

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

---

## **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.*