar facilities. The IRS anticipates issuing separate guidance addressing the extension of ITC for solar facilities.

For wind facilities, the extension provides for a phase down of PTCs over five years. Wind facilities for which construction begins before January 1, 2017 are eligible for the PTC at 100% of the current level. Wind facilities for which construction begins in 2017, 2018, and 2019 are eligible for reduced PTCs. The PTC reduction is 20% for 2017, 40% for 2018, and 60% for 2019. Wind facilities for which construction begins after December 31, 2019 would not be eligible for PTCs.

The IRS had previously provided guidance on when construction begins (Notices 2013-29, 2013-60, 2014- 46, and 2015-15). Notice 2013-29 provides two methods by which to satisfy the start of construction requirement. One method is to perform physical work of a significant nature. The other method is to pay or incur five percent or more of the total cost of a facility (the five percent safe harbor). In addition, work on the facility must be "continuous" in order for either method to be met (by meeting a "continuous program of construction" test or a "continuous efforts" test, as applicable). The continuity requirement is generally a facts and circumstances test. In Notice 2015-25, which was issued before the extension, the IRS provided that the continuity requirement would be deemed met if a facility is placed in service before January 1, 2017 (two years after the former begun construction deadline).

Notice 2016-31 provides that the continuity requirement will be deemed met if a facility is placed in service before the later of (i) a calendar year that is no more than four calendar years after the calendar year during which construction of the facility began or (ii) December 31, 2016. For example, if construction begins on a facility on January 15, 2016, and the facility is placed in service by December 31, 2020, the facility will be considered to satisfy the continuity safe harbor. As a result of the four-year rule provided for in Notice 2016-31, it will be necessary to determine the year in which construction began when evaluating whether a facility qualifies for the continuity safe harbor. Under the prior guidance, this was not necessary because the continuity safe harbor was satisfied by placing a facility in service by a specific deadline.

Notice 2016-31 provides that the physical work test and the five percent safe harbor may not be relied upon in alternating years to satisfy the beginning of construction requirement or the continuity requirement. This prevents taxpayers from extending the four-year rule by, for example, relying on the physical work test in one year and then relying on the five percent safe harbor in a subsequent year.

If the continuity safe harbor is not met, the continuity requirement is evaluated under a facts and circumstances analysis. In prior guidance, the IRS had provided examples of excusable disruptions that would not cause the continuity requirement not to be met. Notice 2016-31 adds interconnection-related delays and delays in the manufacture of custom components to the list of excusable disruptions.

Notice 2016-31 provides additional examples to illustrate what qualifies as physical work of a

significant nature for different types of renewable energy facilities, as follows:

- Wind facilities. On-site physical work of a significant nature may include the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation.
- Hydropower facilities. On-site physical work of a significant nature may include the excavation for or construction of a penstock, power house, or retaining wall structure.
- Biomass and trash facilities. On-site physical work of a significant nature may include the performance of site improvements (as opposed to site clearing), such as filling or compacting soil, or installing stack piling.
- Geothermal facilities. On-site physical work of a significant nature may include physical activities that are undertaken at a project site after a valid discovery.

Finally, consistent with prior IRS guidance, Notice 2016-31 states that a facility may qualify as originally placed in service even though it contains some used property, provided the fair market value of the used property is not more than twenty percent of the facility's total value (the cost of the new property plus the value of the used property). Notice 2016-31 provides that, for purposes of the five percent safe harbor, only expenditures incurred that relate to new construction are taken into account.

Article by Greg R. Riddle and Wolfram Pohl

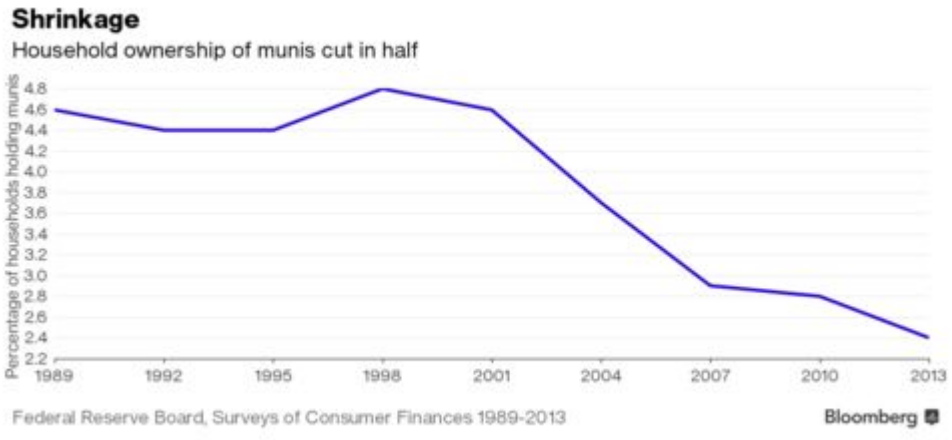
Last Updated: July 8 2016

Orrick

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Muni Tax Exemption Risks Becoming Target as Ownership Narrows.

Municipal bonds are becoming concentrated in a fewer number of hands and that may not be good for bondholders and states and local governments.



The share of households owning muni bonds fell by almost half between 1989 and 2013 to 2.4

percent from 4.6 percent as the focus of their investing has shifted to tax-deferred retirement accounts such as 401(k) plans, according to a paper by faculty from Brandeis University and the Massachusetts Institute of Technology.

At the same time, the securities are increasingly concentrated among the wealthiest households. The share of total muni bonds held by the wealthiest 0.5 percent of households rose to 42 percent from 24 percent, according to the paper.

The drop in ownership could weaken the political will of municipalities to pay their debt and of Congress to maintain the tax-exemption of municipal bonds, write Daniel Bergstresser, an associate professor of finance at the Brandeis International Business School, and Randolph Cohen, a senior lecturer at MIT's Sloan School of Management.

"A declining share of households who hold municipal bonds and perceive themselves as benefiting from the tax exemption may place this exemption on a shakier political foundation," they write in a paper presented this week at the 5th Annual Municipal Finance Conference hosted by the Brookings Institution's Hutchins Center on Fiscal and Monetary Policy.

Annual Consternation

Proposals to eliminate or curtail the $3.7 trillion municipal market's tax break are a perennial, if little-noticed, feature of Washington, D.C., budget and tax debates. A 35-page plan released by House Speaker Paul Ryan last month that referred to repealing several "special-interest carve-outs" from the tax code without naming them was enough to raise alarm bells with lobbying groups representing local finance officials and investment banks.

Both the Republican chairman of the House Ways and Means Committee and President Barack Obama have previously proposed limiting the tax-exemption.

Representatives of the National Association of State Treasurers, the Bond Dealers of America and the Government Finance Officers Association questioned the paper's conclusion saying it ignored a vital constituency for the tax exemption: states and local governments that save billions of dollars in financing costs for roads, sewers, schools, and airports. Curtailing the tax exemption would raise state and local government financing costs by $17 billion, according to Washington State Treasurer James McIntire, president of the state treasurers group.

Survey Sample

"Where is that $17 billion going to come from? It's going to come largely from sales taxes and property taxes which have a disproportionate impact on the poor," said McIntire. "We are a necessary and important part of providing the infrastructure necessary to build our economy."

Bergstresser and Cohen's paper is based on data from the Federal Reserve's Survey of Consumer Finances, a survey of about 6,000 families.

Internal Revenue Service data from individual income tax returns differ from Bergstresser and Cohen's findings. According to the IRS, the percentage of individual filers who report tax-exempt income has increased to 4 percent in 2013 from 3.4 percent in 1990, IRS data shows. About 6 million filers reported tax-exempt income in 2013, according to the IRS.

The discrepancy between the data may come from filers who own taxable bond funds, like Pacific Investment Management Co.'s Total Return Fund, that also buy munis, generating some tax-exempt interest, Bergstresser said. The Fed survey would probably classify these funds as general bond funds.

In addition, the Fed survey has a separate category for money-market funds so tax-exempt income generated by a muni money-market funds would be reported to the IRS, but wouldn't be included in the survey's municipal bond and tax-exempt fund category.

Households owned about $2.6 trillion of municipal bonds, either directly or through mutual funds and exchange-traded funds at the end of 2015, down from $2.9 trillion in 2010, according to the Fed's flow of funds data. Banks and insurance companies owned about $990 billion. Foreign investors, who have increasingly come to the muni market because they face negative interest rates in their own countries, held $87.2 billion.

The declining share of muni holdings has been most pronounced in the upper middle class, where 2.6 percent of households reported holding municipal bonds, down from a high of 9.6 percent in 1998, according to Bergstresser and Cohen. The upper middle class is defined as households with average financial assets $215,000.

As the ownership rate of munis fell, the share of households owning stocks has soared to 42.7 percent from 27.3 percent, coinciding with the rise of 401(k) s and IRAs.

"Municipal bonds' tax exemption reduces their pre-tax yields and makes them a very unusual (and even inappropriate) asset for tax-deferred accounts."

Municipal bondholders tend to invest locally, creating a significant constituency that can be counted upon to support repayment, Bergstresser and Cohen write. A declining base of owners could weaken that connection, they said.

Emily Brock, federal liaison for the Government Finance Officers Association said the authors didn't cite any evidence supporting that conclusion.

Bloomberg Business

by Martin Z Braun

July 14, 2016 — 2:00 AM PDT

TAX - WASHINGTON

United Airlines, Inc. v. King County

Court of Appeals of Washington, Division 1 - June 6, 2016 - P.3d - 2016 WL 3190515

Prior to 2006, the County and State employed an imputed return approach to valuing possessory interests in airline leaseholds at SeaTac Airport. The value was computed using a discounted cash-flow model that capitalized the net annual lease payments assuming a seven-year remaining life.

In 2006, the department decided to change to a variation of what is known as a residual approach for valuing possessory interests. The residual approach first computes the present value of the leasehold by capitalizing the net amount of lease payments for a single year using a capitalization rate determined from a review of rate studies. The second step is to consider the present value of the government-owned reversionary interest and to subtract it if it has any material value. Using the residual approach, the department "looked for evidence suggesting that the lease would not be renewed at the end of its express term." Where the evidence suggested that the lease would continue to be renewed into the foreseeable future, the port's reversionary interest "was considered to be minimal." According to the department, a significant difference is that the residual approach used a direct capitalization method, whereas the imputed return approach used limited-life yield capitalization.

The residual approach resulted in valuations that were significantly higher than the valuations calculated under the imputed return approach.5 Using the residual approach, the department, at least in some cases, calculated the value of the government-owned reversionary interest at "nil" or "zero."

After receiving objections from airline companies, and after internal study and discussion, the department agreed to change from the residual approach to a modified version of the earlier imputed return approach. This methodology used the actual lease term rather than a hypothetical perpetual lease.

United requested an administrative refund of taxes paid to King County from 2009 through 2011. For each year, the department had valued United's possessory interest by using the residual approach and assuming a hypothetical perpetual lease. The county denied the request.

United brought this action in superior court. The superior court granted the department's motion for summary judgment and United appealed.

The Court of Appeals affirmed, holding that an administrative refund of taxes under chapter 84.69 RCW is not available as an avenue for challenging an alleged error in determining the valuation of property. To challenge a tax as unlawful or excessive, a taxpayer must pay the tax under written protest and then file suit under RCW 84.68.020.

Because United attempted to use the administrative refund process to challenge the appraisal method by which appellant's property interest was valued, the trial court properly dismissed the action on summary judgment.

"In summary, the use of an appraisal method that assigned a nil value to the port's reversionary interest after consideration of all the circumstances cannot be characterized as the manifest error of assessing property exempted by law from taxation."

Recent IRS Private Letter Ruling Provides Helpful Guidance on Management Contracts: Squire Patton Boggs

On May 27, 2016, the National Office of the Internal Revenue Service ("IRS") released Private Letter Ruling ("PLR") 201622003. PLR 201622003 continues the trend of favorable PLRs issued by the IRS on the question of whether, under a facts-and-circumstances analysis, a management contract that fails to satisfy a Rev. Proc. 97-13 safe harbor from private business use results in private business use of a tax-exempt bond issue. PLR 201622003 also provides helpful guidance in interpreting the scope of the safe harbor from private business use set forth in Rev. Proc. 97-13 §5.03(7) in the case of a management contract that provides for incentive compensation based on the attainment of a threshold for an increase in gross revenue of the managed facility or a decrease in the expenses of operating the managed facility (but not both an increase in revenue and decrease in expenses).[1]

PLR 201622003 involves a management contract for a hotel that was financed with the proceeds of a tax-exempt bond issue. The PLR does not state the precise term of the management contract, but it does make clear that the contract's term exceeded five years. The manager's compensation under the contract consisted of a base fee equal to a stated percentage of the hotel's gross revenue, as well as an incentive fee equal to an additional stated percentage of the hotel's gross revenue in those years where: (1) the net profits of the hotel exceeded a specified threshold; and (2) the hotel's revenue-per-available-room exceeded a stated percentage of the average revenue-per-available-room for a pre-determined group of comparable hotels.

The IRS found that the contract did not satisfy a safe harbor from private business use contained in Rev. Proc. 97-13. The IRS further found that the although the hotel's net profits served as a partial trigger for the payment of incentive compensation, the incentive compensation consisted of an additional stated percentage of the hotel's gross revenues, rather than a portion of the hotel's net profits, because the incentive compensation was a fixed percentage of gross revenue and did not rise or fall in proportion to increases or decreases in the hotel's net profits. Ultimately, the IRS concluded that the manager's compensation under the contract was comprised entirely of a percentage of the hotel's gross revenues, and that the management contract's only deviation from the safe harbor set forth in Rev. Proc. 97-13 §5.03(7) was the contract's term, which exceeded five years. The IRS found that the contract's term was reasonable under the facts and circumstances. Consequently, the IRS held that the management contract did not give rise to private business use of the tax-exempt bond-financed hotel.

The holding in PLR 201622003 with respect to the use of a net profits threshold for the payment of incentive compensation that consists of a fixed percentage of gross revenues accords with the same conclusion the IRS reached on this issue in PLR 201145005. It is helpful to have some consistent indication from the IRS that a net profits trigger for the payment of incentive compensation will not be treated as the sharing of net profits with the manager if the incentive compensation is a stated amount or a specified percentage of an item like gross revenues, where the incentive compensation itself does not constitute a portion of the net profits of the managed facility.

PLR 201622003 also provides helpful guidance with respect to the scope of the safe harbor from private business use contained in Rev. Proc. 97-13 §5.03(7). This safe harbor was added to Rev. Proc. 97-13 by IRS Notice 2014-67, and it provides that a management contract does not result in private business use where:

> All 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 revenues and expenses). The term of the contract, including all renewal options, does not exceed five years. Such contract need not be terminable by the qualified user prior to the end of the term. For purposes of this section 5.03(7), a tiered productivity award as described in section 5.02(3) will be treated as a stated amount or a periodic fixed fee, as appropriate.

Rev. Proc. 97-13 §5.03(7) therefore specifically includes a qualifying tiered productivity award under Rev. Proc. 97-13 §5.02(3) among the mix of compensation that will satisfy the safe harbor from private business use. Rev. Proc. 97-13 §5.02(3), which was modified in large extent by Notice 2014-67, provides as follows regarding productivity awards and tiered productivity awards:

For purposes of § 1.141-3(b)(4)(i) and this revenue procedure, a productivity reward equal to a stated dollar amount based on increases or decreases in gross revenues (or adjusted gross revenues), or reductions in total expenses (but not both increases in gross revenues (or adjusted gross revenues) and reductions in total expenses) in any annual period during the term of the contract, generally does not cause the compensation to be based on a share of net profits. A productivity reward for services in any annual period during the term of the contract generally also does not cause the compensation to be based on a share of net profits of the financed facility if:

(1) The eligibility for the productivity award is based on the quality of the services provided under the management contract (for example, the achievement of Medicare Shared Savings Program quality performance standards or meeting data reporting requirements), rather than increases in revenues or decreases in expenses of the facility; and

(2) The amount of the productivity award is a stated dollar amount, a periodic fixed fee, or a tiered system of stated dollar amounts or periodic fixed fees based solely on the level of performance achieved with respect to the applicable measure.

Safe harbors are narrowly construed, and the only reference to a tiered productivity award in Rev. Proc. 97-13 §5.02(3) is with respect to productivity awards that are paid for the achievement of a given level of performance for a measure of the quality of services provided, rather than the attainment of a quantitative target, such as a level of revenue or expense (but not both). Thus, the reference to qualifying tiered productivity awards in Rev. Proc. 97-13 §5.03(7) could easily be interpreted as limited to incentive compensation arrangements that are based on qualitative, rather than quantitative, measures. PLR 201622003 does not adopt this narrow reading of the safe harbor.

Incentive compensation paid on the basis of quantitative measures is quite common, so a restrictive interpretation of the Rev. Proc. 97-13 §5.03(7) safe harbor would leave these arrangements dependent on a favorable facts-and-circumstances analysis to avoid resulting in private business use of a tax-exempt bond issue. Prior to the modification of Rev. Proc. 97-13 by Notice 2014-67 to include the safe harbor from private business use set forth in Rev. Proc. 97-13 §5.03(7), the IRS had found in certain instances that such incentive compensation arrangements do not result in private business use, based on that facts-and-circumstances analysis. See, e.g., PLR 201338026. It is refreshing that the IRS has indicated in PLR 201622003 that the safe harbor from private business use in Rev. Proc. 97-13 §5.03(7) can extend to incentive compensation arrangements that are based on quantitative measures and that a facts-and-circumstances analysis therefore need not be applied to determine whether the management contract results in private business use.

[1] Code Section 6110(k)(3) provides that a private letter ruling cannot be used or cited as precedent unless regulations to the contrary are issued. Nonetheless, as reasoned by the U.S. Supreme Court, private letter rulings “reveal the interpretation put upon the statute by the agency

charged with the responsibility of administering the revenue laws," and such rulings aid in the interpretation of the internal revenue laws. Hanover Bank v. Comm'r, 369 U.S. 672, 686-87 (1962). See also Rowan Cos. Inc. v. United States, 452 U.S. 247, 261 n.17 (1981). Moreover, the Tax Court has found that private letter rulings may be cited to show the practice of the IRS. Rauenhorst v. Comm'r, 119 T.C. 157, n.8 (2002); Estate of Cristofani v. Comm'r, 97 T.C. 74, 84 n.5 (1991); and Woods Inv. Co. v. Comm'r, 85 T.C. 274, 281 n.15 (1985).

by Michael A. Cullers

July 6, 2016

Squire Patton Boggs

TAX - ILLINOIS

Hampshire Tp. Road Dist. v. Cunningham

Appellate Court of Illinois, Second District - June 9, 2016 - N.E.3d - 2016 IL App (2d) 150917 - 2016 WL 3201419

Township road district brought action seeking to compel county clerk to extend permanent road-fund tax authorized by electors at town meeting and levied under Highway Code, after clerk refused to permit district to levy tax.

The Circuit Court granted clerk's motion for summary judgment, and district appealed.

The Appellate Court held that direct referendum was required for county clerk to levy tax under Property Tax Extension Limitation Law (PTELL).

Although permanent road fund tax approved by electors at town meeting was not new rate authorized by statute to be imposed without referendum, direct referendum was required for county clerk to levy tax, under provision of Property Tax Extension Limitation Law (PTELL), which required direct referendum to "levy a new tax rate authorized by statute or increase the limiting rate applicable to taxing districts" in accordance with PTELL procedures and Election Code.

TAX - RHODE ISLAND

Whittemore v. Thompson

Supreme Court of Rhode Island - June 24, 2016 - A.3d - 2016 WL 3508315

Taxpayers filed petitions for relief from property tax assessments on their home.

The Superior Court granted petitions. Tax assessor appealed.

The Supreme Court of Rhode Island held that:

- Taxpayer had burden to produce evidence from which the trier of fact could sufficiently discern fair market value;
- Taxpayers overcame presumption of correctness applicable to tax assessor's assessment of home;
- Evidence supported trial court's decision to reject comparable sales data, and reduce the property's previous assessment in accordance with a market trend approach; but

- Town's failure to provide proper notice did not preclude the affirmative defense that taxpayers failed to file timely accountings.

Taxpayers challenging property tax assessments on their home, purchased for $7,100,000 at a time when home's assessed value was $5,260,900, presented sufficient evidence to overcome presumption of correctness applicable to tax assessor's assessment of home at $5,905,000 one and a half years after sale. Despite testifying that he would not consider a sale price that he believed to be an outlier when assessing a neighboring property, assessor used outlier sales values for subject property and neighboring property to justify raising the assessments, the only comparable sale assessor could identify was the sale of neighboring property, and there was evidence that the neighborhood had been affected by a decline of 6 percent in market value during the relevant time period.

Evidence in action challenging property tax assessment on high-end residential real estate supported trial court's decision to reject comparable sales data, and reduce the property's previous assessment in accordance with a market trend specific to the neighborhood at issue. Experts testified about the paucity of useful comparable sales during the relevant time period during an economic downturn, experts testified that sales in the high-end market tended to be less reliable in calculating fair market value, assessor's own testimony indicated that he did not believe there were any reliable comparable sales for supporting the assessments, and there was evidence that the neighborhood had been affected by a decline of 6 percent in market value during the relevant time period.

Town's failure to provide proper notice to taxpayers of the consequences of their failure to file a sworn and timely account with petition for relief from property tax assessment did not preclude town from raising the affirmative defense that taxpayers failed to file timely accountings. Tax assessor's obligation to provide required notice in a single form was directory, rather than mandatory, as governing statute did not provide any specific remedy for the town's failure to provide the specific language on application form.

House Blueprint for Tax Reform Worries Muni Pros.

WASHINGTON – House Republicans released a blueprint for tax reform that left some muni groups and experts concerned that the tax-exempt status of municipal bonds may be in jeopardy.

The 35-page plan, which at no point directly references municipal bonds, was released Friday by House Speaker Rep. Paul Ryan, R-Wis., under his "A Better Way" agenda. The blueprint includes several significant, though not unexpected reforms to the current tax code: A reduction of the corporate income tax rate to 20%; a reduction of the current seven-bracket individual income tax rate to three brackets with a top rate of 33%; and a repeal of the Alternative Minimum Tax for both corporations and individuals.

Because the blueprint doesn't mention munis directly but does mention repealing unnamed special-interest provisions, Jessica Giroux, general counsel and managing director for Bond Dealers of America, said the organization was concerned that munis' tax exemption could be included.

Republicans have proposed several tax reform plans that limit or eliminate exclusions like tax-exempt bond interest in an effort to lower tax rates and broaden the tax base in the past.

"It's definitely a real concern," Giroux said. "The general statements they're making now are going

to appeal to a lot of people, but we're going to be more concerned with the details. We can glean that tax exemption is not safe."

She said BDA will continue its effort to educate both staff and members of Congress about the importance and value in maintaining the tax-exempt status of municipal bonds.Emily Brock, director of the Government Finance Officers Association's federal liaison center, said her organization also noted the lack of any explicit reference to munis in Friday's blueprint. She said that GFOA will continue to stress the importance of their tax-exempt status to lawmakers.

"I hope not," Brock said of any potential loss of tax exemption. "As this plan starts to materialize, we'll continue to maintain the importance of municipal bonds and the partnership between federal and state governments."

Rep. Kevin Brady, R-Tex., who chairs of both the House Ways and Means Committee and its Task Force on Tax Reform, said Friday that lawmakers will continue to seek input from taxpayers and lobbying groups ahead of a formal tax reform bill Republicans hope to introduce in 2017. He said the blueprint will continue to be amended to help achieve a "fairer and simpler" tax code.

"Tax reform only happens once in a generation," Brady said. "House Republicans believe it is time for a change."

The plan would reduce the corporate rate to 20% from 35%, which Brady said would encourage businesses to remain in the United States rather than relocate overseas. It would also condense the current seven-bracket individual income tax rate with a top rate of 39.6% into three brackets of 12%, 25% and 33%, and require taxpayers to submit returns on a postcard.

Like the Tax Reform Act of 2014, the legislation introduced by former Ways and Means Committee chairman Dave Camp, R-Mich., the current proposal would repeal the corporate and individual alternative minimum taxes (AMT).

This, Giroux said, could spell positives for bonds.

High-income earners as well as private activity bonds are subject to the AMT, meaning taxpayers who invest in the latter must include interest earned on the bonds in their modified adjusted gross income. Some of that interest is subject to the current federal income tax rate of 28%, which shrinks the yield on those bonds.

Eliminating the AMT removes the need to determine if investing in the bonds makes sense, she said,but if interest on municipal bonds eventually becomes taxable, the change in AMT will be a moot point.

Speaking at a news conference at the Capitol Friday, Brady said the Republicans' proposed "pro-growth" tax code is "built for the growth of paychecks, growth of local jobs and economy, and the growth of America's economy."

"I'm convinced our nation's biggest threat is government debt and deficits," Brady said. "Spending cuts will get us halfway back to a balanced budget but we'll need a much stronger economy to finish the job and start paying down the national debt. Tax reform can get this economy going again."

Ryan, also speaking to reporters Friday morning, said the proposed tax code is being developed to not only make the tax code less burdensome, but to also reform the Internal Revenue Service. It would include the installation of a new IRS commissioner, he said.

“All of these things are going to grow our economy and grow jobs,” Ryan said. “And all of these things will fix our tax code.”

House Republicans first announced plans to reform the tax code at their annual issue conference in January before announcing the formation of the committee-led task force in February. The task force released a set of principles in March where it sought to limit deductions, exclusions and credits in the current tax code as well as close existing loopholes.

The task force held several hearings throughout the spring that focused on shifting from an income tax base to a consumption or cash-flow tax base. It also discussed as well as legislation targeting the income tax base.

Its policy reform goals include lowering tax rates for families, small businesses and corporations; eliminating special-interest carve-outs; simplifying the tax code; reducing the double taxation of savings and investment; and preventing American businesses from relocating overseas for tax purposes.In an op-ed published in The Wall Street Journal Friday, Brady said the IRS will be redesigned into three independent units: one for business taxation, another for individual taxation, and one to help resolve tax issues in the form of a small-claims court.

“It delivers simplicity and fairness, yet is built primarily for growth in jobs, paychecks and America’s economy,” Brady wrote.

In both the blueprint and at Friday’s news conference, Republicans said efforts to implement these changes are targeted for 2017, as most lawmakers and experts have concluded that tax reform is not probable in an election year.

The blueprint marked the first major tax reform proposal since Camp’s, which drew criticism from muni experts because of its curbing of the muni exemption in order to pay for other aspects of his plan. That bill would have capped the muni exemption at 25% and eliminated the tax exemption for qualified private activity bonds and advance refunding bonds issued after 2014.

Earlier this year, Rep. Bob Goodlatte, R-Va., introduced the Tax Code Termination Act (H.R. 27), which would repeal the current tax code at the end of 2019 and would require Congress to adopt a new tax system by July of that year. It is currently in front of the House Rules committee.

Ryan’s “A Better Way” agenda also includes reforms to improve poverty, national security, the economy, health care and the Constitution. House Republicans introduced their tax proposal before a one-week recess set to begin Monday and roughly a month before the party’s national convention.

The Bond Buyer

By Evan Fallor

June 24, 2016

TAX - ILLINOIS

Moline School Dist. No. 40 Board of Educ. v. Quinn

Supreme Court of Illinois - June 16, 2016 - N.E.3d - 2016 IL 119704 - 2016 WL 3348847

School district board of education brought constitutional challenge to amendment to Property Tax

Code that provided real property tax exemption on leasehold interests and improvements on land leased from county airport authority to fixed based operator (FBO) providing aeronautical services.

The Circuit Court granted summary judgment in favor of intervening company that received exemption. Board appealed. The Appellate Court reversed. FBO appealed.

The Supreme Court of Illinois held that amendment to Property Tax Code violated special legislation clause of state constitution.

Classification created by amendment to Property Tax Code that provided real property tax exemption on leasehold interests and improvements on land leased from county airport authority to fixed based operator (FBOs) was not rationally related to legitimate governmental interest, and therefore violated special legislation clause of state constitution. There was no legitimate justification for singling out particular for-profit business over other business in the state or other FBOs, legislation was based on speculation that the entity receiving the exemption would reinvest money saved in such way to create jobs and economic growth, and entity's circumstances were not unique as would warrant exemption.

IRS Memo on Closing Agreement Sanction Payments.

The IRS Tax-Exempt and Government Entities division has issued revised procedural guidance for employee plans voluntary compliance employees on how to process sanction payments associated with voluntary closing agreement requests, including those involving section 457(b) plans made in accordance with Rev. Proc. 2013-12.

Read the Memo.

Lawmakers Target the Tax-exemption for Municipal Bonds……..Again.

The Internal Revenue Code and corresponding Treasury Regulations encourage taxpayers to participate in various activities by using subsidies (including deductions, exclusions, and other tax preferences) often referred to as "tax expenditures."[1] For example, there is a strong federal policy in favor of employer-provided health insurance. To accomplish this, employer contributions to pay for employee health insurance plans are not taxed as income to the employee, but the employer is still permitted to deduct the expense as an ordinary and necessary business expense. Likewise, there is a strong federal policy in favor of permitting low-cost financing options for certain borrowers (e.g., municipalities, tax-exempt organizations) and for certain projects (e.g., airports, docks and wharves, etc.). In furtherance of this policy, interest on certain types of debt is exempt from federal income taxes.

The Tax Foundation periodically compiles a list of the largest tax expenditures, and I have included the list from 2014 here.

Any expenditure on this list would, if eliminated, result in increased tax revenue for the federal government. As a result, the majority of expenditures on this list are periodically challenged by lawmakers. Not surprisingly, certain expenditures are more assailable than others.

Unfortunately, lawmakers have targeted (see previous post for one such instance) the exclusion of interest on state and local bonds as an expenditure that may be able to be eliminated (or limited by an interest rate cap) without sacrificing political capital. Interestingly, the expenditure has been targeted notwithstanding the fact that its elimination would only result in an additional $34 billion in revenue for the U.S. Treasury.

The Blueprint Heard Round the World

On Friday, June 24th, House Republicans released a blueprint for tax reform. Although the blueprint does not reference municipal bonds, it does mention repealing unnamed special-interest provisions which could be interpreted as calling into question municipal bonds' tax-exemption. Over the last few years, the President and various members of Congress have proffered proposals to eliminate or cap the tax exemption for interest on municipal bonds, all of which have been scrapped amid a slew of criticisms. In addition, the blueprint put forward by Speaker Ryan calls for a reduction of the corporate income tax rate to 20%; a reduction in individual tax brackets to three from seven and a reduction of the top rate to 33%; and a repeal of the Alternative Minimum Tax ("AMT").[2]

Very generally, it is cheaper for issuers to finance eligible expenditures using proceeds of tax-exempt debt because the yield on tax-exempt debt is less than the yield on taxable debt. The reason for this spread is that bondholders do not pay tax on the interest from the debt; therefore, bondholders are able to earn the same return as taxable debt without needing to be compensated for any tax liability. All things held equal (they aren't but let's imagine that they are), a bondholder that is subject to U.S. tax is indifferent as to whether it will invest in tax-exempt or taxable debt because the bondholder's return will be the same.

Because the spread in yields between tax-exempt and taxable debt is primarily to compensate the bondholder for taxes, the spread is correlated with federal income tax rates. As income tax rates go down, the spread also decreases, making tax-exempt debt less attractive to investors. Therefore, the overall reduction in the corporate and individual income tax rates suggested in the blueprint could cause the yields on tax-exempt debt to increase in the future to attract investors.

However, one of the proposals in the blueprint is extremely positive for municipal bond issuers – the blueprint proposes to eliminate the Alternative Minimum Tax ("AMT") in its entirety. Although interest on tax-exempt bonds is excluded from the federal income tax, the interest on many types of bonds (e.g., exempt facility bonds) remains subject to the AMT for many bondholders. Many bondholders and potential bondholders are subject to the AMT. In effect, for these bondholders, they have unexpectedly taxable bonds. Therefore, eliminating the AMT would increase the value of the tax-exemption for certain bonds and decrease the borrowing costs for municipal issuers. An elimination of the AMT would be a positive development for municipal bonds, but only so long as the exclusion for municipal bond interest is not repealed. If it is repealed, then the repeal of the AMT becomes a moot point.The blueprint contains only broad goals for reducing tax rates across the board. There are many significant issues that must be addressed and specifics that must be explained before the plan has a chance of becoming law. The blueprint should be watched to follow how the proposed plan develops and what tax expenditures, if any, the House of Representatives ultimately decide should be eliminated.

[1] While this blogger appreciates that the complexities of the federal tax laws are viewed by many as overly burdensome, one has to marvel at the ability of the federal tax laws to manipulate the US economy by influencing the spending habits of US Citizens.

[2] A more comprehensive discussion on the blueprint can be found here.

by Joel Swearingen

Squire Patton Boggs (US) LLP

The Public Finance Tax Blog

Friday, July 1, 2016

TAX - WEST VIRGINIA

Town of Cowen v. Cobb

Supreme Court of Appeals of West Virginia - May 20, 2016 - Not Reported in S.E.2d - 2016 WL 2969917

Former mayor brought action against town to recover money that he was forced to pay to Internal Revenue Service (IRS) due to his and town's failure to pay employment taxes on his behalf.

The Circuit Court, Webster County, ruled in former mayor's favor. Town appealed.

The Supreme Court of Appeals held that:

- Trial court had jurisdiction over action;
- Evidence supported finding that town was unjustly enriched by former mayor's payment of taxes to IRS; and
- Doctrine of unclean hands did not bar former mayor's recovery.

State court had jurisdiction over former mayor's action against town for unjust enrichment based on town's failure to pay employment taxes on mayor's behalf as required by federal law. Former mayor did not contest government's collection of taxes, claim was one invoking doctrine of unjust enrichment, and federal statutes were inapplicable.

Evidence supported finding that town was unjustly enriched by former mayor's payment to Internal Revenue Service (IRS) of employment taxes that town and former mayor had failed to pay on mayor's behalf. Town received benefit of monies being credited to IRS as result of former mayor's payment, and town was aware that payments had not been made and could have been liable as well as mayor.

Doctrine of unclean hands did not bar former mayor's recovery from town of partial reimbursement of employment taxes that had not been paid by town or former mayor. Both parties acknowledged their role in non-payment of taxes.

In determining former mayor's entitlement to reimbursement for town's failure, during his term, to pay federal employment taxes on mayor's behalf, trial court did not err in limiting former mayor's liability for penalties and interest incurred by town to time that he served as mayor. Town did not file counterclaim against former mayor in effort to collect from him amounts it allegedly paid after his resignation.

Advisory Committee Recommends Electronic 8038 Filing, More Targeted Enforcement to IRS.

The Advisory Committee on Tax-Exempt and Government Entities provided its annual set of recommendations to the IRS recently. Among other things, the panel recommended that the IRS implement electronic filing of Form 8038s and decrease the frequency of random audits, shifting instead to more targeted audits of tax-advantaged bond issues.

The Committee is a group of private sector individuals that work in various areas under the jurisdiction of the IRS Tax-Exempt and Government Entities. The Committee provides an organized forum for discussion between IRS officials and the private sector; three of the Committee's members come from the tax-advantaged bond community.

The Committee provides annual reports to the IRS Commissioner of the Tax-Exempt and Government Entities division (currently Sunita Lough), and the section of the Committee from the tax-advantaged bond community makes recommendations for continuous improvement and enhancing resources in the tax-advantaged bond market. Two of the Committee's comments are worth discussing.

The Committee recommends that the IRS should adopt electronic filing for Forms 8038.

Issuers of tax-advantaged bonds file one of the forms in the 8038 series to report the issuance of tax-advantaged bonds (or, in the case of direct pay tax-advantaged bonds, they file Form 8038-CP to request a direct payment) to the IRS. As the parties to a tax-advantaged bond transaction rush to close the deal, they often push the filing of the 8038 until after the bond deal closes; the due date can be as far off as several months depending on where the issuance date falls in a calendar quarter. And in some cases, the parties forget to do it altogether. The Form is filed via snail mail to the IRS Service Center in Ogden, Utah. While at one time the IRS would send mail confirmation that it had received the applicable 8038, it no longer does so. It is difficult, if not impossible, to contact the IRS to affirmatively confirm that the IRS received the form. Often, the only confirmation available comes when the IRS writes to ask for missing information or to ask the parties to correct information on the form that is incorrect. Once the IRS receives the forms, they are presumably scanned or entered by hand into the IRS's computer system.

The Committee recommends that the IRS allow electronic filing of 8038s. This is a great idea. While it is clear that the IRS faces a tightened budget from Congress, spending money to improve the IRS's technology so that it can accept electronic filing of 8038s should make the IRS operate more efficiently and allow it to save money elsewhere. The IRS already allows electronic filing of income tax returns for various taxpayers, so it should not be a stretch to extend the technology to information returns for tax-advantaged bonds. Electronic filing would prevent errors in transcription and allow IRS employees to focus their efforts on other tasks.

An even better approach would be to take the "interactive form" approach that the IRS has recently implemented for Forms 8038-CP and expand it to all 8038s. The new "interactive" Form 8038-CP can be accessed here. It contains some very helpful features for 8038-CP filings that would greatly benefit issuers filing other 8038s to report the issuance of tax-advantaged bonds. For example, the interactive form (best viewed in Internet Explorer), contains a number of error-checking features. After a bit of monkeying around, I discovered that the form will tell you if you've accidentally entered an interest payment date that precedes the issue date, if you've improperly done the multiplication required to calculate the amount of the subsidy payment, and many other helpful

checks. The form also contains a "Verify and Print" button that allows for final confirmation that everything is in place before filing the form. (But you do still have to print the form and mail it in.) The ultimate goal should be to combine both the interactive form and electronic filing of 8038s.

The Committee recommends that the IRS move more resources away from random audits and shift them to targeted audits.

In addition, putting the information on the 8038 into an electronic format from the beginning should allow the IRS to more easily review trends in 8038 filing and better determine particular topics in which to concentrate its enforcement efforts. As the Committee Report notes, some stakeholders might find this unappealing on a superficial level because it arguably makes it easier for the IRS to audit bond issues. But this result would be in everyone's best interest. Anyone who has slogged through a random audit of a tax-exempt bond issue that has no defects, and the attendant time-consuming gathering of papers and payment of legal bills to defend the audit, knows that it would be more appropriate and efficient for the IRS to be able to more efficiently parse the 8038s that it receives to determine which truly need a further look.

For this reason (and others), the Committee recommends that the IRS increase its use of targeted audits. This is also a good idea. The first Information Document Request of the audit routinely contains over 30 questions that require a great many pieces of information simply to acquaint the IRS agent with the transaction in the first place.

It remains to be seen whether either suggestion will be adopted, but both suggestions would be an improvement.

The Public Finance Tax Blog

by John W. Hutchinson

June 23, 2016

Squire Patton Boggs

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The Bond Buyer

By Evan Fallor

June 24, 2016

TAX - TEXAS

Lower Colorado River Authority v. Burnet Central Appraisal District

Court of Appeals of Texas, Austin - June 7, 2016 - S.W.3d - 2016 WL 3230596

The Lower Colorado River Authority (LCRA) sought review in the trial court of a final order of the Burnet Central Appraisal District (BCAD) determining that LCRA's Sunset Point RV Park (the Park) was not exempt from ad valorem taxes.

The trial court granted BCAD's motion for summary judgment, and LCRA appealed.

The central issue was whether the fact that LCRA leases the Park to a private for-profit entity to be operated as a public facility and park cause LCRA to forfeit the Park's tax exemption?

The Court of Appeals concluded that it does not, as the legislature had explicitly authorized LCRA to negotiate contracts with any firm or corporation "for the operation and maintenance" of its parks and recreational facilities.

U.S. House of Representatives Release: "A Better Way: A Pro-Growth Tax Code for All Americans"

Today, the U.S. House of Representatives released "A Better Way: A Pro-Growth Tax Code for All Americans". This document represents the long-awaited outline of a federal tax reform plan that is an out-growth of dozens of hearings, meetings, and briefings conducted by the House Ways and Means Committee. BDA has carefully examined the document for insights into how the tax-treatment of municipal bonds may be altered and for other initiatives that could incentivize investment in infrastructure and municipal bonds.

- The document is very general in nature and provides a broad outline of proposed changes to corporate and individual tax laws. The following proposals outlined in the document will be of interest to issuers and investors in municipal bonds:
- The proposal contains no direct commentary on municipal bonds or the future of the current-law tax exempt status of municipal bonds. Rather, the document does reference the need to eliminate numerous deductions, exemptions, and credits that are viewed as "special interest" provisions. However, no details are provided on which deductions, exemptions, and credits may be impacted.
- The Alternative Minimum Tax is eliminated for both individuals and corporations.
- The corporate income tax rate is reduced to 20 percent. The current slate of individual tax brackets is reduced to three brackets of 12%, 25%, and 33%.
- The plan proposes to retain items such as the mortgage interest deduction and the charitable deduction for individuals and also provide for immediate expensing for corporations and indefinite net operating loss carry-forward.

This tax reform plan is expected to serve as the basis for future discussions on tax reform conducted by the House of Representatives in 2016, but mostly in 2017. The House Ways and Means Committee has promised to continue conducting hearings and briefings on tax reform matters and to gradually refine and provide further details on provisions in the plan. BDA expects that most of this activity will occur in 2017 and beyond as the House is in session for legislative business for less than 30 days between today and the end of 2016 (including an anticipated lame duck session) following the November presidential elections.

Additional Information

- You can view a summary of the tax plan here.
- You can view the Washington Post's coverage here.

For more information on the Municipal Bonds for America coalition, please visit our website: www.munibondsforamerica.org

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TAX - FLORIDA

City of Fort Pierce v. Treasure Coast Marina, LC

District Court of Appeal of Florida, Fourth District - May 31, 2016 - So.3d - 2016 WL 3087680

After city was granted exemption from ad valorem taxes on two marinas it owned and operated, owner of private marina, which was not exempted, brought suit seeking declaratory and injunctive relief against application of the exemption to the city's marinas. Both parties moved for summary judgment.

The Circuit Court granted summary judgment to owner. City appealed.

On motion for rehearing, the District Court of Appeal held that city's marinas served a municipal or public purpose, and thus city was entitled to an ad valorem tax exemption.

City's marinas served a "municipal or public purpose," and thus city was entitled to an ad valorem tax exemption, even though they competed with other private marinas in the area. The marinas were open to public use, were exclusively owned and operated by the city, provided recreation for local residents, supported the local economy by attracting non-local residents, and were part of a larger recreational park complex.

Bill Would Create New $5B Category of PABs for Government Buildings.

WASHINGTON – A bipartisan bill introduced in the House would allow state and local governments to issue up to $5 billion in private activity bonds to finance the construction and upkeep of certain publicly owned buildings.

The Public Buildings Renewal Act (H.R. 5361), introduced by Rep. Mike Kelly, RPa., would create a new category of private activity bonds for governments to join with private parties to help finance schools, medical facilities, police stations and other social infrastructure.

The recently introduced bill, which has nine co-sponsors, would amend the federal tax code to provide another layer of tax-exempt financing that would encourage the use of public-private partnerships.

Section 142 of the federal tax code includes 15 categories of "qualified" PABs, one of which is qualified public educational facilities. Kelly's legislation would add a 16th category for qualified government buildings.

Kelly, a member of the House Ways and Means Committee, said his legislation would help resolve an "ongoing infrastructure crisis" that exists in public schools.

Kelly's bill defines qualified government buildings as an elementary or secondary school; public university buildings used for educational purposes; public libraries; courts; hospitals, health care facilities, laboratories and research buildings; public safety buildings including police and fire stations, medical facilities and jails; and government offices.

Tom Qualtere, a spokesman for Kelly, said the bonds would be exempt from state volume cap restrictions generally applied to PABS, and instead would be subject to a new, national cap of $5 billion.

State and local governments would be required to submit a funding application to the Treasury Department that includes the amount requested; the governmental unit that will own the project; and a project description and timeline.

Governments would also be required to provide anticipated funding sources and uses of funds for the project. Entities would be required to issue bonds in the amount allocated by Treasury within two years after the allocation date. If they fail to do so, the unused portion of the allocation would be revoked.

The bill would exclude any retail food or beverage facilities or buildings used for recreation and entertainment, including private golf courses, country clubs, convention centers and sports arenas.

Jessica Giroux, general counsel and managing director of federal regulatory policy for Bond Dealers of America, said the organization supports the proposed legislation because of the new financing routes it could provide municipalities.

"BDA would be supportive of this effort as yet another tool to provide state and local governments additional flexibility to build and rebuild important infrastructure projects, coupled with the benefits of leveraging private expertise," Giroux said. "It is important to remember that tax-exempt bonds have been the cornerstone by which local governments have been able to keep taxes and utility rates lower for ratepayers for over 100 years and it is critical that we maintain this important avenue for growth."

Under current tax regulations, public entities often must choose between taxable P3 financing or a non-P3 structure using tax-exempt bonds. If the legislation were to be enacted, P3 deals could use tax-exempt financing, thus expanding municipalities' ability to take advantage of the P3 structure for public building projects. Qualified PABs are also commonly used to fund transportation and public works projects.

Linda Schakel, a partner at Ballard Spahr in Washington, said there is a "fair amount" of privatization that currently exists in jail and correctional facilities as well as government offices, but is not sure if such private arrangements are common in public schools. She also supported Kelly's bill, but said it was yet to be seen if the partnerships would be based on a lease or a management contract.

"I think it's a great idea to get private parties to come in and do particularly renovations that are needed," Schakel said.

Still, Schakel said some private entities may have hesitations about entering into these agreements because they would not receive depreciation on the government-owned facilities.

"It may narrow the number of private parties interested in participating in the program," she said. "Or it may end up being mainly private parties want to enter into long-term management contracts."

Kelly's legislation was referred to the House Ways and Means Committee on May 26.

The Bond Buyer

By Evan Fallor

June 14, 2016

NABL: House Bill Would Create New PAB Category for Government Buildings.

Representative Mike Kelly (R-PA) has introduced H.R. 5361, the Public Buildings Renewal Act, which would create a new category of private activity bonds (PABs) to finance the construction and continued upkeep of publicly owned buildings. H.R. 5361 defines qualified government buildings as elementary or secondary schools, colleges or universities, public libraries, courts, hospitals, public safety buildings and government offices. The bonds issued under H.R. 5361 would also be exempt from state volume caps restrictions usually given to PABs, and would instead be subjected to a new national cap of $5 billion. The intent of the bill is to encourage public-private partnerships by using the definition of governmental ownership applicable to airports, docks and wharves, and mass commuting facilities. H.R. 5361 was referred to the House Ways and Means Committee.

H.R. 5361 is available here.

GFOA Testifies at IRS/Treasury Department Hearing on Political Subdivisions.

On June 6, 2016, Patrick J. McCoy, GFOA President-Elect and director of finance for the New York City Metropolitan Finance Authority testified on behalf of GFOA at a hearing held by the Internal Revenue Service and the Department of the Treasury on their proposed rule on political subdivisions. The proposal would increase restrictions on the definition of "political subdivision" for the purpose of being able to issue tax-exempt bonds.

McCoy's testimony reiterated concerns expressed in GFOA's member survey—specifically, that it isn't possible to construct a one-size-fits-all definition of what constitutes acceptable governmental control of a political subdivision, given the varied nature of states and tens of thousands of local governments. The proposed rule creates a high level of uncertainty about the status of political subdivisions that have been authorized by governments and a high level of risk for many entities across the country concerning their ability to issue tax-exempt bonds. This is especially true in cases where districts are intentionally designed to reach across multiple jurisdictions in order to create service delivery efficiencies directly to citizens.

McCoy underscored the heart of GFOA's argument against the proposed regulations, stating that they "question the legitimacy and authority of the bodies that enacted the enabling legislation that created the political subdivisions in the first place." The additional requirements of the proposed rule attempt to regulate governing matters that, in the absence of abuse, should be left to the states, as have been the case for decades.

Please click here for the testimony.

Wednesday, June 8, 2016

IRS TE/GE Advisory Committee Issue 2016 Report of Recommendations.

On June 8, 2016, the 21 members of the ACT presented its 15th report of recommendations to the IRS in a public meeting in Washington, DC.

The ACT report addressed five issues:

> **Employee Plans:** Analysis and Recommendations Regarding Changes to the Determination Letter Program
>
> **Exempt Organizations:** Stewards of the Public Trust: Long-Range Planning for the Future of the IRS and the Exempt Community
>
> **Federal, State and Local Governments:** Revised FSLG Trainings and Communicating with Small Local Governments
>
> **Indian Tribal Governments:** Survey of Tribes Regarding IRS Effectiveness with Current Topics of Concerns and Recommendations
>
> **Tax Exempt Bonds:** Recommendations for Continuous Improvement and Enhancing Resources in the Tax Exempt Bond Market

ACT members provide observations about current or proposed IRS policies, programs and procedures, and suggest improvements. The members are selected by the Commissioner of the IRS and then appointed by the Department of the Treasury. The IRS seeks a diverse group of members representing a broad spectrum of people experienced in employee plans; exempt organizations; tax-exempt bonds; federal, state, local and Indian tribal governments.

Read the Report.

Grassley Seeks Updates from IRS on Tax-exempt Hospital Work in Light of Recent Cases.

WASHINGTON – Sen. Chuck Grassley of Iowa today asked the IRS for updates on implementing tax-exempt hospital accountability measures, citing two instances of non-profit hospitals in the news for aggressively suing patients.

“As Commissioner of the Internal Revenue Service (IRS), you should be made aware of problematic activity within the charitable hospital community,” Grassley wrote to IRS Commissioner John Koskinen. “Granted, we can both agree that many charitable hospitals perform good work on behalf of the communities that they service. However, some charitable hospitals get as close to the line as possible, while others callously breach it. It is important that Congress, via its oversight role, and the IRS ensure that charitable hospitals are functioning as intended.”

Grassley cited the example of Mosaic Life Care, a Missouri non-profit hospital that ultimately forgave $16.9 million in debt for patients after news coverage of its aggressive collection practices

and a persistent inquiry from Grassley. He also cited an Indiana non-profit hospital, Deaconess, that also agreed to help low-income patients after being in the news for patient collection lawsuits.

“These are welcome improvements to the charitable hospital community and others should follow the examples set by Mosaic and Deaconess to better fulfill their charitable mission,”Grassley wrote.

Grassley asked for updates on the IRS’ implementation of non-profit hospital reforms that he authored and that were enacted in 2009. These include the public provision of a financial assistance policy and imposing restrictions on certain billing and collection procedures. “Given the abuses observed in my investigation of Mosaic, I am interested in learning more about the IRS’ implementation and enforcement of these provisions,” Grassley wrote. “The information provided with respect to Mosaic illustrates the value of congressional oversight and sheds light on some of the steps that other charitable hospitals can take to ensure that low-income patients are treated fairly.”

Grassley also asked about the status of the requirement, which he also authored, that the IRS and the Department of Health and Human Services collect information on non-profit hospitals and provide an annual report to Congress. The first report was issued in January 2015 covering 2011. The IRS has yet to issue a 2016 report covering 2012.

Grassley has a long record of holding tax-exempt organizations accountable for the tax benefits they receive. His efforts have resulted in well-funded universities’ voluntarily spending more from their tax-favored endowments on student aid and reforms to governance at major tax-exempt organizations including the Nature Conservancy and the Red Cross.

Grassley’s letter today is available here. More information on his Mosaic inquiry is available here.

Jun 09, 2016

TAX - NEW YORK

Westchester Joint Water Works v. Assessor of City of Rye

Court of Appeals of New York - June 9, 2016 - N.E.3d - 2016 WL 3189055 - 2016 N.Y. Slip Op. 04438

Taxpayer commenced tax certiorari proceeding challenging real property tax assessments on parcels. School district intervened.

The Supreme Court, Westchester County, denied assessor’s motion to dismiss proceedings on ground that notices of petition and petitions were not served upon school district’s superintendent, but granted school district’s motion to dismiss on same ground. Taxpayer appealed, and assessor cross-appealed. The Supreme Court, Appellate Division, affirmed as modified. Leave to appeal was granted.

The Court of Appeals held that recommencement of a tax certiorari proceeding is unavailable where such proceeding is dismissed for an unexcused failure to comply with the requirement that, within ten days of the service of the notice of petition and petition on a municipality, a petitioner must mail a copy of the same document to the superintendent of schools of any district within which the property is located; abrogating *Matter of MM 1, LLC v. LaVancher*, 72 A.D.3d 1497, 899 N.Y.S.2d 774, and *Matter of Consolidated Edison Co. of N.Y., Inc. v. Assessor & Bd. of Assessment Review for the Town of Pleasant Val.*, 82 A.D.3d 761, 918 N.Y.S.2d 169.

SIFMA Calls for IRS to Withdraw Proposal on Political Subdivisions.

Last week, SIFMA staff testified at a public hearing conducted by the IRS on proposed changes to the definition of "political subdivision" in the context of which issuers are eligible to issue tax-exempt bonds. In our presentation, we reiterated our call for the IRS to withdraw its proposal on the basis that the rule is unnecessary and that it would drastically constrain the ability of state and local governments to finance needed infrastructure. The proposal would have a particularly onerous effect on special districts and similar issuers.

Under the IRS's proposal, in order to qualify as a political subdivision and issue tax-exempt bonds, an entity such as a special district would need to possess "sovereign powers, governmental purpose, and governmental control." Sovereign powers would be demonstrated by "eminent domain, police power, or taxing power," which is the extent of the current definition. Governmental purpose would require that an entity serve a public purpose and operate "in a manner that provides a significant public benefit with no more than incidental benefit to private persons." Governmental control would be demonstrated by the ability to approve and remove a majority of an entity's governing body, the ability to elect a majority of the governing body, or the ability to approve or direct an entity's funds or assets. The proposal includes other provisions as well. Read the full IRS proposal.

At last week's hearing, of the approximately 10 presenters, which included representatives of dealers, issuers, bond lawyers, developers and other market participants, all but one expressed substantial opposition to the IRS proposal.

View SIFMA's full comment letter to the IRS on this issue.

TAX - OHIO

Hyde Park Circle, L.L.C. v. Cincinnati

Court of Appeals of Ohio, First District, Hamilton County - May 25, 2016 - N.E.3d - 2016 WL 3003413 - 2016 -Ohio- 3130

Developer brought action against city alleging that city breached development agreement and illegally used tax-increment-financing (TIF) funds. City filed counterclaim for breach of agreement.

The Court of Common Pleas enjoined city from loaning itself TIF-account funds to pay general-fund obligations, ordered city to return $4 million to TIF accounts, awarded developer $177,124.65 in attorney fees and costs, determined that developer could not be reimbursed for actions it took prior to entering agreement, that city was not liable for handling of city improvements, but that developer should have been reimbursed in amount of $247,500, and found that developer had materially breached agreement, but that city suffered no damages. Both parties appealed.

The Court of Appeals held that:

- Developer was entitled to $89,448.77, as opposed to $247,500 on its breach of contract claim, and
- Developer had standing to bring its statutory-taxpayer action.

Developer was entitled to $89,448.77, as opposed to $247,500, on its breach of contract claim against city for failure to reimburse developer for work performed by subcontractor. While there was no dispute that services provided by subcontractor were proper subject for tax-increment-financing

(TIF) reimbursement, and, thus, developer was not barred from seeking to recover money from city for reimbursement under development agreement between developer and city, agreement was clear that project was capped at $4 million in TIF funds, and evidence showed that city had spent $49,000 in TIF funds to complete work that should have been performed by developer and that only $138,448.77 remained of funds.

Developer had standing to bring its statutory-taxpayer action against city alleging that city illegally used tax-increment-financing (TIF) funds. Taxpayer action did not only benefit developer, as, in determining that city had illegally used TIF funds to cover budget shortfall with city public schools, court found that city had treated TIF accounts as if they were mini-general fund from which it could randomly make loans to itself that could be delayed or forgiven, taxpayer action sought relief in form of injunction to keep city from engaging in illegal loaning practice in future and judgment requiring city to return $4 million to all of neighborhood TIF accounts, and, TIF laws were established to encourage economic development, which benefited public at large, not just developer.

NABL: IRS TEB Announces Form 8038-CP Changes.

The Internal Revenue Service (IRS) Office of Tax-Exempt Bonds (TEB) has announced changes to how TEB processes Form 8038-CP requests for refundable credit payments, which applies to all forms received after May 16, 2016. Form 8038-CP is now interactive, and includes a "Verify and Print" feature, which will alert you of any missing fields and other errors. If any information is missing from the form, the IRS will mail a correspondence letter requesting the missing information and give 30 days for a response. Failure to respond to IRS correspondence results in the IRS not processing Form 8038-CP.

More information on the changes, including the interactive form, is available here.

Market Groups, Regulators Clash Over Political Subdivision Rules.

WASHINGTON – The Internal Revenue Service and Treasury Department's proposed rules on political subdivisions are "overly restrictive" and "misguided," and should be withdrawn or reproposed with a much narrower scope, municipal market groups told the agencies on Monday.

The complaints came during the agencies' joint public hearing over a proposed new definition of political subdivision that has drawn sharp criticism since it was first proposed in February.

Representatives from groups including the Government Finance Officers Association, the Securities Industry and Financial Markets Association and the National Association of Bond Lawyers said the proposed political subdivision rules are unnecessary and could potentially upend much of the muni market.

"We believe the approach taken is misguided," said Scott Lilienthal, a former president of the National Association of Bond Lawyers. "It would create continued uncertainty in the financial markets."

Pat McCoy, the director of finance for the Metropolitan Transportation Authority in New York who spoke on behalf of GFOA, said the group, like others, has been unable to fully grasp the reason for

requiring a political subdivision to have a government purpose "with no more than an incidental private benefit."

"Our view is this adds a new layer of incidental private benefit that we were feeling was ambiguous and difficult to define," McCoy said.

Historically, the determination of whether an entity was a political subdivision was based on whether it had the right to exercise a substantial amount of at least one of three sovereign powers: eminent domain, taxation, and policing.

The proposed Treasury and IRS regulations would add two new requirements – that political subdivisions serve a governmental purpose "with no more than an incidental private benefit" and that they be governmentally controlled. To be governmentally controlled, a political subdivision would have to be controlled by a state or local governmental unit or an electorate. Whether an entity serves a governmental purpose would be based on whether it carries out public purposes stated in its enabling legislation and provides no more than incidental private benefit.

The new rules were proposed in response to concerns about who was controlling political subdivisions, John Cross, the Treasury Department's associate legislative tax counsel, said Monday. Some IRS audits found that developers or other private entities were wielding significant control over political subdivisions and this raised concerns among numerous federal officials.

"A core policy goal of the proposal was to enhance accountability in a targeted way," Cross said. "We wanted to add safeguards to ensure that an unreasonably small number of people do not control political subdivisions."

But several speakers at the hearing, including Michael Decker, managing director and co-head of munis at SIFMA, said the current definition is sufficient and does not need any amendment. Decker said the new rules would create "substantially higher" financing costs for local governments in two ways: either investors would pay less for the bonds, creating higher yields, because the bonds would pose more risk or issuers would simply have to issue taxable bonds.

The taxable market would be entirely different due to expectations about issuance size and cash flow structure, he said.

Several of the ten speakers called for a full withdrawal of the rules without suggesting any alternatives, which Cross challenged as unconstructive. Several of those speaking on behalf of utility organizations said the abuses perceived by Treasury and IRS over private parties' control of political subdivisions do not seem to apply to them.

Thomas Devine, general counsel for the Airports Council International – North America, called for more targeted rules that wouldn't disturb what he called "non-problematic" entities like airport authorities.

"We believe there is a bullseye on our back," Devine said. "We believe we are not the subject of your concerns."

In response, Cross said the IRS is not targeting airports or other similar agencies.

That message was echoed by Erica Spitzig, deputy general counsel for the National Association of Clean Water Agencies, who said that the new definition could threaten access to the tax-exempt bond market for water and sewer issuers.

Spitzig said 48 states used tax-exempt bonds to fund sewer and water projects in 2012, a testament to their importance in public infrastructure.

David Schryver, executive vice president of the American Public Gas Association, also called for the withdrawal of the rules, which he said would eliminate the ability for communities to purchase gas with tax-exempt financing.

“Our message is the proposed regulations throw the baby out with the bathwater,” he said.

The four-member panel of IRS and Treasury officials said they would consider the comments in finalizing the rules, but also defended much of what was proposed.

Spence Hanemann, an IRS attorney, said the rules were developed to “limit undue private control,” while Timothy Jones, senior counsel for the IRS, said the agency was “particularly interested in development districts with a single owner.”

Hanemann called the proposed rules “prospective,” stressing that they would not go into effect for three years if and when they are finalized. He did not say whether the agencies would withdraw, repropose or leave the current proposed rules unchanged before they are finalized.

Other speakers included: James Thompson, mayor of Sugar Land, Tex.; T.J. Sullivan, a former IRS official and current lawyer with Drinker Biddle & Reath representing Clemson University; and Bond Dealers of America director of federal policy John Vahey.

Vahey was particularly concerned about the public purpose test. “It introduces a level of subjectivity and a significant level of uncertainty,” he said, adding that the proposed regulations would also raise the costs of infrastructure projects.

The IRS and Treasury panel also included Diana Imholtz, special counsel for the IRS.

The hearing follows months of criticism leveled at the Treasury and IRS over the proposed rules on political subdivisions.

The agencies received a total of 124 written comments from groups including the NABL and port authorities who argued the new regulations threaten the tax-exemption of many entities long considered political subdivisions as well as the tax-exempt status of their bonds.

The Bond Buyer

By Evan Fallor

June 6, 2016

IRS Publishes New Guidance On Renewable Energy Tax Credits.

In December 2015, the U.S. Congress passed a multi-year extension of renewable energy tax credits, including credits for wind, solar, geothermal, hydropower and biomass facilities. Many of the deadlines for credit qualification in the new law involve the starting date of renewable energy projects, although the time of completion is also significant. Previously, the IRS provided guidance for the “beginning of construction” period. The IRS has now issued additional guidance with respect to the newly passed schedule of credits.

The new guidance, which generally is viewed as favorable to renewable energy project development, is in the form of "safe harbors." If a taxpayer meets the requirements of either of two safe harbors (the "Physical Work Test" or the "Five Percent Safe Harbor"), then it is deemed to have complied with the requirements of the new law that concern when construction commences. After construction has begun, it becomes necessary to show that the work is continuing, which is the purpose of the "Continuity Safe Harbor."

By its recent action, the IRS extended and modified the Continuity Safe Harbor for the third time and provided additional guidance regarding the application of the Continuity Safe Harbor and the Physical Work Test. Additionally, the IRS clarified the application of the Five Percent Safe Harbor to retrofitted renewable energy facilities.

Specifically, the IRS explained that if a taxpayer places a facility in service during a calendar year that occurs no more than four calendar years after the calendar year during which the construction of the facility began, then that facility will be considered to have satisfied the Continuity Safe Harbor requirement. The IRS also noted that a taxpayer may not rely on the Physical Work Test or the Five Percent Safe Harbor in alternating calendar years in order to satisfy the beginning of construction requirement or the Continuity Requirement. The IRS guidance outlines the following factors (among others): (i) "excusable disruptions" to Continuous Construction, or Continuous Efforts Tests, and (ii) the conditions of qualification for the Physical Work Test.

Finally, the IRS emphasized that a facility may qualify as originally placed in service even though it also may contain some used property, as long as the fair-market value of the used property is not more than 20% of the facility's total value (i.e., the cost of the new property plus the value of the used property) (the "80/20 Rule"). Because the Five Percent Harbor is applied only with respect to the cost of new property that is used to retrofit an existing facility, the IRS explained, only expenditures paid or incurred that relate to new construction should be taken into account for purposes of the Five Percent Safe Harbor.

The IRS stated that this guidance clarifies and modifies Notices 2013-29, 2013-60, 2014-46 and 2015-25.

Last Updated: June 2 2016

Article by Cadwalader, Wickersham & Taft LLP

Cadwalader, Wickersham & Taft LLP

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

TAX - WASHINGTON

Lee v. State

Supreme Court of Washington, En Banc - May 26, 2016 - P.3d - 2016 WL 3042994

Taxpayers brought action to challenge adopted ballot initiative which provided for an immediate reduction in the sales tax rate unless the legislature proposed a constitutional amendment.

The Superior Court entered order voiding the initiative, and State appealed.

The Supreme Court of Washington held that:

- Action presented a justiciable controversy under the Uniform Declaratory Judgments Act (UDJA);
- Action was justiciable under the public interest exception;
- Title of adopted ballot initiative violated single subject rule and thus was unconstitutional; and
- Adopted ballot initiative altered the process for amending the state constitution and thus was unconstitutional.

Taxpayers' action for declaratory relief that adopted voter initiative, which provided for an immediate reduction in the sales tax rate unless the legislature proposed a constitutional amendment, was unconstitutional presented issues of substantial public interest which required prompt resolution, and thus was justiciable under the public interest exception. If constitutional, the initiative would result in either an immediate and yearly $1.4 billion reduction to the State's operating budget or a change to the State's constitution by essentially only a majority of voters.

Title of adopted ballot initiative which provided for decrease in sales tax rate unless the legislature amended constitution to requiring supermajority vote or voter approval to raise all taxes and legislative approval to increase any fees violated single subject rule and thus was unconstitutional, as sales tax reduction was unrelated to both a constitutional amendment, which would impact future legislatures, and to the way that future taxes and fees would be approved. While both subjects related to general title of fiscal restraint or taxes, they were not germane to each other, legislative action was not contingent on sales tax reduction, but rather was a means to avoid it, and there was no nexus between constitutional amendment and current sales tax rate.

Adopted ballot initiative which provided for decrease in sales tax rate unless the legislature amended constitution to require supermajority vote or voter approval to raise all taxes and legislative approval to increase any fees altered the process for amending the state constitution and thus was unconstitutional. while legislature would still have to go through the processes outlined in the constitution, the "do this or else" structure of the initiative established a new process for amending the constitution by simple majority vote.

IRS PLR: Management Contract Will Not Result in Private Business Use.

The IRS ruled that a management contract between a bond issuer — which issued bonds for permanent financing of a hotel — and the manager of the hotel for payment of the manager of annual fees composed of both base fees and incentive fees based on gross revenue will not result in private business use of the hotel.

Read the Private Letter Ruling.

Winnetka Man Gets New Chance to Press Case Village Stormwater Fee is Unconstitutional Tax.

A Winnetka resident, whose lawsuit challenged whether the stormwater utility fee slapped on property owners by the north suburban village is actually a tax, has clearance to sail on, after a state appeals panel said the legal arguments in the challenge hold enough water to survive the village's attempt to sink it via motion to dismiss.

The Illinois First District Appellate Court on May 31 issued an unpublished order overturning the decision of Cook County Circuit Court Judge Kathleen G. Kennedy, who had dismissed the complaint brought against the village by Mark Green. That declaratory judgment action, filed Feb. 13, 2015, alleged Winnetka's stormwater fee actually is a tax. The lawsuit argued the fee violated the uniformity in taxation clause of the Illinois Constitution and Illinois Municipal Code.

Justice Sheldon A. Harris wrote the order, with Justice Joy V. Cunningham concurring. Justice Maureen E. Connors dissented. The order was issued under Supreme Court Rule 23, which restricts its use as precedent, except under very limited circumstances permitted by the Supreme Court rule.

Winnetka's motion to dismiss relied heavily on the 2005 Illinois Third District Appellate Court ruling in Church of Peace v. City of Rock Island, in which the court upheld Rock Island's stormwater fee. Kennedy granted the motion to dismiss on Aug. 19; Green appealed Aug. 28.

Winnetka responded to severe flooding in 2008 by seeking infrastructure improvements, then scuttled those plans after a 100-year flood in 2011 instilled a need for a more significant solution. The result was a stormwater master plan that, among other components, "called for the construction of a 7,900 foot long storm sewer running underneath Willow Road." The tunnel was to cost $34.5 million and would provide flood relief to half the village. Another $8 million in improvements would affect three other drainage areas.

The village, however, opted not to construct the Willow Road tunnel in mid-2015, after projected costs soared to more than $80 million, according to published reports.

A year earlier, however, the village had issued 30-year municipal bonds worth $61.5 million to pay for the stormwater management work. And to cover the debt service on those bonds, the village enacted the stormwater utility fee in March 2014.

In examining the ordinance, Harris noted the village "acknowledges that all real property in the village contributes to runoff and either uses or benefits from the maintenance of the stormwater system." However, the fee is based on the amount of impervious surfaces in the village, such as driveways, sidewalks and roofs. As such, "only those with developed property are subject to the" stormwater fee.

Green alleged the way the village structured the fee scale to cover the debt issuance "bears no relation to a property owner's actual use of the existing stormwater system." He further alleged, "and the Village concedes, no attempt is made to measure the actual stormwater discharged into the system by any property owner," the court documents said.

Harris and Cunnigham agreed with Green's assertion that his complaint states a valid cause of action. Specifically, Green argued the fee is incurred regardless of "whether a property owner actually discharges storm runoff into the system," and further that the fee does not provide a service to property owners, but rather to retire bonds to fund building the tunnel, "which the village has recently decided not to construct."

The order also notes the village's ordinance contradicts its claims the fee is compensatory, since the ordinance directly references the bond debt. The reliance on Church of Peace was misplaced, Harris noted, because that case was decided on summary judgment, whereas Green's complaint remains at litigation.

Ultimately, Harris wrote the court does not have an opinion on the ultimate question of whether the stormwater fee is indeed a tax, "only that the circuit court erred in dismissing this matter at the

pleading stage." As such, Kennedy's ruling is reversed and the case remanded for further proceedings.

In her dissent, Connors contended Winnetka's "ordinance specifically contradicts Green's allegations" and said the Church of Peace decision "clearly states that stormwater service charges are a fee and not a tax."

The Cook County Record

By Scott Holland

Jun. 2, 2016, 12:52pm

New Reporting Rules Subject OID on Tax-Exempt Bonds to Information Reporting.

Generally, a person that pays interest on a debt to another person must report the amount of interest, usually on IRS Form 1099-INT. In the past, payments of tax-exempt interest did not have to be reported in this way; however, beginning in 2006, the statutory exclusion from information reporting for interest on tax-exempt obligations was eliminated. Since that time, interest on tax-exempt obligations has been reported in the same manner as taxable interest. Mercifully, for information reporting purposes, the amount of tax-exempt interest that must be reported has been limited to qualified stated interest (a fancy term which typically refers to the coupon on a debt instrument). Bond trustees and other payors of tax-exempt interest found refuge in a line item in the instructions to the Form 1099-INT that says "[n]o information reporting for tax-exempt OID under section 6049 [of the Internal Revenue Code] will be required until such time as the IRS and Treasury provide future guidance."

If you read the title of this post and your internet server has frozen so that you are unable to navigate away from this page, you have probably guessed that this "future guidance" has now arrived. The Treasury Department recently finalized Treas. Reg. § 1.6049-10 in TD 9750 (the "Final Regulations"). The Final Regulations, among other things, will now require bond trustees and other payors to report original issue discount on tax-exempt obligations.[1] This post will discuss the motivations behind the change as well as the ramifications that the Final Regulations will likely have on the tax-exempt bond community.

Why Would Congress Require the Reporting of Tax-Exempt Interest to the IRS?

You likely know that when you receive a tax information return (e.g., a mortgage statement, Form 1099-INT, etc.) the person that sent it to you also sends the exact same information to the IRS a few weeks later.[2] This "dual reporting" enables the IRS to monitor the taxpayer-recipient to ensure that the taxpayer properly reports on its income tax return (Forms 1040, 1120, 1065 etc.) all of the income that was listed on the information return. For obvious reasons, the IRS has been less concerned with ensuring that tax-exempt interest (including OID) is properly reported on an information return, because tax avoidance is less of a concern when talking about interest that is tax-exempt.

Congress has imposed information reporting requirements on tax-exempt interest (including OID) for two reasons. First, in 2008, Congress enacted the Energy Improvement and Extension Act of 2008 (the "2008 Act"). Tucked away in Section 403 of the 2008 Act is a requirement that brokers use

an information return to report "gross proceeds" from the sale of a "covered security."[3] Now, as you might expect when reading a blog dedicated to all things 103, tax-exempt bonds are considered "covered securities" provided they are acquired by the bondholder on or after January 1, 2014.[4] To comply adequately with the 2008 Act, brokers need to report the "adjusted basis" of tax-exempt obligations (to ensure that taxpayers are recognizing the correct amount of gain or loss upon the disposition of tax-exempt obligations[5]), which is calculated by taking into consideration original issue discount and original issue premium.[6]

Second, the information is required to enable the IRS to verify that bondholders are reporting the correct amount of tax-exempt interest (including OID) for alternative minimum tax and other purposes. Interest (including OID) on certain tax-exempt obligations, such as exempt facility bonds, is directly subject to the alternative minimum tax. In addition, even if not directly subject to the alternative minimum tax (e.g., interest on governmental use obligations, qualified 501(c)(3) bonds, etc.), tax-exempt interest (including OID) is frequently included in adjusted current earnings for corporations, which indirectly subjects the interest (including OID) to the alternative minimum tax.

Final Regulations

Pursuant to the Final Regulations, for "tax-exempt obligations" that are acquired on or after January 1, 2017,[7] a "payor" is required to report the daily portions of accrued OID to the holder as if the payor actually paid those daily portions to the holder in the calendar year.[8] "Tax-exempt obligations" include any obligations the interest on which is not includible in gross income under Section 103 of the Code or under any other provision of the law. OID is determined without regard to the de minimis rule in Section 1273(a)(3) of the Code.

"Payor" is broadly defined in the Final Regulations to include (i) every person who makes a payment of the type and of the amount subject to reporting to any other person during a calendar year, or (ii) every person who collects on behalf of another person payments subject to reporting or who otherwise acts as a "middleman" with respect to such payment.[9] A "middleman" includes any person, including a financial institution and a broker, who makes payment of interest for, or collects interest on behalf of, another person, or otherwise acts in a capacity as intermediary between a payor and a payee.[10] It is unclear to what extent, if any, that municipal issuers are considered payors; however, trustees and broker-dealers are almost certainly included.

Conclusion

Prior to 2006, interest as well as OID and original issue premium were exempt from all information reporting requirements. However, the desire to narrow the "Tax Gap" has led to the recent expansion of the information reporting requirements.[11] Although the Final Regulations do not expand on the definition of "payor" beyond the scope of persons previously obligated to report tax-exempt interest, the Final Regulations certainly expand the breadth of reportable payments subject to information reporting. In addition, this expansion signals a fundamental shift in certain payors' annual reporting obligations to include amounts not actually paid during the calendar year.

Footnotes

[1] Reporting bond premium (Box 13 of the Form 1099-INT) was introduced a few years ago in 2014. In addition, "Specified Private Activity Bond Interest" is reported in Box 9 of the Form 1099-INT so payments on a single tax-exempt obligation are often reported in multiple different boxes on the Form 1099-INT.

[2] The obligation to report various types of "reportable payments" could fall on any number of

individuals or entities in addition to financial institutions.

[3] The form to be used is Form 1099-B, which was recently voted the “worst tax form” according to an informal survey of tax preparers.

[4] The January 1, 2014 implementation date was in response to practitioners concerns that the information needed to populate an information return with the details of tax-exempt obligations was not available on the Electronic Municipal Market Access if the obligation was outstanding as of November 1, 2012.

[5] Disclosures frequently say that original issue discount and original issue premium will have no impact on the bondholder if the bondholder holds the instrument to maturity. However, if the bondholder disposes of the bond prior to its maturity, there may be tax consequences that arise from the fact that the bond had original issue premium or discount.

[6] See Treas. Reg. 1.6045-1 (Definition of “adjusted basis” for a debt instrument).

[7] Although OID must be reported to the bondholder for obligations acquired on or after January 1, 2017, brokers have been required to monitor and compute OID on tax-exempt obligations since 2013 when the final basis reporting regulations were promulgated.

[8] See Treas. Reg. 1.6049-10(a) and Treas. Reg. 1.1272-1(2)(b) (for rules governing the accrual of OID and the determination of daily portions of OID).

[9] See Treas. Reg. 1.6049-4(a)(2).

[10] See Treas. Reg. 1.6049-4(f)(4).

[11] The most recent estimated tax gap for calendar years 2008-2010 is $406 billion each year with a net compliance rate of approximately 83.7 percent.

Squire Patton Boggs

The Public Finance Tax Blog

by Joel Swearingen

June 2, 2016

Local Governments Cry Foul Over Feds' Move to Limit Tax-Free Municipal Bonds.

Public officials in Minnesota and across the nation are scrambling to head off a proposal they say would deliver a devastating blow to their ability to fund infrastructure and economic development projects.

Affordable housing in Albertville, a community gym in Edina, a fire station in Pelican Rapids: These and other projects could become tougher to build and pay for if the IRS succeeds in clamping down on the use of tax-exempt municipal bonds.

“It affects everything in the country that has bonding,” said Lori Economy-Scholler, Bloomington’s

chief financial officer. “It could affect every piece of public financing as it pertains to port authorities and economic development agencies.”

The IRS, she added, “is really overstepping their bounds.”

IRS officials did not respond to requests for comment on the proposal. The open period for comments on the proposed rules ended May 23, and a hearing is scheduled June 6 in Washington.

The agency is proposing strict new limits on municipal bonding — so strict, critics say, that they would virtually end the use of tax-exempt bonds by port authorities, housing authorities and other economic development agencies.

Some cities might no longer be able to issue tax-exempt bonds for schools, hospitals and other infrastructure.

The regulations would rewrite the rules for bond issuers, including a new requirement that elected officials must exercise significant control over the agency issuing bonds. That would restrict or eliminate the ability of appointed or semi-independent economic development authorities to issue bonds.

Another change would allow the use of tax-exempt bonds only if the project provides no more than “an incidental benefit” to a private entity. That could rule out using tax-exempt bonds to finance items such as parking decks at the Mall of America.

Schane Rudlang, administrator of the Bloomington Port Authority, said the IRS is concerned about the misuse of tax-exempt bonds in some areas of the country. But the severe limits the agency is proposing, he said, “is like using a sledgehammer to kill a mosquito.”

Drawing the line

Last year alone, economic development authorities in Minnesota issued more than $275 million worth of bonds, according to Springsted Inc., a financial adviser to municipal governments. That figure doesn’t include bonds issued by cities themselves.

Nationally, more than $3.7 trillion in municipal bonds of all types are in force, according to the Municipal Securities Rulemaking Board.

Tax-exempt bonds allow cities and development agencies to borrow money for development projects at below-market interest rates. If taxes were assessed on the bonds, the interest rates would go up a percentage point or more. That doesn’t sound like a lot, but it could amount to extra payments totaling hundreds of thousands or even millions of dollars over the life of a bond.

To make up the difference, cities would have to either assess local taxpayers more or scale back their projects.

That might not be a bad thing, said Jay Kiedrowski, a senior fellow at the Humphrey School of Public Affairs and state commissioner of finance under Gov. Rudy Perpich from 1985 to 1987.

“There have been many critics of states and cities who say that tax-exempt debt has been overused as an economic development tool,” Kiedrowski said. “Tax-exempt debt makes sense for streets, water projects, sewers, parks, schools. But when tax-exempt debt is used for economic development, it’s always been fuzzy as to where that line should be drawn to prevent bad projects vs. good projects.”

Minnesota cities overall have a track record of using bonding for worthwhile projects, local officials said.

“Our housing and port authorities have existed for a long time and have done a lot of good work,” said Tom Grundhoefer, general counsel for the League of Minnesota Cities. “And that’s why we’re concerned about these proposals.”

Rudlang said the IRS proposal would endanger public infrastructure improvements planned over the next few years in Bloomington’s South Loop district, which the city planned to finance with tax-exempt bonds of up to $100 million. The South Loop includes the Mall of America.

State Auditor Rebecca Otto called tax-exempt bonding “an extraordinary tool for local governments. We have 853 cities in Minnesota, and this tool is very important to make sure we can maintain and replace our infrastructure.”

The Star Tribune

By John Reinan

May 31, 2016 — 8:07PM

Nonprofits' Tax-Exemption Battle Moves to the Courts.

Legislative attempts to tax nonprofits have fallen short. But recent legal challenges could present a financial problem for nonprofits and a financial boost for governments.

Faced with tight budgets and in search of new sources of revenue, municipalities increasingly have been eyeing the tax-exempt status of nonprofits. Legislators say that universities’ record-high endowments and the corporate-like structure of nonprofit hospitals is making it harder and harder to swallow giving these institutions a tax break.

While many of the legislative attempts to start taxing nonprofits have failed, recent legal challenges have proved more promising. If the trend continues, it could present a financial problem for nonprofits and a financial boost for governments. So far, the focus of both legislation and legal action has been on hospitals and higher education institutions, but some worry they could spill over to smaller nonprofits and charities.

The dollars at stake are significant. According to a 2009 study by the Congressional Research Service, property tax exemption is worth $17 to $32 billion nationwide.

Also driving these challenges is the issue of tax fairness. Many nonprofits fork over an annual PILOT, or Payment In Lieu of Taxes, to help offset the governments’ loss of revenue. But residents in the vicinity of hospitals or universities often feel that they still end up paying higher taxes to compensate for the revenue lost to nonprofits’ exemptions.

But when lawmakers try to address these issues, their efforts often fall short. For instance, a bill in Connecticut proposed taxing earnings on university endowments valued above $10 billion. The law would have only applied to Yale University, but it died last month. Last year, Maine Gov. Paul LePage tried to strip nonprofits of their exemption as part of his overall tax reform package. It was rejected.

When towns and residents resort to lawsuits, however, they appear to be finding more success.

In New Jersey, the town of Morristown sued Memorial Hospital in a case that opened the door for other challenges. After the hospital agreed to pay more than $15 million in back taxes as well as future property taxes, more than a dozen New Jersey hospitals became embroiled in similar litigation.

Even more worrisome for nonprofits is a case in Princeton, N.J. Residents argue that the university there acts like a for-profit institution and that their property taxes are higher because Princeton doesn't pay any. In an unusual ruling, the judge determined that Princeton University must prove its tax-exempt status again. The case is expected to go to trial in the fall.

The Princeton case differs from previous legal challenges in one important way: It was brought by residents. The fee for filing a property tax challenge is typically very low — less than $100. If the residents of Princeton win, it could lead to copycat challenges aimed at nonprofits that have a controversial mission, said Linda Czipo, executive director of the New Jersey Center for Nonprofits. She warns that places like abortion clinics or alcohol and drug rehab centers would be particularly vulnerable.

David L. Thompson, vice president of public policy for the National Council of Nonprofits, argues the real issue is one of public finance and not tax fairness. Many governments' long-term liabilities — health care and pensions — are growing faster than their annual revenue streams. Because of that, said Thompson, it's tempting for politicians and policymakers in times of tight revenue to view nonprofits — however inaccurately — as freeloaders.

For instance, last year he testified before the Pennsylvania General Assembly, which has dealt with chronic budget deficits in recent years. Thompson spoke after the state auditor who testified that taxing the state's tax-exempt properties would net about $1.5 billion in new revenue — but, Thompson immediately clarified, government buildings account for most of that figure.

"They always talk about that dollar figure then say that's why we need to tax nonprofits," said Thompson. "But it's a bait-and-switch argument. And they don't even mention the tax breaks that developers get in incentives. Nonprofits are typically only somewhere between 4 and 8 percent."

GOVERNING.COM

BY LIZ FARMER | JUNE 2, 2016

Political Tax Avoidance Chokes Off Infrastructure Investment.

Every state or municipal government will eventually face the question of whether to raise taxes. Since the era of George H.W. Bush, officials answer increasingly "No."

"It's politically hard to make a case for tax increases, and particularly at a time when people have less money in their pockets," said Lucy Dadayan, a senior policy analyst with the Nelson A. Rockefeller Institute of Government.

The nation's reluctance to talk taxes has resulted in a drop in borrowing for needed infrastructure as well as missed opportunities to take advantage of historically low interest rates to finance long-term projects.

The political response to rebuilding the Washington D.C. Metro, the nation's second-largest subway system, has been, don't expect a bailout.

States increased taxes by $33 billion in response to the Great Recession, 38 percent less than the $54 billion raised after the 1990 recession, according to a 2015 study by the Rockefeller institute.

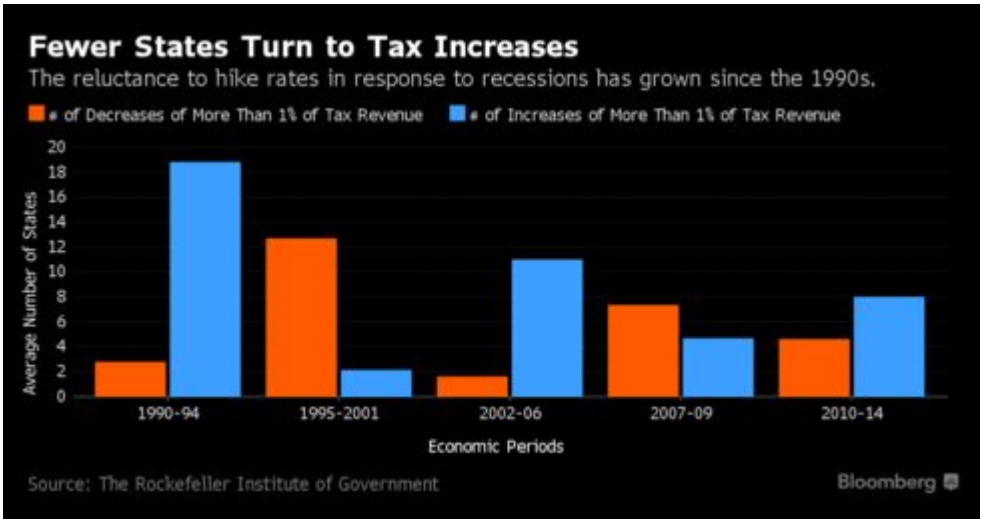
Meanwhile, some states still haven't recovered completely from the 2008- 2009 financial crisis. At some point, something will have to give. Sooner or later they'll have to raise taxes.

"It's inevitable," Dadayan said. "Otherwise, the fiscal systems are not going to be sustainable over a long period of time."

George H.W. Bush's famous 1988 mantra, "Read my lips: No new taxes," has stuck with state and local government officials to this day, said Emily Evans, a former Nashville councilwoman who is now a managing director at investment research firm Hedgeye Risk Management.

"We are not past that point at all," said Evans. It varies, "depending where you are. If you're in a really deep red state like Tennessee, we're really not past it. If you're in the purple and blue states, there's a whole lot more open mindedness about it."

While Bush's promise had an impact, so did what happened afterwards, she said. The president eventually raised taxes and didn't win a second term. "That stands in the minds of most elected officials as a serious problem," Evans said. "If I raise taxes, I won't get reelected. That's the equation. That still is a big part of the thinking that goes into those decisions to vote 'yes' or 'no' on new tax projects."



One example of a changing approach to tax increases can be seen in the state sales tax, said William Fox, a business professor at the University of Tennessee at Knoxville, who studies the subject.

During the 1980s recession, about 30 states raised their rates, he said. The number of states that enacted increases fell to about 20 during the 1990s and continued to decline during the 2000s to the mid-teens, Fox said.
"The pressure is ever-stronger on keeping taxes low," he said. "If you went back into the 1980s, when money got tight in state governments, particularly during recessions, what you would get is a wave of tax-rate increases," he said. "While that is true today, the propensity for that to take place has fallen over time."

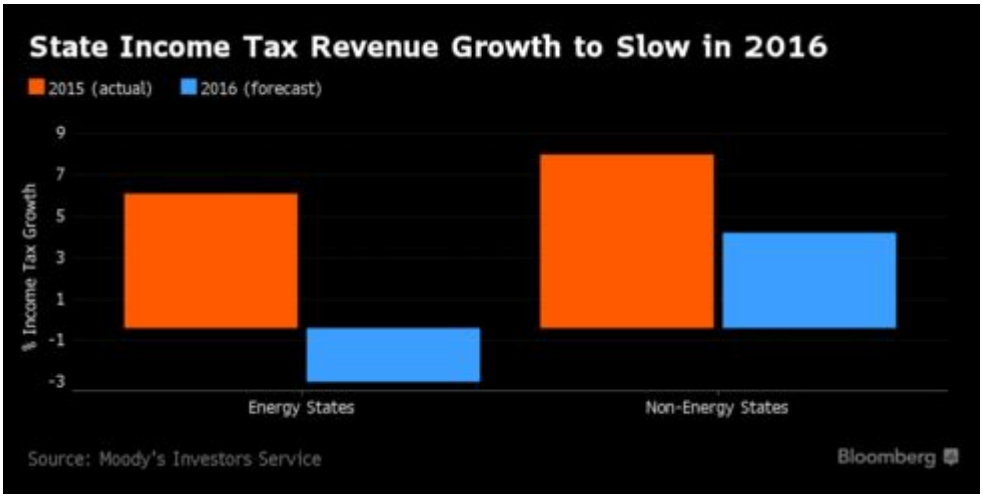
The impact of politicians' reluctance to raise taxes has been felt in the municipal market. New-money municipal issuance has averaged $150 billion annually from 2011 to 2015, which is a marked decline from the previous 10 years, according to an April report by Citigroup Inc.

New-money issuance averaged $242 billion annually during 2001 to 2010, Citigroup found. "In other words, state and local debt as a source of funding for needed projects has been running, on an inflation adjusted basis, at least 45 percent lower over the past five years than it was over the prior 10," Citigroup said in the report.

"State and local governments aren't able to keep up with new project funding needs and urgently needed major maintenance and replacements, and the extent to which they are falling behind continues to grow," Citigroup said.

This reduced level of borrowing is "astonishing" given the state of the country's infrastructure, said Citigroup strategist George Friedlander. "The Republican tax pledge still exists — 'we will not raise taxes in any way that is not offset by reductions in spending somewhere else,"' he said. "That's a big issue. The whole concept of cost-benefit when it comes to infrastructure has vanished. It is not part of the discussion right now.

"Is there a benefit in raising spending on infrastructure which, in terms of keeping us competitive with the rest of the world, will pay an economic benefit down the road? Well, probably, yeah, but nobody cares."



Additionally, politicians' concerns about raising taxes are preventing them from taking advantage of historic low interest rates, said Michael Mazerov, a senior fellow with the Center on Budget and Policy Priorities. "In most cases, those services and the infrastructure is going to be paid through bonding," he said. "Interest rates are so low now that this is a time when states should be investing in infrastructure."

Governments only have a few choices when budgets get tight — taxes are one of the only ways they can generate revenue. Another option is to refinance debt to delay final repayment. This can be a "trick" that state and local governments resort to instead of raising taxes, Evans said.

Evans saw this happen first hand during her time on the Metropolitan Council of the Metropolitan Government of Nashville and Davidson County in 2010. The council approved the issuance of $600.2 million in general obligation bonds, which included retiring commercial paper and refinancing debt. Evans said the refinancing resulted in about $48 million in additional debt service payments because

it extended the life of the debt.

The council did so after the mayor at the time promised residents he would not raise property taxes, she said.

“Instead of doing one, cutting expenses, or two, raising revenue, [the mayor] opts for a refinancing of outstanding debt, which cost the taxpayers,” she said. “There wasn’t any other compelling reason to refinance that debt.”

Two Choices

Richard Riebeling, the chief operating officer for Nashville’s mayor’s office, disputes the $48 million figure, and says the refinancing was one of the smartest things the city did from a financial standpoint during that time.

“It was real simple,” he said. “We were in the middle of a recession. The city had two choices that were very poor. One was raise taxes on people during the middle of a recession, which was not a very good idea.

Or second, you significantly reduce services. And so neither of those were strong options, so the third was a slight restructuring of our debt to move back some principal a few years.”

Nashville and Davidson County enacted a 53-cent property tax increase per $100 of assessed value for fiscal 2012-13. Riebeling said economic conditions supported a property tax increase.

“There was a need to continue to fund schools and the other needs of the city,” he said. “We did a small property tax [increase] that year because we thought it was the right thing to do. Could we have re-done the debt again? Probably. Would it have been the right thing to do? No, it would have been the wrong thing to do. This restructuring of the debt is not something that you do very often at all.”

One of the first major modern instances of voters voicing their displeasure with tax policies was in 1978, when California voters enacted Proposition 13. The referendum enacted a limit on property tax rates. It was one of the first laws that put a hard limit on municipalities’ ability to raise revenue, Fox said.

To be sure, voters can also approve tax increases, like Californians did in 2012 with Proposition 30, which temporarily increased sales and income taxes.

Voters may be willing to raise taxes for specific issues such as education, said Vladimir Kogan, a political science professor at Ohio State University. “It’s not like voters are clamoring for this,” he said. “It’s a matter of selling it.”

Bloomberg Business

by Amanda Albright

June 3, 2016 — 5:42 AM PDT

NASACT Responds to IRS Proposal on Amending the Definition of Political Subdivision for Municipal Bond Purposes.

Read the comment letter.

National Association of State Auditors, Comptrollers and Treasurers

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Using the Tax Structure for State Economic Development.

Abstract

Every state uses a different combination of taxes to fund government services. Some rely more heavily on income taxes, and others see the most revenue from consumption taxes, such as general sales taxes or excise taxes on select goods. The effect of a state's tax structure on economic development includes not just the mix of taxes but specific features of those taxes as well. It also depends on the overall tax burden from the combination of different taxes levied. This brief is part of the State and Local Finance Initiative's series on state economic development strategies.

Download the brief.

The Urban Institute

by Norton Francis

May 31, 2016

Airbnb Talking to 100-Plus Cities in Bid to Address Tax Concerns.

Airbnb Inc. is in talks with more than 100 cities about ways to collect taxes, following tactics that have helped it appease regulators in cities like Amsterdam and Paris.

"We're actively trying to engage with cities — we've put out a pledge indicating our willingness to work with cities on things like taxes and transparency," the San Francisco-based company's Chief Technology Officer, Nathan Blecharczyk, said in Amsterdam at a startup conference. "New policies that have been passed have been overall favorable to home sharing."

Airbnb has agreements to automatically collect tax on behalf of 30 cities upon client payment and the municipality gets a lump sum check at the end of the month, Blecharczyk said. Last year, 5.5 million euros ($6.1 million) were collected in Amsterdam for example, he said. There's a similar deal in Paris, one of Airbnb's biggest markets.

Other cities are proving tougher to crack. Legal woes in Berlin are leading the city to start restricting Airbnb rentals, AFP reported. That's the delayed result of unfavorable policy that was put in place two years ago but wasn't enforced, "a ticking issue that has gone unaddressed," Blecharczyk said.

"Home sharing is thriving in Berlin," he said. "I'm sure it'll get solved over time, there are ups and downs with these issues."

Travelers, landlords

The European piece of the puzzle is key for Airbnb. The region in 2015 generated about $3 billion in revenue for its hosts, and accounts for more than half of the site's travelers and about half its landlords, Blecharczyk said.

But issues with taxation — namely whether clients declare income from renting property on an online platform and pay tax on it — are part of Airbnb's challenges, not only in Europe, but also in the U.S.

While it can collect tourist tax on behalf of municipalities, Airbnb doesn't plan on declaring how much its hosts make to governments because that would violate customer privacy, Blecharczyk said.

To convince local governments to get on board with Airbnb, Blecharczyk said, the company is highlighting the application's positive influence on cities. It has encouraged tourists to spend more in less-visited residential areas, as well as use less energy and water during their stay, he said.

Bloomberg Business

by Marie Mawad

May 24, 2016 — 9:36 AM PDT

Study Could Boost Fizzled Efforts to Tax Soda.

Despite many failed attempts, only one city in America taxes sugary drinks. The results of a new study might change that.

In Philadelphia, former Mayor Michael Nutter tried and failed several times to convince the City Council to tax soda and other sugary drinks. He wanted to use the money to help fund the financially struggling school district. The new mayor, Jim Kenney, is still pushing for a soda tax, and a recent study may persuade people in Philadelphia — and around the nation — to finally pass one.

According to a Harvard study released last month, if Philadelphia enacts a tax on soda, the city would prevent 36,000 cases of diabetes and save almost $200 million in health-care costs.

"I knew the findings would be big, but this was more than I expected," said Philadelphia Health Commissioner Thomas Farley, who helped create New York City's infamous-but-failed cap on the size of sodas. "It's especially gratifying since the study came out so close to the City Council debate," which will take place in the coming weeks.

If the City Council warms to the idea this year, Philadelphia would only be the second U.S. municipality to tax the sale of soda (Berkley, Calif., was the first). But the City of Brotherly Love isn't the only place considering soda taxes this year. After statewide legislation in California died, two of Berkeley's neighboring cities — Oakland and San Francisco — have put measures to tax soda on the ballot for this fall. A similar measure is also expected to appear on Boulder, Colo.'s ballot in November.

So far, though, these taxes haven't been popular with voters. They've been rejected 43 times over the past several years at the state and local levels, according to Lauren Kane, senior director of

communication for the American Beverage Association.

“These taxes are regressive, they fall hardest on people with the lowest [income],” said Kane. “It would also impact small businesses across the map, from delivery trucks to movie theaters to mom-and-pop corner stores.”

Mayor Kenney, however, argues that the soda tax would benefit the city by bringing in $400 million over the next few years — which he wants to use to fund universal pre-K. He has so far focused mostly on the economic windfall of the tax. But the study concludes that such a tax would have a positive impact on residents’ health as well.

“For an 18-year-old, one sugary drink a day adds up to 20 extra pounds a year,” said Steve Gortmaker, the study’s lead researcher. “When people with disposable incomes are forced to pay more for something, they’ll slow down with their consumption.”

Soda taxes have proven divisive, even among progressives. Hillary Clinton last month came out in support of the Philadelphia measure, while her Democratic presidential opponent Bernie Sanders called soda taxes regressive because they would impact low-income people the most.

In Philadelphia, Kenney’s proposal would add 3 cents per ounce to the cost of sugary drinks, which would increase the cost of a 12 oz. bottle of soda by 36 cents.

Farley is hopeful that the study will drum up support for councilmembers who might have been on the fence. But, he said, “we just don’t know what will happen at this point.”

GOVERNING.COM

BY MATTIE QUINN | MAY 26, 2016

Why Groups Are Demanding IRS Withdraw Proposed Political Subdivision Rules.

WASHINGTON – Municipal market participants are urging the Treasury Department and Internal Revenue Service to withdraw their proposed rules on political subdivisions, claiming they are unnecessary, possibly illegal and would disrupt the municipal bond market.

The National Association of Home Builders warned that if the proposed rules are adopted, they “could spark legal challenges” that create uncertainty in the market.

Historically, the determination of whether an entity was a political subdivision was based on whether it had the right to exercise a substantial amount of at least one of three sovereign powers: eminent domain, taxation, and policing.

But IRS officials, through audits, learned some developers had created political subdivisions and were in complete control of them, issuing tax-exempt bonds partly for their own benefit.

After an unsuccessful attempt to change the definition through the audit process, the Treasury and IRS proposed new rules in February that would add two new additional requirements, besides the sovereign powers one, to the definition of political subdivisions. They also would have to serve a government purpose “with no more than an incidental private benefit” and they would have to be

governmentally controlled.

The rules had been retroactive, but following an outcry, Treasury and the IRS made them prospective. Political subdivisions would three years to comply with them and if they don't, they would no longer be political subdivisions and would no longer be able to issue tax-exempt bonds.

But the proposed rules have continued to draw strong opposition from muni market groups and participants.

In a May 23 letter, Securities Industry and Financial Markets Association managing director Michael Decker told IRS and Treasury that their position in the proposed rules "is not supported by existing legal authority" and that the proposed rules' departure from a longstanding principle used to evaluate political subdivisions is "unwarranted" and would be "disruptive to the market."

"We believe the federal government should not attempt to define a federal standard for what constitutes a governmental purpose," SIFMA wrote. Rather, this issue should be determined by state or local law, the group told the agencies.

"The new standard would substantially hinder financing of significant infrastructure needs in many states and local governments due to increased costs to issuers," SIFMA wrote. The higher costs would come from issuers having to use taxable instead of tax-exempt bonds to finance many projects or from the market demanding a risk premium from bonds due to the uncertainty created by the rules, it explained.

"For these reasons, we urge the [IRS] to withdraw the proposal," SIFMA wrote.

In a letter sent to the agencies on the same date, Bond Dealers of America also called for the rules to be withdrawn. Mike Nicholas' BDA's chief executive officer urged the proposed rules to be replaced with a new set that are more targeted to the IRS' concerns.

BDA said the proposed rules are "overly prescriptive" and that the government purpose section of them "will likely have a chilling effect on development projects."

"The proposed government control section introduces a new federal standard that BDA does not believe is necessary and will result in a market disruption as states have to adjust from sound, legal structures to a federally mandated political subdivision structure," the group wrote.

"The proposed rule[s] would unnecessarily disrupt the ability of projects serving the public interest, including hospital, school, road, water, sewer, gas, and electric projects to access the tax-free debt capital markets in the future," BDA said. It also would "cause significant confusion amongst issuers, legal professionals, underwriters, and investors about the current tax status and investment quality of the outstanding issuances of political subdivisions."

"These destabilizing factors outweigh the potential benefits of the proposal as drafted," the group wrote.

The Government Finance Officers Association also wrote the agencies on Monday, asking them to withdraw the rules and rewrite them "to directly address the specific types of abuses the IRS believes to exist."

"If the IRS and Treasury are concerned with new development districts as political subdivisions or perceived abuses within the current districts as they related to tax-exempt bond issuances, [they] should more carefully develop parameters to combat these real areas of concern rather than

completely disrupt states' rights to create these entities and create roadblocks that would hinder [their] ability … to effectively, efficiently and economically serve communities," GFOA wrote.

The issuers' group told the agencies it objects to the proposed regulations "due to the far-reaching scope and negative impact to political subdivisions across the U.S." There are 38,572 special districts in the U.S., according to the 2012 U.S. Census of Governments. "These entities serve a purpose that is in the best interest of the particular state by which they are created and whose governing body has approved their existence," GFOA wrote.

These districts have the ability to issue tax-exempt bonds to help fulfill their purposes, the group added. State and local authorities in 2015 issued $177 billion on bonds, nearly half of the $404 billion issued that year, according to Thomson Reuters data that GFOA cited.

Florida Gov. Rick Scott told the agencies on Monday that his state is home to about 500 community development districts (CDDs), mostly created for residential projects and governed by state law, that have issued more than $12 billion of bonds to fund public infrastructure since the 1990s.

"Any change to the ability of Florida's governments to issue tax-exempt bonds could have severe consequences for hundreds of thousands of Floridians and for the Florida economy, which is growing and vibrant again after one of the worst real estate recessions in history," Scott wrote. "The proposed regulations also run contrary to the current stated Obama administration policy of finding solutions to solve our country's infrastructure needs."

Scott told the agencies that special districts, like CDDs, "have been a cornerstone of Florida's growth and development for nearly 100 years." They are, and have always been "creatures of Florida law," he added.

"The ability of CDDs and other local governments to continue to issue tax-exempt municipal debt for public improvements and services is vital to Florida's economic growth," Scott wrote. "I am committed to doing everything possible to ensure that Florida stays on its current path of economic prosperity," he added, sending the letter to the states U.S. congressional delegation.

The National Association of Home Builders told the agencies that the proposed rules would "have far-reaching negative consequences for local communities and their residents, particularly in states that rely on development districts to finance the services needed to support new residential construction in the face of constrained municipal revenues."

NAHB said the proposed rules are unnecessary based on available case law and congressional intent" and warned they could "spark legal challenges that would result in additional uncertainty."

The National Association of Bond Lawyers told the agencies that the proposed rules are the result of the IRS position in audits of two CDDs in Florida – the Village Center CDD and the Sumter Landing CDD.

"There has been no independent development in the market or a change in the law that needed to be addressed, but rather only this instance of the IRS' position in an examination causing significant uncertainty and disruption in the financial market and legal community," NABL wrote, adding, "The IRS created the legal issue that the proposed regulations now seek to solve."

As a result of the audits of the bonds of these CDDs, the IRS chief counsel issued a technical advice memorandum in May 2013 that concluded the Village Center CDD is not a political subdivision because its board is, and will always be, controlled by a private developer rather than by residents or other publicly elected officials. Under the TAM, millions of dollars of tax-exempt bonds issued by

the CDD would become taxable.

But bond lawyers fought against the TAM, arguing it was an attempt to change existing standards retroactively through enforcement rather than prospectively through rulemaking, which gives market participants a chance to provide input. Eventually the TAM was made prospectively effectively and the IRS resorted to rulemaking and issued these proposed rules.

NABL cited a 1981 ruling by the U.S. Court of Appeals for the Third Circuit in Philadelphia National Bank v. U.S., in which the court found Temple University was not a political subdivision because it did not have a significant amount of any of the three sovereign powers: eminent domain; taxation and policy power.

“This standard was straightforward and easily applied for decades,” NABL told the agencies, referring to it as the “Shamberg rule.” This rule should continue to be the sole standard for political subdivisions, the bond lawyers group added.

NABL also wrote that the proposed rules “are not administrable” and would “create significant new burdens on governmental organizations seeking to qualify, or maintain qualification, as political subdivisions.”

The group included in its comments a one and half page analysis that entities would have to go through to determine if they comply with the proposed rules.

The bond lawyers group also warned that the proposed rules would have many unintended consequences, some outside the federal income tax law.

For example, NABL wrote, if an entity failed either of the three tests in the IRS proposed rules – sovereign powers, governmental purpose and governmental control – “not only could it not issue tax-exempt bonds, but its use of bond-financed facilities would constitute private use and may, therefore be shut out from government borrowing programs such as the state clean water revolving loan programs.” The entity also could be liable for federal income tax on its taxable income that it didn’t have to previously pay because of a tax provision, according to NABL.

The Bond Buyer

By Lynn Hume

May 23, 2016

TAX - LOUISIANA

Yesterdays of Lake Charles, Inc. v. Calcasieu Parish Sales and Use Tax Dept.

Supreme Court of Louisiana - May 13, 2016 - So.3d - 2016 WL 2879996 - 2015-1676 (La. 5/13/16)

After his night clubs were subjected to a purported random audit by collector of revenue, taxpayer appealed sales and use tax assessments.

The District Court ruled in favor of taxpayer, denied collector’s motion for new trial, and awarded attorney fees to taxpayer. Collector appealed. The Court of Appeal affirmed. Collector petitioned for writ of certiorari, which was granted.

The Supreme Court of Louisiana held that:

- Tax collector had no obligation to provide taxpayer with guidance regarding what constituted suitable records;
- Bank statements and deposit slips did not constitute suitable records of nightclubs' retail sales;
- Collector was not required to provide false or fraudulent intent in order to estimate taxpayer's retail sales;
- ULSTC did not require agreement between a taxpayer and the tax collector regarding the sampling procedure to be used to determine the correct tax to be in writing;
- Collector provided taxpayer with sufficient notice of sampling method to be used;
- Sampling method used was developed and applied in accordance with generally recognized sampling techniques; and
- Collector was prescribed from issuing amended assessments for 2005 and 2006 tax years.

TAX - OHIO

Dublin City Schools Bd. of Edn. v. Franklin Cty. Bd. of Revision

Supreme Court of Ohio - May 18, 2016 - N.E.3d - 2016 WL 2908564 - 2016 -Ohio- 3025

Following county auditor's valuation of commercial property at $2,205,000, property owner filed a complaint seeking a reduction to $1,000,000.

Board of Revision (BOR) reduced value. City board of education (BOE) appealed. The Board of Tax Appeals (BTA) affirmed. BOE appealed.

The Supreme Court of Ohio held that BTA was precluded from reverting to auditor's valuation of the property.

Pursuant to Bedford rule, when the board of revision (BOR) has reduced the value of the property based on the owner's evidence, that value eclipses the auditor's original valuation, and the city board of education (BOE) as the appellant before the Board of Tax Appeals (BTA) may not rely on the latter as a default valuation. Instead, the BOR's adoption of a new value based on the owner's competent evidence has the effect of shifting the burden of going forward with evidence to the BOE on appeal to the BTA.

Board of Tax Appeals (BTA) was precluded from reverting to auditor's valuation of commercial real property consisting of office space and a bank, where county board of revision (BOR) adopted new value based on owner's competent evidence of value, which shifted burden of going forward with evidence to city board of education (BOE), and no new evidence was presented at the BTA.

NABL and Others Call for Withdrawal of Political Subdivision Regs.

On May 23, the National Association of Bond Lawyers (NABL) submitted its comments on the proposed regulations on the definition of political subdivision (REG-129067-15). NABL urged the Treasury Department to withdraw the proposed regulations and affirm the applicability of the Shamberg rule as the sole standard for evaluating a governmental entity's status as a political subdivision. NABL said that the proposed regulations would increase uncertainty and disruption in the municipal market. Also, the proposed regulations would be unworkable and create significant

uncertainty about whether governmental organizations qualify as political subdivisions because of multiple facts and circumstances tests.

In total, one hundred and five out of one hundred and seven comments submitted opposed the proposed regulations in whole or in part. Among the commenters, the Government Finance Officers Association wrote that the rules should be withdrawn and rewritten to directly address specific concerns that the Internal Revenue Service might have on possible abuses by political subdivisions. The Bond Dealers of America emphasized that the proposed regulations would have a profound effect on development projects, as states adjust "to a federally mandated political subdivision structure." The National Association of Home Builders also wrote in their comments that the proposed regulations would have profound effects on local communities, especially those that rely on developmental districts to finance projects "in the face of constrained municipal revenues."

NABL plans to submit more detailed comments in the future and will testify at the public hearing on June 6, 2016, along with eight other organizations.

NABL's comments are available here.

The full set of comments is available here.

Redefining 'Special Districts' Could Have Big Taxing Consequences.

If the IRS gets its way, it may be harder for special districts to issue tax-exempt municipal bonds.

Special districts spend more public money than all city governments combined, much of it raised through borrowing in the municipal bond market. But proposed new regulations from the Internal Revenue Service could make it harder for special districts to borrow that money tax-free. And that could be very expensive for states and localities.

All totaled, the Census Bureau counts 39,000 special-purpose district governments, which are usually created to address — and raise revenue for — specific functions, such as airports, libraries, wastewater, mosquito control and so on. They exist separately from general-purpose governments, and may cross the borders of cities, counties and states.

In order to issue tax-exempt bonds, an entity has to meet the definition of a municipality. In many ways, special distrcits do not. They aren't like traditional state or city entities at all. As creatures of the state, special-purpose districts have governing boards as determined by state law. But those boards may be appointed by public officials or by private entities. Or they may be elected by property owners within the special district — even though there may be only one or two residents, or in some cases, zero residents, to participate in a board election. While most special-purpose districts have employees, some don't, distinguishing them from every other kind of government in the country.

So if these entities don't resemble traditional state and local governments, why should they be allowed to borrow in the same tax-exempt way? That's just what the IRS wants to know. In February, the agency proposed regulations that would more clearly define the difference between a municipality and a special district. It may seem like a fine point, but in fact there's big money at stake. Special districts could see a nearly 30 percent increase in the costs of borrowing, which could work out to about $700 billion. It could be prohibitive enough to force many special districts out of existence.

Up until now, the IRS has defined a political subdivision — that is, any entity that's allowed to issue municipal tax-free bonds — by using a three-prong test. If an entity is authorized by the state to exercise at least one of three sovereign powers — the power of taxation, the power of eminent domain, or police power — then it qualifies to issue bonds tax free.

Under the proposed rule, those old tests of sovereign power still apply. But the new regulations would add another criterion: An entity must serve a governmental purpose and be governmentally controlled. That means that in order for a district to issue tax-free bonds, it must be controlled either by a general-purpose state or local government or by an electorate established by state or local law.

In short, the IRS has cast itself into the difficult role of defining when, and under what circumstances, there can be special districts (other than school districts, which wouldn't be affected by the new rule). Sussing out the definitions of 39,000 different districts would be a Herculean task, and it raises fundamental questions about just how we define government.

If finalized — and that decision won't be made for months — the new rules may cause special districts in some states to lose their right to issue tax-exempt municipal bonds, which could have huge taxing and governing consequences for states and localities.

GOVERNING.COM

BY FRANK SHAFROTH | MAY 2016

The Final Allocation and Accounting Regulations - What Do They Mean For "Phantom Investment Proceeds"?

The flexibility to reallocate proceeds to expenditures using an accounting method other than direct tracing has been a well-recognized and much-appreciated opportunity under the allocation and accounting rules of IRC section 141. The former proposed section 141 regulations (REG-140379-02, Sept. 26, 2006) ("Proposed Regulations"), now replaced by the final section 141 regulations issued October 27, 2015 ("Final Regulations") on which we reported here, here, here, and here and cross-referenced the arbitrage allocation rules in 1.148-6 in allowing the reallocation of proceeds away from the expenditures for which the proceeds were actually spent to different expenditures producing more favorable tax results. If the expenditures to which the proceeds were reallocated were paid later than the proceeds were actually spent, the reallocation raised the question of whether the proceeds had to be treated as spent later for arbitrage purposes, resulting in additional, "phantom" (because they were never actually earned) investment proceeds that were deemed to arise during the time between the date when the issuer originally spent the proceeds, and the date of the expenditure to which it later reallocated proceeds. Fortunately, the Proposed Regulations included an explicit exception from the otherwise applicable consistency rule between the section 141 and section 148 allocation and accounting rules, thereby avoiding phantom investment proceeds. The Final Regulations do not include this rule. So where are we now? Might we have phantom investment proceeds?

Background

Proposed Regulation 1.141-6(a) stated:

> Except as otherwise provided in this section, for purposes of 1.141-1 through 1.141-15, the provisions of 1.148-6(d) apply for purposes of allocating proceeds and other sources of

> funds to expenditures (as contrasted with investments). Except as otherwise provided in this section, allocations of proceeds and other sources of funds to expenditures generally may be made using any reasonable, consistently applied accounting method. *Allocations of proceeds to expenditures under section 141 and section 148 must be consistent with each other. . . .* (Emphasis added.)

Had the Proposed Regulations stopped here, we would have been left with the question of the appropriate arbitrage analysis if proceeds were reallocated to different, later expenditures, e.g., to avoid private business use, and the expenditures to which the proceeds were reallocated were paid later than when the proceeds were actually spent. Specifically, would phantom investment proceeds be imputed for the period from the actual expenditure to the reallocated expenditure? Aside from the potential rebate cost of such a rule, the record-keeping burden would have been horrendous. Apparently to avoid this, Proposed Regulation 1.141-6(a) further provided:

> . . . For purposes of the consistency requirements in this paragraph (a), it is permissible to employ an allocation method under paragraph (a)(2), (c), or (d) of this section (for example, the general pro rata allocation method under paragraph (a)(2) of this section) to allocate sources of funds within a particular project for purposes of section 141 in conjunction with an accounting method allowed under 1.148-6(d) (for example, the first-in, first out method) to determine the allocation of proceeds or other sources of funds to expenditures for that project.

The Proposed Regulations have now been replaced by the Final Regulations. Section 1.141-6(a) of the Final Regulations states: "The allocations of proceeds and other sources of funds to expenditures under §1.148-6(c) apply for purposes of §§1.141-1 through 1.141-15." As supported by the preamble explanation, this rule apparently requires consistency in accounting between IRC sections 141 and 148. This consistency rule, however, is not followed (as it was in the Proposed Regulations) by an exception eliminating the concern of phantom investment proceeds. So we are left to determine whether phantom investment proceeds might arise.

As we previously reported in this blog (here),the Final Regulations automatically allocate tax-exempt proceeds to governmental use and qualified equity to private business use, to the extent possible. Moreover, the allocation of proceeds and qualified equity shifts from time to time if and when the location of private business use within the project shifts. Since this rule does not purport to allocate proceeds to particular expenditures and that allocation can shift over time, it appears reasonably clear that the application of this rule will not result in phantom investment proceeds.

The Final Regulations, however, would also appear to permit an affirmative allocation of proceeds to expenditures that is not inconsistent with the general rule described above. For example, assume that all of the proceeds of an issue are actually spent for a particular project (the "first project"). Assume further that the issuer would prefer to allocate a portion of those proceeds to a second, contemporaneous project while allowing the remainder of the issue proceeds to remain allocated to the first project. (Such a reallocation can enable the issuer to increase the benefit of its qualified equity, particularly if both projects are then financed in part with qualified equity.) The Final Regulations would appear to permit this affirmative allocation, but might this reallocation result in phantom investment proceeds?

While the Final Regulations (and the preamble) are silent on this question, it does not appear that issuers need to be concerned with the prospect of phantom investment proceeds. If there were a possibility of having to calculate and track additional investment proceeds, surely Treasury would have made that requirement clear, at least in the preamble if not in the Final Regulations themselves. For example, the method of determining the investment earnings rate alone would raise

many unanswered questions that, if Treasury thought applicable, we should be able to assume would have been addressed. Accordingly, it appears appropriate to conclude that under no application of the Final Regulations should an issuer have to calculate phantom investment proceeds resulting from a potential difference in timing of actual proceeds expenditure versus reallocated proceeds expenditure.

I would further submit that such a result should obtain under IRC section 142 (exempt facility financings), where the consequences of phantom investment proceeds would be much greater. Rather than largely an arbitrage issue as in the case of governmental bonds, under section 142 the consequences would include qualification under the 95% qualified cost requirement. Again in the absence of any indication from Treasury or the IRS to the contrary, a reallocation of proceeds in a section 142 financing should not result in the possibility of phantom investment proceeds.

Squire Patton Boggs

The Public Finance Tax Blog

by Robert J. Eidnier

USA May 26, 2016

SIFMA Submits Comments to the IRS on Proposed Regulations Defining Political Subdivisions.

SIFMA provides comments to the Internal Revenue Service (IRS) on proposed regulations defining political subdivisions. The Proposed Regulations provide guidance re-defining the definition of political subdivision for purposes of entities that may qualify as issuers of tax-exempt bonds under section 103 of the Internal Revenue Code of 1986.

Read the comment letter.

May 23, 2016

TAX - OHIO

Riverside v. State

Court of Appeals of Ohio, Second District, Montgomery County - May 6, 2016 - N.E.3d - 2016 WL 2621415 - 2016 -Ohio- 2881

City brought action against State, seeking declaration that statute creating exemption to municipal commuter income tax for Air Force base employees and contractors was unconstitutional.

On cross-motions for summary judgment, the Court of Common Pleas granted State's motion. City appealed.

The Court of Appeals held that:

- Statute was rationally related to legitimate government interest and thus did not violate equal protection clause;

- Trial court acted within its discretion in granting State's motion for protective order to prevent city from deposing State, through State's representative or designee; and
- Trial court's statement that city could not establish unconstitutionality of statute "beyond a reasonable doubt" did not establish that trial court applied improper standard in ruling on State's motion for summary judgment.

Tax-Exempt Bonds: Is It Possible for a Municipal Corporation Not to be a Political Subdivision?

With the recent issuance of the proposed regulations that would redefine the term "political subdivision" for purposes of determining which entities can issue tax-exempt bonds under Section 103 of the Internal Revenue Code, as amended (the "Code"), the answer to this seemingly rhetorical question is "yes," at least according to the Treasury Department. This is a significant, and startling, departure from the current Treasury regulations that define "political subdivision" for purposes of Code Section 103.

Current Treasury regulation § 1.103-1(a) provides that interest on an obligation issued by a political subdivision of a State is, except as otherwise provided, excluded from gross income of the holder of the obligation under Section 103(a) of the Code. Current Treasury regulation § 1.103-1(b) further provides that "the term 'political subdivision' . . . denotes any division of any State or local governmental unit which is a municipal corporation . . . ." A municipal corporation is therefore by definition treated as a political subdivision for purposes of Code Section 103. Although the term "municipal corporation" is not defined for this purpose, it has been interpreted, as illustrated by Revenue Ruling 80-136, 1980-1 C.B. 25, with deference to the laws of the applicable State to mean a city, village, town, or borough that is treated under the constitution or laws of the applicable State as a municipal corporation and imbued under such constitution or laws with the powers of self-government.

Like existing Treasury regulation § 1.103-1(a), proposed regulation § 1.103-1(a) provides that, subject to certain limitations, interest on an obligation issued by a political subdivision of a State is, pursuant to Code Section 103(a), excluded from gross income of the holder of the obligation. Proposed regulation § 1.103-1(c), however, goes on to state that:

> The term political subdivision means an entity that meets each of the requirements of paragraphs (c)(2) (sovereign powers), (c)(3) (governmental purpose), and (c)(4) (governmental control) of this section, taking into account all of the facts and circumstances, or that is described in published guidance issued pursuant to paragraph (c)(5) of this section. Entities that may qualify as political subdivisions include, among others, general purpose governmental entities, such as cities and counties (whether or not incorporated as municipal corporations) . . . . (Emphasis added.)

The proposed regulations are to be commended for providing that incorporation as a municipal corporation is not a prerequisite for qualifying as a general purpose governmental entity. Counties and townships of counties are unincorporated but, like municipal corporations, clearly have the characteristics of general purpose governmental entities. The proposed regulations should, however, be revised to define a "general purpose governmental entity" as "a county, township of a county, city, town, village, or borough that is created under the constitution or laws of a State, regardless of whether incorporated as a municipal corporation." Moreover, the proposed regulations should be revised to make clear that a general purpose governmental entity, as so defined, is a political

subdivision without application of the sovereign powers, governmental purpose, and governmental control tests set forth in proposed regulations § 1.103-1(c).

The foregoing refinements of the proposed regulations would accord with existing Treasury regulation § 1.103-1(b), which automatically treats a municipal corporation as a political subdivision for purposes of Code Section 103, and with sound policy. Under the constitution or laws of each State, a general purpose governmental entity, as defined above, is no mere special district, but instead: (1) has a substantial amount of taxing, eminent domain, and/or police powers; (2) exists to govern the area that comprises its physical jurisdiction; and (3) is accountable to its electorate and is not susceptible to private control. Subjecting these entities to the sovereign powers, governmental purpose, and governmental control tests of the proposed regulations introduces unwarranted confusion regarding their status as political subdivisions under Code Section 103 without advancing any discernable policy objective. Further, the application of the sovereign powers, governmental purpose, and governmental control tests to general purpose governmental entities is unnecessary to prevent privately controlled special districts from issuing tax-exempt bonds.

Wednesday, May 18, 2016

by Michael A. Cullers

Partner

Michael Cullers focuses his practice on matters involving tax-exempt bonds, and state and local taxation. Michael has extensive experience in the tax aspects of state and local bond issues including governmental use bonds, qualified 501(c)(3) bonds and other tax-exempt private activity bonds, such as airport financings, as well as tax-advantaged bonds such as Build America Bonds and qualified school construction bonds. This experience includes private business use and private payment analyses; arbitrage issues in new money, refunding and multipurpose bond issues; multipurpose issue…

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Colorado Lawmakers Aim to Head Off Challenges to Metro Tax Districts That Worry Developers.

Top Colorado lawmakers introduced legislation Thursday that would prohibit legal challenges to the qualifications of special district electors in all past elections.

The proposal, if approved, would deem all of the special district electors created in special district elections up until April 21, 2016 and in the upcoming May 3 special district elections as eligible and would consider all of the elections since 1981 valid.

The bill is a reaction to a Colorado Court of Appeals ruling earlier this month in a case titled Landmark Towers Association vs. UMB Bank case, which upheld the position of a group of Landmark condo owners that the creation of the Marin Metropolitan District was created by ineligible electors

and that legitimate property ownes were cut out of the process.

The ruling has put bond traders, bankers and real estate lawyers on edge and some metropolitan districts that were ready to sell bonds are now in a holding pattern as millions of dollars in transactions came grinding to a halt in the wake of the ruling.

Lawyers who helped craft Senate Bill 16-207 said the situation is urgent. The majority of the state's metropolitan districts were created using the same mechanism used in the Marin metro district. In that case, electors that voted to form the district were qualified because they took out low-down payment options on real estate.

The fear is that the court ruling could lead to lawsuits challenging the eligibility of special district electors in districts created long ago by that very mechanism.

Senate Bill 16-207, wouldn't allow those challenges. It says, "No district election conducted prior to April 21, 2016 may be contested on the ground that any person who voted at such election was not an eligible elector unless such a contest was invalidated prior to April 21, 2016."

The bill, backed by Senate President Bill Cadman, Majority Leader Mark Scheffel and House Speaker Dickey Lee Hullinghorst and House Majority Leader Crisanta Duran, has 10 days to get through the Senate and House before the legislative session ends.

Brian K. Matise, shareholder of Burg Simpson law firm who represented Landmark Towers Association, said he doesn't understand what the urgency is all about. The ruling, he said, is very narrow and wouldn't affect special districts created long ago.

In the Landmark case, the special district was created and approved by six people who were qualified as electors because they bought options on tiny pieces of a 10-by-10-foot parcel of land in the proposed district. To be eligible electors in that district, the six organizers executed option contracts to purchase a sliver of land within the district and agreed to pay $500 each. Then, they held an election in 2007 that created the metro district and authorized the district to issue bonds. But those six electors never paid for the land or paid taxes on the land.

In addition, a group of condo owners in Landmark Towers were lumped into the taxing district but they received no infrastructure benefit from the taxes collected and they were excluded from voting in the tax election, which the appeals court ruled was a violation of the Taxpayers Bill of Rights (TABOR).

Landmark Towers Association argued that the organizers' contracts were a sham. A lower court judge ruled that even though the organizers never paid the down payments for the so-called "director's parcels" or paid any taxes on the land, the option contracts were a legitimate way to create eligible electors for the special district.

But the Court of Appeals disagreed, ruling that the option contracts weren't sufficient to make the organizers eligible electors. The ruling listed six reasons why the electors in the Marin district were ineligible, including that they never paid property taxes.

"The ruling did not say that using option contracts to qualify electors is illegal," Matise said. "What it says, is that you can't have sham contract to qualify the directors. That is different."

But Dee Wisor. a Denver attorney that specializes in public finance issues, said the ruling is unclear on whether it applies only to the electors of the Marin metro district or could be applied to other metro district electors as well.

The ruling did, however, put an immediate chill on bond activity. Sam Sharp, managing director of D.A. Davidson & Co., a brokerage and investment banking firm, said he knows of at least seven transactions representing about $70 million in bond transactions that are on hold since the ruling.

Jan Bilsborrow, a board member of the Red Leaf Metropolitan District in Broomfield, said the district was refinancing its bonds to take advantage of lower interest rates for its taxpayers. The district sold $4.6 million in bonds. But one day later – the day of the Landmark court ruling – the transaction was suspended.

Bond counsel wouldn't sign off on the deal because of questions the ruling raised, she said.

"The projected savings will not happen unless something can change," Bilsborrow said.

The refinancing would have saved each of the 492 property owners in the Red Leaf district about $1,370 in property taxes over the life of the bonds, she said. The timing is unfortunate, she said.

"The original board was fiscally responsible and was doing what was needed for the infrastructure of our neighborhood," she said. "It was done exactly how it should have been done."

The Denver Business Journal

by Monica Mendoza

Apr 29, 2016, 6:00am MDT Updated Apr 29, 2016, 8:43am MDT

TAX - NEW JERSEY

Palisadium Management Corp. v. Borough of Cliffside Park

Tax Court of New Jersey - May 2, 2016 - N.J.Tax - 2016 WL 2343387

Corporate taxpayer challenged tax assessments on property with improvements consisting of a building containing a banquet facility and a fitness/health spa facility.

The Tax Court held that:

- Cost approach was not an appropriate methodology for valuing the property;
- A hybrid approach, applying both the sales comparison and income capitalization approaches, was appropriate; and
- Expert's valuation adjustments were not credibly supported.

The cost approach was not an appropriate methodology in property tax assessment proceedings for valuing property consisting of two lots comprising approximately 4.19 acres, with an improvement on one of the lots consisting of 74,668 square feet, containing a banquet hall on the upper level and a fitness center and health spa on the lower level, notwithstanding borough's contention that the property's location, with its superior views of river and city skyline, and its unusual combination of uses, qualified it as a "unique" and "special-purpose" property. The subject properties were constructed more than thirty years before the first valuation date, neither a banquet hall nor a fitness center was unique or specially built, and there was unquestionably a market for the sale of banquet halls and the lease of health fitness centers.

A hybrid approach, applying both the sales comparison and income capitalization approaches, was

appropriate in property tax assessment proceedings relating to property consisting of two lots comprising approximately 4.19 acres, with an improvement on one of the lots consisting of 74,668 square feet, containing a banquet hall on the upper level and a fitness center and health spa on the lower level. The sales comparison approach was appropriate for the banquet facility, and the income and expense approach was appropriate for the fitness/health spa.

Expert's valuation adjustments were not credibly supported in property tax assessment proceedings relating to property consisting of two lots comprising approximately 4.19 acres, with an improvement on one of the lots consisting of 74,668 square feet, containing a banquet hall on the upper level and a fitness center and health spa on the lower level. Expert's conclusion as to market conditions/time adjustment was not discernible from the evidence nor adequately supported by any objective facts, expert used same comparable sales to support multiple paired sales analyses, there was no objective data supporting conclusion that the reason the subject property was able to command higher prices than competitors was a result of its "above average" view of city skyline, and there was insufficient evidence to assess whether subject property actually charged higher prices than comparable venues.

TAX - LOUISIANA

Trunkline LNG Co., LLC v. Calcasieu Parish School System

Court of Appeal of Louisiana, Third Circuit - April 13, 2016 - So.3d - 2016 WL 1445938 - 2015-1062 (La.App. 3 Cir. 4/13/16)

Taxpayer appealed decision of the Board of Tax Appeals reducing amount of refund of taxpayer's overpayment of sales taxes to parish school board.

The Court of Appeal held that:

- Taxpayer was not entitled to set off overpayment from some months against deficiency in other months, and
- Taxpayer was not entitled to call school board employee as a witness.

Taxpayer that was originally assessed sales tax excessively in some months and deficiently in others was not entitled to set off what it owed for months in which it was deficient with refund to which it was entitled for months in which it had overpaid, but was instead required to pay interest in amount of 15% for months it was deficient and was entitled to interest of 2–3% for months in which it had overpaid.

TAX - NEW HAMPSHIRE

Everett Ashton, Inc. v. City of Concord

Supreme Court of New Hampshire - April 29, 2016 - A.3d - 2016 WL 1719255

Manufactured housing park owner brought action against city for declaratory relief, injunctive relief, and damages, after city refused to issue demolition permits for abandoned manufactured homes until owner paid taxes owed by tenants.

The Superior Court held that city was required to issue the permits, that city could not place a lien on owner's land for its former tenants' unpaid water bills, and that owner was entitled to compensation and attorney's fees. City appealed.

The Supreme Court of New Hampshire held that:

- As a matter of first impression, city's refusal to allow owner to remove homes exceeded its discretion;
- Municipalities may place a lien on a park owner's property if tenants, who have individual meters, fail to pay their water bills; and
- City's decision to withhold demolition permits was not a regulatory taking that required just compensation.

City's refusal to allow manufactured housing park owner to remove valueless, abandoned homes until it paid taxes thereon, despite express statutory provision that park owners were not responsible for such taxes, exceeded scope of city's discretion, and therefore city was required to issue demolition permits for homes in park. City could not hold owner hostage by refusing to allow removal of derelict homes even though owner could not have been held liable for unpaid taxes, and legislature could not have intended for discretion granted to city to allow removal of structures taxed as real estate to be exercised in way that would allow city to nullify statute stating park owners were not liable for taxes due upon manufactured housing.

NABL: Lawmakers Seek Guidance on Student Loan Bonds.

Bipartisan groups of House and Senate lawmakers have sent letters to the Treasury Department and the Internal Revenue Service (IRS), asking for guidance to facilitate the refinancing of student loans.

In similar letters from the House and Senate, lawmakers appreciated the guidance from Treasury and IRS in Notice 2015-78, which clarified that tax-exempt bonds can be used for a wide range of refinancings to allow student loan borrowers to take advantage of lower rates.

However, the lawmakers asked for further guidance on three issues: 1) guidance that bonds issued for refinancing purposes not be considered refunding bonds; 2) guidance for issuers to help them determine that the original student loans met loan size limitations for tax-exempt financing; and 3) guidance that a former student can refinance an original loan that was a parent loan and vice versa and that parents' current state of residence is not an impediment to refinancing.

The letter from the House members is available here. The letter from the Senators is available here.

TAX - LOUISIANA

Bridges v. Nelson Indus. Steam Co.

Supreme Court of Louisiana - May 3, 2016 - So.3d - 2016 WL 2338036 - 2015-1439 (La. 5/3/16)

Following remand of electricity producer's suit against parish for refunds of sales and use taxes and state's suit against producer to collect sales and use taxes, the District Court rendered judgments in favor of state and parish. Producer appealed. The Court of Appeal affirmed. Producer sought writ of

certiorari.

The Supreme Court of Louisiana held that limestone bought and used by producer in producing ash was subject to “further processing” exclusion from sales tax.

Limestone bought and used by electricity producer for dual purpose of inhibiting sulfur in production of electricity and producing ash was subject to “further processing” exclusion from sales tax. Ash was an article of tangible personal property for sale at retail, chemical makeup of limestone was found in ash and was an integral part thereof, and limestone was purchased with purpose of inclusion in final product of ash although that was not the primary purpose for purchasing limestone.

TAX - FLORIDA

Island Resorts Investments, Inc. v. Jones

District Court of Appeal of Florida, First District - March 21, 2016 - So.3d - 2016 WL 1085225 - 41 Fla. L. Weekly D721

Owner of 99-year leasehold interest in unimproved 12-acre parcel filed action for a declaratory judgment that its interest could be taxed only as intangible personal property, and for an injunction prohibiting the assessment and collection of ad valorem taxes on the land.

The Circuit Court entered judgment for county appraiser and tax collector, and leasehold interest owner appealed.

The District Court of Appeal held that leasehold interest owner was not the equitable owner of the leased land.

Owner of 99-year leasehold interest in unimproved land owned by county was not the equitable owner of the leased land and thus was not required to pay ad valorem taxes on the land, where owner did not have the right to the perpetual renewal of its lease or the right to purchase the property for nominal consideration at the end of the lease, owner bore all the burdens during the term of the lease, at the end of which all the rights to the property reverted, rental payments were due in consideration for the leasehold interest, and the property was not financed, acquired, or maintained through the issuance of bonds.

TAX - PENNSYLVANIA

City of Philadelphia v. Auguste

Commonwealth Court of Pennsylvania - April 29, 2016 - A.3d - 2016 WL 1718844

Property owner moved to set aside sheriff’s sale after property was sold for nonpayment of real estate taxes.

The Court of Common Pleas set aside sale. City and assignee of tax sale purchaser appealed.

The Commonwealth Court held that city’s service on owner of petition and rule to show cause why property should not be sold for nonpayment of real estate taxes was sufficient to meet requirements of Municipal Claims and Tax Liens Act.

City's service on property owner of petition and rule to show cause why property should not be sold for nonpayment of real estate taxes was sufficient to meet requirements of Municipal Claims and Tax Liens Act, despite argument that other addresses existed at which property's mortgagee could have been served, where city sent petition and rule via certified mail to owner, return receipt requested and by first class mail with prepaid postage, at mailing address listed on city's tax information certificate, service was also made in same manner on mortgagee at its registered agent for service of process, city filed affidavit of service, and petition and rule were posted on property.

Proposed Political Subdivision Regulations Recall Earlier Failed Regulations: Squire Patton Boggs

As we have discussed here before, we may be coming to the point where there are no new ideas in public finance tax law. Yet another example: The recent proposed political subdivision regulations hearken back to a similar regulation project on a related topic many years ago, which suffered from many of the same drawbacks found in the proposed political subdivision regulations.

In 1976, Treasury issued proposed regulations (41 Fed. Reg. 4829) that would have codified a specific definition of a "constituted authority" of a State or political subdivision that can issue tax-exempt bonds on its behalf. These concepts are similar to the concepts that we find in the proposed political subdivision regulations, but the result is somewhat different. An entity can be a constituted authority of either a State or a political subdivision. (See here for prior coverage of this topic.) Prior to the proposed constituted authority issuer regulations, issuers looked to a series of revenue rulings (the first of which was Rev. Rul. 57-187) to determine whether an entity was a constituted authority of a State or a political subdivision.

Like the proposed political subdivision regulations, the constituted authority proposed regulations articulated tests that sound eminently reasonable when you hear them for the first time. And like the proposed political subdivision regulations, the devil (or devils) were in the details.

First, like the proposed political subdivision regulations, the proposed constituted authority regulations would have required the constituted authority to serve a public purpose of the governmental unit on whose behalf it was issuing bonds. But the test was quite a bit more specific than that.

Click here to view the image.

As the Preamble to the proposed constituted authority regulations noted: A constituted authority "must be specifically authorized pursuant to State law to issue obligations on behalf of the unit to accomplish a public purpose of the unit." The authorization would need to specify the public purpose of the governmental unit that would be accomplished by the constituted authority, and the authority would have to be created "solely to accomplish a public purpose of the governmental unit."

Second, like the proposed political subdivision regulations, the proposed constituted authority regulations would have required the constituted authority to be controlled by a State or local governmental unit. Again, the test was quite a bit more specific than that.

Click here to view the image.

The proposed regulations would have required a governmental unit to control the authority's board. In addition the proposed regulations had specific requirements for the composition of the board, and

would have barred a private person from appointing even a small minority of the board. The proposed regulations would have imposed a requirement that certain board members not have a term of more than 6 years. In addition, the governmental unit would need to exercise either "organizational control" or "supervisory control" over the authority. The tests for each of these were exhaustive and exhausting.

Finally, to round out the tests, the proposed constituted authority regulations would have required that no part of the earnings of the constituted authority could inure to the benefit of any person other than the governmental unit and upon dissolution of the authority all property of the authority must vest in the governmental unit.

Each of the elements above are present in very general terms in the revenue rulings that preceded the proposed constituted authority regulations. In its attempt to codify the principles, though, Treasury went far beyond anything that might be considered workable.

After sustained criticism, Treasury withdrew the proposed constituted authority regulations on January 1, 1984. LR-8-73, 1984-1 C.B. 592 (Jan. 1, 1984). In the notice of withdrawal, Treasury stated that "A large number of comments were received, and a public hearing was held on April 26, 1976. After consideration of the comments it has been determined that this notice be withdrawn." Instead, the tax-exempt bond community could (and still does) continue to rely on prior revenue rulings (such as Rev. Rul. 57-187) to determine whether an entity is a constituted authority of a State or of a political subdivision. Treasury has never again attempted to promulgate regulations on this topic.

It seems that a number of conditions that caused the on behalf of issuer regulations to fail are also present with the proposed political subdivision regulations. Treasury and the IRS have said that the proposed political subdivision regulations are based on commonsense principles and are an attempt to be surgical in responding to a particular perceived abuse – the issuance of tax-exempt bonds by special districts that in Treasury's view are politically unaccountable. But, as in the proposed constituted authority regulations from 1976, their attempt to codify these principles has gone far beyond even their modest stated goal. As with the 1976 proposed constituted authority regulations, the proposed political subdivision regulations take up the quixotic task of trying to tease apart what activities serve a "public" purpose and which do not. The response to this point so far has been a rather unsatisfying "but it's a federal subsidy!" That may be, but it seems that a fundamental change to a longstanding definition is better resolved by the fount of the subsidy – Congress – rather than an administrative agency. Given the many similarities between the proposed political subdivision regulations and the proposed constituted authority regulations from 1976, many in the tax-exempt bond community are hoping that the proposed political subdivision regulations suffer a similar fate.

Squire Patton Boggs – John W. Hutchinson

The Public Finance Tax Blog

USA May 12 2016

IRS Updates Start-Of-Construction Rule: Four Years For Project Completion.

On May 5, 2016, the US Internal Revenue Service released Notice 2016-31 (available here) (the "Notice"). The Notice updates previous guidance on satisfying the "start of construction" requirement to reflect the fact that wind, hydropower, geothermal, and biomass and trash facilities

can now qualify for the full renewable electricity production tax credit ("PTC") under Section 45 of the Internal Revenue Code of 1986 (the "Code") (e.g., 2.3 cents per kilowatt) if construction starts before 2017 (or a reduced credit, if construction starts before 2020).

The Notice provides that the US Treasury Department and the IRS will issue separate guidance to address the application of these rules to solar energy facilities claiming the investment tax credit ("ITC") under Section 48 of the Code.

The basic rules regarding the "five percent safe harbor" and "significant physical work test" remain unchanged. The Notice provides projects with a four-year window for completion and provides additional guidance regarding multiple "facilities" that operate as a "single project."

Background

In the final days of 2015, the Consolidated Appropriations Act of 2016 (P.L. 114-113) (the "Act") extended the PTC to qualified facilities, such as wind facilities, that begin construction before January 1, 2020 (the previous expiration date was January 1, 2015). The Act also phased out the wind PTC, which generally is an amount equal to the product of 1.5 cents, adjusted for inflation (which, for 2016, results in a credit rate of 2.3 cents), multiplied by the kilowatt hours of electricity produced by the taxpayer and sold to an unrelated person, by providing that the amount of the credit shall be reduced by 20 percent for facilities that begin construction during 2017, 40 percent for facilities that begin construction during 2018 and 60 percent for facilities that begin construction during 2019. For a more detailed analysis of the Consolidated Appropriations Act of 2016, see our December 28, 2015, Legal Update).

Prior to the extension, the PTC was available for a qualified facility, such as a wind facility, only if construction of the facility began before January 1, 2015. The IRS also had issued guidance in the form of a series of notices (the "Prior Guidance") to clarify when construction of a facility was deemed to have begun.

Under Notice 2013-29 (available here), a taxpayer can establish that construction has begun by starting physical work of a significant nature prior to January 1, 2014 (the "Physical Work Test") or by paying or incurring at least five percent of the total cost of the facility before January 1, 2014 (the "Five Percent Safe Harbor"). In addition, under the Physical Work Test, the taxpayer is required to maintain a continuous program of construction, while the Five Percent Safe Harbor requires that the taxpayer make continuous efforts to advance toward completion of the facility (for a more detailed analysis of Notice 2013-29, see our April 16, 2013, Legal Update). Subsequently, in Notice 2013-60 (available here), the IRS clarified that the continuous program of construction and continuous efforts requirements would be deemed satisfied if the facility were placed in service before January 1, 2016 (the "Continuity Safe Harbor") (for more complete coverage of Notice 2013-60, see our September 23, 2013, Legal Update). In Notice 2014-46 (available here), the IRS further clarified and modified Notices 2013-29 and 2013-60 (for a discussion of Notice 2014-46, see our August 8, 2014, Legal Update). Finally, the IRS issued Notice 2015-25, which updated previously issued guidance to reflect the one-year extension of the PTC until December 31, 2014, including the extension of the date of the Continuity Safe Harbor to January 1, 2017 (for more complete coverage of Notice 2015-24, see our March 12, 2015, Legal Update).

Until the issuance of the Notice, there was uncertainty as to whether the Prior Guidance would continue to apply with respect to the five-year extension. Of particular concern was how the IRS would roll forward the date of the Continuity Safe Harbor in light of the multi-year extension and the phase-out of the PTC.

The Notice

Completion Window – Continuity Safe Harbor. Previously, Notice 2013-29 had imposed a requirement that a project owner continuously advance the construction of the project from the time construction starts through the placed-in-service date. In reaction to industry comments, the IRS had created the Continuity Safe Harbor in Notice 2013-60 to deem continuous construction to have occurred if the project was placed in service before January 1, 2016. The Notice significantly expands the Continuity Safe Harbor to deem a project to meet the "continuity" requirement if the project is placed in service by December 31 of the year that includes the fourth anniversary of the date of the start of construction. The Notice provides the following example in which "construction begins on a facility on January 15, 2016, and the facility is placed in service by December 31, 2020, the facility will be considered to satisfy the Continuity Safe Harbor."

To head off gamesmanship with respect to the application of the four-year rule, the Notice provides that a project "may not rely upon the Physical Work Test and the Five Percent Safe Harbor in alternating calendar years." For example, a project owner that started physical work in 2016, and thus had until December 31, 2020, to place the project in service, may not in 2017 incur five percent of the cost of the project and take the position that it has until December 31, 2021, to place the project in service. Thus, taxpayers are advised to carefully select the year in which a project satisfies the Physical Work Test or Five Percent Safe Harbor, although the four-year window for satisfaction of the Continuity Safe Harbor may take some pressure off this selection.

Completion Window – Facts and Circumstances. In addition to the Continuity Safe Harbor, Notice 2013-29 provided that a taxpayer may satisfy the continuity requirement based on all the relevant facts and circumstances. Notice 2013-29 further provided a non-exclusive list of excusable disruptions in the taxpayer's construction of a facility that will not be considered as indicating that a taxpayer has failed to maintain a continuous program of construction. The Notice adds additional excusable disruptions to the list, including interconnection-related delays and delays in the manufacture of custom components. The Notice also expands some of the already-listed excusable disruptions including by broadening safety related delays to include all matters of safety, not just public safety, and by eliminating the limitation of no more than six months on financing delays. As with Notice 2013-29, the list of excusable disruptions provided by the Notice continues to be non-exclusive.

Physical Work Test. Under Notice 2013-29, the Physical Work Test requires "physical work of a significant nature." Notice 2014-46 clarified that this test focuses on the nature of the work performed, not the amount or cost. To illustrate activities that constitute "physical work of a significant nature," Notice 2014-46 provided a non-exclusive list of activities that included (i) the beginning of the excavation for the foundation, the setting of anchor bolts in the ground or the pouring of the concrete pads of the foundation, (ii) physical work on a custom-designed transformer that steps up the voltage of electricity produced at the facility to the voltage needed for transmission and (iii) roads that are integral to the facility.

The Notice confirms that the Physical Work Test is satisfied with the performance of work of a significant nature, irrespective of the amount or value of the work performed. To illustrate physical work of a significant nature, the Notice provides a non-exclusive list of qualifying activities that, with respect to wind facilities, includes only the beginning of the excavation for the foundation, the setting of anchor bolts in the ground or the pouring of the concrete pads of the foundation. Although the Notice does not reiterate the other examples included in Notice 2014-46, nothing in the Notice suggests that the IRS is abandoning its earlier guidance. On the contrary, the Notice expressly provides that the Prior Guidance continues to apply except as otherwise provided in the Notice.

Multiple Facilities as a Single Project. The Notice and the Prior Guidance apply the start-o--construction rules to a "project," whereas other IRS guidance had viewed each turbine as a separate unit of property for federal income tax purposes. The definition of a single project is critical because whatever facilities are within the scope of a single project have the same start-o--construction date for purposes of determining the level of tax credits to which the project is entitled. For example, for a project using the Physical Work Test, this principle means the work need only occur with respect to the project generally and not with respect to each turbine.

The single project principle also makes it feasible to have a project built in large phases and have all of the phases have a common start-of-construction date for purposes of determining the level of tax credit eligibility.1

While Notice 2013-29 had generally provided that whether multiple facilities will be treated as a single project will depend on the relevant facts and circumstances, it also identified eight non-exclusive factors that indicate that the multiple facilities are operated as part of a single project. Some of the factors did not apply to certain projects. For example, a "merchant" project would not have a common power purchase agreement, and an equity-financed project would not have a common construction loan. The Notice retains the language indicating that the single project determination will depend on the relevant facts and circumstances; however, it does not identify any specific relevant factors. Nevertheless, nothing in the Notice suggests that the IRS no longer considers the previously identified factors as indicating that multiple facilities are operated as part of a *single project* and, as previously noted, the Notice expressly provides that the Prior Guidance continues to apply. The omission of any specifically identified factors, however, could suggest that the emphasis is on how an individual project *operates*, as opposed to whether all eight identified factors are satisfied.

Disaggregation. The Notice also provides additional guidance with respect to the single project determination that was not addressed in the Prior Guidance.

First, the Notice clarifies that although multiple facilities may be treated as a *single project* for purposes of the Physical Work Test or the Five Percent Safe Harbor Test, the fact that some facilities may not satisfy the continuity requirement (and thus will not be eligible for the PTC) will not disqualify the other facilities that have satisfied that requirement from being eligible for the PTC. This is helpful guidance that resolves, in favor of the taxpayer, the considerable uncertainty as to whether the *single project* concept may be used, not only to qualify otherwise disqualified individual facilities within a single project, but to disqualify otherwise qualified individual facilities within a project as well.

Second, the Notice clarifies that the *single project* determination will be made in the year in which the last of the multiple facilities is placed in service. While this point was not entirely clear under the Prior Guidance, it is consistent with the Prior Guidance's focus on factors that have bearing on how a project will be operated once it is placed in service.

Retrofitted Facilities. A project must be originally placed in service (i.e., essentially be new) to be eligible for the PTC. The Notice clarifies that a facility may qualify as originally placed in service even if it contains some used property, as long as the fair market value of the used property is not more than 20 percent of the facility's total value (i.e., the cost of the new property plus the value of the used property). The application of the so-called 80/20 rule to a project claiming PTCs comes as no surprise, as the IRS in other guidance has indicated that the 80/20 rule would apply in such a situation (see Rev. Rul. 94-31). The Notice clarifies that, in the case of a single project comprised of multiple facilities, the 80/20 rule is applied to each individual facility comprising the single project, not to the project as a whole.

Footnotes

1.”Phases” is an industry term, rather than nomenclature used in the notices.

Mayer Brown

Article by Jeffrey G. Davis, David K. Burton, Anne S. Levin-Nussbaum and Isaac L. Maron

Last Updated: May 10 2016

Why House Panel Leaders Should Care About Munis.

WASHINGTON – Rep. Randy Hultgren, R-Ill., warned House subcommittee leaders considering tax reform proposals on Thursday that a cap or elimination of tax exemption for municipal bonds could raise the cost of infrastructure projects in their own districts.

Hultgren made the remarks during the House Ways and Means Committee’s tax policy subcommittee’s hearing for members of Congress to discuss proposals for tax reform.

He told subcommittee chairman Rep. Charles Boustany, R-La., that bonds issued last year by St. Martin Parish in his state to build new schools and improve existing ones would have had an additional $1.2 million in issuance costs had the tax exemption of the bonds been capped.

He told Rep. Richard Neal, D-Mass, the top Democrat on the subcommittee, that a recent issuance by Springfield, Mass. to fund 22 separate projects, including a school renovation project and heating ventilation and air conditioning work at its city hall, would have cost taxpayers an additional $7 million.

“While serving in local government in Illinois I saw firsthand the benefits provided by this reliable option of financing community development,” Hultgren said of municipal bonds. “Washington disagrees on how to strengthen our infrastructure but I believe decisions made by local communities

handling local products and projects tend to be more efficient than from one size fits all policy from Washington D.C."

Hultgren also cited a 2013 study that found if tax exemption is capped or eliminated that it will be more costly to issue debt. He also cited an example from his own state. The Red Gate Bridge that spans the Red Fox River in St. Charles would have cost the city an additional $617,000 in interest costs without the tax exemption, he said.

Hultgren and Rep. Dutch Ruppersberger, D-Md., in March launched a bipartisan Municipal Finance Caucus made up of House members that works to protect the tax-exempt status of municipal debt.

The two Congressmen also sent a letter to House leaders last year urging them to reject any cap on or elimination of the tax exemption for municipal bonds. That letter had more than 120 signatures.

Boustany said he would take the collective panel's remarks into consideration.

House Ways and Means Committee chairman Rep. Kevin Brady, R-Texas, said it has been "years" since the committee held a member day hearing on tax code reform, and called the hearing an "important step" in creating opportunities for legislators to put forth tax ideas. Testimony was limited to members of Congress who have either introduced or co-sponsored tax legislation.

Brady, who chairs both the committee and the House Task Force on Tax Reform, has previously said tax reform should lower tax rates for families and businesses as well as eliminate special-interest carve-outs.

"We are deliberately and thoughtfully considering improvements to the tax code that will grow our economy and make the tax code fairer and simpler," Brady said Thursday. "The fact that over 30 members are sharing their ideas today is a testament to our new process – and to our return after so many years to regular order."

House Republicans in February announced the formation of the committee-led task force on tax reform that is to consider recommending limits to deductions, credits and exclusions, and will consider tax-exempt bond interest along with other tax preferences.

The tax policy subcommittee held its first hearing on tax reform on March 22, where its members considered shifting from an income tax base to a consumption or cash-flow tax base.

Several tax reform plans would either limit or eliminate tax-exempt bond interest in order to help pay for lowering tax rates and broadening the tax base.

In his fiscal 2017 and previous budget requests, President Obama has proposed capping the value of tax-exempt interest at 28 percent.

Former House Ways and Means Committee chair Dave Camp, R-Mich., floated an earlier tax reform plan that would have capped the value of tax-exemption at 25% and eliminated the tax exemption for both new private-activity bonds and new advance refundings. Hultgren argues that the elimination or cap on tax exemption would increase public borrowing costs and hamper state and local governments' ability to invest in themselves.

Neal called for a bipartisan effort to pass tax reform legislative proposals sooner rather than later.

"If legislation is not controversial, opposed by the administration, and introduced in a bipartisan and fiscally responsible manner, the committee should work expeditiously to get it approved," Neal said.

The Bond Buyer

By Evan Fallor

May 12, 2016

Why Is an Indianapolis Authority Settling a Rebate Dispute with the IRS?

WASHINGTON – The Indianapolis Airport Authority said this week that it has agreed to settle a dispute with the Internal Revenue Service over rebate liability in connection with $347 million of tax-exempt bonds, even though it disagrees with the IRS' position on the bonds.

"Although the authority disagrees with and has opposed the field office's position, the authority and the Internal Revenue Service have agreed to a settlement of the dispute that will close the examination with no change to the tax exempt status of the bonds," authority officials wrote in an event notice posted on the Municipal Securities Rulemaking Board's EMMA website on May 6. The authority said in the notice that the settlement agreement is to be executed on May 20.

Robert Thomson, the senior finance director for Indianapolis Airport Authority, declined to comment on the details of the proposed settlement, saying it hasn't been reviewed yet by the authority's board.

But Thomson said the disagreement centered on the interpretation of the federal tax law related to "replacement proceeds." When certain material terms of bonds are changed, the bonds can be considered to be newly issued to replace the earlier bonds so that they become subject to the latest tax laws.

Thomson added that the IRS examination was a "normal review" rather than an audit. Thomson said the IRS opened its examination of the bonds in 2013.

In the event notice, the airport authority officials stressed that neither it nor the bond bank had received a Notice of Proposed Issue from the IRS as of May 6.

"There was a difference in interpretation of the law," Thomson said. "We've ultimately been working on this for three years. It's been a while — lots of meetings and lots of data, so we said, 'Let's come to a settlement. Let's not continue this investment of services and time.'" The IRS requires issuers to pay a rebate at least every five years and after the final maturity of the bonds. Failure to comply with federal rebate requirements can lead to the loss of tax-exempt status of the bonds.

The $347 million of tax-exempt Series 2006F were issued by the bond bank, which loaned the proceeds to the airport authority. The proceeds were to be used to purchase airport revenue bonds issued by the authority, pay for the cost of issuance of both the 2006F bonds and series 2006A Authority bonds, and pay for certain program expenses of the bond bank, according to the official statement for the bonds. The authority issued $42.8 million in Series 2006G taxable bonds at the same time.

The proceeds of the Series 2006A authority bonds were used to fund the airport authority's 2001-2010 capital improvement program for the airport system, including the development of a 1.2 million-square-foot midfield passenger terminal.

The Series 2006F and G bonds were underwritten by a syndicate led by City Securities, Inc. Ice Miller LLP and Coleman Graham & Stevenson, LLC served as co-bond counsel and First Albany Capital Inc. was financial advisor for the issue.

The bond bank is independent of the city of Indianapolis and the airport authority, according to the official statement for the 2006 bonds. Its purpose is to "buy and sell securities of 'qualified entities'" and is governed by a board of five directors appointed by the mayor of Indianapolis. The bond bank routinely serves as the conduit issuer for the airport's bond deals.

The airport authority, the owner and operator of Indianapolis International Airport, in March cancelled a proposed $500 million medical center and sports complex that would have been developed on the site of the airport's former terminal. The proposal, which was seen as too ambitious by the board, included several medical office buildings and a 20,000-seat sports stadium.

Indianapolis International Airport served nearly 8,000,000 passengers in 2015, according to the Federal Aviation Administration. It also serves as a hub for FedEx Express.

The Bond Buyer

By Evan Fallor

May 11, 2016

IRS ACT to Submit Recommendations at June Meeting.

WASHINGTON — The Internal Revenue Service's Advisory Committee on Tax Exempt and Government Entities (ACT) will hold a public meeting on June 8, 2016, when the panel will submit its annual report and recommendations to the IRS.

The ACT includes external stakeholders and representatives who deal with employee retirement plans; tax-exempt organizations; tax-exempt bonds; federal, state, local and Indian tribal governments. They advise the IRS on operational policy and procedural improvements.

At the public meeting, the ACT subcommittee members will present their report that includes recommendations on:

- **Employee Plans:** Analysis and Recommendations Regarding Changes to the Determination Letter Program
  Exempt Organizations: Stewards of the Public Trust: Long-Range Planning for the Future of the IRS and the Exempt Community
- **Federal, State and Local Governments:** Revised FSLG Trainings and Communicating with Small Local Governments
- **Indian Tribal Governments:** Survey of Tribes Regarding IRS Effectiveness with Current Topics of Concerns and Recommendations
- **Tax Exempt Bonds:** Recommendations for Continuous Improvement and Enhancing Resources in the Tax Exempt Bond Market

The ACT was established under the Federal Advisory Committee Act to provide an organized public forum for discussion of relevant issues affecting the tax exempt and government entities communities.

The ACT's public meeting will begin at 2:00 p.m. ET on June 8, 2016, at the IRS headquarters at 1111 Constitution Ave. NW, Washington, D.C. The 2016 ACT report will be available on IRS.gov on the day of the meeting.

Due to limited seating and security requirements, members of the public interested in attending the public meeting should call Nicole Swire at 202-317-8736 (not a toll-free call) or email tege.advisory.comm@irs.gov to confirm their attendance. Attendees must have photo identification and are encouraged to arrive at least 30 minutes before the session begins.

ACT Members Continuing on the Committee in 2016

Employee Plans

- Susan Bernstein, Schulte Roth & Zabel LLC, New York, New York
- Judith Boyette, Hanson Bridgett, San Francisco, California
- Christopher W. Shankle, Argent Trust Company, Shreveport, Louisiana
- Matthew I. Whitehorn, Dilworth Paxton LLP, Philadelphia, Pennsylvania

Exempt Organizations

- Natasha Cavanaugh, Bill & Melinda Gates Foundation, Seattle, Washington
- Cindy Lott, Columbia Law School, New York, New York
- Amy Coates Madsen, Standards for Excellence Institute, Baltimore, Maryland
- Andrew Watt, Association of Fundraising Professionals, Arlington, Virginia

Federal, State and Local Governments

- Dean J. Conder, State of Colorado, Denver, Colorado
- Vandee V. DeVore, State of Missouri, Jefferson City, Missouri

Indian Tribal Governments

- Tino Batt, Shoshone-Bannock Tribes, Fort Hall, Idaho
- Marcelino Gomez, private practice, Phoenix, Arizona

Tax Exempt Bonds

- David Danenfelzer, Texas State Affordable Housing Corporation, Austin, Texas
- William Johnson, First Southwest, Dallas, Texas
- Floyd Newton III, King & Spalding, Atlanta, Georgia

IR-2016-73, May 3, 2016

TAX - NEW YORK

Highbridge Broadway, LLC v. Assessor of City of Schenectady

Court of Appeals of New York - May 5, 2016 - N.E.3d - 2016 WL 2350154 - 2016 N.Y. Slip Op. 03544

Owner of commercial property in city brought proceeding alleging that property was overassessed in first year for which business investment property tax exemption had been granted, because the exemption had been undervalued.

The Supreme Court, Schenectady County, granted summary judgment to owner, and ordered city, city school district, and county to issue refunds for multiple years. Thereafter, the Supreme Court denied owner's motion to hold city school board in civil contempt for failing to pay refunds for multiple years. On cross-appeals, the Supreme Court, Appellate Division affirmed as modified. Owner appealed.

The Court of Appeals held that owner's single petition alleging that property was overassessed in first year and that exemption had been undervalued preserved right to obtain tax refunds in subsequent years for taxes paid based on the initial assessment.

TAX - ALASKA

City of Valdez v. State

Supreme Court of Alaska - April 29, 2016 - P.3d - 2016 WL 1719372

Municipalities challenged Department of Revenue regulation, under which all appeals of oil and gas property tax valuation were to be heard by State Assessment Review Board (SARB), while appeals of oil and gas property taxability were to be heard by Department, arguing that regulation contradicted statute that granted SARB exclusive jurisdiction over all appeals from Department's assessments of oil and gas property.

The Superior Court upheld regulation as valid. Municipalities appealed.

The Supreme Court of Alaska held that:

- Regulation was subject to substitution of judgment standard of review;
- Regulation was not entitled to deference afforded to longstanding and continuous interpretations of enabling statutes; and
- As a matter of first impression, regulation was invalid.

Department of Revenue regulation, under which all appeals of oil and gas property tax valuation were to be heard by State Assessment Review Board (SARB), while appeals of oil and gas property taxability were to be heard by Department, did not implicate Department's expertise or fundamental policies, and thus substitution of judgment standard of review applied in assessing validity to Department's interpretation of enabling statute establishing overarching regime for statewide assessment of oil and gas property in municipalities' challenge to regulation. Case involved both statutory interpretation of a non-technical statutory term, a task in which courts were well versed, and question of scope of and relationship between Department's and SARB's jurisdictions.

Department of Revenue regulation, under which all appeals of oil and gas property tax valuation were to be heard by State Assessment Review Board (SARB), while appeals of oil and gas property taxability were to be heard by Department, was not entitled to additional deference afforded to longstanding and continuous interpretations of enabling statutes in proceedings on municipalities' challenge to regulation as conflicting with statute establishing overarching regime for statewide assessment of oil and gas property. Application of regulation was not consistent.

Department of Revenue regulation, under which all appeals of oil and gas property tax valuation were to be heard by State Assessment Review Board (SARB), while appeals of oil and gas property taxability were to be heard by Department, was invalid, since regulation had no reasonable basis in enabling statute establishing overarching regime for statewide assessment of oil and gas property. Department's interpretation of statute through regulation was inconsistent with statute's text, which

indicated that assessment encompassed initial taxability determination, statute's legislative history, which indicated it was unlikely that legislature intended to create a bifurcated appeal process without expressly doing so, and statute's purpose.

TAX - FLORIDA

City of Fort Pierce v. Treasure Coast Marina, LC

District Court of Appeal of Florida, Fourth District - April 27, 2016 - So.3d - 2016 WL 1660600

After city was granted exemption from ad valorem taxes on two marinas it owned and operated, owner of private marina, which was not exempted, brought suit seeking declaratory and injunctive relief against application of the exemption to the city's marinas.

Both parties moved for summary judgment. The Circuit Court granted summary judgment to owner. City appealed.

The District Court of Appeal held that city's marinas served a municipal or public purpose and thus, city was entitled to an ad valorem tax exemption.

City's marinas served a "municipal or public purpose" and thus, city was entitled to an ad valorem tax exemption, even though they competed with other private marinas in the area. The marinas were open to public use, were exclusively owned and operated by the city, and were part of a larger recreational park complex, providing recreation for local residents and supporting the local economy by attracting non-local residents.

Colo. Court Case Puts Spotlight on Special Districts that Issue Munis.

WASHINGTON – A broad ruling by the Colorado Court of Appeals in a case of a developer's egregious fraud has sent lawyers to the state's General Assembly for legislation to protect existing special districts that issue tax-exempt bonds.

The case could have been the poster child for English Comedian John Oliver's recent television segment skewering special districts and is an example of everything the Treasury Department is concerned about with such districts. But lawyers in Colorado say it shouldn't be used to taint other special districts that have been properly set up and followed the law.

The case involves a high-profile developer, Zachary Davidson, who used sham contracts to make him and five associates organizers or "eligible electors" who formed a special metropolitan district in Greenwood Village, Colo. that issued almost $35 million of bonds now in default. Davidson included nearby condominium purchasers in the district and obligated them to pay taxes to help pay off the bonds, even though the condo owners were unaware they were in the district or that bonds had been issued.

Davidson stole millions of dollars of bond proceeds for his personal use and was eventually indicted on 20 felony counts by an Arapahoe County, Colo. grand jury. He eluded law enforcement for months and ultimately committed suicide by hanging himself from a tree in Withlacoochee State Forest in Florida at age 46.

After several years of litigation, the Colorado Court of Appeals issued a ruling on April 21 favoring the condo owners' Landmark Towers Association, Inc., ruling in part that Davidson used sham contracts to give him and his associates control of the special district and the bond issue.

Muni market participants in Colorado fear the case will be used to try to undo previously existing special districts and their taxing powers.

"This case has exceptionally unique and bad facts," said Dee Wisor, a lawyer with Butler Snow in Denver. The appeals court's ruling "was broadly written" and "not limited to the facts" of the case, he said.

"The risk here is that lawyers will go out and recruit taxpayers in special districts to invalidate elections that happened many years ago to avoid paying taxes," said Wisor. "We're trying to get the General Assembly to adopt legislation to validate other special district elections that have been previously held and which are not the subject of previous disputes," he said.

"It's common for the General Assembly to weigh in on legislative intent," said Mary Kay Hogan, director of government affairs for R&R Partners. Special districts are governed by state laws.

There's a lot at stake for special districts in Colorado, which were responsible for 240 general obligation bond deals totaling $2.9 billion in the six years from 2009 through 2014, according to the Special District Association of Colorado.

That group and the Colorado Municipal Bond Dealers Association, Inc. each filed friend-of-the-court briefs in the case, asking the appeals court to reverse certain findings of the district court. The two groups warned that the findings, if left standing, would hurt the muni bond market in Colorado.

Beyond Colorado

But the case may have national implications as well.

It comes as the Treasury and Internal Revenue Service have proposed controversial new rules for political subdivisions because of concerns that some special districts, or community development districts as they are called in Florida, are controlled by developers and their associates rather than taxpayers. Treasury and the IRS contend that developer-controlled districts should not be able to issue tax-exempt bonds.

Muni market participants argue that historically, many developers have set up special districts to issue bonds to pay for infrastructure improvements for projects such as retirement communities or business parks until homeowners or businesses can move in and begin to pay assessments or taxes to pay for the bonds.

For years, the test under the federal law for whether a district is a political subdivision that can issue tax-exempt bonds has been based on whether an entity has been delegated a substantial amount of at least one of three sovereign powers: eminent domain, taxation, and policing.

The Treasury and IRS are now proposing rules to expand that test to add two new requirements. Under rules they proposed February, a political subdivision that can issue tax-exempt bonds, would also have to serve a governmental purpose and be governmentally controlled "with no more than an incidental private benefit."

The proposed rules have met with a firestorm of criticism from muni lawyers who have warned they would threaten existing special districts and potentially millions of dollars of bonds.

But this case epitomizes the concerns of Treasury and the IRS. Davidson, through 7677 East Berry Avenue Associates, L.P. where he was managing partner, built two high-rise residential condominium towers in Greenwood, Colo., called Landmark and Meridian, from 2005 through 2007, according to court documents.

He did not create a special district for the project and instead entered into agreements with Greenwood Village in 2005 to build the towers and to receive a rebate of 50% of city sales taxes collected by commercial activities conducted on the project site for 20 years. Sales and use taxes on the building and construction materials as well as building permit fees were waived.

The towers were to be completed in 2007 and 2008. By the end of 2006, Davidson's company had 130 buyers for the condos under contract. The buyers paid $35,000 to $100,000 in nonrefundable deposits and agreed to pay pro-rated taxes for the year at closing, according to court documents.

That same year, Davidson, through Everest Marin, L.P., where he was also managing partner, bought 11.1 acres adjacent to the towers to develop a residential community to be called European Village that was to include manor homes, brownstones and infrastructure.

Davidson decided to create a special district, called the Marin Metropolitan District, to issue up to $35 million of general obligation bonds to finance the project. But he found the village property would not provide a sufficient tax base to support the GO bonds. So, acting on behalf of both his 7677 East Berry and Everest companies, Davidson decided to include the Landmark and Meridian Towers in the special district, without telling the condo buyers, documents show.

Contracts

Davidson entered into option contracts with five associates to qualify them and him as "eligible electors" who then elected to form the district and issue the bonds. The option contracts were for the purchase of an undivided 1/20th interest in a 10 foot by 10 foot parcel. These six individuals were the only ones who received notices of elections and votes and the only ones who voted on anything.

The six "electors" of the district submitted a service plan to Greenwood Village stating the district would provide public infrastructure improvements to all property within the district and would finance them with bond proceeds.

The Marin Metropolitan District hired Piper Jaffray to assist it in issuing the bonds. In June 2008, nearly $30.49 million of district GO bonds were underwritten by Piper Jaffary and sold to Colorado Bondshares, a tax-exempt mutual fund. The bonds had an interest rate of 7.75% and a maturity of 20 years, according to bond documents. UMB Bank, N.A. was trustee. About $13 million of the bonds were redeemed after that. The bonds went into default last year, according to bond documents. Davidson, who as a managing partner of Everest and an "elector" of the district had unsupervised access to the bond funds, was hurting for cash. He withdrew about $8 million of the bond proceeds, using much of it for his personal benefit.

The Landmark condo owners would never receive any benefits from the use of those bond proceeds and yet all of a sudden, they were on the hook for paying back the bonds.

In 2011, the Landmark Towers Association began to uncover the fraud and filed a complaint in a Colorado district court against the Marin Metropolitan District, Colorado Bondshares and UMB Bank to enjoin them from the future levying of taxes under the state's Taxpayers Bill of Rights (TABOR).

Landmark claimed the bond and tax election was illegally conducted because the option contracts of

the district's organizations were a sham and Landmark buyers had not been allowed to participate. It claimed the district had improperly disbursed bond funds for the benefit of Davidson. It also charged the district had set the property tax levy for debt service higher than allowed by law. Landmark said taxing the condo owners violated their constitutional right to due process because the bond-financed improvements would not benefit them.

The district court ruled in favor of Landmark on most of its claims and ordered the Marin district to refund to the condo owners the portion of the misused bond proceeds they had paid. The court also ordered the district to refund some of the property taxes collected and enjoined it from imposing further taxes on the condo owners.

But the court ruled that, even though district's organizers never made down payments for "director's parcels" or paid any taxes on the land, the option contracts were not a sham and were a legitimate way to create "eligible electors" of the district.

The defendants, including Colorado Bondshares, appealed the ruling, arguing in part that Landmark's challenge was untimely and that neither the taxes levied nor the misuse of bond funds violated TABOR. Landmark cross appealed disputing the court's findings that its challenge to the bond and tax election was time-barred. It also challenged the court's alternative determination that the election complied with TABOR and applicable statutes.

The appeals court affirmed parts of the district court's ruling, reversed other parts, and remanded the case back to the lower court.

Particularly important was that the appeals court disagreed with the district court's conclusion that the contracts were sufficient to make the organizers of the district eligible electors. It concluded instead that the organizers' contracts were sham agreements because of seven factors, including that none of the organizers (electors) made down payments or paid taxes, and that the parcel of land was too small to have any beneficial use.

"The purpose of requiring a district to gain approval from persons who own property within a district before it imposes a new tax is to allow the people who will have to pay the tax to decide whether the tax should be levied," the appeals court judges said in their ruling.

Wisor and other lawyers say they are trying to get the Colorado General Assembly to pass legislation before the session ends on May 11 validating existing special districts that have followed the law.

The Bond Buyer

By Lynn Hume

April 29, 2016

Bill Would Expand Indian Tribes' Ability to Issue Tax-Exempt Bonds.

WASHINGTON – A bipartisan bill introduced in the House would expand the ways in which Indian tribes can issue tax-exempt bonds and place them more on par with state and local governments under the federal tax law.

The Tribal Tax and Investment Reform Act of 2016 (H.R. 4943), introduced by Rep. Ron Kind, D-Wis.

on April 14, would amend the federal tax code to remove special status for Indian tribal governments and instead establish a volume cap for their tax-exempt bonds similar to those for state governments.

Kind is a member of the House Ways and Means Committee, which writes tax laws. His bill is co-sponsored by Lynn Jenkins, D-Kan., who is also a member of that committee.

Tribes currently can issue governmental bonds only if the proceeds are used for an "essential government function" such as for projects involving schools, streets or sewers. They cannot issue bonds for activities for which state and local governments issue private activity bonds.

Congress removed the essential government function limitation for tribal government bonds in 2009 and 2010 under the American Recovery and Reinvestment Act. President Obama, in his budget requests in recent years, has proposed repealing the "essential governmental function" standards for tribal governments.

Under the bill, the Treasury Department would create a national bond volume cap for tribal governments based on a tribe's national population, similar to the population formula it uses for states.

Kind said that Indian tribes face "historic disadvantages" in accessing capital and that "codifying tax parity with respect to tribal governments is consistent with federal treaties recognizing the sovereignty of tribal governments."

The bill says that Indian tribes are also currently excluded from certain federal tax code provisions, which "results in unfair tax treatment for tribal citizens or unequal enforcement authority for tribal enforcement agencies."

"It is long past time that changes are made to give tribes fair treatment in the tax code and access to a full range of financing options," Kind said on Monday. "Tax exempt bonds are a critical tool for raising capital and I am pleased to have bipartisan support for this legislation. I will continue to work with my colleagues across the aisle to move this important legislation forward."

The bill has been referred to the House Ways and Means committee and House Education and the Workforce committee.

Kind introduced a similar bill last Congress, which was not acted upon.

The bill would also allow Indian tribal governments to offer pension plans to their employees and to have access to the Federal Parent Locator Service run by the Department of Health & Human Services.

Indian tribes have long called for repeal of limitations on the tax-exempt bonds they can issue, which they have contended puts them at a competitive disadvantage to state and local governments.

Perry Israel, a lawyer with his own firm in Sacramento, said Monday it would "be good" to eliminate special status and put an end to an issue he remembers as lasting more than three decades. Confusion over essential government functions, he said, also gave rise to Tribal Economic Development Bonds, the 2009-2010 bonds issued under the ARRA, which were not required to be issued for "essential governmental functions."

"I think it's about time we stopped having special rules for Indian tribes," Israel said. "There is this big question – what is an essential government function? We ought to go and treat tribes the same as

we treat other states."

The Bond Buyer

By Evan Fallor

April 25, 2016

Hawkins Advisory: Internal Revenue Service Revenue Procedure 2016-25 Regarding Mortgage Revenue Bonds and Mortgage Credit Certificates.

Read the Advisory.

IRS PLR: LLC's Restructuring Will Not Result in Gulf Opportunity Zone Depreciation Recapture.

The IRS ruled that restructuring transactions undertaken by two limited liability companies owned by the same individual will not result in the recapture of any Gulf Opportunity Zone bonus depreciation under section 1400N(d)(5) in connection with property transferred between the two companies.

Read the Letter.

Enhancing Tax Abatement Transparency.

As a follow-on to last week's blog post describing 3 steps economic developers should take to prepare for GASB 77 tax abatement disclosures, I want to share a set of recommendations from the Government Finance Officers Association (GFOA) that complement our suggestions for economic development groups.

GFOA is concerned, as we are, that the tax abatement disclosure guidelines will not provide complete information to citizens and other users of government financial reports because they do not include "the justification and expected long-term benefits of tax abatements."

GFOA offers several helpful recommendations on how and where to provide this information. The full, two-page best practice statement from GFOA on Enhancing Tax Abatement Transparency is available here. To summarize the recommendations:

The government should disclose additional tax abatement information in its letter of transmittal

The letter of transmittal accompanies the comprehensive annual financial report (CAFR), which includes the financial note providing the tax abatement disclosure. GFOA suggests that this letter include:

- a reference to other documents where a complete cost/benefit analysis can be found
- an explanation of how tax abatements are accounted for and incorporated into the budget
- a description of policies governing tax abatements, including what the government is hoping to achieve and methods used to determine the return on investment (ROI)
- an identification of those responsible for monitoring compliance with abatement agreements
- an explanation of the relationship between tax abatements and the government's goals as set forth in its strategic plan
- a five-year chart of benefits anticipated and received

The tax abatement information in the letter of transmittal should be simple, straightforward and material

The information should not be duplicative or provide unnecessary detail. Using charts and graphs to supplement written material can be helpful. GFOA also suggests aggregating information by government and tax abatement program, consistent with the GASB guidelines.

Finance staff should communicate with economic development partners

As we said last week, complying with GASB 77 will require cooperation between the economic development organization and the government's finance staff because, in many cases, neither will have all the information necessary to determine the financial disclosure. GFOA is also concerned with ensuring the proper flow of information to comply with disclosure guidelines.

Build relationships and establish a timeline

GASB 77 requires disclosure of tax abatements entered into by other governments that reduce the reporting entity's tax revenues. GFOA recommends establishing relationships with these other governments and creating a timeline for sharing information to prevent reporting delays.

As a reminder, the Governmental Accounting Standards Board (GASB) last year approved Statement No. 77, Tax Abatement Disclosures, which establishes guidance requiring state and local governments to disclose certain information about tax abatement agreements for periods beginning after December 15, 2015.

Check out our previous blog posts on this topic for economic developers:

- 3 steps economic developers should take to prepare for GASB 77 tax abatement disclosures
- What will tax abatement disclosures mean for economic development groups?
- Smart Incentives comments on tax abatement disclosure guidelines

Smart Incentives

Posted by Ellen Harpel | April 26, 2016

TAX - OHIO

Christian Voice of Cent. Ohio v. Testa

Supreme Court of Ohio - April 14, 2016 - N.E.3d - 2016 WL 1459544 - 2016 -Ohio- 1527

Nonprofit corporation that operated radio station broadcasting religious programming sought review of the tax commissioner's denial of a real-property tax exemption for houses used exclusively

for public worship.

The Board of Tax Appeals affirmed. Corporation appealed.

The Supreme Court of Ohio held that corporation's property was exempt under the public-worship exemption.

Nonprofit corporation's appeal of denial of the public-worship property tax exemption for its property that was used to operate a Christian radio station presented a question of law, and Supreme Court's review was not deferential but de novo, where the parties' dispute concerned not the underlying facts but whether those undisputed facts indicated that the property and attendant lands were a house used exclusively for public worship and thus entitled to the exemption.

Primary use of nonprofit corporation's property, including a radio station that broadcast religious programming, was for public worship, and therefore the property qualified for exemption for houses used exclusively for public worship, where corporation conducted religious activities through its broadcasts and on its premises, the majority of broadcasts were devoted to contemporary Christian music, corporation employed a full-time minister who led a weekly Bible study and gathered on a regular basis with other staff members in the on-site chapel to pray for intentions submitted by listeners, and corporation was active in community performing charitable acts.

Statute defining a church for purposes of real-property tax exemption does not require a congregation or worship activity; instead, its concern is whether the organization has a primarily religious purpose and is not for profit.

TAX - INDIANA

Angel v. Vanderburgh County Treasurer

Court of Appeals of Indiana - April 15, 2016 - N.E.3d - 2016 WL 1535783

Tax sale purchaser petitioned for tax deed. After granting purchaser's petition, the Superior Court, granted property owner's motion for relief, ordered tax deed rescinded, and denied purchaser's motion to establish a redemption amount. Purchaser appealed.

The Court of Appeals held that:

- Tax sale purchaser could recover from the owner of the real property, or any other person primarily liable for the payment of taxes and special assessments on the property, an amount which included the amount of purchaser's lien, together with interest, and
- Three-year limitation period for a tax sale purchaser to claim tax sale surplus funds upon redemption of a tract of real property did not apply to property that was not redeemed.

NABL: IRS Issues Final Regs on Determining AFRs for Tax-Exempt Bonds.

The Internal Revenue Service (IRS) published today in the Federal Register final regulations that provide the method to be used to adjust the applicable Federal rates (AFRs) to determine the corresponding rates under section 1288 of the Internal Revenue Code (Code) for tax-exempt obligations (adjusted AFRs) and the method to be used to determine the long-term tax-exempt rate and the adjusted Federal long-term rate under section 382. For tax-exempt obligations, the

regulations affect the determination of original issue discount under section 1273 and of total unstated interest under section 483. The IRS final regs, which are effective today, April 26, 2016, adopt proposed regs (REG-136018-13) issued in March 2015 without substantive change.

The final regulations are available here.

NABL: Bill Would Expand Bond Issuance for Indian Tribes.

Rep. Ron Kind (D-WI) introduced the Tribal Tax and Investment Reform Act of 2016 (H.R. 4943), which would, among other things, establish a tax-exempt bond volume cap for Indian tribal governments, similar to the volume caps for state governments. The tax-exempt bond volume cap would be based on the total national tribal population and allocated to individual tribes by the Secretary of the Treasury. H.R. 4943 would also repeal the essential government function requirement. H.R. 4943 has been referred to both the House Ways and Means Committee and the House Education and the Workforce Committee.

H.R. 4943 is available here.

TAX INCREMENT FINANCING - IOWA

Concerned Citizens of Southeast Polk School Dist. v. City of Pleasant Hill, Iowa

Supreme Court of Iowa - April 22, 2016 - N.W.2d - 2016 WL 1612935

Citizens filed petition for writ of certiorari and for a declaratory judgment and an injunction to prevent annexation near high school and amended urban renewal plan from taking effect. City filed motion for summary judgment, and school district intervened.

The District Court granted summary judgment in part. Citizens and school district appealed, and the Court of Appeals affirmed. The Supreme Court granted further review.

The Supreme Court of Iowa held that:

- City lacked authority to extend renewal area and tax increment financing (TIF) arrangement after consolidation of urban renewal areas;
- City could not use TIF revenue from original urban renewal area to fund street improvements and construction and other aspects of economic development outside the boundaries of the urban renewal area; and
- Amended urban renewal plan was not inconsistent with city's comprehensive plan.

City, which had consolidated urban renewal areas in order to use tax increment financing (TIF) from original renewal area across a greater area, lacked authority to extend renewal area and TIF arrangement in light of statute limiting a TIF division based upon an economic development determination to 20 years. While original urban renewal area pre-dated statute and thus was grandfathered, that original urban renewal area no longer existed due to consolidation and thus grandfathered right was lost.

City could not use tax improvement financing (TIF) revenue from original urban renewal area to

fund street improvements and construction and other aspects of economic development outside the boundaries of the urban renewal area. While city could consolidate urban renewal areas and then use TIF revenue from one former area in another former area, city could not then extend former area, which no longer existed, while simultaneously treating that former area as integrated within the consolidated area.

Amended urban renewal plan, which contemplated street improvements and construction, conformed to city's comprehensive plan, which had designated area as commercial. Although city was working toward development of industrial warehouse on land, warehouse was not part of urban renewal plan, and street improvements were not themselves inconsistent with the general plan, which simply did not mention some of the improvements when describing goals for road development.

Revenue Procedure 2016-25: Qualified Mortgage Bonds

On April 15, the Internal Revenue Service released Revenue Procedure 2016-25, which provides issuers of qualified mortgage bonds and issuers of mortgage credit certificates with (1) nationwide average purchase prices for residences located in the United States, and (2) average area purchase price safe harbors for residences located in statistical areas in each state, the District of Columbia, Puerto Rico, the Northern Mariana Islands, American Samoa, the Virgin Islands, and Guam.

Revenue Procedure 2016-25 is available here, and will appear in IRB 2016-18 dated May 2, 2016.

NABL: Bill Would Remove PAB Caps on Water Infrastructure.

On April 20, Sen. Ben Cardin (D-MD) introduced the True LEADership Act (S. 2821), which would provide $70 billion over the next ten years for water infrastructure and lead relief programs. Among other provisions, S.2821 would remove the cap on private-activity bonds for water and wastewater projects, and increase funding to the Environmental Protection Agency's clean water state revolving fund programs. S.2821 has been referred to the Senate Finance Committee.

A press release from Sen. Ben Cardin and a copy of the S.2821 are available here.

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3 Steps Economic Developers Should Take to Prepare for GASB 77 Tax Abatement Disclosures.

State and local governments will soon begin disclosing financial information about tax abatements in their annual financial reports. As a reminder, the Governmental Accounting Standards Board (GASB) last year approved Statement No. 77, Tax Abatement Disclosures, which establishes guidance requiring state and local governments to disclose certain information about tax abatement agreements for periods beginning after December 15, 2015.

Economic development organizations should consider taking these three steps now to help their communities comply with disclosure rules.

1. Determine which tax incentives meet the criteria for disclosure

This rule applies only to tax abatements – it does not include all tax breaks, nor does it include other types of incentives. It is not limited to business attraction tax abatements. GASB Statement 77 defines a tax abatement as:

> A reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forego tax revenues to which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments.

It is critical to note that "a transaction's substance, not its form or title" determines whether the transaction meets the definition. In other words, it doesn't matter what it's called or the form it takes: if it fits the criteria, it needs to be disclosed.

However, data may be aggregated by program. Individual transactions may be, but do not need to be, disclosed.

2. Reach out to your government's finance staff to begin sharing information

Complying with GASB 77 will likely require cooperation between the economic development organization and the government's finance staff because, in many cases, neither will have all the information necessary to determine the financial disclosure.

The Government Finance Officers Association has similarly recommended that, "finance staff initiate communication and develop/maintain relationships with its entity's economic development partners and/or budgetary officials charged with initiating, developing and affirming tax abatement to ensure the proper flow of information."

3. Consider how to supplement the limited information that will be provided in the financial disclosures

The disclosure rules focus on the costs, but not the expected benefits, of tax abatements. Accordingly, it will become important for economic developers to use other outlets to provide context and detail on the reasons for the tax abatement agreements and the anticipated outcomes. At a minimum, economic development organizations should prepare to respond to questions post-disclosure about how and why incentives were used. A better strategy would be to develop additional reports or material to be reviewed alongside the financial disclosures to convey how those funds are designed to achieve the community's economic development goals.

I've written previously on the specifics of the standard, including what needs to be disclosed and what does not, so I won't repeat that here, but you can follow this link to the blog post or this link to the GASB standard itself.

Smart Incentives

Posted by Ellen Harpel | April 19, 2016

Income Tax Reform Bills Could Drive Up Muni Borrowing Costs.

WASHINGTON – Two House Republicans presented a committee with their legislative proposals to reform or abolish the federal income tax system, sparking concerns from some members of the municipal bond community.

Speaking before the House Ways and Means Tax Policy Subcommittee Wednesday, Reps. Roger Williams, R-Tex., and Bob Goodlatte, R-Va., said their bills would lead to a fairer, flatter and simpler federal income tax system.

The hearing on Wednesday was the tax policy subcommittee's second on fundamental tax reform proposals, and this week's specifically focused on legislation targeting the income tax.

Williams talked about the Jumpstart America Act, a collection of seven tax reform bills introduced last June and July. That package includes the Individual Rate Implication Act (H.R. 2842); Incentivize Corporate America Act (H.R. 2946); Invest in America Act (H.R. 3017); Bring Jobs Back to America Act (H.R. 3083); Fixed Asset Relief Act (H.R. 3213); and Paycheck Relief Act (H.R. 3267) as well as H. Con. Res. 69, which would keep the last-in, first-out method of accounting for inventories.

Williams' collective plan would lower the corporate tax rate to 20%, which he said would increase investment in infrastructure and make businesses more competitive on an international scale. It also would lower individual tax brackets to 20% and 30% and would cut payroll taxes by 2%.

The capital gains and dividends tax would be reduced to between 0% or a maximum of 15%, and the bill would allow for 100% depreciation of fixed assets. The inheritance tax would also be eliminated. Williams said his plan would provide relief for small businesses.

But Frank Shafroth, the director of the Center for State and Local Government Leadership at George Mason University, said that Williams' plan would radically increase the federal debt and deficit, which state and local governments cannot afford.

"Because of the singularly reduced rates, it would reduce incentives for Americans to purchase state and local bonds," Shafroth said. "It would perhaps better be named as the Mandatory Increase in the Cost of Education, Safe Drinking Water, & Transportation Act – as it would singularly increase the cost of the state and local public finance which provides the nation's critical infrastructure."

Goodlatte this year introduced the Tax Code Termination Act (H.R. 27), which would repeal the current tax code at the end of 2019. It would also require Congress to adopt a new tax system by July 2019. That plan, which uses the motto "sunset the tax code," would abolish all of the current code minus payroll taxes. It currently has 129 co-sponsors, and was referred to the House Rules committee in January.

The Virginia Congressman said he hoped setting such a deadline would move tax reform to the "front burner."

"While the bill does not advocate for one tax system over another, it does outline a framework for Congress to consider," Goodlatte said.

Shafroth said Goodlatte was simply seeking a state and local tax increase.

"There is something terrifically taxing to the nation's state and local leaders….to say one is going to

eliminate the current code and make up some new code in the fuzzy future," he said. "That could only foist higher interest rates on municipal bonds issued by state and local governments – thereby forcing higher state and local taxes and higher rates on utilities."

In an opening statement Wednesday, tax policy subcommittee chairman Rep. Charles Boustany, R-La., said Goodlatte and Williams' proposed legislation make the current tax code "more conducive to economic growth."

Boustany called the current tax code "complex, unfair and outdated," while tax policy subcommittee ranking member Rep. Richard Neal, D-Mass., said a new code that "promotes job growth, lifts wages for all workers, and grows the middle class," needs to be developed. Developing a consensus plan will be unlikely, he added.

"If you really want tax reform, you're going to have to swallow some things you don't like," Neal said.

While tax reform is not likely in an election year, most involved in this week's hearing agreed that the current system is in need of improvement, and that time is of the essence.

"Ultimately, the Ways and Means Committee must weave the most pro-growth concepts and ideas into a bold plan that fundamentally and comprehensively reforms our tax system," Boustany said.

"We've been talking about it [tax reform] and now we need to get it done," added Rep. Jim Renacci, R-Ohio.

Thomas Barthold, the chief of staff of the Joint Committee on Taxation, also spoke Wednesday about the Tax Reform Act of 2014 (H.R. 1), the legislation introduced by former Ways and Means Committee chairman Dave Camp, R-Mich., in December of that year. The Camp bill proposed broadening the income tax base while lowering statutory tax rates, and Barthold used it as an illustration a roughly revenue neutral plan that would increase the cost of capital.

Camp's bill proposed capping the value of the exemption for munis at 25% and eliminating the tax exemption for qualified private-activity bonds and advance refunding bonds issued after 2014. It also would repeal the corporate and individual alternative minimum taxes.

Conversely, should Congress pursue a tax plan that reduces the cost of capital through expensing, Barthold said business tax receipts would be dramatically lowered.

"We'd probably run a larger deficit then," Barthold said. "That can drive up interest rates and real interest costs – which are a negative to cost calculation."

Several muni experts and a Treasury official told The Bond Buyer in 2014 that they had concerns with Camp's plan, specifically in regards to its curbing of the muni exemption to pay for other aspects of tax reform.

The tax policy subcommittee held its first hearing on tax reform on March 22. That hearing, which focused on shifting from an income tax base to a consumption or cash-flow tax base, included testimony from Reps. Devin Nunes, R-Calif.; Michael C. Burgess, R-Tex.; and Robert Woodall, R-Ga.

The committee has increased efforts to promote tax reform ahead of this year's income tax return filing deadline, which is April 18.

Rep. Kevin Brady, R-Tex., the chairman of the House Ways and Means Committee, is also leading a

committee-led task force on tax reform that aims to limit the deductions, exclusions and credits in the current code.

The Bond Buyer

By Evan Fallor

April 15, 2016

TAX - KENTUCKY

Sewell-Scheuermann for Use and Benefit of City of Audobon Park v. Scalise

Court of Appeals of Kentucky - April 15, 2016 - S.W.3d - 2016 WL 1534636

Taxpayer filed action against city's mayor and members of city council, alleging that city council diverted a portion of tax revenue generated from a sanitation tax and placed such funds in city's general fund in violation of state constitution and statutes.

City defendants filed motion to dismiss. The Circuit Court granted the motion.

The Court of Appeals held that, despite fact that diverted funds were used for the benefit of the city, allegations stated claim under private-right-of-action statute.

Allegations by taxpayer that city of the home rule class diverted a portion of tax revenue generated from sanitation tax and placed such funds in city's general fund stated claim against city's mayor and members of city council under statute providing private right of action when tax revenue was expended for purpose other than that for which the tax was imposed, despite fact that diverted funds were used for the benefit of the city. Statutes served as a check for the very conduct that appeared to have occurred, and while city may not have been damaged in the traditional sense, it was apparent that the statutes were violated.

D.C. And IRS In Muni Bond Tax Dispute Tied To Oyster School P3.

WASHINGTON – The Internal Revenue Service is preliminarily challenging the tax-exempt status of bonds issued by the District of Columbia as part of a much lauded public-private partnership to build a new elementary school.

The district, which issued $11 million of bonds in late 1999 for the James F. Oyster Elementary School P3, disclosed the IRS stance in a material event notice recently posted on the Municipal Securities Rulemaking Board's website.

The district said it had received a Notice of Proposed Issue (Form 5701-TEB) from an IRS examiner in February regarding $8.73 million of the bonds that are still outstanding. The IRS sends NOPIs to issuers when it believes tax laws have been violated. A NOPI contains the issues, facts, law and TEB examiner's preliminary position that the bonds are not tax-exempt.

The district said in the event notice that it "is currently discussing its options with respect to the notice and its counsel."

Mark Scott, former head of the IRS TEB office who now has a private practice focused on representing whistleblowers, recently tweeted that the Oyster School P3 "is a tax scam … that cost district residents millions in tax dollars."

He called the transaction a "PPP disaster" and asked whether this is the kind of project Mayor Muriel Bowser's new P3 office wants to support. Bowser launched an Office of Public-Private Partnerships in November of last year "to build collaborations between private sector businesses and [the district government] to support large-scale projects such as infrastructure development and enhancements."

The office is headed up by Seth Miller Gabriel who wrote in an Internet post last October that he'd been taking government officials on tours of P3 projects, including the Oyster school. "Could a PILOT structure, similar to the one used to save the Oyster School, also be the answer to the DC General Hospital-shelter (or temporary housing around the country)?" Gabriel asked in the post.

Scott, who is looking into the Oyster P3 for a client under the whistleblower program, claims the bonds are actually taxable private-activity bonds because the district made an indirect private loan to the developer, LCOR New Oyster School LLC (LCOR).

Asked about the dispute with the IRS and Scott's statements, the District sent the following email to The Bond Buyer on Wednesday: "The District confirms that it has responded to an IRS inquiry regarding bonds issued in connection with the construction of the District's James F. Oyster Elementary School. The developer received no proceeds from the bond sale. One hundred percent of the bond proceeds were used to build a new public school and the developer has no right to use any school property. All property tax-related payments made by the developer to the District are dedicated to pay debt service on the bonds that funded the school's construction."

The email continued: "The District is confident that the bonds comply with federal tax law. The District has responded to the IRS preliminary findings."

According to descriptions of the Oyster school P3 in the official statement for the bonds and documents from district officials and staff, some of which were obtained by Scott through Freedom of Information Act requests, the district issued roughly $11 million in revenue bonds. The proceeds were used by the developer to finance the demolishment of an old school and the design and construction of a new Oyster Elementary School within two years.

The 32-year bonds are to be entirely repaid by payments-in-lieu of taxes to be made by the developer.

The school was built on .79 of an acre, owned by the district. But the district transferred to the developer .88 of an acre next to the school on which the developer constructed a 210-unit luxury apartment complex with an estimated value, at the time of the OS, of $23 million. The district would have no financial interest in the apartment project.

But the developer was exempted from paying property taxes on the property for the apartment complex in return for making PILOTS to the district for debt service.

At the time of the bond offering, the district estimated the value of the land for the apartment building to be between $3.2 million and $3.76 million and estimated that $6.6 million of property taxes would be abated, after taking into account the cost of capital for the revenue bond financing, assuming a 6% yield on the bonds.

The yields on each of two sets of term bonds maturing in 2015 and 2021 was 6.65% and 6 3/8%,

respectively, according to the OS.

Scott contends that what really happened in the transaction was that the district made an indirect loan to the developer of between $3.2 million and $3.76 million and then allowed the developer to pay for it with PILOTS, based on a tax-exempt rate.

The district contends that the bonds proceeds were allocated to financing the school project. But Scott says the transaction is abusive and that the IRS commissioner should reallocate the $3.2 million to $3.76 million of bond proceeds as a loan to the developer.

Under federal tax laws, bonds are PABs if more than the lesser of 5% or $5 million of the bond proceeds are used directly or indirectly to make or finance loans to private parties. If a PAB-financed project doesn't fall within a specified category, the bonds are not "qualified" and therefore not tax-exempt.

In this case, 5% of the $11 million of bond proceeds would be $550,000 and that amount would be less than $5 million for purposes of the private-loan test. Scott says $3.2 million to $3.76 million of the bond proceeds that should be allocated as a loan to the developer is roughly one third of the bond issue and substantially in excess of the private-loan 5% limitation.

Scott claims the bonds are PABs and taxable since they meet the private loan test for PABS and do not fall within a "qualified" category of projects that can be financed with tax-exempts.

Gabriel said he was not aware of the dispute. Ed Oswald, a partner with Orrick, Herrington, & Sutcliffe who is representing the district in the dispute with the IRS, could not be reached for comment.

The Bond Buyer

By Lynn Hume

April 20, 2016

IRS Webinar: TE/GE Worker Classification.

Watch this free webcast about TE/GE Worker Classification: Employee or Independent Contractor?

When: May 12, 2016; 2 p.m. (Eastern)

How: Register for this event. You will use the same link to attend the event.

Learn about:

- Why this matters
- How to recognize Control Factors
- Benefits of Voluntary Compliance
- How the Form SS-8 can help

SPECIAL ASSESSMENTS - MINNESOTA

Rehbein v. City of Lino Lakes

Court of Appeals of Minnesota - March 28, 2016 - Not Reported in N.W.2d - 2016 WL 1175055

Taxpayer appealed special assessment with regard to six of his properties to the District Court. Following a bench trial, the District Court concluded that each subject property received a greater special benefit than the amount assessed against them. Taxpayer appealed.

The Court of Appeals held that:

- City was authorized to finance highway interchange project with a special assessment, and
- Evidence was sufficient to support a finding that highway interchange project conferred a special benefit on taxpayer's real property parcels, as required to allow city to issue a special assessment against taxpayer.

Highway interchange project qualified as an improvement to a street, and thus, city was authorized to finance project with a special assessment; the main east/west street that stretched across city was a street, and it did not cease to be a street where it crossed interstate highway at interchange.

Evidence was sufficient to support a finding that highway interchange project conferred a special benefit on taxpayer's real property parcels, as required to allow city to issue a special assessment against taxpayer. City presented testimony that while the interchange would benefit the public at large, it conferred a special benefit on taxpayer because he was pursuing development of one parcel that would have been stalled until the failing interchange could be reconstructed, which the state Department of Transportation did not have plans for for another nine years.

Squire Patton Boggs: Tax-Exempt Stadium Financing? - There They Go Again.

Rep. Steve Russell, R-Okla., recently introduced a bill (H.R. 4838) in the House to prohibit tax-exempt financing of professional sports stadiums and for-profit entertainment facilities. This is only the most recent in a string of similar proposals, including by President Obama and former Senator Tom Coburn. In this case, tax-exempt financing would be prohibited for any "stadium or arena for professional sports exhibitions, games, or training" and for any "venue for any entertainment event (i) the live audience for which exceeds 100 individuals, and (ii) any net earnings from which inure to the benefit of an individual or any entity other than [the United States or any State or local governmental entity or certain tax-exempt organizations, including but not limited to 501(c)(3) organizations]," in each case if the facility is used for such purpose at least five days during any calendar year. (This post won't address the over-breadth of "entertainment facilities" included in this prohibition other than to note that, for example, many if not most public and private college arenas, theaters, etc. would be precluded from tax-exempt financing as a result of hosting performances, lectures, concerts, etc. provided by groups or individuals who are paid for their services.) The question considered in this post is not so much the propriety of permitting tax-advantaged financing of these sports and entertainment facilities but whether it is good policy to create targeted rules for certain facilities that may currently be out of favor rather than to rely on the fundamental principles of industrial development bond/private activity bond status that have limited the availability of tax-exempt financing for facilities with private involvement for almost 50 years.

Under current law, professional sports stadiums and arenas generally can be financed on a tax-exempt basis if the private security/payment limit is not exceeded. Some proposals to preclude these financings would impose a special rule to eliminate the private security/payment test for these facilities so that private business use by the teams alone is enough to prohibit tax-exempt financing. In contrast, Rep. Russell proposes an explicit prohibition against tax-exempt financing of professional sports and entertainment facilities. Both approaches reflect a fundamental departure from the private use and security/payment tests that have established the line between tax-exempt governmental financing and taxable governmental financing since 1968. As stated in Conference Report No. 1533, page 32, accompanying H.R. 15414, which first rendered interest on industrial development bonds taxable in 1968:

> On March 23 of this year the Internal Revenue Service published proposed regulations providing that the interest paid on industrial development bonds described in the proposed regulations would no longer be considered to be exempt under section 103. The proposed regulations represented a change in the position previously taken by the Internal Revenue Service and were based on the theory that industrial development bonds described in the proposed regulations were not "obligations of a State * * * or any political subdivision" within the meaning of section 103 since the primary obligor was not a State or political subdivision.

This underlying theory – that the governmental issuer was not the primary obligor of the bonds — explains why the private security/payment test has consistently been one of the two tests for the fundamental distinction between governmental bonds and private activity bonds (formerly known as industrial development bonds). (Of course it has long been recognized that even where the proceeds of state or local bonds are loaned to a private person and the loan payments are the sole source of payment of the bonds, the state or local issuer of the bonds is respected as the issuer for federal income tax purposes. Nevertheless, the above theory explains the presence of the private security/payment test.)

The basic question of whether private activity bond status should rest on both a use test and a security/payment test was seriously reconsidered in 1985-'86 when bills preceding the Tax Reform Act of 1986 were progressing through Congress. The House bill, H.R. 3838, would have eliminated the private security/payment test, explained as follows:

> The committee is concerned . . . because under present law, a significant amount of bond proceeds from a governmental issue are being used in many cases by nongovernmental persons for activities which have not been approved specifically by Congress for tax exempt financing. . . . [G]overnmental bond issues are intentionally structured to fail the present-law IDB security interest test, when the bonds otherwise would be considered IDBs and subject to the restrictions that Congress has placed on such conduit financing for nongovernmental persons or would be prohibited altogether. The committee believes that this diversion of governmental bond proceeds to nongovernmental users should be limited . . . .
> H.R. Rep. No. 99-426, page 515.

The Senate Finance Committee recognized the same concern but addressed it differently, by subjecting both "direct and indirect" payments by a private user to the private security/payment test:

> The bill clarifies that both direct and indirect payments to an issuer of bonds made by a private user of bond-financed facilities are considered when determining whether the security interest test . . . is satisfied. Thus, payments by such private users of bond-financed

> facilities equal to or exceeding 25 percent [now 5%/10%] of debt service result in the bonds being IDBs, whether or not the payments are formally pledged as security or are directly used to pay debt service on the bonds.

Rep. No. 99-313, p. 831.

The Conference Committee generally adopted the Senate proposal, with an even more inclusive definition of private security/payments. The important point is that Congress carefully reconsidered the propriety of the private security/payment test and determined to retain it. (It is also worth noting that this Congress eliminated the previous ability, preserved in H.R. 15414 mentioned above, to use tax-exempt industrial development bonds to finance sports facilities. Thus Congress chose to eliminate the advantageous treatment of these facilities and to subject them to the same tests generally applicable to other facilities used by private business.)

So is the argument here that today's Congress is somehow bound by the actions of Congress 30 or 48 years ago? Of course not. The point is that this most fundamental concept in the tax-exempt bond rules – the definition of private activity bonds — has been carefully addressed twice during the existence of the tax-exempt bond rules and each time Congress has concluded that the private security/payment test, together with private business use test, are necessary. Maybe it did so in each case because of the resemblance of state or local bonds to private debt when a private person is effectively paying a significant portion of the debt service. Or maybe Congress didn't feel it should intrude on state or local governments that have decided to use their own tax or other revenues to subsidize a private business activity. Likely, given the overlap in these concepts, it was a combination of the two.

In light of this history, if state or local governments can issue tax-exempt bonds to finance other subsidies to private business, why should the federal government single out sports and entertainment facilities for worse treatment? Stated otherwise, why should the federal government substitute its judgment for that of the local government by picking winners and losers. It might be argued that the cost of the subsidy to the federal government gives it the right to choose. While undoubtedly true as a legal matter, it must also be recognized that the local government is making the policy decision to subsidize the activity despite its cost in doing so (which is much greater than the cost to the federal government since it won't be receiving material payments from the private entities).

While professional sports facility financings have suffered much negative publicity in recent years, the fundamental question of whether these facilities are more or less worthy of local government subsidies relative to other private activities seeking local government subsidies is a question that is and should remain the decision of the local government. Furthermore, to the extent that the federal government has historically meddled in the affairs of local government, as described above, it has repeatedly determined that the private security/payment tests properly preserve the interests of the federal governments. The historic tests for tax-exempt status – the private business use test and the private security/payment test – should apply to sports and entertainment facilities, just as they apply to all other facilities used in private business.

Squire Patton Boggs

The Public Finance Tax Blog

Robert J. Eidnier

USA April 14 2016

Butler Snow: Support the Tax-Exemption for Municipal Bonds.

Please ask your Congressmen to join the bipartisan House Municipal Finance Caucus. Why? What is this caucus? This caucus provides support for the federal tax-exemption for municipal bonds by directly opposing the President's cap of tax-exemption at the 28 percent bracket. The two Congressmen who established this caucus are Randy Hultgren (R-IL) and Dutch Ruppersberger (D-MD). Your Congressmen need to join because this caucus will help support the building of important infrastructure needed in your areas, and having this tax-exemption will allow more projects to come to fruition.

How to get your Congressmen to join? You have to ask them. Congressmen hear from their constituents on important matters, and this tax-exemption is important. Your congressmen need to know that this caucus can help area build the infrastructure you need to support and help your community grow. Contact your Congressmen and have them contact Randy Hultgren or Dutch Ruppersberger to join.

You may want to use the following links to find contact information for your Congressional representatives:

https://www.usa.gov/elected-officials

https://www.nabl.org/DesktopModules/Bring2mind/DMX/Download.aspx?portalid=0&EntryId=1036

https://www.nabl.org/DesktopModules/Bring2mind/DMX/Download.aspx?portalid=0&EntryId=1035

Last Updated: April 10 2016

Article by Blake C. Sharpton

Butler Snow LLP

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

TAX INCREMENT FINANCING - CALIFORNIA

Macy v. City of Fontana

Court of Appeal, Fourth District, Division 1, California - February 23, 2016 - 244 Cal.App.4th 1421 - 198 Cal.Rptr.3d 867 - 16 Cal. Daily Op. Serv. 3133 - 2016 Daily Journal D.A.R. 1817

Resident and community organizations petitioned for writ of mandate challenging redevelopment agency's, housing authority's, and city's alleged failure to use 20 percent of city tax increment revenues in support of low- and moderate-income housing under the Community Redevelopment Law (CRL).

The Superior Court sustained demurrer without leave to amend. Resident and organizations appealed.

The Court of Appeal held that:

- CRL did not subject city to its redevelopment agency's statutory duty to use tax increment revenues for affordable housing;
- Redevelopment agency dissolution law did not subject city to its redevelopment agency's statutory duty to use tax increment revenues for affordable housing; and
- City's agreement to receive tax increment revenues from redevelopment agency did not require city to use the revenues for affordable housing.

Squire Patton Boggs: Crossover Refunding - Does It Really Have to Come to This?

Suppose you, or a friend, issued build America bonds or another form of direct payment subsidy bonds in 2009 or 2010, as permitted by the American Recovery and Reinvestment Act, to do your bit to stimulate aggregate demand during the depths of the Great Recession. You, or your friend, as applicable, did not, however, include an extraordinary optional call feature in the BABs that would allow for the immediate redemption of the BABs if the direct payment subsidy was reduced. Consequently, you've been suffering with the reductions to the direct payment subsidy mandated by sequestration (and that will continue through fiscal year 2024), which have increased the net cost of your BABs.

You would like to advance refund your BABs to replace them with (historically) low-coupon tax-exempt bonds, but you know that the Internal Revenue Service has taken the position that a legal defeasance of tax-advantaged bonds, such as BABs, results in the reissuance for federal tax purposes of those bonds as taxable bonds that are no longer entitled to a direct payment subsidy (even one reduced by sequestration). Under this position, the BABs would lose their direct pay subsidy long before they are called in an advance refunding, a result that's best avoided. Is there anything that can be done in this seemingly hopeless situation?

Crossover Refunding – Back to the Future?

Pretty much nothing from the 1980s, including, but not limited to, mullets, Members Only jackets, and the Laffer Curve, should be revived. But a limited number of items, such as Paul's Boutique, the Super Bowl Shuffle, and the television program ALF, are long overdue for a reprise. Into the latter category falls the technique of a crossover refunding, a tax-exempt financing concept from that era, which could prove useful to an issuer of BABs where the BABs lack an extraordinary optional redemption feature and cannot (at least at this point) be currently refunded.

A crossover refunding differs from a traditional advance refunding in that proceeds of the refunding issue are used to pay interest on the refunding bonds, rather than the refunded bonds, until the call date of the refunded bonds, at which point the balance of the refunding bond proceeds in the refunding escrow are applied toward the repayment of the refunded bonds. Under Treas. Reg. § 1.148-10(c)(4), the crossover advance refunding bonds will not be treated as taxable arbitrage bonds. Moreover, under Treas. Reg. §1.149(g)-1, the crossover refunding should not be treated as comprised of taxable hedge bonds if the refunding results in debt service savings (taking into account the direct payment subsidy on the refunded BABs) or relieves the issuer of significantly burdensome document provisions.

The allure of a valid crossover advance refunding to an issuer of BABs that are not subject to

extraordinary optional redemption is that the crossover refunding does not effect a legal defeasance of the BABs for purposes of Treas. Reg. § 1.1001-3(e)(5)(ii)(A). Under that provision of the Treasury regulations, the legal defeasance of a debt instrument (other than a "tax-exempt bond" – more on this below) changes the nature of the debt instrument from recourse to nonrecourse, which results in a significant modification of the debt instrument and the treatment of that instrument as reissued for federal tax purposes. For this purpose, Treas. Reg. § 1.1001-3(e)(5)(ii)(A) describes a legal defeasance as a defeasance "in which the issuer is released from all liability to make payments on the [defeased] debt instrument."[1]

As noted above, the IRS has taken the position in Chief Counsel Advice Memorandum Number AM 2014-009 (the "Memo") that the legal defeasance of direct payment subsidy obligations, such as BABs, results in the reissuance of those obligations for federal tax purposes as obligations that are no longer entitled to the direct payment subsidy. A crossover advance refunding would not, however, result in the legal defeasance of the defeased BABs, because the issuer would remain liable for the payment of debt service on the BABs until their call date. In the absence of a legal defeasance, the BABs should not be treated as reissued for federal tax purposes upon the issuance of the crossover advance refunding bonds, and the issuer should retain the benefit of the direct payment subsidy (as reduced by sequestration) on the BABs until their call date.

Should a Crossover Refunding Really Be Necessary?

The IRS reached its conclusion in the Memo by determining that BABs are not "tax-exempt bonds" within the meaning of Treas. Reg. § 1.1001-3(f)(5)(iii), which defines a tax-exempt bond as "a state or local bond that satisfies the requirements of [Internal Revenue Code] section 103(a)." Under Treas. Reg. § 1.1001-3(e)(5)(ii)(B), the defeasance of a tax-exempt bond does not result in a significant modification of the bond and therefore does not cause the reissuance of the bond for federal tax purposes.

Under Internal Revenue Code section 54AA(d)(1)(A), a bond cannot be a BAB unless that bond satisfies the requirements of Internal Revenue Code section 103. How then does the IRS justify a position in the Memo that is contrary to the plain wording of its own Treasury regulation? By citing the preamble of the Treasury Decision that promulgated the definition of "tax-exempt bond" for purposes of the reissuance regulations. As we have previously discussed, the IRS's citation to the preamble is flawed, but it is also unavailing where the language of the Treasury regulation in question is unambiguous. As the Tax Court held in *Woods Investment Company v. Commissioner*, 85 T.C. 274 (1985), the IRS's remedy if it disagrees with the clear language of a Treasury regulation that it has promulgated is to amend the regulation – not to enforce a position that is contrary to the express provisions of the regulation.

In light of this, there's no reason to fire up the flux capacitor to bring a crossover refunding from the 1980s to the present day, because the legal or economic defeasance of BABs simply should not result in their reissuance for federal tax purposes.

Sequestration – Does it Result in the Repudiation of Debt Owed by the Federal Government?

The question of whether BABs are tax-exempt bonds for purposes of the reissuance regulations arises because of the application of sequestration to the direct payment subsidies paid by the federal Treasury in respect of tax-advantaged bonds, such as BABs.

The effect of sequestration is to adopt mandatory reductions in items of discretionary spending that are subject to annual appropriation if expenditure levels exceed specified thresholds. The direct

payment subsidy on tax-advantaged bonds is treated for federal tax purposes as the refund of an overpayment of tax (see IRS Notice 2009-26, Section 3.3, for discussion). The refund of a tax overpayment is not subject to annual appropriation – it is the repayment (albeit without interest) of a debt owed by the federal government to the taxpayer. If the refund is not paid in the full amount owed to the taxpayer, there has been a repudiation of some portion of the debt owed by the federal government to the taxpayer. Is the federal government therefore repudiating a portion of its debt by subjecting to sequestration the direct payment subsidies owed on tax-advantaged bonds?

We'll leave that as a rhetorical question for the time being.

[1] A legal defeasance is illustrated in Treas. Reg. § 1.1001-2(d), ex. 6, as the placement in trust "of government securities that provide interest and principal payments sufficient to satisfy all scheduled payments on the bond." The example concludes that such a defeasance is a modification of the defeased bonds for purposes of the reissuance regulations.

Squire Patton Boggs

The Public Finance Tax Blog

by Michael A. Cullers

USA April 6 2016

Political Subdivision Politics.

Recently released proposed Treasury regulations seek to change the requirements for municipal bond issuers to qualify as issuers of tax-exempt bonds. Many lawyer and industry groups, as well as many States and local government agencies, will be commenting unfavorably on this proposal by the Internal Revenue Service. There are a number of areas in which the proposed regulations seem to make the wrong policy choice and create ambiguity instead of clarity, but that is not the focus of this article. Instead, this article focuses on the intellectual integrity of the proposed rules and the misuse of the rulemaking process.

"The term 'State or local bond' means an obligation of a State or political subdivision thereof." Being a "State or local bond" is the threshold requirement for tax exemption, and this language from Section 103 of the Internal Revenue Code and the underlying definition of the term political subdivision has existed for a very long time. Essentially, a political subdivision is a government agency with substantial taxing power, eminent domain power or police power. The proposed regulations attempt to redefine the meaning of the term political subdivision for purposes of the issuance of tax-exempt bonds.

The proposed regulations spring from the controversy surrounding an IRS challenge to the tax exempt status of bonds issued by certain community development districts in Florida and an associated IRS Technical Advice Memorandum 201334038. The Technical Advice Memorandum appeared to create new requirements for issuers to qualify as political subdivisions, and practitioners clamored for a repeal of the Memorandum or at least a rulemaking process that allows for comments and deeper consideration. The IRS chose the rulemaking process.

The Proposed Changes Impact the Tax Law Generally

The federal tax definition of political subdivision is important for a number of purposes independent of whether an entity is qualified to issue tax-exempt bonds (for example, whether the entity is subject to income tax or excise tax liability). The definition of political subdivision under Section 103 has been widely referenced as definitive for all federal tax purposes. Rather than coordinate with other parts of the IRS, the drafters of the proposed regulations would make dramatic changes to a long-standing definition and claim that those changes are intended only to impact tax-exempt bond qualification. But the changes could significantly impact other areas of the federal tax law. Are each of the other impacted areas of the federal tax law now required to adopt their own definition, to apply an old definition that no longer exists in the income tax regulations or to simply go along with this change?

Moreover, if the new rules really do apply only to the issuance of tax-exempt bonds, the proposed regulations package is significantly incomplete. A large number of issuers of tax-exempt bonds (possibly the majority) are not political subdivisions under existing law. Rather, these issuers are constituted authorities, integral parts of political subdivisions or other "on behalf of" issuers. The true impact of the proposed changes cannot be assessed unless the IRS also states its intention with respect to these other entities. If an entity with significant governmental powers is disqualified as a political subdivision due to more than incidental private benefit (one of the proposed new regulatory requirements), will a bond issuing agency of a State, city or county be disqualified if its bonds result in more than incidental private benefit? Perhaps such an authority would also qualify as an integral part entity, but the IRS has refused to provide any guidance, even informal guidance, on the integral part analysis, leaving the State and local government community in the dark.

The IRS Is Changing the Wrong Regulation

The new requirements are designed to thwart the abuse perceived by the IRS that certain tax-exempt, governmental purpose bonds are being issued for the impermissible benefit of private developers. The problem is that the proposed prohibition of non-incidental private benefit incorporates a private business use concept into a regulation relating to something entirely different – the authority to issue bonds. This is effectively changing the private business use rules (which exist under Section 141 of the Internal Revenue Code) through a new requirement under Section 103. This is a deeply flawed and troubling approach. The private business use rules are well-developed and intricate. If there is a legitimate concern about non-incidental private benefit, that concern should be dealt with in a rulemaking project under Section 141, so that the appropriate context and impact on other rules is apparent.

This is a bigger point than the mere placement of a new rule in the income tax regulations. To date, the regulatory requirements for an issuer to qualify to issue tax-exempt bonds has focused on the governmental powers held by the issuer because the related language in the Internal Revenue Code focuses on the attributes of the issuer, not on the attributes of the particular bonds or the project being financed. By comparison, the concepts relating to private business use have focused on the project being financed and the other attributes of individual bond issues because that is the focus of the related language in the Internal Revenue Code. If this distinction between issuer attributes and project/bond issue attributes is not maintained, the resulting requirements will conflict. For example, in at least some circumstances the proposed regulations would make the private security or payment test of Section 141 irrelevant. The point here is not to argue against an incidental private benefit prohibition. The point is that any such prohibition needs to be vetted as a change to the rules under Section 141 and not Section 103.

In fact, this new requirement is similar in many respects to heavily criticized and subsequently withdrawn general prohibitions relating to "economic benefit" and to the "discharge of a primary legal obligation" originally set forth in 1994 proposed regulations under Section 141. There were

many negative comments on those proposed regulations. The comments focused on whether the mere existence of private economic benefit was enough to result in private business use and whether traditional assessment bond financing of government mandated infrastructure should be prohibited. In the end, the IRS correctly determined to focus on the use of the assets financed and not to take away from States and local government agencies one of their most powerful and consistently used infrastructure financing mechanisms.

Assuming that there in fact is a problem to fix, this proposal by the IRS to change the political subdivision definition is not an acceptable approach. At best, it raises significant questions about which entities qualify as political subdivisions for general tax purposes. Worse, it creates a new private business use limitation that is not consistent with the Internal Revenue Code or the existing regulatory framework. Thus, this new limitation creates significant uncertainty, because it exists outside the context of similar, well-developed rules. In municipal finance, where investors demand unqualified legal opinions, creating uncertainty is bad policy.

The Bond Buyer

By Chas Cardall

April 7, 2016

Chas Cardall, a partner in the San Francisco office of Orrick, Herrington & Sutcliffe LLP, is the chair of the Tax Department and a member of the Public Finance Department.

IRS: Understanding the Tax Exempt Bonds Examination Process.

The primary objective of a tax-exempt bond examination is to determine if a municipal debt issuance complies with Internal Revenue Code provisions.

This page discusses general rules and procedures that we follow in examinations and how to correct certain compliance problems.

Selection of returns
TEB uses a centralized case selection and review process to enhance the consistency of our enforcement activities and to focus resources on the areas that will have the most positive impact on the compliance of municipal debt issuances. This process includes identifying areas of noncompliance, developing corrective strategies, and assisting with those strategies. The reasons your municipal debt issuance may be selected for examination include as a part of a market segment's statistical selection, project or referral.

Your role in the process
The issuer of the municipal debt is treated as the "taxpayer" throughout the examination process. You, any conduit borrower, and any other party to the transaction are responsible for maintaining and producing adequate records to substantiate the tax-exempt status of the bonds. If the requested information is organized and complete, we can conduct the examination in a timely and efficient manner.

For certain tax credit bonds where direct payment of the allowable credit has been elected, the issuer of the debt is the party subject to taxation. As the taxpayer, the general provisions of Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund, including those

dealing with assessments, collections, and appeals, apply to you.

Publication 556 may also be useful in understanding the examination process of tax-exempt bonds. Your examiner can answer questions about the difference between tax-exempt and tax credit bond examination processes.

Representation
If you choose to have someone represent you on the examination, your representative must be a person eligible to practice before the IRS. You can submit Form 2848, Power of Attorney and Declaration of Representative, to authorize an individual to represent you before the IRS.

Your representative may have a conflict of interest if they also had a role in the issuance of your municipal debt, such as providing the approving opinion as to the qualifications of the municipal debt issuance, or is also representing other parties to the transaction, such as the conduit borrower. A representative with a conflict of interest may not represent a client before the IRS unless:

1. The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client,
2. The representation is not prohibited by law, and
3. Each affected client gives informed consent, confirmed in writing.

You may find it appropriate to permit direct communication between the examiner and any conduit borrower. If the TEB examiner agrees to conduct the examination in that manner, you must provide us with a Form 8821, Tax Information Authorization. This form permits the examiner to discuss your tax matter with the conduit borrower.

During the examination, we may also need to contact various third parties, including underwriters, financial advisors, bond counsel, and any other parties (and their counsel) with a transactional relationship to the municipal debt issue.

The examination
A Tax Exempt Bonds examiner notifies you by phone or letter that a municipal debt issuance has been selected for examination. If the initial contact is by phone, a confirmation letter will follow. The letter details the required items for the examination and may indicate how the return was selected. We may request additional items at a later date.

The examination may include a comprehensive review of the municipal debt issuance, or focus only on specific aspects. The examination continues until the examiner is reasonably certain that the municipal debt issuance has met the applicable requirements.

The TEB examiner will discuss any potential compliance problems with you or your representative. In some instances, we may issue Form(s) 5701-TEB, Notice of Proposed Issue, and Form(s) 886-A, Explanation of Items, to identify any areas of noncompliance. Upon completion of the examination, all unresolved issues will be included in a Notice of Proposed Adverse Determination Letter and Form(s) 886-A, Explanation of Items.

Resolving qualification issues – the closing agreement process
With respect to tax-exempt bonds, a failure to comply with the federal tax laws that govern municipal debt issuances may result in the loss of the tax-exempt status of the bonds under examination. Holders of these bonds would be taxed on the interest they receive. With respect to tax credit bonds, a failure to comply with the federal tax laws that govern municipal debt issuances may result in the loss of the tax credit status of the bonds under examination. Holders of these bonds

would lose the ability to claim tax credits with respect to the bonds.

However, in most situations, the IRS will allow the issuer to enter into a closing agreement where you agree to correct the compliance failures and pay a resolution amount to the U.S. Treasury. A violation corrected in a closing agreement will allow the bond interest that's payable to the holders of tax-exempt bonds to retain its tax exempt treatment or the holders of tax credit bonds to maintain the ability to claim tax credits.

Closing Letter
The final step in the examination process is a letter explaining the examiner's conclusions. Sometimes the conclusion results in a tax liability for related entities and/or individuals and may require coordination with other business units within the IRS.

Appeal rights
The Office of Appeals settles unresolved issues. Your appeal rights are explained in detail in Publication 5, Your Appeal Rights and How to Prepare a Protest if You Don't Agree. Appeal requests must be in writing and timely. If not, we will issue a Notice of Final Adverse Determination. Fast Track Settlement, an expedited appeals process, may be used in certain situations. You should discuss this with your examiner. For more information about the appeals process, see Revenue Procedure 2006-40, Administrative Appeal of Proposed Adverse Determination of Tax-Exempt Status of Bond Issue.

Post-issuance compliance and the TEB Voluntary Closing Agreement Program
TEB encourages issuers and other parties involved in bond transactions to adopt and follow procedures for monitoring and achieving post-issuance compliance with federal tax requirements applicable to their tax-exempt and tax credit bonds. Monitoring post-issuance compliance will significantly improve the issuer's ability to identify noncompliance and prevent violations from occurring, or timely correct violations to ensure the continued tax-advantage status of the bonds.

TEB's Voluntary Closing Agreement Program is available to issuers who are not under exam and who have discovered a violation of the law associated with the issuance of tax-exempt or tax credit bonds. TEB VCAP allows you to correct violations as expeditiously as possible before the violations are discovered during an examination. Generally, an issuer will receive more favorable resolution terms under TEB VCAP than for the same tax violation discovered during an examination.

S&P's Public Finance Podcast (State and Local Governments' Tax Increment Debt and Special Assessment Bonds)

In this segment of Extra Credit, Associate Director Sarah Sullivant discusses the highlights of our recent article about state and local government tax increment debt and Senior Director Michael Stock discusses our commentary on special assessment bonds.

Listen to the Podcast.

Apr. 4, 2016

NABL Submits Recommendations for 2016-2017 Priority Guidance Plan.

On April 7, the National Association of Bond Lawyers submitted recommendations for inclusion in the 2016-2017 Guidance Priority List in response to IRS Notice 2016-26. The list included updating the management and service contract safe harbors, issuing clarifying guidance concerning the application of the final allocation and accounting regulations in section 1.141-6 of the Treasury Regulations, revising and finalizing the proposed June 2015 regulations concerning issue price matters under section 148, and revising and re-proposing the February 2016 regulations concerning the definition of political subdivision.

The comment letter can be read here.

NABL: House Bill Prohibits Tax-Exempt Bonds for Sports Stadiums.

Rep. Steve Russell (R-OK) introduced the No Tax Subsidies for Stadiums Act (H.R. 4838), which would prohibit tax-exempt bonds from being used for professional sports stadiums and for-profit entertainment arenas. H.R. 4838 defines a professional sports facility as a location used as a stadium or arena during at least 5 days per year for professional sports exhibitions, games or training. The bill would also prohibit tax-exempt financing for certain entertainment facilities. H.R. 4838 has been referred to the House Ways and Means Committee. The Obama Administration also proposed in its budget eliminating tax-exempt financing for professional sports facilities.

Click here to read the bill.

TAX - ALASKA

Pursche v. Matanuska-Susitna Borough

Supreme Court of Alaska - March 25, 2016 - P.3d - 2016 WL 1168200

Landowner filed objection to borough's tax foreclosure list. The Superior Court granted borough's motion for summary judgment and denied landowner's motion to dismiss. Pro se landowner appealed.

The Supreme Court of Alaska held that:

- As a matter of first impression, superior court properly exercised jurisdiction over the case, despite federal land patent in the property's chain of title, and
- Land once owned by federal government is subject to local property taxes after it is conveyed to a private party.

Superior court, as Alaska's court of general jurisdiction, properly exercised jurisdiction over tax foreclosure action brought by borough against landowner's property, despite federal land patent in the property's chain of title. There was no exception that removed patented property from superior court's broad jurisdictional grant.

TAX - OHIO

Veolia Water N. Am. Operating Servs., Inc. v. Testa

Supreme Court of Ohio - March 2, 2016 - N.E.3d - 2016 WL 827776 - 2016 -Ohio- 756

Taxpayer, a private owner and operator of a waste-water-treatment plant, treating both industrial and residential waste water, filed application for an exempt-facility certificate. The tax commissioner granted certificate for only a percentage of the personal property the commissioner deemed to be exempt. Taxpayer appealed. The Board of Tax Appeals affirmed. Taxpayer appealed.

The Supreme Court of Ohio held that Board's application of primary-purpose test to each article of plant's property was reasonable and lawful.

Board of Tax Appeals' application of primary-purpose test to each article of property of waste-water treatment plant individually, in determining tax exempt status of plant pursuant to statute governing tax exemption for industrial water pollution control facilities, was reasonable and lawful. Pollution-control statute imposed a direct functionality test, under which, plant's trucks and general buildings were not themselves designed, constructed, or installed for primary purpose of either "collecting or conducting industrial waste to a point of disposal or treatment," or of "reducing, controlling, or eliminating water pollution caused by industrial waste," as required for exemption.

Hot Topics from the Tax and Securities Law Institute's Annual Meeting: Squire Patton Boggs

Every year, the National Association of Bond Lawyers ("NABL") hosts the Tax and Securities Law Institute ("TSLI"), which is an advanced conference with various workshops related to pressing issues confronting tax and securities lawyers in the public finance arena. Essentially, the annual TSLI is like Chrismukkah for tax and securities lawyers. This year's meeting was held on March 11th and 12th and was sure to be a barn burner in light of the meaningful guidance released by the IRS over the last year including the proposed issue price regulations, the allocation and accounting regulations (the "Allocation Regulations") and, most recently, the proposed political subdivision regulations (the "Proposed Political Subdivision Regulations"). This year's meeting did not disappoint as one tax practitioner loudly interrupted a panel consisting in part of IRS and Treasury agents to proclaim that the proposed political subdivision regulations were the worst piece of guidance to come out of the Treasury in recent history.

Below is a list of tax items discussed at TSLI that this blogger thought were particularly noteworthy. When reading the information below, please keep in mind that statements made by personnel from the IRS or Treasury reflect the individual's personal beliefs and are not necessarily reflective of an official position taken by the IRS or the Treasury.

Helpful commentary on the Allocation Regulations

The Allocation Regulations have been the subject of multiple prior blogs (see here, here, here, and here). The Allocation Regulations released last fall are extremely taxpayer friendly; however, there remain a number of important items regarding their application.

One open item is whether the definition of "mixed-use project" is broad enough to encompass projects financed exclusively with proceeds other than tax-exempt bond proceeds. The heightened value of "qualified equity" (discussed here) under the Allocation Regulations has encouraged practitioners to try to incorporate as much qualified equity as possible. To do this, one possibility is

to expand the project to include ancillary projects that are not expected to have any private business use and that were not originally considered for tax-exempt financing. Confusingly, the inclusive definition of "project" in the Allocation Regulations would seem to permit this approach while the narrower definition of "mixed-use project" may not. A "mixed-use project" is any "project" that is financed with proceeds other than tax-exempt bond proceeds as well as tax-exempt bond proceeds. Therefore, an ancillary project financed exclusively with proceeds other than tax-exempt bond proceeds may fall outside the definition of "mixed-use project."

When considering what "mixed-use project" was intended to include, officials from the IRS and Treasury made two interesting observations. First, in response to a panelist suggesting that any ancillary project needs to be related to the bond-financed project, a senior Treasury official indicated there is no "relatedness" requirement when determining the scope of what constitutes a mixed-use project. Second, the same official indicated that there should be some "intent" to finance a portion of each component of the mixed-use project (including any ancillary project) with tax-exempt bond proceeds.

Issuers and borrowers often finance multiple, unrelated project expenditures with a single bond issue so disavowing any "relatedness" requirement was not surprising. However, suggesting that a project cannot be extended to incorporate ancillary projects not anticipated to be tax-exempt bond-financed would be a substantive limit. For an issue of qualified 501(c)(3) bonds, query whether listing the ancillary project in a public notice for a TEFRA hearing would be sufficient? Alternatively, for qualified 501(c)(3) or other types of tax-exempt bonds, is it necessary to affirmatively allocate tax-exempt bond proceeds under Treas. Reg. Section 1.148-6(d) or by a reimbursement allocation to a component of a project not otherwise financed with proceeds of tax-exempt bonds?

Applying the Allocation Regulations to Refunded Bonds

In response to a question about how to apply the Allocation Regulations to bonds issued prior to the release of the Allocation Regulations, a senior Treasury official acknowledged that the application of the Allocation Regulations to bonds outstanding prior to October 27, 2015 (including bonds refunded subsequent to that date) is uncertain and that the Allocation Regulations were written primarily to address new money issues. In addition, that same Treasury official acknowledged that "qualified equity" excludes certain expenditures that could have been included such as invoices paid after the project's placed-in-service date and preliminary expenditures paid prior to the beginning of the period during which qualified equity can be contributed to a project.

Political Subdivision

As suggested in the introductory paragraph, the recently released Proposed Political Subdivision Regulations have been extremely controversial, initially because of the transition rule but also because of the introduction of what many practitioners consider to be new requirements that political subdivisions be shown to (i) operate in furtherance of a "governmental purpose" (with no more than an incidental benefit to private persons) and (ii) be "governmentally controlled". In response to a panelist's observation that the Proposed Political Subdivision Regulations shift away from the historic reliance exclusively on the Shamberg powers (discussed here),1 a senior Treasury official commented that the Proposed Political Subdivision Regulations were not intended to be a radical departure from the historic approach. Rather, notwithstanding the development of the law surrounding application of the Shamberg powers, the senior Treasury official suggested that the requirement that a political subdivision have a governmental purpose and operate under government control has always been a historic, albeit less developed, requirement for political subdivisions. The official emphasized that imposing heightened scrutiny on what entities qualify to be political subdivisions was not an imposition on a state's constitutional rights because the

exemption is from *federal* income taxes.

In response to one panelist indicating that the incidental benefit limit is troubling, a senior Treasury official responded by requesting that those concerns be included in comment submissions. The same official emphasized that practitioners should take comfort in the historically broad definition of governmental purpose. Throughout TSLI, Treasury and the IRS emphasized the need to receive comments to the Proposed Political Subdivision Regulations and it seems likely there could be significant changes to the regulations before they become final.

In discussing the policy behind the proposed regulations, a senior Treasury official indicated that, historically, reliance on the Shamberg powers was predicated under the belief that states do not delegate certain rights very easily. However, in certain circumstances, the official indicated that this may not be the case.

Upcoming Guidance

A senior Treasury official and a senior IRS official indicated that guidance on the following issues is "on the horizon":

- Finalize the 2007 and 2013 proposed arbitrage regulations;
- Update safe-harbors in Rev. Proc. 97-132 to include longer term contracts (possibly 15-years) and provide factors to distinguish management contracts from leases;3
- Finalize the proposed issue price regulations;
- Streamline the Voluntary Closing Agreement Program ("VCAP') to address an escrow agent's failure to reinvest proceeds in SLGS (see IRM 7.2.3.4.2(9)).4

In addition, although not imminent, the same senior Treasury official suggested that the following items will be next in line:

- Incorporating Notice 2008-41 (reissuance rules originally intended to apply to qualified tender bonds) into regulations under Section 150 of the Code to address certain issues that are present with refunding tax-advantaged bonds including Build America Bonds ("BABs");5
- Guidance involving change-in-use; and
- Finalize the proposed 2008 TEFRA regulations.

Odds and Ends

The following odds and ends were also discussed:

- In response to criticism that the IRS never utilizes its authority to waive the arbitrage rebate penalty for bonds under audit (a discussion of which is here), a senior IRS official said that the Service has not historically waived the penalty for fear that they could not do so on a consistent basis applying a consistent standard. However, the IRS official indicated that a "penalty committee" has recently been formed to determine how to consistently waive certain penalties, including the arbitrage rebate penalty; and
- When discussing the recent change in the IRM which indicates that it is no longer necessary to have written post-issuance compliance procedures, one senior IRS official indicated that the IRS is much more concerned about the content of procedures and that unwritten procedures (e.g., electronic monitoring) could be sufficient depending on the content of such procedures.

To view all formatting for this article (eg, tables, footnotes), please access the original here.

Squire Patton Boggs

by Joel Swearingen

USA March 30 2016

TAX - LOUISIANA

Board of Com'rs of Port of New Orleans v. City of New Orleans

Court of Appeal of Louisiana, Fourth Circuit - March 16, 2016 - So.3d - 2016 WL 1061490 - 2015-0768 (La.App. 4 Cir. 3/16/16)

Political subdivision of state, as taxable entity, filed suit against city tax assessor, challenging ad valorem tax assessments on properties owned by subdivision. The Civil District Court granted subdivision summary judgment. Tax assessor appealed. The Court of Appeal reversed. On remand, the Civil District Court granted summary judgment to subdivision. Tax assessor appealed.

The Court of Appeal held that lease improvements to several properties owned by subdivision were exempt from ad valorem taxation.

Improvements owned by port and leased to third-party, private, for-profit, commercial tenants were exempt from ad valorem taxation under constitutional article expressly providing that public property used for public purposes is exempt from ad valorem taxation. Activities of the tenants fit within the port's broad, legislating mission to maintain, develop, and promote the commerce and traffic of the port and city harbor.

Engaging in for-profit activities on public property does not preclude those activities from having a public purpose, under constitutional article expressly providing that public property used for public purposes is exempt from ad valorem taxation.

TAX - GEORGIA

Columbus, Georgia, Bd. of Tax Assessors v. Medical Center Hosp. Authority

Court of Appeals of Georgia - March 22, 2016 - S.E.2d - 2016 WL 1102625

Hospital authority and city tax board appealed county board of equalization decision finding one of eight parcels exempt from ad valorem taxes. The Superior Court entered summary judgment that all eight parcels were exempt public property. Board appealed.

The Court of Appeals held that:

- Authority parcels that contained parking lots and walking trails, but generated no income, were "public property" exempt from taxes, and
- Parcel purchased by authority with non-profit hospital and for-profit clinic was exempt from taxes.

Hospital authority parcels that contained parking lots and walking trails, but generated no income, were "public property" exempt from ad valorem property taxes. Even if the authority could not justify use as a free benefit to patients, the parking lots furthered hospital function by providing free parking for doctors patients, visitors, and employees, and walking trails in wooded lot on hospital grounds were available to patients, visitors, and employees.

Parcel purchased by hospital authority with non-profit hospital and for-profit clinic in separate buildings was exempt from ad valorem property taxes, where clinic square footage was less than half that of the hospital's square footage.

IRS Releases Model Closing Agreements for Tax-Exempt Bonds: Squire Patton Boggs

When an issuer of tax-advantaged bonds discovers a problem with the bonds, the issuer can resolve the problem by requesting a closing agreement through the IRS Voluntary Closing Agreement Program (VCAP). Similarly, where the IRS discovers a problem in the course of an audit of a tax-advantaged bond issue, and the issuer agrees that there is a problem, the issuer can resolve the problem by entering into a closing agreement with the IRS.

In the closing agreement, the IRS agrees not to attempt to tax bondholders or reclaim direct payments from the issuer, and in exchange the issuer agrees to cut a check and redeem the "nonqualified" bonds.

As part of its campaign for greater consistency and standardization, the IRS has released "standard form" closing agreements for each of these situations. In VCAP, issuers or borrowers must submit a draft of the closing agreement based on this new model agreement when they submit the VCAP request (in addition to new Form 14429 and the descriptive information it requires).

Somewhat strangely, it is usually easier to get the IRS to negotiate the amount of the closing agreement payment and the amount of bonds to be redeemed than it has been to get the IRS to change the factual statements and representations in the closing agreement. The IRS has been extraordinarily resistant to even minor, common-sense changes to the terms of the closing agreement, even its boilerplate provisions. The release of the model agreements could give issuers and borrowers some additional flexibility in proposing the terms that will necessarily vary from the terms of the draft agreement, because they now will be drafting it first, at least in the VCAP context. Or, more likely, it may signal the official calcification of many of the terms; the IRS notes that if the issuer and borrower want to change the model language, it will require "additional review" by the IRS. If prior experience in negotiating the language of these agreements is any guide, we should read the phrase "additional review" as "a slight delay before telling you 'no.'"

The model closing agreements can be found on the IRS's website by clicking here. The webpage provides some commentary on some of the provisions. We summarize the interesting points below.

First, click here for a comparison of the provisions of the model VCAP agreement table. As you will see, most of the provisions in the two model agreements are the same.

Analysis

1. The closing agreement uses the example of an issue of tax-exempt qualified 501(c)(3) bonds.

So, in the case of garden-variety governmental use bonds, the issuer usually will remove references to "the borrower." Other details may need to be added in the case of other private activity bonds, such as exempt facility bonds (e.g., solid waste disposal facility bonds).

Also, the agreement will need to be modified for tax-advantaged bonds that are not tax-exempt

bonds, such as build America bonds.

2. The closing agreement covers only the bond issues in Recital A and only the tax problems in Recital C for those bond issues.

Recital A has a description of the bond issues that the closing agreement covers. This seems informational, but it is important. Only the bonds mentioned in Recital A will be covered by the closing agreement.

Recital C further specifies the tax problems with the bonds in Recital A that the closing agreement will resolve. This provision is also important – the closing agreement will cure only the violations listed in Recital C. If it's not explicitly there, it's not resolved.

Importantly, Recital C in each agreement says that the IRS "has a basis to conclude" that a violation has occurred. It does not say, for example, that a violation "*has occurred*." This subtle linguistic change could prevent situations like the recently-concluded New Hampshire student loan bond saga. Under Section 7121 of the Code, which governs closing agreements, the IRS does not have to conclude that a violation has occurred before it signs a closing agreement with an issuer.

3. Recital B in the VCAP agreement describes the bond issues and the circumstances leading to the violation.

This is the Recital that will vary the most from situation to situation. Most of the information for this recital will come from the VCAP request and Form 14429.

4. Section 5 is the punchline – it notes that the closing agreement will prevent bondholders from having to include interest on the bonds in their gross income for tax purposes as a result of the violation described in Recital C.

Where applicable, the issuer and borrower should modify Section 5 to address other collateral tax consequences that will be avoided because of the closing agreement. One example, which the IRS describes on its website, is a statement about whether the facilities acquired with bond proceeds by a taxable conduit borrower will continue to be treated as tax-exempt bond financed property under Section 168(g) of the Code and continue to be subject to less taxpayer-friendly (i.e., slower) rates of depreciation. Other examples can be found in Code Section 150(b).

5. Section 7 waves a magic wand over the original proceeds of the nonqualified bonds and breaks the link between those proceeds and the expenditures the issuer originally spent them on.

Take note of Section 7. This section states that proceeds of any bond redeemed as a condition of the closing agreement are treated as unspent proceeds for any future refunding of those bonds. The IRS website makes clear that this applies not just to unspent bond proceeds of the redeemed bonds, **but also to bond proceeds that were previously spent.**

The IRS website describes this provision as follows: "The effect of this paragraph is to sever the connection between bond proceeds and the expenditures to which they were originally allocated. Accordingly, should a taxable refunding of the nonqualified portion of the bonds subsequently be refunded with tax advantaged bonds the proceeds would not be considered as "spent," which could result in violations of tax rules regarding the expectation to use proceeds and certain arbitrage restrictions."

This provision appears to be intended as an anti-abuse rule that will prevent issuers from borrowing in the taxable markets to redeem nonqualified bonds and then using tax-advantaged bonds to refund that taxable borrowing at some later date. This provision will make it quite difficult to do so, because the issuer will be treated as essentially borrowing most of the bond issue twice, which will lead to any number of nightmares.

Not to get too metaphysical, but Section 7 treats the nonqualified bonds as irredeemably nonqualified (also the title of my upcoming memoirs). To illustrate: Assume that the reason for a closing agreement for a bond issue was excessive private business use of the bond-financed property, and assume that the issuer had to redeem the nonqualified bonds, which were a portion of the issue, but not all of it. To redeem the nonqualified bonds, the issuer borrowed money in the traditional taxable markets. Now assume that soon after that, the issuer ended the private business use, so that the bond-financed property could technically be eligible for tax-exempt bond financing. Even so, Section 7 of the model closing agreement prevents the issuer from refunding the taxable borrowing with tax-exempt bonds.

6. The IRS reserves the right to audit the bonds in Section 8.

Section 8 of the VCAP agreement notes that the closing agreement isn't based on an audit of the bonds and that the IRS reserves the right to audit the bonds. This is somewhat troubling. The point of the closing agreement is to resolve, once and for all, the tax issue described in Recital C of the agreement. This provision seems to undercut that point. It would be nice to have the agreement modified to say that the IRS will not audit the bonds and challenge their tax-exempt status as a result of the violation described in Recital C of the agreement. This provision is omitted from the audit model agreement, but it would be better to add it back in and restrict it to the issue described in Recital C.

7. Exhibit A requires a certification from the trustee that the issuer has redeemed the nonqualified bonds.

Exhibit A will be a certificate from the trustee listing the amounts and CUSIPs of the nonqualified bonds. It will also contain a certification that the bonds were redeemed on a pro rata basis, in accordance with the requirements in Reg. 1.141-12(j). Where the bonds won't be redeemed until a date after the closing agreement is signed (for example, because the bonds aren't yet callable), the IRS will modify this exhibit to tell the issuer how to notify the IRS that the nonqualified bonds have been redeemed.

8. Issuers and borrowers should incorporate a review of the model closing agreements into their post-issuance compliance planning.

When deciding how to approach potential violations that issuers and borrowers discover looming on the horizon, or deciding tactics in an audit, issuers should include a review of the model agreements as part of their planning process, in addition to preparing a preliminary calculation of the potential closing agreement amount and the amount of nonqualified bonds to be redeemed.

Article By John W. Hutchinson

Squire Patton Boggs (US) LLP

The Public Finance Tax Blog

Thursday, March 24, 2016

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Senior Associate
Johnny Hutchinson focuses his practice on taxation. He has significant experience in tax issues relating to public finance. Johnny has devoted substantial time to all types of tax-advantaged state and local debt, including governmental financings and financings for 501(c)(3) health systems, colleges and universities throughout the country. He also has experience with private activity financings, including solid waste disposal and sewage facilities for large utilities and one of the nation's largest waste management companies.

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IRS Publishes Population Figures for Housing Credit, Private Activity Bonds.

The IRS has published the 2016 resident population figures for the 50 states, the District of Columbia, Puerto Rico, and the U.S. possessions for use in determining the state housing credit ceiling under section 42(h) and the private activity bond volume cap under section 146.

IRS Issues Simplified Procedure to Extend Empowerment Zone Designation Period.

Notice 2016-28 provides a simplified procedure under the PATH Act for a State or local government to amend an empowerment zone nomination, extending the designation of the empowerment zone remaining in effect through December 31, 2016.

Notice 2016-28 will be in IRB 2016-15, dated April 11, 2016.

TAX - FLORIDA

Island Resorts Investments, Inc. v. Jones

District Court of Appeal of Florida, First District - March 21, 2016 - So.3d - 2016 WL 1085225

Owner of 99-year leasehold interest in unimproved 12-acre parcel filed action for a declaratory judgment that its interest could be taxed only as intangible personal property, and for an injunction prohibiting the assessment and collection of ad valorem taxes on the land. The Circuit Court entered judgment for county appraiser and tax collector, and leasehold interest owner appealed.

The District Court of Appeal held that leasehold interest owner was not the equitable owner of the leased land.

Owner of 99-year leasehold interest in unimproved land owned by county was not the equitable

owner of the leased land and thus was not required to pay ad valorem taxes on the land, where owner did not have the right to the perpetual renewal of its lease or the right to purchase the property for nominal consideration at the end of the lease, owner bore all the burdens during the term of the lease, at the end of which all the rights to the property reverted, rental payments were due in consideration for the leasehold interest, and the property was not financed, acquired, or maintained through the issuance of bonds.

TAX - LOUISIANA

Coastal Drilling Co., L.L.C. v. Dufrene

Supreme Court of Louisiana - March 15, 2016 - So.3d - 2016 WL 1050541 - 2015-1793 (La. 3/15/16)

Taxpayer filed suit against parish tax collector to recover amount paid in use taxes for materials purchased for use in rebuilding inland marine drilling barge damaged by fire. The District Court granted summary judgment to collector. Taxpayer appealed. The Court of Appeal affirmed. Taxpayer's application for writ of certiorari was granted.

The Supreme Court of Louisiana held that:

- Regulation permitting sales tax exemption if reconstruction restored ship, vessel, or barge to seaworthiness following its destruction by sinking, collision, or fire was constitutionally valid;
- "Seaworthiness" in the regulation has its general maritime meaning of fitness for its intended purpose;
- "Destruction" in regulation involves such extensive impairment from very specific event that vessel no longer can operate for its intended purpose; and
- Barge was destroyed making materials, equipment, and machinery eligible for the exemption.

TAX - LOUISIANA

Crowne Air, Inc. v. St. Tammany Parish

Court of Appeal of Louisiana, First Circuit - February 29, 2016 - So.3d - 2016 WL 852480 - 2015-0741 (La.App. 1 Cir. 2/29/16)

Sublessees under long-term subleases from city, which had leased land from parish and airport authority, brought action against parish tax collector, parish assessor, and chairman of state tax commission seeking declaratory judgment and to recover taxes paid under protest. The District Court entered summary judgment in favor of parish assessor. Sublessees appealed.

The Court of Appeal held that:

- Sublessees' leasehold improvements were not owned by the public, and thus were not exempt from ad valorem taxation, and
- Improvements were not for a public purpose, and thus were not exempt from ad valorem taxation.

Leasehold improvements made by sublessees, which subleased airport land from city for purpose of building hangars, were not owned by the public, and thus were not exempt from ad valorem taxation under applicable state constitutional provision, since language of sublease clearly contemplated that any permanent improvements made by sublessees during lease term remained property of

sublessees until lease was terminated, and improvements were not translated into public domain, since sublessees did not let public use the land with intention of making dedication to public use.

Leasehold improvements made by sublessees, which subleased airport land from city for purpose of building hangars, after parish and airport authority had leased airport land to city, were not for a public purpose, and thus were not exempt from ad valorem taxation under applicable state constitutional provision, even though agreement between city, parish, and authority declared the land be used for non-commercial aeronautical activities essential to city's operation of its public airport and beneficial to city's economic development, where subleases did not contain such language, and subleases and operating agreements specifically provided that sublessees were permitted to lease of hangars to third parties for profit.

What Presidential Candidates' Tax Plans Mean For Munis

WASHINGTON – As the 2016 presidential race narrows down to a handful of candidates, it appears likely that business mogul Donald Trump and former Secretary of State Hillary Clinton will be the nominees with the most votes at the Republican and Democratic conventions.

Should Trump and Clinton secure the nominations, voters will be presented with two candidates whose tax plans share many similarities, but would have vastly different implications for the municipal bond market, in the eyes of some tax and muni bond experts.

Trump says his plan would simplify the tax code, cut taxes for the middle class and grow the economy without adding to the debt or deficit. But his plan, which would lower tax rates, could hurt munis, the experts said.

Clinton's plan, on the other hand, would maintain or raise tax rates for the highest earners, and that could spell positives for munis, they said. And as 2016 is a lame duck year, most experts agree that tax reform before January is not likely.

No matter who comes out on top in November, muni market participants will try to make sure they understand the importance of muni bonds. Bond Dealers of America CEO Michael Nicholas stressed that munis have funded critical infrastructure needs effectively for more than a century.

"They are the proven, economically efficient solution to the U.S. infrastructure problem that the presidential candidates have been discussing all across the country," Nicholas told The Bond Buyer this week. "BDA urges all the candidates to avoid eliminating or placing an unnecessary limit or cap on the value of the municipal bond interest exemption if they are truly serious about reducing fiscal burdens on localities while simultaneously putting people to work building roads, bridges, schools, and hospitals."

Donald Trump

Trump's plan is perhaps best defined by its across-the-board tax cuts, including an elimination of the individual income tax for 73 million households. The tax brackets would be reduced to four brackets from seven and set at rates of 0%, 10%, 20% with a top rate of 25%, according to Trump's campaign website. Those in the 10% bracket would keep all or most of their current deductions; those in the 20% bracket would keep more than half of their current deductions; and those in the 25% bracket would keep fewer deductions. The current top rate stands at 39.6%.

On the business side, Trump also calls for a reduction of the corporate income tax rate to 15 percent as well as an elimination of the death tax, the marriage penalty and the alternative minimum tax.

The Tax Foundation, a research think tank, estimated his plan would reduce tax revenues by $10.14 trillion, after taking into account an estimated 11% increase in GDP in the long term and an estimated 5.3 million new full-time jobs. The organization estimated a plan like Trump's, which would increase the federal deficit by more than $10 trillion on both a static and dynamic basis, would "greatly increase" the size of the U.S. economy in the long run.

Neither Trump nor Clinton mention municipal bonds specifically in their tax plans, but several experts have previously expressed concerns over what Trump's plan could mean for the market. Frank Shafroth, the director of the Center for State and Local Government Leadership at George Mason University, warned that Trump's plan would "lead to a fiscal double whammy for states and local governments and the nation's public infrastructure" because it would reduce the incentives for purchasing munis, while increasing the federal debt and failing to offset spending reductions. This would create "significant, adverse" impacts on the muni market and "debilitating" effects on public infrastructure, he said.

Trump "would almost certainly force even deeper federal cuts in federal infrastructure programs – even as the dramatically reduced taxes proposed for the highest income Americans would equally reduce incentives for the purchase of municipal bonds," Shafroth said.

The plan would be paid for by a one-time repatriation of overseas-held corporate cash at a discounted 10% tax rate; ending the deferral of taxes on corporate income earned abroad; and the reduction or elimination of several loopholes available to the most wealthy. He would steepen the curve of the personal exemption phaseout and the "pease limitation" on itemized deductions. He would also phase out the tax exemption on life insurance interest for high-income earners and reduce or eliminate other loopholes for the very rich and special interests.

Speaking at the 2016 National Association of State Treasurers Legislative Conference here earlier this month, David Burton, a conservative, called Trump's tax plan "unusual," adding that many financial analysts have estimated it would cost the country roughly $1 trillion per year.

The Tax Policy Center, in a December report, predicted increased government borrowing under Trump's proposal would drive up interest rates and crowd out private investment, which could offset any positive incentive effects.

"Offsetting a deficit this large would require unprecedented cuts in federal spending," the center wrote in the report.

Trump has said he would take the $4 trillion spent toward toppling various regimes and instead put it toward what he has repeatedly called a "crumbling" domestic infrastructure.

Still, Susan Collet, president of H Street Capitol Strategies, but doesn't think the business mogul's plan is well-developed enough to assess the likelihood of its potential positives for infrastructure spending. "He definitely wants to fix the infrastructure of the nation," Collet said. "How to get there from his tax plan is a big question. The infrastructure spending has got to come from somewhere."

"With deficits and debt climbing that high, the future White House and Congress are going to have to grapple not only with the tax code but also entitlements and spending," she added.

"These federal cuts, and the resulting federal revenue losses would be unprecedented in U.S. history," Shafroth said.

Hillary Clinton

Clinton's plan is centered around a "Rising Incomes, Sharing Profits" tax credit that would award a two-year tax credit to companies that share profits with employees. The credit would be equal to 15 percent of the profits they share, and the profits would be capped at 10% on top of current employee wages.

The cost of the tax credit, estimated at $20 billion over a ten-year budget window, would be paid for through the closure of tax loopholes Clinton has said she will identity in the "weeks and months ahead."

Hillary Clinton's campaign recently released a detailed tax proposal, one that includes $1.1 trillion in tax increases. In its analysis of the report, The Tax Policy Center said the top 1% of households would pay more than three-fourths of Clinton's increases, while the bottom 95 percent would remain relatively unaffected by any cuts. Citing Clinton representatives, The Tax Policy Center said it also anticipates a tax cut for low- and middle-income households to be released later in the campaign.

Clinton's proposals are expected to raise tax revenue by $498 billion over the next decade, the majority of which would come from the Buffett Rule, or a cap on itemized deductions, The Tax Foundation estimated in January,

The $1.1 trillion the plan is expected to raise over the next decade would effectively reduce the economy's size by one percent as a result of higher marginal tax rates on capital and labor income, the group said. Using its tax and growth model, the group projected a 1% drop in GDP and a 2.8% percent smaller capital stock.

A tax reform task force led by House Ways & Means Committee Chairman Kevin Brady, R-Texas, released a mission statement this month that stresses a limit of exclusions, deductions and credits in hopes of creating a stable tax code and a larger economy – quite the opposite from what experts believe would come from a Clinton tax plan.

As part of her plan to raise taxes on the wealthiest Americans, Clinton in January proposed a 4% surtax on those with an annual income of more than $5 million.

Howard Gleckman, a senior fellow at the Tax Policy Center, said that Clinton's plan, which would raise rates for the highest earners, lends itself more to a thriving muni industry than Trump's. He added that Trump's plan, barring any unreleased planned spending cuts, would add enormously to the budget deficit and create a "big challenge" for state and local governments.

"The general rule of thumb is the lower the tax rate for the individual, the worse it is for tax-exempt bonds," he said. "The higher the rate, the better it is."

"Trump plans to dramatically lower the tax rates, giving people a much less reason to buy tax exempt bonds. Clinton, on the other hand, by raising tax rates for people at the top would make tax exempt bonds more attractive," said Gleckman.

Other candidates

This week's third incarnation of Super Tuesday saw Sen. Marco Rubio, R-Florida, exit the race after losing by double digits to Trump in his home state, leaving Trump with Sen. Ted Cruz, R-Texas, as the closest remaining competitor in a previously overcrowded GOP field.

The Tax Foundation, the tax research think tank, estimated Cruz's plan would grow 10-year capital

by 43.9%. Cruz, as he has mentioned throughout his campaign, has proposed a flat tax rate of 10%, and has plans to abolish the Internal Revenue Service. He would instead rely on a mail-in postcard tax payment system overseen by an office within Treasury.

He has proposed to replace the income tax with a consumption tax, which Shafroth said would cut taxes by an average of roughly $6,000, higher than any of remaining candidate. Cruz's plan, which reduces both the corporate and individual tax rate, could very well push the tax system toward pro-growth, according to Burton.

Shafroth said a Cruz or Trump presidency would spell many of the same problems for munis, but what stands out about Cruz's plan is what he called "disproportionately" proposed tax cuts – those in the top 1 percent would see an average federal tax cut of 26%, while middle income households would see just a 3.2 percent cut. This in itself, he said, would be disincentives for the purchase of general obligation and revenue municipal bonds both at the state and local level, Shafroth said.

Cruz has proposed an $8.6 trillion federal tax cut, roughly $1 trillion less than that of Trump.

"These two candidates would confront states, counties, and cities with much greater infrastructure or muni borrowing costs, even as federal investment resources for the nation's infrastructure would be depleted," Shafroth said.

The Tax Foundation said the plan of Sen. Bernie Sanders, I-Vt., the only other remaining Democratic presidential candidate, would result in a "substantial reduction" of the size of the U.S. economy in the long run. Sanders has proposed a number of increased payroll taxes and individual income taxes as well as four new income tax brackets for high-income households: 37%, 43%, 48% and 52%. The organization estimated that it would reduce the size of GDP by 9.5% in the long term, and increase federal tax revenues by $9.8 trillion over the next decade.

A report issued by the Tax Policy Center estimated Sanders' plan would cost the government roughly $13.5 trillion.

The likelihood of any of the candidates' plans coming to fruition is largely dependent on a number of factors, including the makeup of Congress and the Supreme Court, said the experts.

Chuck Marr, a self-described liberal and the director of federal tax policy for the Center on Budget and Policy Priorities, said at the NAST conference that the U.S. tax system is currently "bleeding," and speculated a divided Congress and more modest tax reform, specifically in the corporate sector should Democratic frontrunner Hillary Clinton win the presidency, and a "steamroll" effect in terms of implementing new tax measures should a Republican win.

"The highest probability for big change is if Republicans win and control a whole Congress and presidency. Then they'll have major tax cuts," he said. "They'll reduce rates on capital, and that is the most likely major action."

The Bond Buyer

By Evan Fallor

March 20, 2016

Lawmakers, Bankers Discuss How to Ease Tax Laws for P3s.

WASHINGTON – Municipal finance leaders and a bipartisan group of lawmakers met Wednesday on Capitol Hill to discuss how tax laws might be eased so that more public-private arrangements could be used to finance public infrastructure projects.

The event, hosted by the Securities Industry and Financial Markets Association, included policymakers and industry executives with expertise in P3s. Some of the discussion focused on whether there should be more kinds of public infrastructure projects that can be financed with tax-exempt private-activity bonds and P3 arrangements.

At the roundtable discussion, several executives from investment banks provided information about P3s to members of Congress. They included Chris Hamel, the managing director and head of municipal finance for RBC Capital Markets; Stephen Howard, the director and head of infrastructure project finance for Barclays Capital; Howard Marsh, the managing director of municipal securities for Citigroup; and Michael Decker, a managing director and co-head of municipal securities for SIFMA.

Following the roundtable discussion, which was closed to the press, Decker told The Bond Buyer the roundtable was a "constructive discussion" with input both from industry officials and members of Congress.

"There seems to be a lot of interest from members of Congress here, who asked a lot of questions like, 'What can Congress do to encourage this type of financing?'" he said.

Legislators who attended the discussion included Reps. Steve Stivers, R-Ohio; Terri Sewell, D-Ala.; and Randy Hultgren, R-Ill., all of whom serve on the House Financial Services Committee.

Hultgren said afterward that infrastructure financing is a subject that "needs to be discussed," adding that is a broader issue than just maintaining the tax-exempt status of bonds. He said the timing of the discussion does not mean there is imminent legislation, but it does follow the bipartisan Municipal Finance Caucus he launched earlier this month that would protect the tax-exempt status of municipal debt.

"There are so many times where it has worked well and a few times where it hasn't," Hultgren said. "We have to figure out what we can do to build on [the P3s that worked well and] to make sure bad decisions aren't made that would harm something that effective."

In an election year where leading presidential candidates have called infrastructure "crumbling" and "decimated," Stivers cited the $3.98 billion plan to replace the 61-year-old Tappan Zee Bridge connecting Nyack and Tarrytown, N.Y., as an example of a successful P3 that saved $1.1 billion in construction costs and 18 months of construction time.

Stivers said, "The threat to municipal bonds and capping of the benefit of the tax exemption would make tax-free bonds partially taxable and therefore make infrastructure projects more expensive and harder to complete."

"We just need to expand opportunities for public-private partnerships to be a viable means of financing along with the regular municipal financing that comes from state and local governments," he said.

Decker said much of the discussion at the roundtable centered on incentivizing states to adopt

Design-Build policies to a greater extent and to use private sources of capital for infrastructure projects. Design-Build policies allow a state or local government or an authority to enter into a contract with a private partner that takes on the responsibility for both the design and the construction of a project.

Though the tax code generally prohibits the use of tax-exempt bonds for certain projects when there is a more de minimis level of private financing, Decker said there are exceptions such as for airport projects, which can be financed with tax-exempt PABs.

For “social infrastructure” projects, including city halls, courthouses and public parks, tax-exempt financing cannot be used if there is more than a de minimis level of private participation in the project, a hurdle Decker needs to be addressed.

Under federal tax law, a project must be financed with private-activity bonds if more than 10% of it is used by a private party and more than 10% of the debt service is paid or secured by a private party. But PABs are not tax-exempt unless the projects they are financing fall into specific categories, one of which includes airports.

President Barack Obama has proposed eliminating barriers in the tax code to private use of tax-exempt bonds for public infrastructure projects.

“You can make a strong case that the tax code can be agnostic with regards to infrastructure projects when there is public access to the project and where there is local government oversight,” he said.

The roundtable was held the same day as the Flint Water Advisory Task Force released its final report on the water crisis facing Flint, Mich., which it called a “story of government failure, intransigence, unpreparedness, delay, inaction, and environmental injustice.”

Sewell, who represents both Birmingham and several rural communities in Alabama, said that many of the rural areas also face water and sewer issues. She said the U.S. Department of Agriculture helps with financing for these issues, calling them “the only game in town.”

“It’s not a capital problem. It’s a funding problem,” she said. “We need to figure out a better ways of trying to fund these infrastructure projects.”

Going forward Decker said he hoped discussions with legislators will continue, especially before a new administration enters the White House in 2017.

“Our focus is just raising awareness with the issues,” Decker said. “Like we did today, we just want to make sure policymakers in Washington understand the techniques being employed or can be employed for financing infrastructure in a broader array of investments and projects.”

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By Evan Fallor

March 23, 2016