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IRS: Bonds Tax Exempt after Hospital Contract with Pharmacy School.

WASHINGTON – A recent Internal Revenue Service private letter ruling is being greeted by tax lawyers as confirmation that the tax-exempt status of bonds issued by public teaching hospitals isn't jeopardized under most agreements with medical schools, nursing schools and pharmacy schools.

IRS private letter ruling 2017226007 dated July 13 addressed the case of an unnamed county hospital with tax-exempt bonds outstanding that signed a five-year contract with a pharmacy school. The contract does not involve money. It allows pharmacy students to perform clinical rotations but the school creates the curriculum, takes attendance and provides instructors.

The hospital, meanwhile, has the right to immediately remove any student or faculty member who jeopardizes the hospital's license or the health and safety of patients, visitors or staff.

The IRS concluded the agreement is a management contract, but found that it did not meet the safe harbor conditions under the new Revenue Procedure 2017-13. That procedure clarified certain types of arrangements and compensation that would not be treated as providing a share of net profits.

Even so, the IRS concluded that the agreement did not result in a private business use that would jeopardize the tax exempt status of its bonds.

Under the tax code, bonds are private activity bonds if more than 10% of the proceeds are used for private use and more than 10% of debt service payments are from or secured by private parties.

"All big state teaching schools are going to have arrangements like this,'' said Elizabeth Walker, bond and tax attorney at the Indianapolis office of Hall, Render, Killian, Heath & Lyman, the nation's largest health care-focused law firm.

Walker, who says 90% of her work deals with hospitals and health care systems, described the agreements as "the norm around the country.''

Alexios Hadji, an attorney for Squire Patton Boggs in Columbus, Ohio who posted a commentary on the IRS letter on his law firm's public finance blog last week, said the letter ruling was the first involving hospital management contracts since IRS Revenue Procedure 2017-13 took effect.

"If those students are coming from a school there has to be an agreement to allow them access to the facilities of the hospital," Hadji said on Monday, emphasizing the importance of the agreements to teaching hospitals.

Walker said she is reassured that agreements in which no money is exchanged are still considered management contacts by the IRS.

Walker advises clients that agreements with for-profit medical schools, which are often based in the Caribbean, constitute a private use when the school makes a payment to the hospital to place a

graduate into the hospital’s clinical rotation.

“A plumber doesn’t pay me to come do my plumbing,’’ Walker said, making an analogy. “That’s where I have come across this issue a lot.’’

Hadji said the private use issue comes up when a hospital shares profits with a private business, such as an on-site cafeteria run by a vendor that has an incentive measure in the contract.

The IRS cautions that PLRs cannot be relied on by other parties.

The Bond Buyer

By Brian Tumulty

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