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IRS Rules Against $26.5 Million Bond Sale for Downtown Dallas' Historic Statler Hotel.

An IRS ruling could imperil a move to fund part of the historic Statler Hotel renovations with a special bond sale.

Developers revamping the historic downtown Dallas hotel sold the city financial incentives for the project that were used to back tax-exempt municipal bonds.

The deal allowed builder Centurion American Group to access the funds years before they would normally have been paid.

The city of Dallas agreed to provide the developers $46.5 million in city incentives that would be paid through tax increment finance district funds. Those TIF funds were used to finance the sale of $26.5 million in bonds.

In a preliminary ruling, the IRS said that the bonds don't meet its requirements to be "excluded from gross income for federal income tax purposes."

The Wisconsin Public Finance Authority, which issued the bonds last August, said it will appeal the decision and will continue to negotiate with the IRS.

If the ruling stands, it could affect not only the Statler project but also dozens of other real estate developments that were contemplating a similar sale of their incentives.

The IRS decision is unlikely to affect the completion of the Statler redevelopment.

The Statler developers said it could be some time before the issue is resolved.

"We sold our rights to a portion of the TIF," Centurion American's spokeswoman said in a statement. "The Wisconsin Public Finance Authority (WPFA) and its legal counsel (Orrick, Herrington & Sutcliffe LLP) made determinations on all tax matters.

"We will follow whatever ruling is ultimately decided by the IRS," the company said. "But, at this time the WPFA and Orrick are protesting the preliminary ruling of the IRS on this matter. They expect this to be a six- to 12-month process to reach resolution."

The sale of the bonds is just part of the mix of funding developer Centurion American is using for the $230 million renovation of the 61-year-old Commerce Street hotel and the adjoining former Dallas Public Library building.

The 19-story midcentury modern hotel is being converted into a combination of apartments, hotel rooms and retail space.

Tenants have already begun moving into the rental units. And the Hilton Curio Hotel is scheduled to open in early 2018.

The Dallas Morning News is relocating its downtown offices to the former library this fall.

When the sale of the Statler bonds was disclosed last year, it was considered a creative way to provide funding for one of downtown Dallas' largest historic renovation projects.

Since then, developers of other local real estate projects have said they plan to explore similar bond sales to help fund their deals. The IRS ruling, if it stands, could quash those efforts.

Investors who bought the bonds were motivated by the tax-free treatment of the income. Those bondholders could be required to pay back taxes on that income if the exemption is withheld. The IRS did not contest the Wisconsin authority's sale of the bonds, just the tax-free provision.

Tax increment finance grants are a popular way for cities to help developers pay for projects. The incentives designate funds from property taxes in the neighborhood to pay the builders for part of the construction.

The TIF grants are always paid after the development is complete and are typically given in payments over several years.

By selling the TIF incentive for bonds, the developers would be able to access needed upfront money for their projects.

Redevelopment of the landmark Statler Hotel is being financed with a combination of loans, funding from foreign investors and the sale of historic tax credits for the project.

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By Steve Brown

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