Bond Case Briefs

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New IRS Management Guidance is Flexible, Furthers P3s: Ballard Spahr

Ballard Spahr to Conduct Webinar at 12 p.m. ET on September 14, 2016

State and local governments and 501(c)(3) organizations have been given very flexible guidance by the IRS for longer-term private management of tax-exempt bond financed projects to facilitate general operations and major infrastructure initiatives. These safe harbors apply to any management contract that is entered into on or after August 22, 2016.

The maximum term of a qualifying contract is now the lesser of 30 years or 80 percent of the economic life of the managed property. Prior guidance had placed limits on the term of the contract based on the extent to which the compensation was a fixed fee or was variable (percentage of revenues or per unit fees, for example).

Compensation under a qualifying contract must meet the following requirements:

- It must be reasonable compensation for services rendered.
- It must not provide the service provider with a share of net profits from the operation of the managed facility. No element of the compensation can take into account or be contingent upon either the managed property's net profits or both the revenues and expenses for any fiscal year. The Internal Revenue Service will look to the eligibility, the amount, and the timing of the payments to determine if the net profits prohibition is violated.
- Incentive compensation is permissible, so long as it is determined by the service provider's performance in meeting one or more standards that measure quality of services, performance, or productivity.
- It cannot require the service provider to bear the net losses from the operation of the managed property. This requirement is specifically defined for the purposes of the guidance, but would not, for example, limit a contract where the service provider's compensation is reduced by a stated dollar amount for failure to keep the managed property's expenses below a specified target.
- The state or local government or 501(c)(3) organization must exercise a significant amount of control over the use of the managed property, such as approval of the annual budget of the managed property, capital expenditures of the property, disposition of the property, rates charged for the use of the property, and the general nature and type of use of the property.
- The state or local government or 501(c)(3) organization must bear the risk of loss if the managed property is damaged or destroyed. This requirement is met if insurance is purchased from a third party or if a penalty is imposed on the service provider for failure to operate the property in accordance with the standards laid out in the management contract.
- The state and local government/501(c)(3) entity and the service provider must treat the service contract consistently for federal tax purposes. The service provider could not, for example, take depreciation or tax credits with respect to the managed property, which would be inconsistent with the state or local government being the owner having entered into a contract for services.
- The service provider must not have any role or relationship through overlapping boards or executives which limits the ability of the state or local government or 501(c)(3) to exercise its

rights under the contract. The safe harbor for determining what might limit the ability to exercise rights is essentially the same as the 1997 guidance.
- Contracts to provide services before the managed property is placed in service (such as pre-operating services for construction design or construction management) are not management contracts that must be analyzed under the rules.
- Contracts that provide for compensation solely to reimburse eligible expenses (reimbursement of actual and direct expenses paid by the service provider to unrelated parties and reasonable related administrative overhead expenses of the service provider) are not management contracts that must be analyzed under the rules.

If a contract is a qualifying contract, other uses of the managed property, such as on-site office or storage space to perform services, will not be treated as private business use.

These safe harbors essentially replace the prior 1997 and 2014 guidelines. Because the prior guidance was more restrictive, contracts complying with the 1997 and 2014 guidelines would likely continue to be qualifying, but the Revenue Procedure goes on to specifically state that the prior guidelines can be applied to contracts entered into before February 18, 2017.

Our attorneys will continue to do an in-depth analysis of these revisions and how they will impact your organization. On September 14, 2016, at 12 p.m. ET, Ballard Spahr will host a webinar where we will explore how these flexible guidance rules will impact negotiations with service providers, how they can be used in combination with the mixed-use allocation rules, the influence this guidance can have on furthering public-private partnerships (P3), as well as what the guidance means for upcoming bond financings. The webinar registration form is available here.

Attorneys in Ballard Spahr's Public Finance Group have participated in every kind of tax-exempt bond financing and have extensive experience with the rules and regulations set by the IRS and U.S. Treasury. Working closely with attorneys in Ballard Spahr's P3/Infrastructure Group, they routinely monitor and report on new developments that impact federal and state infrastructure programs related to transportation and other types of projects.

by the Public Finance Group

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