Bond Case Briefs

Municipal Finance Law Since 1971

Tax

TAX - CALIFORNIA

Jacks v. City of Santa Barbara

Court of Appeal, Second District, Division 6, California - February 26, 2015 - Cal.Rptr.3d - 15 Cal. Daily Op. Serv. 1950 - 2015 Daily Journal D.A.R. 2246

Utility consumers, who incurred 1% surcharge on their electricity bills collected by electric company and remitted to city, filed class action complaint against city, seeking order declaring that surcharge was invalid as a tax imposed without voter approval, enjoining city from further collection of surcharge, and requiring city to repay revenues already collected. The Superior Court granted city summary judgment. Consumers appealed.

The Court of Appeal held that surcharge was a tax subject to voter approval, rather than a franchise fee.

Franchise agreement between city and electric company treated surcharge differently from franchise fee, from the perspective of utility consumer there was no functional difference between surcharge and user utility tax, and surcharge was not being collected for grant of right of way, but rather for revenue purposes.

IRS Publication: Tax Exempt Status for your Organization.

The IRS has released a publication entitled, Tax Exempt Status for your Organization.

TAX - MICHIGAN

Hartland Glen Development, LLC v. Township of Hartland

Court of Appeals of Michigan - February 19, 2015 - Not Reported in N.W.2d - 2015 WL 728640

Property Owner appealed the opinion and judgment issued by the Michigan Tax Tribunal (MTT) regarding property tax assessments levied by Hartland Township on Owner's golf course for tax years 2011 and 2012. The crux of the appeal concerned the MTT's ruling that sewer-related special assessments encumbering the property and payable in installments, some of which were past due with the remaining due in the future, did not result in a decrease in the property's true cash value (TCV). The MTT essentially found this proposition to be true in all tax cases involving property subject to outstanding special assessments.

This conclusion was based, in part, on the argument that a township special assessment is levied on particular real property to cover the costs of an improvement project that must benefit that real

property, with the requirement that the amount of the assessment be reasonably proportionate to the benefit. Thus, one could conclude that the cost of the special assessment is automatically offset by the directly-proportionate increase to the property resulting from the improvements to the property underlying the special assessment

The Court of Appeal rejected this argument, reversed, and remanded.

The Court of Appeal noted that the Owner's appraiser opined that the outstanding special assessments decreased the golf course's TCV and the Township's appraiser indicated that, if a purchaser had to make future special-assessment payments, it would likely decrease the property's TCV. Therefore, there was no evidence supporting the MTT's ruling that the outstanding special assessments would not decrease the TCV. The MTT treated the issue as a purely legal question, but the testimony of the township's appraiser suggested that it is a factual question, at least in part, where he testified that a decrease in TCV would likely result if a purchaser had to assume an outstanding special assessment, but a new appraisal would have to be undertaken to make a definitive determination.

The Court of Appeals remanded for the purpose of conducting a factual inquiry as to whether the outstanding special assessments can and did decrease the property's TCV.

"To provide clarity on remand, we provide the following directives. First, because the focus of the dispute concerns the special assessments and because the related appeal challenges those assessments, remand proceedings here shall await final resolution of that appeal. Thereafter, and as framed by and depending on the result of the other appeal, proceedings are to be conducted to fully explore the question whether outstanding special assessments can and did decrease the property's TCV. The proceedings should entail arguments, testimony, and evidence on the issues and questions raised and highlighted in this opinion, including clarification and elaboration with respect to the township's appraiser's testimony cited in this opinion and possibly the preparation of new appraisals."

IRS Issues Proposed Regs on Determining AFRs for Tax-Exempt Bonds: Tax Analysts

The IRS has issued proposed regulations that provide the method to be used to adjust the applicable federal rates under section 1288 for tax-exempt obligations and the method to be used to determine the long-term tax-exempt rate and the adjusted federal long-term rate under section 382. (REG-136018-13)

Read the proposed regs (subscription required).

Letter Urges House Leaders to Back Exemption.

Reps. Dutch Ruppersberger (D-MD) and Randy Hultgren (R-IL) are circulating a Dear Colleague letter urging House members to sign onto a letter addressed to House leadership supporting the tax-exempt status of municipal bonds. The letter addresses proposals to both cap and eliminate the deduction, saying those efforts "would severely curtail state and local governments' ability to invest in themselves… increase borrowing costs to public entities and shift costs to local residents through

tax or rate increases."

Both the Dear Colleague letter and the letter to House leadership can be seen here. Despite the deadline on the Dear Colleague in the link, NABL members can contact their Representatives (or suggest their clients do so) and urge the Representatives to sign on to the letter.

MBFA Sends Letter to Senate Finance Committee Tax Reform Working Group.

The Municipal Bonds for America (MBFA) Coalition sent a letter to Senators Dean Heller (R-NV) and Michael Bennet (D-CO), the co-chairs of the Senate Finance Committee Community Development & Infrastructure tax reform working group. The working groups are in the process of gathering information to make recommendations on their group's topic regarding tax reform to the full Senate Finance Committee. The MBFA wrote in strong support of the current law tax exemption for municipal bonds, discussing the benefits of bonds for state and local governments, community investment, and taxpayers.

MBFA Letter to Senate Finance Committee Tax Reform Working Group

February 27, 2015

NABL Questions BABs Reissuance Memo.

NABL sent a memorandum today to the IRS Chief Counsel's office disagreeing with the conclusion in Advice Memorandum 2014-009. The advice memorandum concluded that BABs which were defeased were reissued. The AM relied on part of a sentence, taken out of context, in the preamble to the reissuance regulations to come to its conclusion even though BABs meet the requirements of the regulations.

The NABL memorandum is available here.

FASB Won't Require Nonprofit Disclosure of Taxes on Investment: Tax Analysts

The Financial Accounting Standards Board decided February 25 to not include its proposed guidance on nonprofit financial reporting a requirement that nonprofit organizations disclose the taxes assessed on income from their investment activity.

Continue Reading (subscription required).

FEBRUARY 27, 2015

Thomas Jaworski

IRS Private Letter Ruling "Shinin' Down Like Water" - Squire Patton Boggs

In 1971, Creedence Clearwater Revival (CCR) released the song, "Have You Ever Seen the Rain". One line in the song says "When it's over, so they say, it'll rain a sunny day, I know, shinin' down like water". We have to concede that when it comes to song lyrics, poetic license occasionally must trump the rules of grammar. Whatever John Fogerty (lead singer and song writer) and CCR were trying to convey, it probably had nothing to do with tax-exempt bonds.

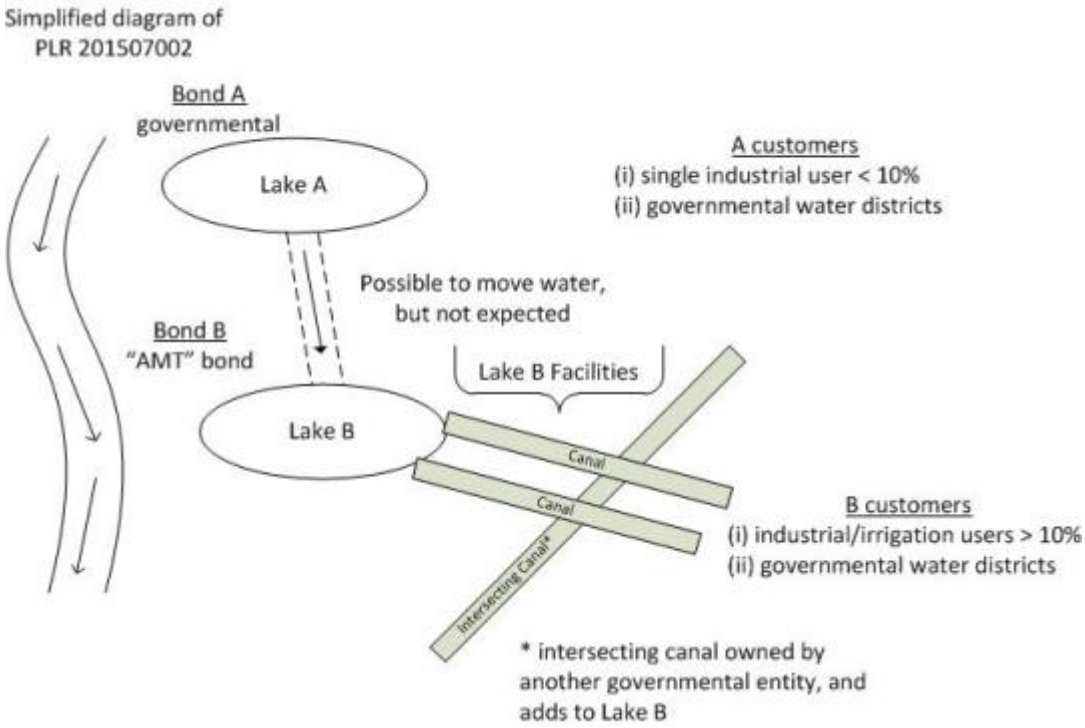
Nonetheless, on October 28, 2014, the IRS issued a private letter ruling, "shinin' down" about bonds for water projects. PLR 201507002, which was publicly released on February 13, 2015, was a favorable ruling for the issuer that requested it. Whether CCR had anything to do with the favorable treatment or it was a simple matter of the IRS correctly applying the law to the facts, we will never know. Perhaps it was a bit of both.

The ruling deals with two different types of water bonds. The first issue is a governmental bond (Bond A). A governmental bond is defined in Treas. Reg. §1.150-1(b) as an issue of tax-exempt bonds none of which are private activity bonds. The second issue is a type of permitted private activity bond, an exempt facility bond issued under Section 142(a)(4) of the Code to finance "facilities for the furnishing of water" (Bond B). Because it is a governmental bond, the interest on Bond A will not be subject to the alternative minimum tax imposed by Section 55 of the Code (AMT) for individual holders (a so-called "non-AMT" Bond) under the exception found in Section 57(a)(5) of the Code. Conversely, the interest on Bond B will be subject to the AMT (a so-called "AMT" bond). Because of the additional tax implications, AMT Bonds carry a higher interest rate than non-AMT bonds. Thus, as a proportion of the overall financing, the issuer would like Bond A to be as large as possible and Bond B to be as small as possible. One nice feature of the ruling is the recognition by the IRS that, while there is a physical connection between the fungible water supplies, they chose to treat each water supply separately.

FACTS

As is the case with all private letter rulings, the IRS begins with a recitation of the facts and representations made by the issuer.

The issuer of the bonds is a political subdivision of a state whose task is to develop, conserve and protect water resources in a river watershed. To accomplish that, the issuer operates facilities to collect, store and distribute raw water for industrial, municipal, and irrigation purposes, primarily relying on gravity. The storage facilities consist of two respective lakes (Lake A and Lake B) and related facilities. The water is distributed to different, respective sets of customers (A Customers and B Customers). The Lake B facilities include two canals that deliver the water to the B Customers. The river that is the source of the water for Lake B and the two canals intersects a third canal which is owned by another governmental entity and that governmental entity's water enters one of the Issuer's canals. The Lake B water is extracted downstream from Lake A and the issuer has the ability to move water from Lake A to Lake B, but the issuer does not expect this to occur in any significant amount based on recent history. The issuer represents that at least 95% of the proceeds of Bond B will be spent on Lake B facilities.



The issuer has entered into or will enter into "take or pay" contracts with both the A Customers and the B Customers. Because a water supply is dependent on the uncontrollable forces of nature, the supply may not always be fully available. A simple "take" contract is a contract where the purchaser agrees to pay for the output only if the facility is capable of producing that output. If the facility fails to meet the customer's needs, the customer does not have to pay. But a "take or pay" contract is defined in Treas. Reg. §1.141.-7(b)(4) as a contract under which the purchaser agrees to pay for the output from the financed facility regardless of whether the facility can actually deliver all of the expected output. This means the A Customers and the B Customers will pay for the output even if there is a drought and the output is less than expected. The A Customers and the B Customers cannot get out of the contract just because there is insufficient water to meet their needs. We note that the printed ruling has a glitch in its cite to Treas. Reg. §1.141-7(c)(4) (instead of (b)(4)) for the definition of a take or pay contract but the meaning is clear.

The A Customers consist of (i) a single industrial user and (ii) governmental water districts. The issuer has already entered into the take or pay contract with the industrial user and expects to enter into the take or pay contracts with the governmental water districts. The issuer expects that the industrial user will use less than 10% of the water supply and the remainder will be used by the governmental water districts.

The B Customers are (i) industrial and irrigation users and (ii) governmental water districts. The industrial and irrigation customers will take more than 10% of the supply funded with proceeds of Bond B. For this reason, Bond B cannot be a governmental, non-AMT bond and has to be issued as an exempt facility, AMT bond. The issuer represents that at least 25% of the Lake B supply will go to the municipal water districts.

LAW

Again, as is the case in every private letter ruling, the IRS then recites its view of the relevant law and applies it to the facts. It breaks that analysis into two parts, the rules for governmental bonds and the rules for exempt facility bonds.

Governmental Bonds. The IRS starts with the fundamental premise that a private activity bond

cannot be a tax-exempt bond under Section 141(a)(1) of the Code. A private activity bond is a bond that meets both the private business use test and the private security or payment tests described in Section 141(b) of the Code. The IRS then turns to an analysis of the private business use test found in Section 141(b)(1) of the Code and the definition of private business use found in Section 141(b)(6) of the Code, which states that private business use is use in a trade or business by any person other than a governmental unit. Use as a member of the general public is not use in a trade or business.

The IRS then notes that the Treasury Regulations provide special rules for the application of the private business use test to the purchase of output from "output facilities". While most people are likely to think of electric generation facilities as output facilities, most people are not likely to have ever thought about whether water production facilities are output facilities. But Treas. Reg. 1.141-1(b) clearly defines an output facility to include water collection, storage, and distribution facilities. The IRS notes that Treas. Reg. §1.141-7(c)(1) provides that purchase of output by a nongovernmental person is taken into account under the private business use test if the contract providing for that purchase transfers the benefits and burdens of paying the debt service on the bonds to a non-governmental person. Treas. Reg. §1.141-7(c)(2) states that a take or pay contract does transfer the benefits and burdens to the purchaser of the output. Treas. Reg. §1.141-7(d) tells the reader that the amount of private business use will be based on the amount of output purchased. Treas. Reg. 1.141-7(h) instructs the reader to determine whether the output contract should be allocated to an issuer's entire system, a particular facility, or a portion of a financed facility based on all the facts and circumstances. This allocation can greatly affect the amount of private business use because the numerator, the amount of the purchase, remains unchanged but the denominator, the capacity against which that use is to be measured, can vary widely as between one unit of a facility versus the capacity of the issuer's entire system. On the other hand, the allocation to a more limited portion of a facility can restrict a contract that gives rise to private business use to a particular bond issue where its use is a more favorable percentage.

The IRS analyzes the facts in this matter and concludes that the A Customers will only receive Lake A supply funded by Bond A and the B Customers will only receive Lake B supply funded by Bond B and that there is no expected interaction between the two supply sources and so no expected interaction between the two bond issues. The IRS therefore concludes that Bond A is a good governmental bond because the one industrial customer of Lake A supply will take less than 10% of supply from Lake A.

Of course, if the facts change over the period of time Bond A is outstanding, the issuer may have to make adjustments. Three conceivable changes would be (i) an increase in the amount of Lake A supply going to the existing industrial user, (ii) the addition of more industrial or irrigation users, or (iii) a mixing of the Lake A and Lake B supply.

Exempt Facility Bonds. The IRS then turns its attention to an analysis of exempt facility bonds for the furnishing of water. A qualified exempt facility bond must (i) use at least 95% of the proceeds (ii) for the permitted purpose, in this case furnishing water.

Because the issuer represented that it will satisfy the 95% test, the IRS focuses on what constitutes furnishing water and determines that several factors are critical in making that determination. First, the IRS reaches the obvious conclusion that the issuer is supplying water and cites the conference report regarding the statute that enacted the furnishing of water category of exempt facility bonds, H.R. Conf. Rep. No. 95-1800, at page 237 (1978), (Vol. 1) C.B. 521, at 571, which states that a facility for the furnishing of water is a facility that must be a component of a system or project which furnishes water. That is not an earth shattering conclusion! The statute, the legislative history and the applicable regulations never require that the water be potable. Raw water is acceptable. Second, the IRS concludes that the facilities financed are for furnishing water. Treas. Reg. 1.103-8(h) defines

water facilities to include “artesian wells, reservoirs, dams, related equipment and pipelines, and other facilities used to furnish water for domestic, industrial, irrigation and other purposes. Interestingly, the IRS never cites these regulations in the ruling. Third, Section 142(e) of the Code also requires that a facility for furnishing of water must be a facility that makes water available to the general public. The general public is defined for this purpose to include electric utilities, industrial, agricultural or commercial users. The Lake B supply will only go to governmental water districts, industrial and irrigation customers (agricultural users) and the issuer had represented that at least 25% was going to municipal water districts, so this test is clearly met. Fourth, Section 142(e) of the Code requires that the facility either be operated by a governmental unit or that the rates to be paid by customers are either established by state or political subdivision thereof, an agency or instrumentality of the United States, or a public service or public utility commission or similar body. In this case, the Lake B facilities will be operated by the issuer, a governmental unit, and so the IRS acknowledges that this requirement is also satisfied.

The IRS also recognizes that there is an interaction between the Lake B supply and another governmental authority where the canal operated by the other governmental authority intersects and adds supply to the Lake B supply. The IRS again reaches an obvious conclusion that the Lake B supply is operated by a governmental unit because the other source of water is operated by another governmental unit.

CONCLUSION

While the facts of this ruling make the legal analysis relatively straightforward, the IRS does a nice job of reciting the relevant law and reaching the foregone conclusion. We often are inclined to criticize the IRS when we disagree and perhaps more reluctant to congratulate them for a job well done. This is a job well done. So, to quote CCR, “Someone told me long ago, there’s a calm before the storm”. We should enjoy the calm this ruling provides as a storm will undoubtedly come along before we know it.

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TAX - IDAHO

North Idaho Bldg. Contractors Ass'n v. City of Hayden

Supreme Court of Idaho, Boise, January 2015 Term - February 26, 2015 - P.3d - 2015 WL 797524

Building contractors association filed action to have city's sewer connection fee declared unlawful because it was an impermissible tax rather than a fee for services. The District Court held fee was lawful and dismissed complaint. Association appealed.

The Supreme Court of Idaho held that:

- Fee was an impermissible tax, and
- Fee was not authorized under Idaho Revenue Bond Act.

Because there was nothing in the record showing that city's sewer capitalization fee was the actual cost of providing sewer service to a new customer connecting to the city sewer system, and also no showing that the amount of the fee was based upon any such calculation, the fee was not a lawful fee for services, but, was rather, an impermissible tax.

Because portion of connection fee charged by city for water and sewer service for new users was not based upon the sewer service rendered to the new user who connected to the city's sewer system, rather, it was based upon the estimated cost of new construction needed to extend the system to future users in other areas, including areas outside the city in its area of impact, in order to meet public needs, fee was not authorized under Idaho Revenue Bond Act.

Orrick: New Clean Renewable Energy Bonds IRS Notice 2015-12 Application Submission and Requirements.

Orrick has published a Public Finance Alert entitled New Clean Renewable Energy Bonds IRS Notice 2015-12 Application Submission and Requirements.

Mixed Reviews on Disclosing Tax Incentives.

While most favor increasing transparency in tax incentives, some of the biggest players in state and local government have spoken out against the latest proposal.

Back in the last century, actors, playwrights and producers of Broadway shows would linger on opening night in the famous restaurant, Sardi's, awaiting the newspaper reviews. While there are minimal similarities between the board members of the Governmental Accounting Standards Board (GASB) and the cast of My Fair Lady, they do have one thing in common: When the board decides to move forward on a project and issues a draft for public comment, there's a great deal of anticipation awaiting the thoughts of a variety of individuals and organizations with strong opinions about GASB's proposals.

The organization has recently been through that process with its recent proposal for governments to share data about tax incentive programs. GASB is the rule-making body for local government public disclosure in America. Its pronouncements form the backbone of generally accepted accounting principles.

“This proposal is trying to fill a pretty important hole in terms of understanding governments’ finances,” said Dean Mead, GASB’s research manager. “Tax abatements are very widespread and involve a tremendous amount of money. But they’re not apparent on the face of the financial statements.”

According to a recent brief by the Pew Charitable Trusts, GASB is seeking required disclosure of “the purpose of the incentive,” “the amount of revenue forgone during the financial reporting period,” “the total number of incentives in effect and awarded during the reporting period,” and “provisions for recapturing abated taxes.”

Given all the interest in recent years in the use of tax incentives to attract or retain business, it seemed to us, since the proposal was first released in October, that this was a winner. We anticipated some problems for smaller governments with tight budgets that might have difficulty complying, but that’s the case with most GASB proposals.

Now, back to Sardi’s. The period of time for comment letters has just ended, and we’ve gone through two hundred plus notes sent to GASB. The vast majority of them were in favor of the proposal — some even wanted more disclosure. Then there were the comments from some of the biggest and most respected membership organizations in state and local government. A note from five of them — the Government Finance Officers Association, the International City/County Management Association, the National League of Cities, the National Association of Counties and the U.S. Conference of Mayors — indicated support for the goals of the proposal but objected the proposal itself.

The major objection cited in the comment letter was that “including only a disclosure about the abated tax revenue, without any mention of the return on investment analysis that preceded it or a discussion of the benefits expected” would be troublesome and would only provide “part of the story and would mislead, rather than inform, the users of government financial statements.”

It’s an interesting point, but the “benefits expected” from tax abatements often turn out to be far more optimistic than the benefits actually achieved. It’s not uncommon for a company to promise far more job creation than actually materializes, for example. There’s a real danger that mixing real forgone revenues with hoped-for savings would leave users with the false impression that tax incentives are always a worthwhile investment. Perhaps the additional disclosure could come after the fact; when the returns the state gets for its abatements have been realized in reality — not just in plan.

GOVERNING.COM

BY KATHERINE BARRETT & RICHARD GREENE | FEBRUARY 19, 2015

TAX - NEW JERSEY

Borough of Hamburg v. Trustees of Presbytery of Newton

Tax Court of New Jersey - February 11, 2015 - 2015 WL 604073

Borough’s tax assessor issued a letter denying the Presbytery of Newton’s request for tax-exempt status of the Subject Property – a storage building adjacent to a Church – for tax year 2013. The Presbytery thereafter filed an appeal to the County Board, challenging the tax assessor’s denial of tax-exempt status. The County Board granted tax-exempt status to the Subject Property, finding that the Presbytery satisfied the requirements of the religious use exemption pursuant to N.J.S.A.

54:4–3.6. The Borough appealed to the Tax Court.

The Tax Court affirmed the County Board's judgment granting tax-exempt status to the Subject Property pursuant to N.J.S.A. 54:4–3.6.

The court found that the testimony during trial adequately established that a substantial quantity of religious artefacts were stored in the Subject Property. Based on the size and quantity of these artefacts, no reasonable storage alternative was available to the Church. Further, the use of the Church to store goods in connection with the Foundation for Peace was a valid charitable purpose that advanced the religious mission of the Presbytery. Accordingly, the court concluded that the Church was reasonably necessary for the Presbytery's religious purpose, and therefore satisfied the actual use requirement of the use test.

As for worship services, there is no requirement in N.J.S.A. 54:4–3.6 that worship services must be offered in order to qualify for exemption. After reviewing the evidence presented during trial regarding the use of the Subject Property, the court found that the Church and Subject Property were an "integral part of the operations of the active parishes" and therefore "reasonably necessary" for the Presbytery's religious purpose. The court found that the Presbytery actually used the Subject Property for its religious purpose, thus satisfying the requirements for exemption under N.J.S.A. 54:4–3.6.

EO Update: e-News for Charities & Nonprofits - February 17, 2015

1. Register for IRS phone forum: Employment Taxes for Exempt Organizations

Thursday, Feb. 19
2 p.m., ET

Topics include:

- What are employment taxes?
- Independent contractors vs. employees
- Voluntary Classification Settlement Program
- Church and the clergy
- Electronic filing and payment options for employment tax returns
- Small Business Health Care Tax Credit
- Additional Employment Tax Resources

Register for this phone forum.

2. Review recent EO published guidance

- TD 9708 Final regulations under section 501(r) of the Code providing guidance regarding the requirements for charitable hospital organizations added by the Patient Protection and Affordable Care Act of 2010.
- Revenue Procedure 2015-17 sets forth procedures for issuing determination letters and rulings on the exempt status of qualified nonprofit health insurance issuers.

Go to the Recent EO Published Guidance page for more information.

IRS to Allocate Nearly $1.4 Billion in New CREBs Volume Cap: McGuireWoods

With close to $1.4 billion in volume cap for New Clean Renewable Energy Bonds (New CREBs) remaining, Notice 2015-12 (the 2015 Notice) announces the March 5 opening of the rolling volume-cap application window for governmental bodies (governments) and cooperative electric companies (co-ops), as well as a closed-end application period for public power providers.1 This Client Alert summarizes the volume-cap application process under the 2015 Notice, including certain new monitoring and filing requirements that require vigilance. For information on New CREBs, including pertinent pronouncements of the Internal Revenue Service (IRS), please see our prior Client Alerts.

Allocation Summary

The amounts, methods and limits of volume cap, as well as application periods and reallocation procedures, for each category are as follows:

Qualified Owners	**Governmental Bodies**	**Cooperative Electric Companies**	**Public Power Providers**
Volume Cap Available	$597,134,963.60	$280,778,469.00	$516,565,691.35
Allocation Method	First-come, first-served	First-come, first-served	Pro rata if oversubscribed
Allocation Limit (per applicant) to be updated periodically	Greater of: (i) 20% of available volume cap, or (ii) $40 million	Greater of: (i) 20% of available volume cap, or (ii) $40 million	Amount requested in application, subject to ratable allocation if oversubscribed
Application Period	Accepting on and after March 5, 2015	Accepting on and after March 5, 2015	Filed by June 3, 2015
Awarded and Forfeited Allocation	Reallocable under the 2015 Notice	Reallocable under the 2015 Notice	Not reallocable under the 2015 Notice; will be subject to future guidance

Application Requirements; Optional Disclosure

Applicants must be qualified issuers and use a form of application substantially similar to the form included in the 2015 Notice as Appendix A. Among other requirements, the application must:

1. be signed by an authorized official of the applicant;
2. designate a person with knowledge of the project and with whom the IRS may communicate;
3. describe the project in reasonable detail, including applicable acquisition, commencement and completion dates, as well as location, expected costs and amount of requested allocation;
4. certify that the project is a qualified facility;2
5. include an engineer’s certification of the facility’s qualification under applicable provisions of the Internal Revenue Code and expectation of electricity production upon project completion;
6. specify the project owner and certify that such owner is a qualified owner, although (a) for governmentally or co-op owned projects, the application must state that the owner is not a public power provider, (b) if the project may satisfy more than one qualified owner category, the application must identify only one such category, and (c) projects owned by public power providers are ineligible for governmental or co-op volume cap;
7. certify that none of the costs were the subject of a prior application, and if they were, (a) the IRS has been notified that the application has been withdrawn or (b) applicable awarded allocation has reverted to the IRS, plus address any situations of awarded and either expired or forfeited

allocation under the 2015 Notice;
8. state that all necessary federal, state and local regulatory and issuance approvals have been received, identify any approvals that have not been received, including the plan and timeframe for securing such approvals and certify that the applicant expects to receive such outstanding approvals to permit the issuance;
9. provide a plan of financing that details use of the proceeds of the New CREBs, other sources of financing, and marketability of the New CREBs prior to the allocation expiration date; and
10. certify reasonably expected compliance with applicable requirements of the Internal Revenue Code and engagement of bond counsel to opine to such compliance.

As with prior awards, the IRS desires to disclose information about the awards, such as the project owner, type, location and amount of awarded volume cap, and it needs the applicant's consent for such disclosure. Such consent is optional and not a condition to receiving volume cap. The form of that disclosure consent is provided in Appendix B of the 2015 Notice.

Application Process; "Accept or Decline" Feature; Allocation Options

Beginning March 5, 2015, the IRS will accept applications for volume cap to governments and co-ops on a first-come, first-served basis, and any applications received before that date will be treated as received on that date. If any government or co-op submits an application requesting an amount exceeding the volume cap available on a particular date, each applicant will be offered a ratable portion of the available volume cap. Each applicant will have 30 days to (i) accept the reduced amount (using Appendix C to the 2015 Notice), or (ii) delay allocation for up to 90 days from its application date in the event additional volume cap becomes available (using Appendix D to the 2015 Notice). If no additional volume cap becomes available, the IRS will notify the applicant, who will have 30 days to accept the reduced allocation or to withdraw its application.

For public power providers, the IRS will accept their applications up to and including June 3, 2015, and in the event of oversubscription, will then offer allocations of volume cap on a pro rata basis relative to the amount of allocation available and the amounts requested. The IRS will notify each applicant of the reduced amount available, and each applicant will have 30 days to accept or decline the reduced amount.

An application will be treated as received either on the date of its receipt or upon the receipt of any supplemental information the IRS requests.

Substantial Deviations

Similar to the prior New CREBs Notice 2009-33, the 2015 Notice contains the "insubstantial deviation" concept; however, unlike the prior notice, an allocation of volume cap under the 2015 Notice will become invalid if, prior to the issuance of the New CREBs, there is a change to, among other things, the New CREB project that substantially deviates from the New CREB project noted in the allocation application. If there is such a change, the 2015 Notice allows the applicant to forfeit its allocation and to submit a new application correcting the deviation.

Additionally, if there is a substantial deviation after the issuance of the New CREBs, the allocation will remain valid if, and only if, the deviation does not change the category of qualified owner and the applicant submits a supplemental notice of issuance to the IRS. The supplemental notice requires the applicant to certify that it reasonably expected, at the time of issuance of the New CREBs, that the use of New CREB proceeds would not substantially deviate from the proposed New CREB project. The supplemental notice further requires a certification that the applicant has obtained an opinion of bond counsel that the change will not cause the New CREBs to fail to meet

the applicable requirements of the Internal Revenue Code.

180-Day Expiration Date; Notice of Issuance

Under the 2015 Notice, New CREBs must be issued within 180 days of the allocation date. After 180 days, any unissued allocation will revert to the IRS and be available for reallocation.

Moreover, upon issuance the issuer must file IRS Form 8038-TC as well as a notice of issuance. Such notice must be filed no later than 15 days after the issuance. Such notice shall provide, among other things, the issue price and the issue date of the New CREBs and a project description. If an applicant fails to file such notice within 15 days of the expiration of the 180-day period, the IRS will request such applicant either to submit such notice or to confirm that the allocation has been forfeited. If the applicant fails either to submit the notice within 15 days of the IRS request or to confirm that the allocation was forfeited, the IRS, in its discretion, may treat the allocation as forfeited and as having reverted back to the IRS and available for reallocation.

Footnotes

1, 2. New CREBs may be used for capital expenditures incurred by governments, public power providers or co-ops for one or more qualified renewable energy facilities. Such facilities include certain wind, closed- and open-loop biomass, geothermal or solar energy, small irrigation power, landfill gas, trash, qualified hydropower and marine and hydrokinetic renewable energy facilities.

February 12 2015

Article by Douglas E. Lamb, Michael Dow, John J. Semeniak and James E. Gross

McGuireWoods 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.

IRS Releases Qualified Zone Academy Bond Allocations for 2014.

The Internal Revenue Service has released Notice 2015-11, which announces the total Qualified Zone Academy Bond allocation for each state, totaling a $400 million national limitation for calendar year 2014. The national limitation allocated for 2014 is effective for QZABs issued after December 31, 2013.

Part III — Administrative, Procedural, and Miscellaneous

SECTION 1. PURPOSE

This notice sets forth the maximum face amount of Qualified Zone Academy Bonds (“QZABs”) that may be issued for each State for the calendar year 2014 under § 54E(c)(2) of the Internal Revenue Code. Under § 54A(e)(3), the term State includes the District of Columbia and any possession of the United States.

SECTION 2. BACKGROUND

.01 INTRODUCTION

Section 313 of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, Div. C of Pub. L. No. 110-343, 122 Stat. 3765 (2008) ("Act") added new § 54E, which provides revised program provisions for QZABs in lieu of the existing provisions under § 1397E, effective for obligations issued after October 3, 2008. The Act amended § 54A(d)(1) to provide that the term qualified tax credit bond ("QTCB") means, in part, a qualified zone academy bond which is part of an issue that meets the requirements of §§ 54A(d)(2), (3), (4), (5), and (6) regarding expenditures of bond proceeds, information reporting, arbitrage, maturity limitations, and prohibitions against financial conflicts of interest. The Act also amended § 54A(d)(2)(C) to provide that, for purposes of § 54A(d)(2), the term "qualified purpose" for a QZAB means a purpose specified in § 54E(a)(1), described below.

The Act added § 54E(c)(1) to provide a national zone academy bond limitation authorization for QZABs of $400 million for each of calendar years 2008 and 2009. Section 1522 of Title I of Division B of the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009) ("2009 Act") amended § 54E(c)(1) to provide an increased national zone academy bond limitation authorization for QZABs of $1.4 billion for each of calendar years 2009 and 2010. Section 758 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Public L. No. 111-312, 124 Stat. 3296 (2010) ("2010 Act") amended § 54E(c)(1) to provide an authorization for QZABs of $400 million for calendar year 2011. Section 310 of the American Taxpayer Relief Act of 2012, Public L. No. 112-240, 126 Stat. 2313 (2012) ("2012 Act") amended § 54E(c)(1) to provide authorization for QZABs of $400 million for each of calendar years 2012 and 2013. Section 120 of the Tax Increase Prevention Act of 2014, Public L. No. 113-295 (2014) ("2014 Act") amended § 54E(c)(1) to provide authorization for QZABs of $400 million for calendar year 2014. The amendment made by § 120 of the 2014 Act applies to obligations issued after December 31, 2013. Section 202 of the 2014 Act also amended § 6431(f)(3)(A)(iii) to provide that the direct-pay subsidy option does not apply to any national zone academy bond limitation for years after 2010 or any carryforward of any such limitation.

.02 QUALIFIED ZONE ACADEMY BOND UNDER § 54E

Section 54E(d) defines "qualified zone academy" as any public school (or academic program within a public school) which is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level provided: (A) the public school or program is designed in cooperation with business to enhance the academic curriculum, increase graduation and employment rates and prepare students for college and the workforce; (B) students will be subject to the same academic standards and assessments as other students educated by the eligible local education agency; (C) the comprehensive education plan is approved by the eligible local education agency; and (D)(i) such public school is located in an empowerment zone or enterprise community including such designated after October 3, 2008; or (ii) there is a reasonable expectation (as of the date of bond issuance) that at least 35 percent of the students will be eligible for free or reduced cost lunches under the school lunch program established under the National School Lunch Act.

Section 54E(a) provides that a "qualified zone academy bond" or QZAB means any bond issued as part of an issue if: (1) 100 percent of the available project proceeds of such issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency; (2) the bond is issued by a State or local government within the jurisdiction of which such academy is located, and (3) the issuer: (A) designates such bond for purposes of this section; (B) certifies that it has written assurances that the private business contribution requirement of § 54E(b) will be met; and, (C) certifies that it has the written approval of the eligible local education agency for such bond issuance.

Section 54E(d)(3) provides that a qualified purpose with respect to each academy means: (A)

rehabilitating or repairing the public school facility; (B) providing equipment; (C) developing course materials; and, (D) training teachers and other school personnel. The private business contribution requirement of § 54E(b) is met if the eligible local education agency that established the qualified zone academy has written commitments from private entities to make qualified contributions having a present value (as of the date of issuance of the issue) of not less than 10 percent of the proceeds of the issue. Section 54E(d)(4) defines "qualified contributions" as any contribution (of a type and quality acceptable to the eligible local education agency) of: (A) equipment for use in the qualified zone academy (including state-of-the-art technology and vocational equipment); (B) technical assistance in developing curriculum or in training teachers to promote appropriate market driven technology in the classroom; (C) employees' services as volunteer mentors; (D) internships, field trips, or other educational opportunities outside the academy; or (E) any other property or service specified by the eligible education agency. Section 54E(d)(2) defines "eligible local education agency" as any local educational agency as defined in § 9101 of the Elementary and Secondary Education Act of 1965.

Section 54E(c)(2) provides that the Department of the Treasury shall allocate the national zone academy bond limitation among the States on the basis of their respective populations of individuals below the poverty line (as defined by the Office of Management and Budget). The limitation amount allocated to a State under the preceding sentence shall be allocated by the State education agency to qualified zone academies within such State.

Under § 54E(c)(3), the maximum aggregate face amount of bonds issued during any calendar year which may be designated as QZABs with respect to any qualified zone academy shall not exceed the limitation amount allocated to such academy for such calendar year. However, under § 54E(c)(4)(A), if for any calendar year the limitation amount for any State exceeds the amount of bonds issued during such year which are designated QZABs with respect to qualified zone academies within such State, the limitation amount for such State for the following calendar year shall be increased by the amount of such excess. Under § 54E(c)(4)(B), however, any carryforward of a limitation amount may be carried only to the first 2 years following the unused limitation year. For these purposes, the limitation amount shall be treated as used on a first-in first-out basis.

Sections 1.1397E-1 (the "Final Regulations") sets forth regulations that were issued under § 1397E. For other guidance concerning the applicability of the regulations issued under § 1397E, the credit rate, and the sinking fund yield see § 1.397E-1(m), and Notice 2009-15, 2009-6 I.R.B. 449, Notice 2009-30, 2009-16 I.R.B. 852, Notice 2010-22, 2010-10 I.R.B. 435, and Rev. Proc. 2011-19, 2011-6 I.R.B. 465.

SECTION 3. NATIONAL ZONE ACADEMY BOND LIMITATION FOR 2014

The national limitation for QZABs issued under § 54E for calendar year 2014 is $400 million. This amount is allocated among the States as follows:

Qualified Zone Academy Bond Allocations (in dollars)
by State or Territory, 2014

State or Territory	QZAB Allocation
Alabama	$7,035,000
Alaska	$575,000
Arizona	$9,550,000

Arkansas $4,410,000
California $50,069,000
Colorado $5,264,000
Connecticut $2,954,000
Delaware $916,000
DC $911,000
Florida $25,858,000
Georgia $14,637,000
Hawaii $1,214,000
Idaho $1,952,000
Illinois $14,574,000
Indiana $7,979,000
Iowa $2,983,000
Kansas $3,099,000
Kentucky $6,354,000
Louisiana $7,099,000
Maine $1,435,000
Maryland $4,680,000
Massachusetts $6,100,000
Michigan $13,024,000
Minnesota $4,688,000
Mississippi $5,476,000
Missouri $7,349,000
Montana $1,260,000
Nebraska $1,857,000
Nevada $3,428,000
New Hampshire $911,000
New Jersey $7,876,000
New Mexico $3,465,000
New York $24,276,000
North Carolina $13,540,000
North Dakota $641,000
Ohio $14,191,000
Oklahoma $4,939,000
Oregon $5,044,000
Pennsylvania $13,355,000
Rhode Island $1,173,000
South Carolina $6,793,000
South Dakota $904,000
Tennessee $8,930,000
Texas $35,854,000
Utah $2,849,000
Vermont $585,000
Virginia $7,446,000
Washington $7,620,000
West Virginia $2,624,000
Wisconsin $5,963,000
Wyoming $491,000

American Samoa $247,000
Guam $287,000

Northern Mariana Islands $211,000
Puerto Rico $12,872,000
U.S. Virgin Islands $183,000

Total Allocation $400,000,000

SECTION 4. EFFECTIVE DATE OF NATIONAL ZONE ACADEMY BOND LIMITATIONS

The national limitation allocated in section 3 for calendar year 2014 is effective for QZABs issued after December 31, 2013.

SECTION 5. DRAFTING INFORMATION

The principal authors of this notice are James A. Polfer and David E. White of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice contact David White or James Polfer at (202) 317-6980 (not a toll-free call).

Ryan: Tax Reform Difficult After the Summer.

WASHINGTON – A tax-reform agreement has to be reached by the end of the summer or it will not happen during this Congress, House Ways and Means Committee Chairman Paul Ryan said Friday.

“We’re operating on the timeline that it’s got to be done within the first seven or so months of the year,” Ryan said at a question-and-answer session with reporters. It’s hard to see how any tax reform gets done after a new budget cycle starts in the fall, he said.

Ryan said he wants tax reform to be comprehensive, applying to both individuals and businesses. However he is open to accomplishing tax reform in phases if it is necessary to do it that way while there is a Democratic president and a Republican-controlled Congress. President Obama is only interested in doing business tax reform.

“The question is, can we find an agreement this year,” Ryan said. That means doing business tax reform and possibly some individual changes under a divided government and doing the rest of tax reform in the next Congress.

“I think we’re going to reform this tax code somewhere between one and three years away,” Ryan said. “And if we can do part of it in year one, great, but if we have to wait for year three to do it all, so be it, as long as we get it done.”

Another issue on the Ways and Means Committee’s agenda this year is a highway bill. The committee will also have to find a way to pay for highway funding, since the current law expires May 31.

One transportation funding idea that has been floated in Congress, notably by Sens. Barbara Boxer, D-Calif. and Rand Paul, R-Ky., is a one-time repatriation holiday. But Ryan is not a fan of this idea.

“That doesn’t work,” he said, adding that it doesn’t produce the money for the Highway Trust Fund. The only way repatriation can work to provide funds for the HTF is if it is done as part of tax reform, Ryan said. Obama is proposing to use one-time revenues from a transition business tax to provide transportation funds.

The top Democrat on the Senate Finance Committee, Ron Wyden of Oregon, wants bonds to be used to help finance infrastructure. Ryan said he hasn't talked to Wyden about this idea.

On Thursday, the Ways and Means committee passed a bill that would make the state and local sales tax deduction permanent. The deduction, which can be taken in lieu of the deduction for state and local income taxes and expired at the end of 2014, is particularly important for states that do not have income taxes.

Ryan said the state and local sales tax deduction is "an issue of parity."

THE BOND BUYER

BY NAOMI JAGODA

FEB 13, 2015 4:28pm ET

TAX - OREGON

Oregon School Boards Association v. Marion County Assessor

Oregon Tax Court, Magistrate Division, Property Tax - February 3, 2015 - 2015 WL 556433

Unincorporated nonprofit association of school boards composed of 196 K–12 school districts, 17 community colleges, 19 education service districts, 87 public charter schools and the State Board of Education purchased property to be used for additional parking and filed an application with the Marion County Assessor seeking a property tax exemption for the property.

The Assessor denied the Association's application for exemption pursuant to ORS 307.090, on the basis that: 1. Association was not itself a "school district;" 2. Association was not a "public or municipal corporation" because it was organized for the benefit of its members; and 3. Association was not organized as a corporation. Association appealed.

The Tax Court held that the Association was in fact a "corporation" under state law, but that record was not sufficiently developed for the court to conclude whether the Association served a public purpose and therefore qualified as a "public corporation."

TAX - NEW YORK

Rite Aid Corp. v. City of Troy Bd. of Assessment Review

Supreme Court, Rensselaer County, New York - February 5, 2015 - N.Y.S.2d - 2015 N.Y. Slip Op. 25036

Commercial lessee, which operated a free-standing retail pharmacy under 20-year lease, challenged city's real estate tax assessment for three tax years. The Supreme Court, Rensselaer County, granted city's motion to dismiss. Lessee filed motion to reargue.

The Supreme Court, Rensselaer County, held that:

- Capitalization rate offered by lessee's appraiser was not based on sound theory and objective data set forth with sufficient particularity, but
- National survey of capitalization rates conducted by accounting firm was based on sound theory

and objective data.

Capitalization rate, which appraiser for commercial lessee, which operated a free-standing retail pharmacy under 20-year lease, derived by reviewing four sales of comparable properties, was not based on sound theory and objective data set forth with sufficient particularity, as would be required to satisfy lessee's initial burden of rebutting the presumption that city's real estate tax assessments were valid. Lessee's appraiser provided information regarding income for two comparable properties but no information regarding expenses, appraiser relied completely on brokers involved in sales of the other two properties for information regarding income and expenses, and appraiser admitted that while a triple-net lease minimized the impact of expenses on the lessor, there were obviously expenses that needed to be paid and estimated.

National survey of capitalization rates conducted by accounting firm, which survey was used by appraiser for commercial lessee that operated a free-standing retail pharmacy under 20-year lease, was based on sound theory and objective data, as required to satisfy lessee's initial burden of rebutting the presumption that city's real estate tax assessments were valid.

IRS LTR: Water Distributor Improvements Constitute Facilities: Tax Analytsts

The IRS ruled that the private business use of proceeds from bonds issued by a water distributor for improvements and equipment does not exceed 10 percent and that other improvements and equipment constitute facilities for furnishing water under section 142(e).

Read the Letter (subscription required).

Citations: LTR 201507002

IRS Issues Guidance on New Clean Renewable Energy Bond Projects: Tax Analysts

The IRS has solicited (Notice 2015-12) applications for allocations of the remaining available amount of the national limitation for new clean renewable energy bonds under section 54C(a). The available amounts include forfeited amounts previously allocated under prior guidance (Notice 2009-33 and Announcement 2010-54).

Continue reading (subscription required).

TAX ANALYSTS
FEBRUARY 3, 2015

Improvements Underway for Exempt Bonds VCAP, Official Says: Tax Analysts

The IRS has made a number of improvements to its voluntary closing agreement program for issuers of tax-exempt bonds and will keep working to improve the program in 2015, Rebecca Harrigal, director of the IRS Office of Tax Exempt Bonds, said February 5.

Continue reading (subscription required).

Fred Stokeld

February 6, 2015

IRS EO Update: e-News for Charities & Nonprofits - February 5, 2015

1. Register for IRS Phone Forum: Employment Taxes for Exempt Organizations

Thursday, February 19, 2015 – 2 p.m., ET

Topics include:

- What are employment taxes?
- Independent contractors vs. employees
- Voluntary Classification Settlement Program
- Church and the clergy
- Electronic filing and payment options for employment tax returns
- Small Business Health Care Tax Credit
- Exempt Organizations: Additional Employment Tax Resources

Register for this phone forum.

2. Renew your PTIN

Recently, the IRS sent expiration notices to PTIN holders who have not yet renewed their PTIN for 2015. Anyone receiving a notice can still renew their PTIN online at any time, but their status has been changed to "expired" until they do so.

To date, approximately 635,000 tax return preparers have valid PTINs for tax year 2015.

If you do not renew your PTIN, you can no longer prepare federal tax returns for compensation. If you intend to renew your PTIN for 2015, you can renew online or submit a paper application.

Online renewal

You can renew online. If you need assistance, review our instructional videos for help.

Paper renewal

If you prefer, you can renew by paper using Form W-12, available via the IRS homepage. It will take 4-6 weeks to process.

3. New EO published guidance posted

Review the following revenue procedures:

- Revenue Procedure 2015-9, which concerns issuing determination letters on the exempt status of organizations under sections 501 and 521 of the Code.
- Revenue Procedure 2015-10, which concerns issuing determination letters and rulings on private

foundation status under section 509(a) of the Code.

4. Register for EO workshops

Register for our upcoming workshops for small and medium-sized 501(c)(3) organizations. Remember to check this page periodically for new workshops being planned in a town near you.

TAX - UTAH

Anadarko Petroleum Corp. v. Utah State Tax Com'n

Supreme Court of Utah - January 30, 2015 - P.3d - 2015 UT 25

Owner of oil and gas interests appealed decision of Tax Commission disallowing severance tax deductions they made for tax-exempt federal, state, and Indian tribe royalty interests.

The Supreme Court of Utah held that severance tax statute categorically excludes any federal, state, and Indian tribe interests from the net taxable value of an oil or gas interest for purposes of calculating the applicable tax rate.

IRS Seeks Applications for New CREB Volume Cap.

Read the Notice.

Recent Favorable IRS Guidance for Tax-Exempt Bond Financed Facilities: Ballard Spahr.

The IRS has released guidance in three areas of interest to entities that benefit from tax-exempt bond financings, particularly hospitals and educational institutions. This guidance creates new rules related to management contracts and participation by a nonprofit entity in an accountable care organization (ACO), final rules addressing requirements for charitable hospital organizations added by the Patient Protection and Affordable Care Act (ACA), and the creation of a standardized voluntary closing agreement program (VCAP) for issuers of 501(c)(3) bonds for the benefit of a 501(c)(3) organization that had its tax-exempt status reinstated after having it revoked for failure to file returns for three consecutive years. Highlights of the guidance are summarized below.

New Five-Year Safe Harbor for Management Contracts

For the first time in 18 years, the IRS made a significant change to existing IRS safe harbors under which management contracts do not result in private business use of tax-exempt bond financed facilities. Notice 2014-67, which was released on October 24, 2014, provides a new favorable five-year safe harbor from private business use for management contracts and expands the types of productivity awards that are permitted. The changes apply to contracts entered into or materially modified on or after January 22, 2015, but may be applied to contracts entered into before that date. The new management contract safe harbor has important immediate implications for borrowers or

issuers of bonds who have entered into management contracts with service providers for their bond financed facilities.

New Bond Guidance on Accountable Care Organizations

Notice 2014-67 also is the first step taken by the IRS in addressing the tax issues raised by nonprofit organizations with tax-exempt bond financing participating in ACOs. According to the Notice, the participation of a 501(c)(3) hospital organization (or governmental entity) in the Medicare Shared Savings Program through an ACO will not result in private business use of the tax-exempt bond financed facility if certain conditions are met. The conditions set forth in Notice 2014-67 parallel the conditions in Notice 2011-20, which provided guidance related to the tax treatment for exempt organizations seeking participation in ACOs. These provisions apply to bonds sold on or after January 22, 2015, but may be applied to bonds sold before that date.

Final Section 501(r) Regulations for Charitable Hospitals

In December 2014, Treasury and the IRS released final regulations regarding the requirements charitable hospital organizations must meet under new section 501(r) of the Internal Revenue Code added by the ACA. Under section 501(r), charitable hospital organizations or entities seeking 501(c)(3) status face additional requirements to maintain their tax-exempt status. These requirements include conducting a community health needs assessment at least once every three years. The final regulations provide needed guidance regarding the potential effects on tax-exempt bonds in the event the charitable hospital organizations do not meet the requirements.

Voluntary Closing Agreement Program for 501(c)(3) Organizations

The IRS announced a simplified process for issuers of 501(c)(3) bonds to request a closing agreement in situations where the borrower received prospective reinstatement after its tax-exempt status was automatically revoked for failure to file an annual return for three consecutive years. The closing agreement amount for each bond issue covered by an agreement is equal to $500 for each calendar month or portion thereof in the period, starting with the month of revocation and ending in the month when the organization’s exempt status was reinstated.

Ballard Spahr will host a webinar on Friday, February 27, from 12:00 p.m. to 1:00 p.m. ET, on the recent IRS developments affecting tax-exempt bond financed educational institutions, which will include a detailed discussion of the new management contract safe harbor. Register for this webinar here.

The firm will also be hosting a webinar on recent health care developments on Thursday, April 16. Registration details will be distributed as soon as they are available.

February 2, 2015

by Vicky Tsilas and Linda B. Schakel

Attorneys in Ballard Spahr’s Public Finance Department have participated in every kind of tax-exempt bond financing. These financings include bond issues for hospitals and health care institutions, as well as universities, colleges, and student housing. For more information, please contact Vicky Tsilas at 202.661.2283 or tsilas@ballardspahr.com, or Linda B. Schakel at 202.661.2228 or schakel@ballardspahr.com.

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This alert is a periodic publication of Ballard Spahr LLP and is intended to notify recipients of new developments in the law. It should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult your own attorney concerning your situation and specific legal questions you have.

College Sports Ticket Tax Break Would Vanish in Obama Budget.

(Bloomberg) — President Barack Obama wants to remove a tax benefit for college sports fans.

Obama's budget proposal sent to Congress Monday would end the deduction available to some fans for donations they make to get seats at college sporting events. This is a new proposal by the administration.

By closing what the White House calls a loophole in the system, people would pay about $2.5 billion over the next decade in higher taxes. Currently, college sports fans can deduct 80 percent of the cost of such donations.

The budget plan also would end the use of tax-exempt bonds to build professional sports facilities. Debt to finance stadiums and arenas would be taxable if more than 10 percent of the location is used for private-business use.

Repealing such financing would save $542 million from 2016 through 2025, according to the proposal.
While some alumni and fans would give money to schools regardless of tax benefits, ending the deduction would hurt revenue at some sports programs, said Robert Spielman, a senior tax partner at Marcum LLP who advises high-net-worth clients.

Some U.S. colleges use the tax benefit to generate more revenue from sports. They set a price for season tickets and then demand donations in the hundreds or thousands of dollars on top of that cost as a condition of the sale. Part of the pitch is that fans can claim the expense as a charitable deduction when they itemize their tax return.

Required Donations

At certain universities, fans can't buy tickets unless they make a donation, and at other schools the donations help people get premium seating on the 50-yard line.

One athletic department that uses the donation is the University of Louisville, whose men's basketball team made $40.5 million in revenue in 2013-2014, about $15 million more than the next closest program.

Louisville requires a donation to the Cardinal Athletic Fund for most of its season tickets — contributions that range from $2,500 to $250 a seat. Of the university's $40.5 million in men's

basketball revenue, $21.7 million come from donations, according to the school's annual report to the NCAA.

Contribution totals, and season ticket policies, vary significantly across the NCAA's top division. The University of Washington, which requires a donation for its premium football season tickets, reported $19.1 million in football contributions in 2013-14. Rival Washington State's program reported $2.1 million by comparison.

Duke Basketball

At Duke University in Durham, North Carolina, people who give $7,000 a year can get priority for coveted men's basketball season tickets, according to the website for the school's booster club. Buyers could then deduct 80 percent of that cost. For those in the top federal income tax bracket of 39.6 percent, the break is worth $2,218.

Richard Schmalbeck is a Duke law professor who has donated to the university's athletic department to secure the right to buy basketball tickets. He has taken the allowed tax deduction, he said in a phone interview Monday. Even so, the law should change because it's inconsistent with how the Internal Revenue Service usually treats charitable gifts, he said.

Typically, to get a deduction when a charity gives something of worth to the donor, the contribution amount must be reduced by the value of the benefit received, such as dinners and concert tickets at fundraising events, Schmalbeck said.

Sports Facilities

The separate proposal in the budget to eliminate the use of tax-exempt debt for sports facilities would affect states and municipalities that are working with professional teams to finance new or improved stadiums and arenas.

Wisconsin Governor Scott Walker Jan. 27 proposed funding a new arena for the Milwaukee Bucks basketball team, in part with $220 million of bonds backed by taxes generated by the team.

Officials in Missouri are considering a new stadium for the St. Louis Rams NFL team. Two other new NFL venues are being considered in San Diego for the Chargers and in Oakland for the Raiders.

Theodore L. Jones, a lawyer in Baton Rouge, Louisiana, who lobbied Congress for the deduction for donations to college sports programs in 1986, said he opposes Obama's plan to eliminate the break for donations because it helps colleges and universities raise money, he said in a phone interview Monday.
"It's one of the best things to come down the pike," Jones, 80, said.

Jones holds season tickets at Tiger Stadium, home of the Louisiana State University football team, and benefits from the tax deduction, he said.

"I wouldn't want to take on all the college presidents and college sports programs around the country," Jones said of the budget plan. "But I'm not the president."

by Margaret Collins and Richard Rubin

February 2, 2015

To contact the reporters on this story: Margaret Collins in New York at mcollins45@bloomberg.net;

Richard Rubin in Washington at rrubin12@bloomberg.net

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Justin Blum

TAX - ARIZONA

Hub Properties Trust v. Maricopa County

Court of Appeals of Arizona, Division 1 - January 27, 2015 - Not Reported in P.3d - 2015 WL 357850

Hub Properties Trust (Hub) purchased real property (the Property) from the City of Phoenix on March, 2011. After Hub purchased the Property, the County Assessor's Office determined the Property was no longer exempt municipal commercial property. As a result, the Property was included in the Assessor's roll as taxable property and was included in the County's tax roll for tax year 2011. The Maricopa County Board of Supervisors then fixed, levied and assessed property taxes for the Property for the County's assessment and tax roll for the 2011 tax year.

Hub appealed, arguing that because the City owned the Property "during the entire assessment period for the tax year 2011, on the tax lien date, and for more than two full months of the tax year at issue herein," the Property was tax exempt during tax year 2011. Thus, Hub contended the Property was illegally taxed that year. Hub's argument stemmed from the notion that once property is exempt, it is exempt for the entire tax year even if there is a change of use or ownership.

The Court of Appeals agreed with the tax court's conclusion that the period of exemption begins on the date the property enters government ownership and ends on the date it leaves government ownership. Although the Property was tax exempt while the City owned it in 2011, the exemption was lifted when Hub purchased the Property in March. Thus, the court affirmed the tax court's ruling that the Property was not tax exempt after the City sold it to Hub in 2011.

TAX - ALABAMA

Montgomery County Com'n v. Federal Housing Finance Agency

United States Court of Appeals, Eleventh Circuit - January 16, 2015 - F.3d - 2015 WL 223699

This consolidated appeal arose from six district court actions in this circuit. In each of the six cases, the district court ruled in favor of the Appellees, the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Federal Housing Finance Agency (collectively referred to as the "federal entities").

Appellants' position on appeal was that the state taxes normally imposed on real estate transfers apply when the federal entities transfer real property in their respective states. The federal entities have not paid the transfer taxes, citing their Congressional charter exemptions from "all taxation." These statutory exemptions contain an exception allowing states to impose real estate taxes on the federal entities, and Appellants contended their transfer taxes fall into that exception. Appellants also made the constitutional argument that even if the exemptions precluded the states from imposing the transfer taxes, the exemptions themselves are unconstitutional under the Commerce, Necessary and Proper and Supremacy Clauses.

The district court in each case, as have several Circuit Courts of Appeal, found the federal entities are exempt from paying transfer taxes, and the statutes are otherwise constitutional. The U.S. Court of Appeals affirmed.

TAX - SOUTH DAKOTA

Deadwood Stage Run, LLC v. South Dakota Dept. of Revenue

Supreme Court of South Dakota - December 17, 2014 - N.W.2d - 2014 S.D. 90

Taxpayer brought action seeking declaratory judgment prospectively establishing the 2006 assessed valuation of tax incremental district, which consisted of taxpayer's land, as the appropriate tax incremental base, rather than the 2007 valuation. The Circuit Court entered summary judgment in favor of Department of Revenue.

Taxpayer appealed, arguing that in calculating the tax incremental base for a tax incremental district, SDCL chapter 11–9 required the Department to use the last aggregate assessed valuation certified by the Department prior to the date of creation of the tax incremental district.

The Supreme Court of South Dakota held that Department was required to determine aggregate assessed value of the property by using the last previously certified valuation for any buildings or additions completed or removed and to adjust it for the value to the date the district was created. The phrase "last previously certified" in the statute referred only to improvements in the land, and this reading harmonized the statute with other statutes.

IRS Issues Favorable But Limited Ruling on Total Return Swaps.

WASHINGTON – The Internal Revenue Service has issued a favorable but limited private-letter ruling concluding a total return swap entered into between a borrower and a bank at the same time the underlying tax-exempt bonds were sold is "not an abusive arbitrage device," tax lawyers said.

The IRS always cautions that its PLRs are based on specific transactions or fact patterns and should not be read broadly to cover other deals. But muni market participants typically read them for clues in areas where there is no current tax guidance.

Tax lawyers said the letter-ruling is favorable to primary market total return swaps and the ever growing number of bank loans that are hedged. The PLR answers some tax questions about TRS that had been troubling, they said. However, because of the narrow facts of the case, the ruling is limited, and the IRS gives no rationale for its conclusions, several of them added.

"I think it's a good ruling," said Rich Moore, a partner at Orrick, Herrington & Sutcliffe in San Francisco. "I think it made clear that if there are no bond proceeds subject to rebate, there is nothing inappropriate about a borrower using a total return swap to hedge its interest rate exposure."

IRS agents have taken positions contrary to that in audits in the past, some lawyers said.

"The ruling indicates that there is nothing improper or abusive per se about the use of a total return swap in connection with a tax-exempt bond issue in a primary market transaction," said Hobby

Presley, Jr., a partner at Balch & Bingham in Birmingham, Ala. “The ruling also indicates that it’s possible for a bondholder who buys a tax-exempt bond in a primary market transaction to provide a hedge agreement with respect to that bond.”

The PLR, which did not identify the parties involved, seems to suggest that a borrower can elect not to integrate its bonds and a total return swap to determine the bond yield for rebate purposes and that the IRS will honor that election, some of the lawyers said.

“I think [the PLR] is favorable, but it doesn’t answer all the questions that may be relevant for transactions, said David Cholst, a partner with Chapman and Cutler in Chicago. “This was a fact pattern that assumed away some of the concerns that have been raised in some transactions.”

TRS’, possibly hundreds of which have been done over many years, hedge interest rate risk and lower the cost of borrowing for a conduit borrower, while providing banks with earnings – possibly more than they would receive from letter of credit or direct loan fees. TRS may also provide banks with deductions of their losses from the swap payments, though this is the case with all swaps.

These involve conduit bond deals. The borrowers are almost always nonprofit hospitals, which tend to have a lot of cash reserves on hand for liquidity purposes. Initially, TRS’ were secondary market transactions. They were done to allow bonds to retain their insurance. They also are used to allow borrowers to refinance their bonds when the tax law does not permit them to do an advance refunding.

Most TRS are done today in primary market transactions. These transactions involve-long term bonds and a short-term TRS. In such deals, a hospital through an issuer privately places long-term bonds with a bank, which then enters into a much shorter term TRS with the hospital. The bank becomes the holder of the bonds as well as the swap counterparty.

The borrower typically swaps fixed for variable rates to lower its cost of borrowing. It also takes risk and provides price protection for the bank/bondholder/swap counterparty. When the TRS terminates, or is terminated, the bonds are valued. If the bonds’ value is below par, the hospital pays the bank. If the value is above par, the bank pays the hospital. But many TRS’ are rolled over or replaced and new negotiated terms during the life of the bonds. The hospital could be forced to pay if interest rates rise.

The bank/bondholder/swap counterparty makes money from the higher tax-exempt bond rate and its deduction of its loss from the swap payments.

Example

For example, a hospital will privately place 30-year fixed-rate bonds with a tax-exempt coupon of 5% with a bank. The bank will then enter into a three-year TRS with the hospital. The bank will pay the hospital a variable rate based on the Securities Industry and Financial Markets index plus 100 basis points. If the SIFMA index is 1%, the bank will pay the hospital a total of 2%, taking into account the 100 basis points. The hospital will pay the bank/bondholder the 5% tax-exempt interest on the bonds. That interest rate may be worth more like 7.5% to the bank, when one takes into account its corporate tax rate. The hospital will also make a swap payment to the bank of SIFMA plus 100, or 2%. The bank will make a swap payment to the hospital of 5%.

In this example, the borrower’s net cost of borrowing is lowed from 5% to SIFMA plus 100 basis points, or 2%. The bank is getting 5% tax-exempt interest on the bonds, which might be worth more like 7.5% to it, and it can also take a deduction for a 3% loss on the swap (the total of the 5% swap

payment it makes to the borrower minus the 2% swap payment it receives from the borrower).

Some sources question whether the bank should be allowed to take the deduction. But the lawyers said banks have many loss carry forwards and that, in any case, this is a question for bank regulators, not the IRS. They also point out that there's always a risk that variable rate bond rates will rise and there will be no deduction.

In the early 2000s, TRS' were done with so-called coerced tenders that were designed to get the bonds in the hands of the bank. The issuer would tell investors they could tender the bonds back to it at a premium, say 101, or wait for the bond call at par. Most investors wanted the premium, but fund managers and analysts were upset that these high-coupon bonds were being taken from them sooner than expected and they began complaining loudly to the press and regulators.

The IRS began auditing these secondary market transactions toward the end of that decade and raised concerns that a TRS either caused the bonds to be reissued and subject to the most recent tax law changes. The Service also said the deal constituted an abusive arbitrage device that could force the integration of the bond and the swap. Integration could lead to a lower bond yield and therefore, a lower investment yield if the hospital wanted to avoid arbitrage earnings that would have to be rebated.

Under the tax law, issuers or borrowers can elect whether or not to integrate the bond and swap. But if the IRS Commissioner finds a transaction is an abusive arbitrage device, he or she and can force the issuer or borrower to integrate the bonds and swap, which might lower the bond yield, and therefore the investment yield.

The PLR

The IRS private-letter ruling was based was a primary market transaction that involved long-term tax-exempt bonds privately placed with a bank and a short-term TRS that was entered into at the same time the bonds were placed. The borrower and bank wanted to extend to the TRS by five years. The pricing of the extended TRS was to be amended so the borrower's net financing would be reduced to the SIFMA index plus 80 basis points.

The bond proceeds had all been used to current refund some previously issued bonds, as well as to pay issuance costs. As a result, there were no proceeds remaining and there was no debt service reserve fund, for which arbitrage might have had to have been rebated. A debt service reserve fund typically holds a year's worth of interest rate payments. If there had been bond proceeds or a reserve fund outstanding, the IRS could have questioned whether rebate calculations should have been based on the bond yield or an integrated bond and swap. But the facts of the case rendered this issue moot.

The IRS said there were no replacement proceeds. Under the tax rules, if a transaction is found to be an abusive arbitrage device, the Commissioner can decide that even though no bond proceeds remained, the hospital's funds could serve as replacement proceeds for the bond proceeds and cause arbitrage problems.

"There are no replacement proceeds otherwise created and no transferred proceeds were received," the IRS said in the PLR. "The proposed extension of the TRS does not affect the gross proceeds of the bonds…."

The IRS declined to take any position whether the TRS extension would cause a reissuance. The issuer and the bank/bondholder/swap counterparty, as a precautionary step, filed another Form

8038 for the bonds in case the IRS decided there was a reissuance. But in that Form 8038, which issuers file for the issuance of 501(c)(3) bonds for nonprofits, they did not include any election to integrate the bonds and swap.

“We specifically express no opinion about whether of the TRS causes a reissuance under Section 1001 [on reissuance] or about issuer’s precautionary treatment of such extension as a reissuance,” the IRS said in its PLR.

The lawyers said that reissuance wouldn’t pose problems for current TRS’ because there have been no tax law changes in recent years that could be applied to these transactions.

The IRS found the transaction was not an abusive arbitrage device because it did not exploit the difference between tax-exempt and taxable rates and it did not overburden the tax-exempt bond market.

“We conclude that the original structure of the financing plan, including the TRS, and the extension of the TRS for the bonds, does not enable the borrower to exploit a difference between tax-exempt and table interest rates to obtain a material financial advantage,” the IRS said. “The financing structure does not result in any gross proceeds available for non-purpose investment beyond the first 30 days during which initial time period they qualified for an applicable temporary period. The financing structure and the terms of the TRS extension do not reflect an intent to exploit tax-exempt versus taxable interest rate differentials for arbitrage purposes. Since rate exploitation is not present, it is unnecessary to determine if overburdening is present.”

Regarding the question of whether the bonds and TRS should be integrated, the IRS said: “We conclude that the structure of the original financing, including the TRS, and the proposed extension of the TRS, does not reflect a principal purpose by the borrower to obtain a material financial advantage by either rate exploitation or by overburdening. Improved market conditions and the improved credit quality of the borrower are the motivating factors for the extension. The modified pricing reflected in the extension was negotiated in an arms’ length transaction based on fair market value pricing and not on the amount of arbitrage earned or expected to be earned on the hedged bonds in a manner that is inconsistent with the purposes of Section 148.” That section of the Internal Revenue Code contains arbitrage provisions and defines an arbitrage bond, which is taxable.

THE BOND BUYER

BY LYNN HUME

JAN 26, 2015 11:05am ET

S&P's U.S. Not-For-Profit Healthcare 2015 Outlook - Webcast Replay Now Available.

Standard & Poor’s Ratings Services held a live Webcast and Q&A on Thursday, December 18, 2014, at 2:00 p.m. Eastern Standard Time, on the 2015 outlook for U.S. not-for-profit health care. We discussed our view on the outlook for the U.S. not-for-profit health care sector, along with the potential impact on ratings for 2015.

Listen to the replay.

Download the slides.

Speakers were:

Martin Arrick
Managing Director, U.S. Public Finance
Standard & Poor's Ratings Services

Kevin Holloran
Senior Director, U.S. Public Finance
Standard & Poor's Ratings Services

Standard & Poor's Ratings Services' Webcasts deliver audio and slides in a streamlined presentation. You will need computer speakers or headphones to listen to the audio stream. Throughout this live webcast, you may submit your questions for the presenters in real time via the Webcast interface.

TAX - CALIFORNIA

Citizens for Fair Reu Rates v. City of Redding

Court of Appeal, Third District, California - January 20, 2015 - Cal.Rptr.3d - 2015 WL 252175

The City of Redding engaged in the practice of making an annual budget transfer from the Redding Electrical Utility to Redding's general fund. Because the Utility is municipally owned, it is not subject to a one percent ad valorem tax imposed on privately owned utilities in California. However, the amount transferred between the Utility's funds and the Redding general fund is designed to be equivalent to the ad valorem tax the Utility would have to pay if privately owned. Redding describes the annual transfer as a payment in lieu of taxes (PILOT). The PILOT is not set by ordinance, but is part of the Redding biennial budget.

Plaintiffs challenged the PILOT on grounds it constitutes a tax for which article XIII C of Proposition 26 required approval by two-thirds of voters. Redding responded that the PILOT was not a tax, and if it was a tax, it was grandfathered-in because it preceded the adoption of Proposition 26.

The Court of Appeal concluded that the PILOT constituted a tax under Proposition 26 for which Redding must secure two-thirds voter approval unless it proves the amount collected is necessary to cover the reasonable costs to the city to provide electric service.

The court rejected Redding's assertion that the PILOT was grandfathered-in by preceding Proposition 26's adoption. As a budget line item, the PILOT is subject to annual discretionary reauthorization by Redding's city council. The PILOT does not escape the purview of Proposition 26 because it is a long-standing practice.

The court remanded for an evidentiary hearing in which Redding has the opportunity to prove the PILOT does not exceed reasonable costs under article XIII C, section 1, subdivision (e)(2).

IRS Addresses Timeliness of Refundable Bond Credit Claims: Tax Analysts

In partially redacted program manager technical assistance, the IRS concluded that because Forms 8038-CP can function as both a return and refund claim, an initial Form 8038-CP filed more than three years after the date of a bond interest payment date may be timely for purposes of section 6511(a), but the amount of the credit or refund will be limited under section 6511(b)(2)(A).

Continue reading. (Subscription Required)

IRS Anticipates Issuing Proposed Regs on Governmental Plans: Tax Analysts

The IRS announced (Notice 2015-7) that it intends to issue proposed regulations that would permit a state or local retirement system that is a governmental plan within the meaning of section 414(d) to cover public charter school employees if specified requirements are satisfied.

Continue reading. (Subscription Required)

JANUARY 23, 2015

NABL Comments on Notice 2014-67.

NABL has submitted comments to the Internal Revenue Service ("IRS") in response to Notice 2014-67 regarding the interim guidance provided for the participation by governmental persons or 501(c)(3) organizations in accountable care organizations ("ACOs") under the Medicare Shared Savings Program of the Patient Protection and Affordable Care Act and regarding the amplification of the private business use safe harbors in Revenue Procedure 97-13.

Regarding ACOs, NABL asked that the IRS and Treasury Department confirm that (1) the six-prong standard described in section 3.01 of Notice 2014-67 (the "ACO Safe Harbor") is in fact a safe harbor for purposes of determining whether participation in an ACO results in private business use; and (2) the ACO Safe Harbor does not displace the general facts and circumstances approach set forth in the Code and Treasury Regulations or other existing guidance, such as Revenue Procedure 97-13, for purposes of determining whether an arrangement gives rise to private business use. NABL requested that further clarification be included in subsequent guidance with respect to several of the specific ACO Safe Harbor requirements.

Regarding Revenue Procedure 97-13, NABL suggested amendments to clarify the application of the Management Contract Safe Harbor, including a definition of the term "stated amount" and an extension of the management contract safe harbor to apply to incentive payments based on maximizing revenue or minimizing expense.

The comments were prepared by an ad hoc task force (listed in Exhibit A of the document) and approved by the NABL Board of Directors. The comments on Notice 2014-67 can be seen here.

Lew: Agreement on Business Tax Reform Possible.

WASHINGTON — Treasury Secretary Jack Lew said Wednesday that congressional Republicans and the Obama administration are too far apart on individual tax reform but could reach an agreement on business tax reform.

The chances of getting business tax reform done by the end of Barack Obama's presidency are "better than 50-50," Lew said at the Brookings Institution.

Lew seemed to discount the possibility of individual tax reform after Senate Finance Committee leaders began pushing for comprehensive tax reform. Finance Committee chairman Orrin Hatch, R-Utah, and ranking minority member Ron Wyden, D-Ore., set up working groups, including one on community development and infrastructure, in order to boost comprehensive tax reform efforts. Hatch said Tuesday that he wants working groups' efforts to lead to tax reform legislation that will be introduced and voted on in the committee later this year.

But Lew said that the administration and congressional Republicans disagree substantially about individual tax reform. Congressional Republicans want to lower the top individual rate, which Lew doesn't think is the best idea. "I don't think lowering the top individual rate is the way to grow our economy or create a better future for middle-class workers or for the country at large," he said.

However, there are tax changes for businesses that both the administration and congressional Republicans can support, Lew said. He added that he's remained in close contact with the chairmen and ranking minority members of the tax-writing committees and is encouraged that there's interest in having bipartisan discussion on business tax reform.

"I'm optimistic that we can reach an agreement here. I really am. I think there's goodwill on both sides to pursue the conversation," Lew said, though he noted doing business tax reform will be challenging.

The Obama administration wants to do business tax reform that makes changes that help small businesses as well as corporations, Lew said.

The Treasury Secretary spoke about business tax reform the day after President Obama gave his State of the Union address. Both Lew and Obama said that revenues from business tax reform should be used for infrastructure.

Lew said, "Rebuilding America's core infrastructure will have the long-term benefit of making America a more attractive place to invest and do business so that our economy is stronger not just today but for the future." He noted that the tax reform plan put out by former House Ways and Means Committee Chairman Dave Camp also would use temporary revenue created by tax reform for infrastructure.

Lew also criticized the new House rule that will require the Joint Committee on Taxation and the Congressional Budget Office to do "dynamic scoring" for some legislation. Dynamic scoring is when the macroeconomic activity that would or wouldn't occur if legislation went into effect is taken into consideration for revenue estimates.

"We think [the House rule] is unwise given the uncertainty involved in dynamic scoring, the assumptions that have to be made, and the unequal treatment of tax cuts versus pro-growth investments funded through annual appropriations," Lew said. It is very dangerous to use scoring methods that may exaggerate savings and underestimate costs, he said.

Lew praised the bipartisan budget agreement reached in December 2013 that "created a framework that showed we can work through the differences to find a path forward."

The House and the Senate appropriations committees implemented the agreement, which set the discretionary spending levels for fiscal 2014 and 2015, with the spending bill that passed last month. That bill didn't make either Democrats or Republicans completely happy, but it was a compromise that funded government programs through the end of the fiscal year, Lew said.

"Looking ahead, we can build on this momentum and pass bipartisan business tax reform so that our economy is one where innovation and ingenuity thrive, where hard work and determination pay off, and where the opportunity to succeed is available to everyone," he said.

The budget agreement left in place the discretionary spending caps for fiscal 2016 and later that were set by the 2011 Budget Control Act. Lew said he doesn't like the levels of the caps, and that conversations about spending above the levels of the caps will have to include discussions about how to pay for that spending.

THE BOND BUYER

BY NAOMI JAGODA

JAN 21, 2015 3:06pm ET

Hatch: Tax Reform Top Priority, Legislation This Year.

WASHINGTON – Senate Finance Committee chairman Orrin Hatch said tax reform is his top priority and that he is aiming for bipartisan tax-reform legislation to be introduced and voted on by the committee later this year.

Meanwhile, the National Association of State Treasurers sent a letter to Hatch, R-Utah, and other leaders of the tax writing committees Tuesday urging them to preserve the tax-exemption for municipal bonds.

Speaking at the U.S. Chamber of Commerce on Tuesday, Hatch said, "I don't want just to release a framework or a proposal that doesn't go anywhere. My only goal when it comes to tax reform is to make new law."

Hatch and the top Democrat on the finance committee, Ron Wyden from Oregon, have set up five working groups on the topic, including one on community development and infrastructure.

"My hope is that the committee members in these five bipartisan working groups will use this opportunity to uncover real tax reform solutions and give us real ideas that will aid us through tax reform," Hatch said.

Addressing those who are skeptical of the intentions of the working group process, Hatch said, "This is not theater, nor is it just for show. This is a very real undertaking." The groups' endeavors should lead to the introduction of tax-reform legislation later this year, he said.

Some members of Congress have suggested using budget reconciliation to pass tax reform. Hatch said that he would prefer for items that fall under his committee's jurisdiction to be done in a

bipartisan manner, but that budget reconciliation should not be taken off the table.

He also said that Congress will need to find a way to fund a highway bill, since the current funding expires at the end of May. A gas tax increase is “very unlikely” but Congress can find other solutions, whether highway funding is addressed in a standalone bill or as part of tax reform, he said.

NAST urged the tax-writing committees not to view the new type of bond Obama proposed Friday to help facilitate public-private partnerships for infrastructure as a substitute for traditional tax-exempt bonds. The bonds, called qualified public infrastructure bonds, would have features of governmental and private-activity bonds.

NAST told the lawmakers that while QPIBs “may increase infrastructure investment by permitting public private partnerships to tap into previously unavailable funding sources,” they would not be “a panacea.”

“Tax-exempt municipal bonds remain critical for the financing and construction of schools and other basic infrastructure needs,” said the letter, which was signed by NAST President and Tennessee Treasurer David Lillard and NAST Senior Vice President and Washington Treasurer James McIntire.

Curbing or eliminating the muni exemption would increase state and local governments’ borrowing costs and lead to fewer infrastructure projects and jobs. It’s important for states and localities to be able to save money by using the tax-exempt market since they have constrained budgets, NAST said.

And while states and localities could ask the federal government for more subsidies, “rather than having Congress dictate which projects get built, it’s far more efficient to have state and local governments set their own priorities and shoulder the bulk of the cost of their investments,” the group said.

In addition to talking about tax reform and highway funding, Hatch talked about other items on the finance committee’s agenda.

Congress will also need to address the debt ceiling this year, likely around the middle of the year, Hatch said. The current suspension of the debt limit expires in March. Hatch said it’s uncertain how the next debt limit extension will be done, but the finance committee will be involved.

In the last Congress, Hatch introduced a pension reform bill called the Secure Annuities for Employee (SAFE) Retirement Act. He said he wants Congress to enact the legislation.

The bill would allow state and local governments to invest in annuity contracts with private life insurance companies for employee retirement benefits. Hatch said that poorly-funded state and local defined benefit pension plans are “bankrupting” governments. He pointed to Illinois as an example.

Also during the last Congress, Hatch worked with Sen. Michael Bennet, D-Colo., to introduce legislation to promote “social impact bonds,” or public-private partnerships to promote social interventions. “This approach to social service delivery could offer states and the federal government a viable pathway to innovate with promising strategies to achieve positive results and save taxpayer dollars,” he said.

THE BOND BUYER

BY NAOMI JAGODA

JAN 20, 2015 11:47am ET

Foley: IRS Releases Guidance on Performance and Quality Standards for Small Wind Energy Property.

The IRS recently released Notice 2015-4 (the Notice), which provides performance and quality standards that small wind energy property (defined under section 48(c)(4) of the Code as property utilizing a "qualifying small wind turbine" with a nameplate capacity of not more than 100 kilowatts (kW)) must meet to qualify for the section 48 investment tax credit (ITC).

ITC eligible small wind energy property acquired or placed in service after January 26, 2015, must now meet the performance and quality standards set forth in either:

(1) American Wind Energy Association Small Wind Turbine Performance and Safety Standard 9.1-2009 (AWEA); or

(2) International Electrotechnical Commission 61400-1, 61400-12, and 61400-11 (IEC).

The Notice further explains that small wind turbines must comply with the applicable AWEA or IEC performance and quality standards in effect at the time of acquisition, defined for these purposes as the time the taxpayer that constructed, reconstructed, or erected the small wind turbine places it in service.

Manufacturers of small wind turbines may certify that the turbine meets the AWEA or IEC performance and quality standards by providing the taxpayer with a certification that satisfies the Notice's requirements. Taxpayers can then rely on the certification to claim the ITC. In the event that the IRS later determines that a manufacturer issued an erroneous certification, the manufacturer may be subject to penalties and its right to provide a certification to future purchasers will be withdrawn. Taxpayers that purchase the small wind turbines after the IRS publishes an announcement withdrawing the manufacturer's certification cannot rely on the certification, but taxpayers that purchased the equipment on or prior to the date on which the announcement of the withdrawal is published can still continue to rely on the certification (even if the equipment is not installed or the credit is not claimed before the announcement of the withdrawal is published).

Takeaways: The Notice imposes performance and quality standards on small wind energy property while providing a convenient and clear certification process that manufactures can utilize to advertise their equipment as meeting these standards and which taxpayers can then rely on to claim the ITC. Going forward we recommend that taxpayers purchase property certified pursuant to this Notice and then ensure that they maintain this certification in their records.

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.

Last Updated: January 17 2015

Article by John A. Eliason and Kurt R. Rempe

Foley & Lardner

TAX - LOUISIANA

Pot-O-Gold Rentals, L.L.C. v. City of Baton Rouge

Supreme Court of Louisiana - January 16, 2015 - So.3d - 2014-2154 (La. 1/16/15)

Taxpayer that operated waste removal business brought action against city seeking refund of sales taxes. The District Court granted taxpayer summary judgment. City appealed. The Court of Appeal reversed and remanded. Taxpayer sought review.

The Supreme Court of Louisiana held that lease of portable toilet with cleaning services included was not taxable pursuant to sales tax statute.

The "true object" of the transactions was, in the least, debatable, requiring the court to adopt the interpretation urged by the applicant as the least onerous to the taxpayer, and, to hold that providing cleaning services for portable toilets was not a taxable event if the toilet was owned by someone else, but was a taxable service if the toilet was owned by the lessor, would have created an absurd result.

Congress Extends QZABs, New Markets Tax Credits; Continuing Effect of Sequestration: McGuire Woods

On Dec. 19, 2014, President Barack Obama enacted the Tax Increase Prevention Act of 2014 (the "Act"), commonly referred to as the tax extenders bill (H.R. 5771), which you may read here. Generally, the Act extends many programs that expired at the end of 2013.

This Client Alert focuses on the extension of Qualified Zone Academy Bonds (QZABs), New Markets Tax Credits (NMTCs), and empowerment zone employment credits and on the enduring impact of sequestration on direct-pay bonds.

Qualified Zone Academy Bonds

The Act authorizes the Secretary of the Treasury to allocate an additional $400 million in QZABs for 2014. Prior to the Act, no additional allocations of QZABs were to be available to the states after Dec. 31, 2013. The 2014 round of QZABs allocations will expire if not issued on or before Dec. 31, 2016. QZABs issued under the 2014 allocations are eligible only for the tax credit and may not use the direct-pay option. This limitation also applies to QZABs issued under the 2013 allocations that expire at the end of 2015.[1]

As a reference, QZABs benefit a "qualified zone academy" (typically, a public school) that is designated as such by the "applicable local education agency," which is oftentimes the governing local school board or district. As more fully described in Section 54A of the Internal Revenue Code of 1986, as amended, a holder of a QZAB receives a credit against federal income taxes.

New Markets Tax Credits

The Act also authorizes $3.5 billion in allocations for the New Markets Tax Credit program. This authorization is for 2014. Prior to the Act, the last round of allocation related to 2013. The 2014 allocations must be used by Dec. 31, 2019.

The New Markets Tax Credit program is designed to encourage investment in qualifying low-income communities. An investor receives a tax credit in return for equity investments in community development entities that use those invested funds for eligible purposes aimed at targeted populations and low-income areas. The credit is 39 percent, taken over seven years. Many states have programs similar to the federal New Markets Tax Credit program.

Empowerment Zones

Moreover, the Act extends the benefits of empowerment zone designation by providing that any existing empowerment zone will remain designated as such until Dec. 31, 2014. Previously, the designation of existing empowerment zones expired on Dec. 31, 2013.

The benefits of empowerment zone status include the empowerment zone employment credit, which provides employers a federal tax credit equal to 20 percent of qualified zone wages paid during a calendar year. Qualified zone wages are wages paid to an employee who lives in an empowerment zone and performs substantially all of his or her employment in that empowerment zone. Other tax benefits include increased deductions for equipment placed in service in empowerment zones and delayed recognition of any gains on the sale of qualifying empowerment zone assets.

Federal Sequestration and Direct-Pay Bonds

All direct-pay bonds, including QZABs, Build America Bonds, Qualified School Construction Bonds, New Clean Renewable Energy Bonds, Qualified Energy Conservation Bonds and Recovery Zone Economic Development Bonds, remain subject to the ongoing effects of federal sequestration. For fiscal year 2015 (which ends on Sept. 30, 2015), the direct-pay subsidy for those bonds issued as direct-pay bonds is subject to a 7.3 percent reduction.

Unless a law is enacted that cancels or otherwise amends the sequestration, the existing subsidy reduction will remain in effect through the end of fiscal year 2024.

1. Included as Title II of H.R. 5771 is the “Tax Technical Corrections Act of 2014.” See Section 202(d) for the above-mentioned provisions relating to QZABs.

NABL Submits Comments on IRS Notice 2014-67.

NABL has submitted comments to the Internal Revenue Service (“IRS”) in response to Notice 2014-67 regarding the interim guidance provided for the participation by governmental persons or 501(c)(3) organizations in accountable care organizations (“ACOs”) under the Medicare Shared Savings Program of the Patient Protection and Affordable Care Act and regarding the amplification of the private business use safe harbors in Revenue Procedure 97-13.

Regarding ACOs, NABL asked that the IRS and Treasury Department confirm that (1) the six-prong standard described in section 3.01 of Notice 2014-67 (the “ACO Safe Harbor”) is in fact a safe harbor for purposes of determining whether participation in an ACO results in private business use; and (2) the ACO Safe Harbor does not displace the general facts and circumstances approach set forth in the Code and Treasury Regulations or other existing guidance, such as Revenue Procedure 97-13, for purposes of determining whether an arrangement gives rise to private business use. NABL requested that further clarification be included in subsequent guidance with respect to several of the specific ACO Safe Harbor requirements.

Regarding Revenue Procedure 97-13, NABL suggested amendments to clarify the application of the Management Contract Safe Harbor, including a definition of the term “stated amount” and an extension of the management contract safe harbor to apply to incentive payments based on maximizing revenue or minimizing expense.

The comments were prepared by an ad hoc task force (listed in Exhibit A of the document) and approved by the NABL Board of Directors. The comments on Notice 2014-67 can be seen here.

Jan 22, 2015

TAX - CALIFORNIA

Williams & Fickett v. County of Fresno

Court of Appeal, Fifth District, California - January 9, 2015 - Cal.Rptr.3d - 2015 WL 128539

Taxpayer brought action against county for refund of personal property taxes. The Superior Court sustained demurrer without leave to amend and dismissed the complaint. Taxpayer appealed.

The Court of Appeal, Levy held that:

- Exhaustion of administrative remedies did not require application for an assessment reduction, and
- Taxpayer’s filing of applications for changed assessment did not trigger one-year limitations period.

Taxpayer was not required to apply to the county board of equalization or assessment appeals board for an assessment reduction to satisfy the exhaustion of administrative remedies requirement for taxpayer’s judicial action for refund of taxes on the basis that taxpayer did not own the personal property covered by the challenged assessment and therefore the assessment was a nullity.

Taxpayer’s filing of applications for changed assessment seeking to cancel an assessment on personal property, which the county assessment appeals board returned as untimely, did not trigger the limitations period for a tax refund claim of one year after the county assessment appeals board fails to hear evidence and fails to make a final determination on an assessment reduction application, since the applications to cancel the assessment were not assessment reduction applications, and taxpayer had not yet paid the tax.

Upping the Ante: Costs Of Luring Top Students Keep the Outlook Negative on U.S. Not-For-Profit Higher Education Sector.

Standard & Poor’s Ratings Services’ 2015 outlook for the U.S. not-for-profit higher education sector remains negative as colleges and universities struggle to balance the demands of their expenditures while addressing student affordability and access. We believe this tug-of-war in an increasingly competitive market will continue to compress overall operating performance and put an additional strain on these institutions’ financial resources, especially those whose credit characteristics are already at the cusp of a lower rating.

Continue reading the report.

15-Jan-2015

Not-for-Profit Hospitals Shunned Bond Market in 2014.

Hospital bond issuances fell to their lowest level in more than a decade last year as not-for-profit providers scaled back their capital spending despite low interest rates and eager lenders.

“Most of our clients have made a deliberate effort to pull back on major capital projects,” said Pierre Bogacz, managing director at HFA Partners. “We’ve seen a lot of them keeping these projects on the backburner.”

Instead of investing in traditional brick-and-mortar building projects, many health systems are focusing their attention on upgrading their information technology systems. These projects are not only less expensive, but they have a relatively short lifespan before providers must make the next upgrade. That makes them better-suited for a 10- to 15-year bank loan than for a bond issuance with a 30-year amortization schedule, Bogacz observed.

In an otherwise stable municipal bond market, the value of healthcare bond issuances in 2014 fell 16% compared with the previous year, according to data from Thomson Reuters. Only borrowers in the education sector had a similar pullback.

The total value of long-term bond offerings from healthcare providers was only $24.3 billion last year compared with $28.9 billion in 2013, and marked the lowest level of activity since 2001’s $23.4 billion in offerings.

“It’s not a situation where hospitals aren’t investing,” Bogacz said. “It’s a situation where they’re not investing so much that they need to go out and borrow.”

Healthcare providers have pulled back on projects that require new funds as they grapple with reimbursement cuts and decreased patient volume, said Cormac Cullen, a healthcare analyst at Fidelity investments.

“Debt, especially additive debt, can limit their flexibility,” he said.

But even refinancings in the beginning of the year suffered because of the complex relationship between yield curves on municipal bonds and Treasury bonds.

“Lower interest rates aren’t the end of the story,” Cullen said. “Both of those two different dynamics are affecting debt issuances.”

When a borrower wants to take out debt before it’s allowed to be redeemed, it can do so by setting up an escrow account that is typically funded with U.S. Treasuries. The Treasuries are purchased with the proceeds from the refinancing offering and used to make payments on the older bonds.

Therefore, it wasn’t until the Treasury yield curve flattened that there was an uptick in refundings in the fourth quarter, said Kevin Ramundo, a municipal portfolio manager at Fidelity.

Nine not-for-profit healthcare providers have filed official statements for bond offerings on MuniOS through Jan. 9. In contrast, just seven healthcare issuers filed official statements for offerings during the entire month of January 2014.

Of this year's nine healthcare issuances, all but one plan to use the proceeds for refundings. Only Lakeland (Fla.) Regional Health Systems is planning to use the proceeds from its $180 million offering to finance a new Women's and Children's Pavilion; build a new inpatient rehabilitation facility; and expand its emergency department, operating suites and cancer center.

Although the debt market typically drives the M&A market in the for-profit healthcare sector, the same is not true on the not-for-profit side, so the slowdown is not a sign that providers will pull back on their deal-making activity.

Most not-for-profit deals do not require up-front cash. Moreover, if not-for-profit providers can't access the bond market for their capital needs, they're more likely to seek out a partner, Cullen said.

Yet the decline in borrowing contrasts with the optimism from lenders, who note that the debt markets are wide open to healthcare borrowers. "They're ready to go—but the hospitals aren't," Bogacz said. "And it takes two to tango to issue debt."

It also comes as hospital financial metrics are improving; cash on hand is continuing to climb while leverage, or the amount of debt that providers have, has fallen, Bogacz said.

But then there's the question of how much longer providers can defer major projects. That may give a boost to the hospital bond market this year, especially if interest rates begin to rise.

"That could be a good opportunity for hospitals to pull the trigger on something they've been considering," Bogacz said. "I think it's going to be a wake-up call for hospitals that don't have a sense of urgency. But that's a big if—it really depends on what the Feds are going to be doing."

Modern Healthcare

By Beth Kutscher | January 12, 2015

IRS Publication: Tax on Unrelated Business Income of Exempt Organizations.

The IRS has released Publication 598 (rev. Jan. 2015), Tax on Unrelated Business Income of Exempt Organizations.

View the publication.

IRS FSLG Newsletter.

The January 2015 edition of the Federal State and Local Government Newsletter is now available.

Inside this issue:

- Withholding on Remuneration Paid to Foreign Students, Scholars, Teachers, Researchers and Trainees
- Tax Treatment of Employer-Provided Meals
- Adjustments for Additional Medicare Tax
- New Edition of Publication 963 Available

- Directory of FSLG Specialists

Click here to read the January 2015 edition of the FSLG Newsletter.

Senate Finance Panel Takes Step Toward Comprehensive Tax Reform.

WASHINGTON -The Senate Finance Committee took a step toward comprehensive tax reform on Thursday by launching five bipartisan working groups charged with issuing a report with recommendations by the end of May.

Several municipal market participants and tax experts suggested the recommendations could include changes to municipal bonds.

The groups will examine current tax law, policy trade-offs and options for reform. They will work with the Joint Committee on Taxation to come up with an in-depth analysis of options and possible legislative solutions in their subject areas, according to a release issued by Senate Finance Committee chairman Orrin Hatch, R-Utah, and ranking minority member Ron Wyden, D-Ore.

The groups' recommendations "will serve as a foundation for the development of bipartisan tax reform legislation," the release said.

Frank Shafroth, director of the Center for State and Local Government Leadership at George Mason University, said muni changes are "more likely than not" to be part of the recommendations, since Congress is still looking to find ways to offset lowering tax rates.

Dustin McDonald, director of the Government Finance Officers Association's federal liaison center, also said that the groups will be looking at ways to raise revenue that could be used to lower rates. "I think they'll be no stone unturned," he said.

The tax reform plan released by former House Ways and Means Committee Chairman Dave Camp, R-Mich., would have capped the value of tax-exemption at 25% and eliminated the tax exemption for new private-activity bonds. McDonald said it is unclear if the working groups will use Camp's plan as a guide, but "the same concerns remain for us" that any tax-reform plan would include changes to bonds.

While John Godfrey, government relations director for the American Public Power Association, agreed that the working groups are unlikely to stay silent on bonds, he said that the groups won't necessarily make changes that would hurt bonds.

If the groups focus on improving the tax code and do not have to come up with a certain amount of money that can be used to lower rates, there are "some opportunities to make improvements," such as updating private-activity bond rules to make it easier for public power utilities to finance electric power transmission investments using PABs, Godfrey said.

Tax experts pointed out that the House Ways and Means Committee similarly had tax reform working groups in 2013. They had mixed views on how these new groups would impact the chances for tax reform.

Howard Gleckman, a resident fellow at the Urban Institute, said the groups "can't hurt" the chances for tax reform, and it's always good to have members engaged in a topic. But he acknowledged that

Camp's working groups didn't necessarily help him move tax reform, and Camp only used a little of the groups' product in his bill.

Godfrey suggested the groups will create subject-matter experts, which could help efforts to do piecemeal tax reform.

But Shafroth said the groups will have to collect a lot of information, which will "bog down" the tax-reform process.

Micah Green, chair of the financial services and tax policy practice group at Squire Patton Boggs, said "irrespective of these bipartisan working groups, it will remain a difficult task to develop a consensus on broad based comprehensive individual and business tax reform."

However, "this process will surely serve as a significant framework for the debate on the various major topics of focus for each group," Green said. "The municipal bond community should take this as a very serious opportunity to have meaningful and timely input."

Michael Decker, Securities Industry and Financial Markets Association managing director and co-head of municipal securities, said, "We're glad to see that Congress is working in a bipartisan manner to address the important issue of tax reform. We look forward to working with these groups on issues important to the municipal bond community, such as preserving the tax exemption for muni bonds."

The working groups will have Democratic and Republican co-chairs. The community development and infrastructure working group will be co-chaired by Sens. Dean Heller, R-Nev., and Michael Bennet, D-Colo.

Mike Nicholas, chief executive officer of the Bond Dealers of America, called the senators "two good choices."

In 2009, Bennet and other senators sent a letter to then-Treasury Secretary Timothy Geithner urging the department to backstop municipal debt during the financial crisis.

Bennet "has been an advocate for municipal debt in the past," Nicholas said.

Also, Bennet previously served as superintendent of the Denver public schools and as chief of staff to a former mayor of the city.

The senator "understands municipal issues and capital expenditures for school construction. That background will certainly be important in analyzing these issues in the context of this particular working group," Green said.

Speaking about Heller, Nicholas said, "We've always found him to be reasonable and open-minded to discussions."

Gleckman said that Bennet and Heller have reputations for reaching across the aisle.

In addition to infrastructure, the groups will focus on individual income tax, business income tax, international tax and savings and investment.

THE BOND BUYER

BY NAOMI JAGODA

JAN 15, 2015 4:15pm ET

TAX - VIRGINIA

CVAS 2, LLC v. City of Fredericksburg

Supreme Court of Appeals Virginia - January 8, 2015 - S.E.2d - 2015 WL 103731

City brought suit against real estate developer seeking to have developer's real estate sold in order to collect outstanding payments for delinquent real estate taxes and special assessments. The Circuit Court entered decree of sale. Developer appealed.

The Supreme Court of Virginia held that:

- City had no authority to bring suit to sell the real estate as a means to collect delinquent real estate taxes;
- City had no authority to bring suit to sell the real estate as a means to collect delinquent special taxes; and
- City had no authority to bring suit to sell the real estate as a means to collect delinquent special assessments.

Because city did not strictly comply with time period in tax code allowing for a suit to sell real estate to be brought, the city had no authority under the code to bring suit to sell taxpayer's real estate as a means to collect delinquent real estate taxes.

Because city did not strictly comply with the time period in tax code allowing for a suit to sell real estate to be brought, and had not adopted an ordinance pursuant to code provision allowing for it to expedite and collect delinquent special taxes independent from its collection of another type of delinquent "locality's taxes," the city had no authority under the code to bring suit to sell taxpayer's real estate as a means to collect delinquent special taxes.

Because city had not shown that it had strictly complied with tax code provisions allowing for it to bring suit to collect delinquent special assessments on behalf of a community development authority, the city did not establish authority under the code to bring suit to sell taxpayer's real estate as a means to collect the delinquent special assessments.

Dynamic Scoring Could Make Tax Reform Easier.

WASHINGTON – New House rules on dynamic scoring could make tax reform easier to do, said municipal and tax experts who differed on whether such scoring would benefit or hurt municipal bonds.

Dynamic scoring is when the macroeconomic activity that would or wouldn't occur if legislation went into effect is taken into consideration for revenue estimates. The House rules package adopted Tuesday require the Congressional Budget Office and the Joint Committee on Taxation, when possible, to take the macroeconomic effects of "major legislation" into consideration in cost estimates.

"Major legislation" is defined as a bill that causes a budgetary effect of at least 0.25% of the

projected gross domestic product in any fiscal year covered by the budget resolution. The House Budget Committee chairman and the top House member on JCT can also designate bills to be major legislation.

Ken Kies, managing director of the Federal Policy Group and a former JCT chief of staff, said that dynamic scoring may slightly improve the chances for tax reform "at the margin." The dynamic scoring models assume that lowering tax rates improves economic growth. As a result, dynamic scoring could make tax-reform plans less costly. Still, he warned that dynamic scoring doesn't make tax reform easy.

Tax experts said that JCT would probably do macroeconomic analyses for whole bills but continue to produce revenue estimates for specific provisions of the bill using static scoring.

Kies said that when JCT does an overall dynamic analysis of a bill, he would expect a favorable treatment of bonds to be a plus. Tax-exempt bonds make capital cheaper and more readily available, he said.

Mike Nicholas, chief executive officer of the Bond Dealers of America, said "we think that tax legislation scored dynamically benefits the municipal market."

Michael Decker, Securities Industry and Financial Markets Association managing director and co-head of municipal securities, said he hopes dynamic scoring would lead to "more realistic estimates of revenue effects."

In theory, dynamic scoring "provides some flexibility to the tax-writers" and could make tax reform easier, said Chris Mauro, director of municipal bond research at RBC Capital Markets. However, munis are most likely to be hurt by comprehensive tax reform, and in order for that to be accomplished, there needs to be cooperation between both parties, both chambers of Congress and the president. That cooperation doesn't exist right now, Mauro said.

Congress is likely to focus on corporate tax reform this year, since they won't have time to do comprehensive tax reform before the 2016 presidential election gets into full swing, said Frank Shafroth director of the Center for State and Local Government Leadership at George Mason University. Dynamic scoring could show that cuts to corporate tax rates will produce revenue because the lower rates will lead to corporations stimulating the economy, he said.

"Moving from static to dynamic scoring will positively impact tax reform," he said. While it's unclear to what extent any tax reform will get done, "if anyone can do it, it's Paul Ryan," the new Republican chairman of the House Ways and Means Committee, Shafroth said.

Under dynamic scoring, Congress does not need to cut as many tax preferences in order to pay for lowering rates. However, Shafroth thinks that tax-exempt bonds are still likely to be on the menu of preferences to cut, since the White House hasn't supported them. President Obama's last few budget proposals have included capping the value of the muni exemption at 28%.

Howard Gleckman, a resident fellow at the Urban Institute, also said that tax preferences for bonds could still be cut even with dynamic scoring. JCT did dynamic scoring for former House Ways and Means Committee Chairman Dave Camp's tax reform proposal, and it found that by using this method, Camp's bill would have raised an additional $50 billion to $700 billion over 10 years. The low end of that range is essentially revenue neutral, meaning that a lot of tax expenditures would still have to be cut, he said.

If dynamic scoring makes it easier for tax reform to be enacted, "it will increase pressure on tax-

exempt bonds," Gleckman said. "Any cut in tax rates makes munis less attractive to investors. And tax-exempts are always a potential target if Congress is looking to curb tax preferences."

The House rules package that included dynamic scoring passed Tuesday, hours after the 114th Congress began, by a vote of 234 to 172. The vote was partisan, with most Republicans favoring the measure and Democrats primarily opposing it. House Democrats accused Republicans of supporting dynamic scoring so that they can use "voodoo economics" to cut taxes for the wealthy.

"They are changing House rules to be able to cook the books to implement their long-held, discredited notion that tax cuts pay for themselves," said Sander Levin, the top Democrat on the House Ways and Means Committee.

John Buckley, former chief tax counsel for the Democrats on the House Ways and Means Committee, said Democrats in Congress won't support tax reform under "dubious" economic scoring and that Republicans don't have enough support for tax reform within their own caucus to do it without some Democratic votes.

Dynamic scoring "turns tax reform, regrettably, into a partisan issue," he said.

House Republicans, on the other hand, argue that dynamic scoring provides more accurate estimates.

"This change will give members of Congress and the American people an accurate idea of the real-world effects of proposed legislation designed to grow the economy and create jobs," House Rules Committee Chairman Pete Sessions, R-Texas, said in a statement.

The House rules do not apply in the Senate, though Senate Finance Committee Chairman Orrin Hatch, R-Utah, supports using dynamic scoring for major reforms, a spokeswoman for the senator said.

THE BOND BUYER

BY NAOMI JAGODA

JAN 8, 2015 3:15pm ET

IRS Announces Simplified Voluntary Closing Agreement Program.

Announcement 2015-2 provides a simplified Voluntary Closing Agreement Program (VCAP) process for issuers of qualified 501(c)(3) bonds. Issuers can request a closing agreement in situations in which the borrower of the proceeds of the bonds received Prospective Reinstatement, as defined in the Announcement, after its tax-exempt status was automatically revoked under section 6033(j)(1) of the Internal Revenue Code.

An issuer of 501(c)(3) bonds can apply for a closing agreement under the announcement if the organization's status had not been previously revoked since the issue date of the bonds. The bonds in question must not be under examination by the IRS. Issuers need to submit the closing agreement within 12 months of the date of the reinstatement letter.

The closing agreement amount for each bond issue covered by the agreement will equal $500 for

each calendar month or portion thereof in the period starting with the month that includes the Revocation Date and ending in the month that includes the effective date of the reinstatement of the exempt status of the Organization.

IRS Chief Counsel Office Hit Hard by Budget Cuts.

The Internal Revenue Service is facing budget cuts that may cause the agency to make drastic changes to the Office of Chief Counsel. The total number of lawyers in the office, the time it can spend speaking with the public, and its ability to issue guidance and private rulings have all already been affected.

In 2014, the number of public letter rulings issued by the office dropped by 10 percent from the previous year. Speaking to press at an event earlier this week held by Buchanan Ingersoll & Rooney PC, IRS Deputy Chief Counsel Erik Corwin told Bloomberg reporters that part of that was by design, telling press that the rulings "are less efficient than published guidance." The agency may consider shaping its annual guidance plan to reflect the cuts. NABL President Tony Martini has written to the Chief Counsel's office urging continued attendance by staff of the Chief Counsel's office at NABL conferences. President Martini's letter is available here.

TAX - OREGON

Evergreen Aviation and Space Museum v. Department of Revenue, State

Oregon Tax Court, Regular Division, Property Tax - December 19, 2014 - 2014 WL 7213197

Plaintiffs ("Taxpayer") own and lease property in Yamhill County that is operated generally as a museum relating to air and space equipment, activity and exploration and related scientific educational activity. The County and Defendant Department of Revenue ("Department") acknowledged that much of the property is exempt from taxation as being related to scientific activity.

However, the Department asserted that some of the property for which Taxpayer claimed exemption did not qualify for exemption, which Taxpayer disputed.

The Oregon Tax Court held that:

- An analysis of the time used for exemption-related movies as compared with time used for nonexemption-related movies and rentals to third parties would be the better analysis than a relative revenue test for purposes of determining whether any portion of the museum's theater was exempt;
- The case would be continued for the purpose of allowing the parties to consider whether they could agree on a conclusion as to partial exemption for the museum's theater;
- The museum's kitchen and cafe were exempt, as the food service activity that existed at the museum implemented the objectives of Taxpayer in a substantial way;
- The concession stand was not exempt;
- The gift shop was not exempt, as the sale of items related to the purpose of the museum were a small fraction of the total sales of the shop and thus the gift shop did not meet the substantial

factor test;
- The land adjacent to the museum not used for the purposes of the museum was nonexempt, notwithstanding Taxpayer's argument that it was used to create a "campus atmosphere"; and
- An allocation was required and should be done on the basis of the ratio of space occupied by the for-profit entity and otherwise found to be nonexempt (such as the space in the theatre allocated to nonexempt use by reason of display of nonexempt movies) as compared with the total space in the museum and theatre properties for the parking area.

Off-Key BABs: IRS Hits Wrong Note in Reissuance Analysis - Mintz Levin

The IRS recently published a December 9, 2014 Chief Counsel Advice Memorandum to the effect that the defeasance of taxable Build America Bonds (BABs) causes a tax reissuance of the bonds, with the consequence that the municipal issuer ceases to be eligible for federal government interest subsidies for the period from the defeasance date to the redemption date. (A "reissuance" means that from a tax perspective existing bonds are deemed exchanged for new bonds issued on the reissuance date.) The BABs subsidy was available for bonds issued in 2009 and 2010; bonds issued or deemed issued in 2014 are ineligible.

This internal counsel advice is not particularly consequential in the specific context to which it applies. As noted in a Bond Buyer article on the advice memorandum, defeasance escrows for taxable bonds tend to be established for short periods, usually the thirty day period between the date a redemption notice is mailed and the redemption date. Accordingly, any loss of BABs subsidy to the issuer resulting from a purported reissuance is minor. Similarly, though a reissuance of taxable bonds may accelerate realization of gain or loss by a bondholder, if the reissuance occurs 30 days before the redemption date, it is unlikely to change the tax year in which such gain or loss occurs.

The larger point is that the advice memorandum reflects a troubling approach by the IRS to the interpretation of its rules. A legal defeasance of taxable bonds generally causes a reissuance (which is why taxable bond indentures provide for "covenant defeasance", which permits the creation of a defeasance escrow that economically defeases the bonds while the issuer retains theoretical liability for any escrow shortfall.) However, the reissuance regulations provide an exception for municipal bonds. The reissuance exception applies to "tax-exempt bonds", which IRS Regulation 1.1001-3(f)(5)(iii) defines as "a state or local bond that satisfies the requirements of § 103(a)." Section 103(a) of the Internal Revenue Code sets forth the requirements that must be satisfied by tax-exempt municipal bonds.

BABs are required to meet the requirements of Section 103(a) in order to be eligible for the federal subsidy. This is because the BABs subsidy, which is paid by the Treasury to the issuer and offsets the issuer's interest cost, is merely an alternative mechanism for lowering the interest costs to a municipal issuer of issuing bonds that satisfy the criteria for a federal subsidy. Instead of exempting the bondholder from income tax on the bond interest, thereby lowering the rate the issuer must pay to attract bond purchasers, the BABs mechanism pays a subsidy directly to the issuer, which some believe to be a more cost-effective form of federal subsidy. But in order to be eligible for either form of subsidy – tax-exemption of interest, or direct subsidy payments to the issuer by the federal government – the applicable bonds must comply with the same Section 103(a) requirements.

So why does the IRS advice memorandum conclude that the reissuance exception for defeasance of bonds that satisfy the requirements of Section 103(a) is inapplicable to BABs? The memorandum

acknowledges that the legislation creating BABs was enacted subsequent to the promulgation of the relevant reissuance exception, and that the regulatory exception was not revised at that time to exclude BABs from the exception. But the memorandum asserts that the concerns that gave rise to the reissuance exception for such defeasances focused on preserving the tax-exemption of interest to bondholders, and that taxable BABs do not present the same concerns for bondholders. Respected bond counsel dispute the advice memorandum's characterization of the regulatory history of the reissuance exception.

But the more troubling feature of the IRS analysis is that BABs satisfy the literal requirements of the reissuance exception for defeasance. Regulatory history and speculation as to whether the rulemakers would or wouldn't have included BABs if they had focused on the question should only be relevant if there is ambiguity in the regulation. In this instance, there is none.

Issuers should be entitled to rely on the plain meaning of IRS regulations in structuring their bond issues and/or refinancing their bond issues. If circumstances change and the IRS does not wish a rule that literally applies to such changed circumstances to be applicable, the burden should be on the IRS to change the rule, versus expecting issuers and practitioners to pre-clear with the IRS whether some unwritten carveout to the rule exists in the minds of individuals at the IRS. A more famous (and tonally adept) Babs once sang "If You Could Read My Mind," but that is no way to run a tax system.

By Len Weiser-Varon

Mintz Levin

December 30th, 2014

IRS TEB Voluntary Closing Agreement Program: Relief From Violation of Qualified Ownership and Use Requirements for Qualified 501(c)(3) Bonds.

Announcement 2015-2 provides a simplified VCAP process for issuers of qualified 501(c)(3) bonds, as defined in the Announcement, to request a closing agreement in situations in which the borrower of the proceeds of the bonds received Prospective Reinstatement, as defined in the Announcement, after its tax-exempt status was automatically revoked under section 6033(j)(1) of the Internal Revenue Code (the "Code").

States Will Have Greater New Capacity to Issue PABs in 2015.

WASHINGTON — States on the whole will see a slight increase in their new capacity to issue private-activity bonds in 2015.

The 50 states, the District of Columbia and Puerto Rico will have a total of about $35.23 billion of new capacity in 2015, up 0.97% from roughly $34.89 billion in 2014. The increase is based on the latest population figures released last week by the U.S. Census Bureau and a revised PAB cap formula published by the Internal Revenue Service in October.

Private-activity bonds are issued by public entities to provide low-cost financing for the projects of

nonprofit organizations or companies that serve a public purpose. Most types of PABs – including certain types of exempt-facility bonds, mortgage-revenue bonds, industrial development bonds, student-loan bonds and first-time farmer bonds – are subject to state volume caps.

States receive annual PAB volume caps and also can carry over any unused cap for up to three years. Volume caps for 2015 are the greater of $100 per capita or $301.52 million, according to the IRS. For 2014, the per capita rate was the same, and the minimum amount was $296.83 million. States use the minimum cap rather than the per capita amount when they have small populations.

Between July 1, 2013 and July 1, 2014, the population of the 50 states and D.C. increased by 0.75% to 318.86 million in 2014, according to the latest Census Bureau estimates. The U.S. population as of July 1, 2013 was 316.50 million, up from the estimate released last year of 316.13 million. The 2014 state volume caps are based on the 2013 population estimates that were released last December.

Nearly all states will see increases in their new capacity to issue PABs in 2015, but none will see an increase of more than 2%. Texas, the nation's second most populous state, will see the greatest increase in new volume cap, with a 1.92% gain. Florida, which overtook New York to become the third most populous state in 2014, will see a 1.74% rise in new cap, the second greatest increase.

California, the most populous state, will have its new capacity increase by 1.23% to $3.88 billion in 2015.

Nineteen states and D.C. used the minimum amount in 2014 and will use it again in 2015. These jurisdictions will see a 1.58% increase in new cap. Mississippi, whose population falls in between the 2014 and 2015 minimum caps, will use the minimum amount in 2015 but did not do so in 2014.

Illinois and Puerto Rico both saw population declines and will have a smaller amount of new capacity to issue PABs in 2015 than in 2014. Illinois' cap will decrease 0.01% to $1.29 billion, while Puerto Rico's cap will fall by 1.84% to $354.84 million. Five other states also saw population declines in 2014, according to the Census Bureau, but they will not see declines in new cap, in most cases because they use the minimum amount.

States rarely issue the maximum amount of PABs that they can issue under their caps in any year. In 2013, states only used about 10% of their total capacity, according to a survey by the Council of Development Finance Agencies.

The PAB volume cap figures for 2015 do not include American Samoa, Guam, the Northern Mariana Islands and the U.S. Virgin Islands because they are not included in the Census Bureau's population estimates.

THE BOND BUYER

BY NAOMI JAGODA

DEC 30, 2014 2:09pm ET

IRS EO Update: e-News for Charities & Nonprofits - December 31, 2014

1. IRS issues final regulations on new requirements for tax-exempt hospitals

The IRS and Department of Treasury have issued final regulations that provide guidance regarding the requirements for charitable hospital organizations added by the Affordable Care Act.

Each Section 501(c)(3) hospital organization is required to meet four general requirements on a facility-by-facility basis:

- establish written financial assistance and emergency medical care policies,
- limit amounts charged for emergency or other medically necessary care to individuals eligible for assistance under the hospital's financial assistance policy,
- make reasonable efforts to determine whether an individual is eligible for assistance under the hospital's financial assistance
- policy before engaging in extraordinary collection actions against the individual, and conduct a community health needs assessment (CHNA) and adopt an implementation strategy at least once every three years.

(The first three requirements listed above are effective for tax years beginning after March 23, 2010 and the CHNA requirements are effective for tax years beginning after March 23, 2012.)

The ACA also added new section 4959, which imposes an excise tax for failure to meet the CHNA requirements, and added reporting requirements under section 6033(b) related to sections 501(r) and 4959.

These final regulations provide guidance on the requirements described in section 501(r), the entities that must meet these requirements, and the reporting obligations relating to these requirements under section 6033. In addition, the final regulations provide guidance on the consequences for failing to satisfy the section 501(r) requirements.

2. Register for IRS webinar: Gaming and Tax-Exempt Organizations

Thursday, January 22 at 2 p.m. ET

Learn about:

- Gaming's impact on tax-exempt status
- Gaming and unrelated business income
- Maintaining records
- Reporting requirements
- Workers conducting gaming activities
- Reporting winnings and withholding income tax
- Gaming Excise taxes
- IRS resources

Register for this event.

3. Register for EO workshops

Register for our upcoming workshops for small and medium-sized 501(c)(3) organizations on:

Jan. 9 – Salt Lake City, UT

Hosted by University of Utah & the Utah Nonprofits Association

4. IRS EO phone forum and webinar Q&As posted

Review answers to questions posed by attendees of recent IRS Exempt Organizations phone forums and webinars. Submit questions to tege.eo.ceo@irs.gov.

Bond Tax-Break Threat Recedes With Federal Deficit: Muni Credit.

One thing is unlikely to change as Republicans take control of Congress: the century-old tax break for investors in the $3.6 trillion municipal-bond market, which has been threatened by proposals advanced in Washington during the past four years.

With the U.S. budget deficit shrinking and President Barack Obama in office through 2016, analysts at banks including JPMorgan Chase & Co. and Citigroup Inc. see little chance of a broad tax-code overhaul that could reduce the subsidies given to state and local government bonds.

The prospect of taxing muni-bond interest has been raised since 2010 as Obama and congressional Republicans looked to lower the deficit or pay for cuts to income-tax rates. Such a change would reduce the value of munis, which command higher prices than other securities because the interest has been exempt from the federal income tax since its creation in 1913.

“As for the risk of a near-term tax reform, it’s very minimal,” said Mikhail Foux, a municipal-market analyst with Citigroup in New York. “We’re unlikely to see anything before the next presidential election.”

Obama said during a press conference last month that he wants to reach an agreement with the new Congress to revamp the tax code. While Republicans will control both the House of Representatives and the Senate, they still don’t have enough power to override a veto by the Democratic president.

Veering Away

Representative Paul Ryan of Wisconsin, the next chairman of the tax-writing House Ways and Means Committee, has said that focusing on business taxes may represent the best chance for success, given how far apart Obama and Republicans are over how to approach taxes on individuals.

That approach lessens the odds that Congress may alter the status of municipal bonds, most of which are held by individuals seeking tax-free income, said Dustin McDonald, Washington lobbyist for the Government Finance Officers Association, which represents local officials.

“That would require a lot of support from those parties that they’ve had trouble corralling,” he said. “You’re going to have to gore a lot of oxen to do that.”

The tax break, forecast to cost the Treasury about $47 billion this year in foregone revenue, has been targeted along with dozens of other provisions in overhauls that failed to advance during the past four years.

In 2010, Obama’s deficit-cutting commission proposed taxing munis to lower rates and increase revenue. Obama and Republican Representative Dave Camp, the departing head of Ways and Means, later endorsed taxing some interest income received by the highest-earning households.

Reaping Gains

The failure of the plans was welcomed by investors and state and local government officials, who

said that changing the tax status of municipal bonds would depress prices because buyers would demand higher yields to offset the cost. On Dec. 31, benchmark 10-year munis yielded 2.11 percent, about 0.07 percentage points less than Treasury bonds, a reflection of the tax advantages.

Josh Gonze, who helps oversee $10 billion in municipal bonds for Thornburg Investment Management in Santa Fe, New Mexico, said he foresees scant risk that tax status of the state and local debt will be changed.

“It’s not on our radar screen,” he said. “This is something that has been discussed for the past 50 years. I don’t think there’s anything that’s happened that’s going to bring this to the forefront.”

Street Yawns

The perspective is widely shared on Wall Street. Since the elections last month, municipal analysts at brokers and banks including UBS AG, Janney Montgomery Scott LLC and Macquarie Group Ltd. have said the divide between Congress and the White House makes change unlikely.

“It’s definitely a good thing for the muni market,” said Foux, the Citigroup analyst. “For the most part, it’s priced in. I think most investors dismiss the risk.”

Governors, legislators and local officials have lobbied Congress to prevent any such change. More than 100 House Democrats and Republicans in 2013 signed a letter supporting the break. At a hearing on the issue in the Ways and Means Committee that year, lawmakers from both parties said taxing munis would push costs onto local governments and taxpayers.

The improving economy has eased the pressure on Congress to reduce the federal budget deficit, said Susan Collet, the president of H Street Capitol Strategies, who lobbied Congress on the issue for the Bond Dealers of America. In the year ended in September, the deficit shrank to $483.4 billion, about a third of the record $1.4 trillion hit in 2009.

“The immediate pressures that Congress would have to feel to put something that controversial on the table aren’t present,” she said. “It’s gone away for a while.”

(An earlier version of this story was corrected to reflect that the income tax code, not munis, dates from 1913.)

Bloomberg Muni Credit

By William Selway Jan 2, 2015 7:23 AM PT

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Expect More Tax Guidance in 2015.

WASHINGTON — The Treasury Department and Internal Revenue Service next year will be working on further guidance on issue price, regulations finalizing other proposed arbitrage rules, and additional rulemaking projects.

The agencies came out with their 2014-2015 priority guidance plan in August. “We hope to work very actively and hard to accomplish as much as we possibly can on that guidance plan,” Treasury associate tax legislative counsel John Cross told state and local finance officials earlier this month.

Cross, who rejoined Treasury in November after working at the Securities and Exchange Commission, discussed the items on the plan at the winter meeting of the Government Finance Officers Association’s committee on governmental debt management. Market participants also spoke to The Bond Buyer about what guidance they would like or expect to see in 2015.

Treasury and the IRS plan to release guidance on the determination of issue price separately from rulemaking on other arbitrage-related issues so that one piece focuses “more quickly and discretely on [issue price],” Cross said.

Treasury and the IRS released proposed arbitrage regulations that addressed several topics, including the definition of issue price in September 2013. Market participants have warned the proposed issue price rules are unworkable. Cross said the IRS may propose new rules on issue price.

Leslie Norwood, managing director, associate general counsel, and co-head of municipal securities at the Securities Industry and Financial Markets Association, — said she is hopeful there will be movement on issue price regulations with Cross back at Treasury. SIFMA was among the groups that sent the regulators comments criticizing the rules proposed in 2013.

Treasury and the IRS also hope to work on guidance that encompasses the non-issue price portions of the arbitrage regulations proposed in 2013 as well as a set of arbitrage rules proposed in 2007. The hope is to “wrap those all up with a bow and finalize those in a somewhat more substantial project,” Cross said.

Jack Browning, a senior partner at Squire Patton Boggs, said that some of the non-issue price proposed arbitrage rules are “noncontroversial,” so it would be helpful if they were finalized.

The National Association of Bond Lawyers has recently released comments on part of the non-issue price part of the 2013 proposed arbitrage rules. NABL president Tony Martini, a partner at Edwards Wildman Palmer, said these comments will hopefully be helpful to Treasury and the IRS.

Also on the guidance plan are final allocation and accounting rules, which relate to facilities that are used for both governmental and private use, Cross said. Allocation and accounting rules were proposed in 2006.

Perry Israel, a lawyer with his own firm in Sacramento, Calif., said he would like to see the final regulations take into account comments on the proposed sent to the regulators, such as that when an issuer contributes both tax-exempt bond proceeds and other funds to a project, they should be able to allocate the private business use first to the other funds, and then to the bond proceeds without having to make a special election to do so. Under the proposed rules, an issuer can only allocate private business use this way if it makes a special election, Israel said.

The IRS is also working on guidance on the definition of a political subdivision, according to its priority list. Cross told state and local finance officers that the IRS chief counsel’s office has a “strong interest” in looking into this topic.

In 2013, the IRS issued a technical advice memorandum that concluded the Village Center Community Development District in Florida was not a political subdivision that can issue tax-exempt bonds. NABL and other members of the municipal bond community have expressed concern about the ruling, Cross said.

Matthias Edrich, a shareholder at Greenberg Traurig and chair of the National Association of Bond Lawyers' tax law committee, said, "The tax committee looks forward to getting clarifying guidance from the Treasury Department regarding political subdivisions."

Dave Caprera, an attorney at Kutak Rock in Denver, said he thinks the political subdivision issue is the most important topic on the guidance plan because "it impacts the most transactions." The issue affects outstanding bonds issued by special districts as well as similar deals that haven't been done because bond lawyers are unable to give an opinion.

Israel, who represents the Village Center CDD in the dispute with the IRS, said it could take a while for Treasury and the IRS to develop political subdivision rules. He pointed out that there hasn't been activity on the audit of the district's bonds for many months.

The Treasury and the IRS also are working on a notice to provide a process for allocating unused volume cap of new clean renewable energy bonds. There was a $2.4 billion authorization of the bonds in 2009, and there is about $1.3 billion of unused volume cap, Cross said.

Finalizing proposed rules on public approval requirements for private-activity bonds is also on the list. Israel said he is "hopeful" that these final rules will be released this year. NABL is looking to see if there's something the group can do to speed up the process of finalizing these regulations, since there is "broad consensus" that they have many positive elements, Martini said.

In October, the IRS released interim guidance on accountable care organizations and management contracts to prevent them from causing private-activity bond problems. The notice invited the public to submit comments on the guidance to the agencies by Jan. 22.

Edrich said NABL plans to prepare three comment documents relating to the notice and the management contract issue. They will address the safe harbor in the notice for when ACOs don't result in private business use, the new safe harbor in the guidance for when management contracts don't result in private business use, and other management contract issues.

In addition to the notice on ACOs and management contracts, Treasury and the IRS also released final regulations on arbitrage rebate overpayments and guidance on temporary relief after a disaster in 2014. Martini said that the regulators are making "good, steady progress" on completing items on the guidance list.

Tax controversy lawyer Brad Waterman said he would like to see guidance about procedural questions related to Build America Bonds, such as those relating to the statute of limitations and litigation procedures that have never been addressed.

IRS Enforcement

Rebecca Harrigal, the director of the IRS tax-exempt bond office, said at the GFOA committee meeting that her office in fiscal 2015 will continue to evaluate its programs for "risks, inefficiencies and ineffectiveness." TEB will also target its resources toward the areas where there is the greatest risk of noncompliance with tax rules, she said.

TEB is looking at certain types of bonds early on in the process of using its revised market segment audit program. The bonds include: certain types of advance refunding bonds, bonds for which Form 8038-T's are filed, governmental bonds for environmental and transportation projects, Build America Bonds, private-activity bonds for non-hospital 501(c)(3) organizations, and PABs for solid waste and single-family and multifamily housing, she said.

Under the program, TEB has come up with hypotheses about where there might be the greatest risk of noncompliance that can be identified from data in information returns or readily available public sources. In order for the IRS to test its hypotheses, issuers that are frequently in the market in selected segments may see multiple audits, Harrigal said.

After the IRS has tested its hypotheses, it will look to see if the predictions were proven. If the hypothesis was validated, the IRS may: conduct more audits in that area; set up a special voluntary closing agreement program; or provide more education. The end goal is for market segments where there is a higher level of noncompliance will see a reduction in that level.

Israel said he would like to see the IRS continue to close market segment audits as quickly as reasonably possible.

In fiscal 2014, which ended Oct. 30, TEB spent a lot of time reworking the closing agreement process, for settlements resulting from audits and from the VCAPs. The office created a closing agreement team that looks at the consistency and enforceability of settlements. TEB also put into place "template closing agreements," so that the closing agreement process is more standardized and structured, Harrigal said.

"As you'd expect, with any new thing, there is a learning curve," Harrigal said. But toward the end of fiscal 2014, closing agreements, especially those that had been stuck in the VCAP process for a while, started to clear out faster.

TEB closed about 51 VCAP settlements in fiscal 2014, and from Oct. 1 through the beginning of December, it has closed about 23. "You can see there's a significant uptick in the amount of closing agreements we're actually processing and getting out," she said.

There were 25 closing agreements that stemmed from audits in fiscal 2014, a five-year high, Harrigal said.

TEB plans to continue to place an emphasis on completing settlements quickly. The office is also looking into further standardizing the closing agreement process. For example, TEB will to see if specific VCAP programs could have "fill-in-the-blank" closing agreements, Harrigal said.

TEB staff is monitoring trends in the market, and if they spot an issue, they will reach out to industry groups to figure out if the problem is big. If it is, TEB will try to figure out how to address it, whether through education or a VCAP initiative. Harrigal said she is also examining whether TEB can use industry director directives, a vehicle that other IRS offices use, to address messy issues.

The office is reworking the Internal Revenue Manual, which provides instructions to TEB staff, to make it clear what the office's process and expectations are, Harrigal said.

Johnny Hutchinson, a senior associate at Squire Patton Boggs, said that people are "eagerly awaiting" the revisions to the IRM.

NABL's tax committee is working on suggestions for additions to the IRM relating to exams and the use of technical advice requests for tax-advantaged bonds such as BABs. The committee is also working on providing comments about the IRM that pertain to VCAPs, Martini said.

TEB hopes to offer three more webcasts in 2015, provided that the office has the budget to do so, Harrigal said. The first, during which Harrigal will speak, will likely take place in January, she said. The IRS has not yet disclosed the topics.

The office also expects to release taxpayer publications on governmental bonds, 501(c)(3) bonds and private-activity bonds soon, Harrigal said she wants to do more of these publications. Additionally, TEB is working on customer satisfaction surveys that will be sent to bond counsel and issuers at the end of VCAPs and audits.

THE BOND BUYER

BY NAOMI JAGODA

DEC 26, 2014 9:07am ET

IRS Chief Counsel: BABs Defeasance Causes Reissuance.

The IRS Chief Counsel's office has issued an Advice Memorandum to the Office of Tax Exempt Bonds that concludes that the legal defeasance of taxable direct pay Build America Bonds resulted in an exchange of the BABs for modified instruments that differed materially from the original issue of BABs and therefore caused the defeased bonds to be reissued.

The Advice Memorandum is available here.

An Overview of S&P's Updated Methodology For Rating U.S. Not-For-Profit Acute-Care Stand-Alone Hospitals.

Standard & Poor's Ratings Services today published its updated criteria for rating U.S. not-for-profit acute-care stand-alone hospitals. The update is part of our regular criteria review process, and its goal is to clarify and enhance certain parts of our methodology. This article addresses some of the questions investors and other market participants might have about our updated criteria.

For the full criteria article, see "U.S. Not-For-Profit Acute-Care Stand-Alone Hospitals — Methodology And Assumptions", and watch the related CreditMatters TV segment titled "U.S. Not-For-Profit Acute-Care Stand-Alone Hospital Revised Criteria Published", also dated Dec. 15, 2014.

Continue reading the Overview.

15-Dec-2014

S&P U.S. Not-For-Profit Acute-Care Stand-Alone Hospitals -- Methodology and Assumptions.

1. Standard & Poor's Ratings Services is updating its methodology for assigning stand-alone credit profiles (SACPs), group credit profiles (GCPs), issue credit ratings, and issuer credit ratings (ICRs) to U.S. not-for-profit acute-care stand-alone hospitals (hospitals). These updated criteria will be implemented under the rating framework established in Chart 1 where the final outcome can be a SACP, GCP, issue credit rating, or ICR. These criteria supersede only in part "Public Finance Criteria: Not-For-Profit Health Care" (June 14, 2007) because health care systems will continue to be

rated under the existing criteria.

2. This update provides additional transparency and comparability to help market participants better understand our approach in assigning ratings to acute-care stand-alone health care providers, to enhance the forward-looking nature of these ratings, and to enable better comparisons between the sector's ratings and all other ratings. This article is related to our criteria article "Principles Of Credit Ratings", published on Feb. 16, 2011.

Continue reading.

15-Dec-2014

How S&P Intends to Implement Its U.S. Not-For-Profit Acute-Care Stand-Alone Hospital Criteria and Apply Them to Ratings.

Standard & Poor's Ratings Services today published its revised criteria for rating U.S. not-for-profit acute-care stand-alone hospitals (see "U.S. Not-For-Profit Acute-Care Stand-Alone Hospitals — Methodology and Assumptions"). The revised criteria is effective immediately. We plan to complete our review of the existing ratings covered by these criteria within 12 months. These criteria apply to hospitals with revenue bonds and hospitals with debt portfolios that include both tax-secured and revenue bonds. Ratings on hospitals with tax-secured bonds continue to be governed by our criteria "Tax-Secured Hospital Debt", published May 3, 2007, while the revenue bond rating is governed by these criteria. Multihospital health systems, as defined in the revised criteria, are not rated under these criteria but will continue to be rated under the applicable sections of our June 14, 2007, criteria "Not-For-Profit Health Care".

The criteria update is part of Standard & Poor's commitment to enhance the transparency, rigor, and specificity of its criteria across sectors and asset classes. Our objective is to provide market constituents with greater insight into how we rate stand-alone hospitals and to enhance the global comparability of our ratings through a clear, coherent, and globally consistent criteria framework.

We began communicating the process for updating our criteria when we published an advance notice of proposed criteria change on Nov. 13, 2013. We then published our proposed revised ratings framework on Dec. 5, 2013 (see "Request For Comment: U.S. Not-For-Profit Acute-Care Stand-Alone Hospitals — Methodology And Assumptions"). During the subsequent three-month comment period which ended in March 2014, we interacted with market participants through seminars, teleconferences, and one-on-one meetings. We used the sessions to increase participants' awareness and understanding of the proposed changes and to solicit, evaluate, and incorporate feedback as appropriate. We also solicited written comments through a criteria mailbox. We have summarized changes to the criteria, which were made based on market feedback as well as additional testing, in a report published today (see "RFC Process Summary: Rating Methodology And Assumptions For U.S. Not-For-Profit Acute-Care Stand-Alone Hospitals"). Summary information about the revised criteria is also available in an article released today: "Credit FAQ: An Overview Of Standard & Poor's Updated Methodology For Rating U.S. Not-For-Profit Acute-Care Stand-Alone Hospitals" on RatingsDirect, and a CreditMatters TV segment, "U.S. Not-For-Profit Acute-Care Stand-Alone Hospital Revised Criteria Published".

Continue reading.

15-Dec-2014

TAX - MICHIGAN

Rental Properties Owners Ass'n of Kent County v. Kent County Treasurer

Court of Appeals of Michigan - December 18, 2014 - N.W.2d - 2014 WL 7202844

Various individuals, companies, and associations involved in property ownership, rehabilitation, and development in Kent County (the 3830 G parties) sought to invalidate tax deeds executed by the Kent County Treasurer (the Treasurer) to Kent County (the County) and the city of Grand Rapids (the City) and from the County and the City to Kent County Land Bank Authority (KCLBA), claiming that their actions deprived the 3830 G parties of the opportunity to purchase the properties.

The Court of Appeals held that the Kent County Treasurer, and not Kent County, was the foreclosing governmental and thus, once Kent County purchased the tax-foreclosed properties from Kent County Treasurer pursuant to MCL 211.78m(1), there was no requirement that its later sale of those properties be by public auction.

TAX - LOUISIANA

Mooring Tax Asset Group, L.L.C. v. James

Supreme Court of Louisiana - December 9, 2014 - So.3d - 2014-0109 (La. 12/9/14)

Tax sale purchaser of real property filed petition to quiet title to the property, which had been sold by the taxpayers to a third-party after the tax sale, and then sold by the third party to the current owner. Current owner filed reconventional demand seeking nullification of the tax sale. The District Court awarded summary judgment to current owner, finding the tax sale to be an absolute nullity due to insufficient notice to the taxpayers. The District Court allowed tax sale purchaser to submit proof of costs, but granted current owner's motion to contest costs. Tax sale purchaser appealed, and the Court of Appeal affirmed. Tax sale purchaser filed petition for writ of certiorari, which was granted.

The Supreme Court of Louisiana held that:

- Trial court could not give immediate effect to its judgment annulling the tax sale without providing for reimbursement of the taxes and costs paid by tax sale purchaser, and
- Current owner was the party responsible for reimbursing the taxes and costs paid by tax sale purchaser.

TAX - SOUTH DAKOTA

Deadwood Stage Run, LLC v. South Dakota Dept. of Revenue

Supreme Court of South Dakota - December 17, 2014 - N.W.2d - 2014 S.D. 90

Taxpayer brought action seeking declaratory judgment prospectively establishing assessed valuation of tax incremental district, which consisted of taxpayer's land, as the appropriate tax incremental base, rather than prior assessed valuation. The Circuit Court entered summary judgment in favor of Department of Revenue. Taxpayer appealed.

The Supreme Court of South Dakota held that Department was required to determine aggregate assessed value of the property by using the last previously certified valuation for any buildings or additions completed or removed and to adjust it for the value to the date the district was created.

Department of Revenue was statutorily required, in establishing assessed valuation of tax incremental district, to determine the aggregate assessed value of the taxable property in the district by using the last previously certified valuation for any buildings or additions completed or removed and to adjust it for the value to the date the district was created. The phrase "last previously certified" referred only to improvements in the land, and this reading harmonized the statute with other statutes.

TAX - NEW YORK

Trump Village Section 3, Inc. v. City of New York

Court of Appeals of New York - December 17, 2014 - N.E.3d - 2014 N.Y. Slip Op. 08788

Residential housing cooperative corporation brought action against a city for a declaratory judgment that a taxable transfer of the residential housing cooperative complex did not occur when the corporation amended its certificate of incorporation as a part of its voluntary dissolution, reconstitution, and termination of participation in the Mitchell-Lama affordable housing program. The Supreme Court, Kings County, granted summary judgment to the city. The housing cooperative corporation appealed.

The Supreme Court, Appellate Division reversed, and leave to appeal was granted on a certified question.

The Court of Appeals held that the corporation's termination of its participation in the Mitchell-Lama affordable housing program was not a taxable transfer of real property.

Congress Extends QZABs, New Markets Tax Credits; Continuing Effect of Sequestration: McGuire Woods

On Dec. 19, 2014, President Barack Obama enacted the Tax Increase Prevention Act of 2014 (the "Act"), commonly referred to as the tax extenders bill (H.R. 5771), which you may read here. Generally, the Act extends many programs that expired at the end of 2013. This Client Alert focuses on the extension of Qualified Zone Academy Bonds (QZABs), New Markets Tax Credits (NMTCs), and empowerment zone employment credits and on the enduring impact of sequestration on direct-pay bonds.

Qualified Zone Academy Bonds

The Act authorizes the Secretary of the Treasury to allocate an additional $400 million in QZABs for 2014. Prior to the Act, no additional allocations of QZABs were to be available to the states after Dec. 31, 2013. The 2014 round of QZABs allocations will expire if not issued on or before Dec. 31, 2016. QZABs issued under the 2014 allocations are eligible only for the tax credit and may not use the direct-pay option. This limitation also applies to QZABs issued under the 2013 allocations that expire at the end of 2015.[1]

As a reference, QZABs benefit a "qualified zone academy" (typically, a public school) that is designated as such by the "applicable local education agency," which is oftentimes the governing local school board or district. As more fully described in Section 54A of the Internal Revenue Code of 1986, as amended, a holder of a QZAB receives a credit against federal income taxes.

New Markets Tax Credits

The Act also authorizes $3.5 billion in allocations for the New Markets Tax Credit program. This authorization is for 2014. Prior to the Act, the last round of allocation related to 2013. The 2014 allocations must be used by Dec. 31, 2019.

The New Markets Tax Credit program is designed to encourage investment in qualifying low-income communities. An investor receives a tax credit in return for equity investments in community development entities that use those invested funds for eligible purposes aimed at targeted populations and low-income areas. The credit is 39 percent, taken over seven years. Many states have programs similar to the federal New Markets Tax Credit program.

Empowerment Zones

Moreover, the Act extends the benefits of empowerment zone designation by providing that any existing empowerment zone will remain designated as such until Dec. 31, 2014. Previously, the designation of existing empowerment zones expired on Dec. 31, 2013.

The benefits of empowerment zone status include the empowerment zone employment credit, which provides employers a federal tax credit equal to 20 percent of qualified zone wages paid during a calendar year. Qualified zone wages are wages paid to an employee who lives in an empowerment zone and performs substantially all of his or her employment in that empowerment zone. Other tax benefits include increased deductions for equipment placed in service in empowerment zones and delayed recognition of any gains on the sale of qualifying empowerment zone assets.

Federal Sequestration and Direct-Pay Bonds

All direct-pay bonds, including QZABs, Build America Bonds, Qualified School Construction Bonds, New Clean Renewable Energy Bonds, Qualified Energy Conservation Bonds and Recovery Zone Economic Development Bonds, remain subject to the ongoing effects of federal sequestration. For fiscal year 2015 (which ends on Sept. 30, 2015), the direct-pay subsidy for those bonds issued as direct-pay bonds is subject to a 7.3 percent reduction.

Unless a law is enacted that cancels or otherwise amends the sequestration, the existing subsidy reduction will remain in effect through the end of fiscal year 2024.

1. Included as Title II of H.R. 5771 is the "Tax Technical Corrections Act of 2014." See Section 202(d) for the above-mentioned provisions relating to QZABs.

December 22, 2014

McGuireWoods LLP

Municipal Bond Interest Paid By a Bond Insurer After an Issuer's Bankruptcy

Discharge Can Remain Tax-Exempt: Mintz Levin.

In the aftermath of recent municipal bankruptcies in which issuers proposed and/or implemented bankruptcy plans involving partial discharges of the issuer's payment obligation on insured bonds, there has been increased focus on whether municipal bond interest paid by a bond insurer after the bankruptcy plan's effective date continues to be tax-exempt.

Market confusion as to the treatment of bond insurance payments in the discharged issuer context is at least partially attributable to an incomplete understanding of why bond insurer payments of municipal bond interest are deemed tax-exempt in other contexts. Although the IRS has not specifically addressed the tax status of bond insurer payments following the issuer's partial (or full) discharge in bankruptcy, review of IRS rulings on bond insurance suggests that, in ordinary circumstances, interest on the insured bond continues to be tax-exempt notwithstanding that the only source of payment is the bond insurance.

The technical basis for the continued tax-exemption of post-discharge interest is discussed in detail below. The analysis is rooted in one simple concept articulated in an IRS revenue ruling: in ordinary circumstances, a payment by a bond insurer is deemed, for tax purposes, to have been made by the issuer of the bonds. For this reason, although a bankruptcy may, for non-tax purposes, discharge an issuer from further liability on all or a portion of bond payments, for tax purposes the bond payments made by the bond insurer continue to be treated as being made by the issuer. All else is detail, for those with an interest in such detail.

And so, on to the technical discussion.

The tax-exempt treatment of interest paid by a municipal bond insurer is founded on a trio of favorable IRS revenue rulings, which, unlike private letter rulings, are statements of IRS policy on which the market can rely.

The first such ruling, Revenue Ruling 72-134, dealt with the situation where the issuer pays for bond insurance when the bonds are issued, and concluded that "defaulted interest paid by the independent insurance company is excludable from the gross income of the bondholders."

Revenue Ruling 72-575 extended such favorable treatment to a bond insurance policy purchased by the underwriter, and Revenue Ruling 76-78 went a substantial step further, upholding the tax-exemption of interest payments received under secondary market bond insurance purchased by a bondholder.

These three rulings state a favorable result without discussing the rationale. The technical basis for the tax-exemption of bond insurance payments is illuminated in Revenue Ruling 94-42, an adverse ruling involving a bondholder that purchased secondary market bond insurance on zero coupon bonds, rerated the bonds AAA and resold the bonds. The bond insurance premium for the secondary market insurance was an amount sufficient to fund the bond insurer's purchase of a high-yielding portfolio of Treasury securities that economically defeased most of its insurance obligation. In the ruling, the IRS expressed concern that treating such bond insurance interest payments as tax-exempt would effectively permit a secondary market arbitrage bond, and set about distinguishing the scenario under review from "customary" bond insurance payments treated as tax-exempt in the earlier rulings.

In the 1994 ruling, the IRS noted that customarily bond insurance enhances marketability and reduces interest rates, which is consistent with the IRS's objective of preventing overburdening of the market with tax-exempt interest. The ruling stated that such tax-exempt treatment is

accomplished by “integrating the insurance contract with the obligation of a political subdivision” instead of treating the bond insurer’s obligation as a separate debt instrument.

According to this key ruling, “an insurance contract or similar agreement is treated as both incidental to bonds and not a separate debt instrument … only if, at the time it is purchased, the amount paid is reasonable, customary, and consistent with the reasonable expectation that the issuer of the bonds, rather than the insurer, will pay debt service on the bonds.” The ruling concluded that at the time the bond insurance policy under review was purchased, the insurance premium was not reasonable and customary and reflected an expectation of default by the issuer. The IRS ruled that because the insurance purchaser looked primarily to the insurer for payment of the debt service on the bonds, the bond insurance was not incidental and should be treated as a separate non-municipal obligation rather than integrated with the insured bonds. The conclusion that the interest payments by the bond insurer were taxable followed from the treatment of the bond insurance as a non-municipal obligation.

Two significant concepts are articulated in Revenue Ruling 94-42. First, the technical basis for treating bond insurance interest payments as tax-exempt is that, for customary bond insurance transactions, the bond insurance is integrated with and treated as the same debt instrument as the insured municipal bond. Second, the treatment of bond insurance as integrated with the insured bond versus as a separate debt instrument that is not a municipal bond is determined based on reasonable expectations at the time the bond insurance is purchased.

In other words, provided the bond insurance is “customary” at the time it is purchased, it becomes another source of payment by the issuer of the insured bonds, albeit one that, at the time the insurance is purchased, is not expected to be needed. If circumstances change and defaulted interest is paid from the bond insurance, it is deemed a payment by the municipal issuer on the insured bond, not a separate payment by the bond insurer.

Nothing in the revenue rulings on the tax-exemption of interest payments sourced to a bond insurer makes the integration of the bond insurance with the bond dependent on the continuing legal obligation of the issuer to make the insured debt service payment. The above-summarized favorable revenue rulings describe customary bond insurance as including provisions under which a bond insurer’s payment to a bondholder does not discharge the bondholder’s payment claim against the issuer, to which the insurer becomes subrogated. But such revenue rulings do not suggest that if a bondholder has no claim against the issuer because the issuer has received a bankruptcy discharge, the worthlessness of the bond insurer’s subrogation claim alters the character of the bond insurance payment as an integrated tax-exempt payment on the municipal bond constructively made by the issuer, notwithstanding the issuer’s discharge as a source of payment for non-tax purposes.

The utility of bond insurance, and the reduction in bond interest rates and the aggregate amount of tax-exempt bond interest that have justified its tax treatment, would be substantially eroded if the IRS were to rule (which it never has) that the tax-exempt nature of bond insurance payments hinges on abstract distinctions between whether non-payment from other sources is due to the issuer’s financial condition or to the legal discharge in bankruptcy of the issuer’s duty to make such payments. Bond insurance is purchased for the precise purpose of insuring against default by the issuer, foreseeably and prominently including the possibility of the issuer’s bankruptcy and the potential legal discharge of part or all of its legal obligation to pay debt service.

The cause of non-payment of the bonds from sources other than the bond insurance is immaterial for tax-exemption purposes once the bond insurance payment is recognized as integrated with and indistinguishable from the other sources of payment of the bond. Moreover, the line between an issuer’s lack of a legal obligation to pay and factual insolvency is often vague, and if such a

distinction affected tax-exemption of bond insurer payments, uncertainty would prevail. For example, a conduit bond issuer whose obligation to pay is limited to loan or lease payments from a conduit obligor that is not making any payments could be characterized as lacking a legal obligation to pay and/or the financial ability to pay. Similarly, an issuer that ceases to operate and is dissolved without assumption of its liabilities by another party could be characterized as legally non-existent and/or factually unable to pay.

The tax treatment of bond insurance should not, and the relevant revenue rulings support the view that it does not, depend on distinctions that are esoteric, unpredictable and impractical. Notably, in a slightly different context, the market does not doubt the continued tax-exemption of interest on innumerable "legally defeased" bonds payable solely from portfolios of Treasury securities, although the issuer is contractually discharged from making payments from other sources.

The tax impact of bankruptcy plan modifications of an issuer's rights and duties on insured bonds are often an afterthought not adequately focused on in the plan or the plan disclosure. Documentation and characterizations of what is technically occurring to the insured bonds under the plan may be imprecise. A bankruptcy plan may suggest that portions of insured bonds that the issuer will be discharged from paying are being extinguished, when what is actually meant is that such bonds will remain outstanding and payable from bond insurance that for tax purposes is attributed as an issuer payment.

To be sure, some bankruptcy plans may purport to make changes to insured bonds beyond the full or partial discharge of the issuer's liability. Presumptively, a modification of the issuer's contractual duties under a bankruptcy plan does not change the payment obligations insured by the bond insurer. Nonetheless, to avoid muddying the waters plan language should be crafted in a manner that ensures that any portion of the original insured bond from which the issuer is discharged remains outstanding for tax purposes as well as for purposes of claiming against the bond insurer.

Any purported changes by a bankruptcy plan to the terms of the bonds beyond a reduction or elimination of the issuer's liability require separate tax analysis. The devil is frequently in the details, and the debtor and its representatives may not be focused on or impacted by the tax treatment of insured future bond payments from which the issuer has been discharged. Holders of insured tax-exempt bonds that are being modified in any manner by a bankruptcy plan may wish to obtain input from tax counsel experienced in bankruptcy-related tax-exemption issues in time to impact the plan wording and structure relating to such bonds. But, although the IRS has not directly addressed the topic, there is no reason to presume that interest paid by a bond insurer on an outstanding municipal bond will be taxable simply because the issuer will have no remaining legal obligation to make the insured payment from another source.

THE NATIONAL LAW REVIEW

DECEMBER 23, 2014

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Len is active in both municipal finance and corporate finance, with an emphasis on financings for 501(c)(3) institutions, project finance, secured lending, structured finance transactions, workouts and restructurings, corporate debt, and Section 529 college savings programs.

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Fitch: US Healthcare Spending Rise Will Lift Nonprofit Hospitals.

Fitch Ratings-New York/Chicago-11 December 2014: Overall spending on healthcare should rise in the coming years as the overall economy has become more robust, Medicaid spending increases and certain procedures delayed due to costs are addressed, Fitch Ratings says. We believe the impact of this growth will be beneficial to the nonprofit hospital sector. However, continued migration toward high-deductible health plans is likely to inhibit the rate of spending growth and increase bad debt expense.

The Centers for Medicare and Medicaid Services (CMS) reported that total healthcare spending rose by 3.6% in 2013. This marked the fifth straight year of increases below 5%. The rate of health spending grew by 3.9% annually from 2009 to 2011, compared with an annual growth rate of between 4.7% and 6.6% the prior three years.
One of the main drivers of this year's increased healthcare spending is the expansion of Medicaid coverage. The Congressional Budget Office projects total Medicaid payments will rise from approximately $300 billion in 2014 to $368 billion in 2016. This benefit will accrue to hospitals and healthcare systems operating in states that expanded Medicaid coverage under the Patient Protection and Affordable Care Act (ACA), while providers in states that did not will not benefit.

We believe that, over the last several years, certain medical care and procedures have been delayed as rising patient co-pays and deductibles have caused people to postpone care. Gallup polls have consistently suggested that one in three respondents reported that they or a family member delayed medical care because of the costs. As the economy has become more robust and coverage options

are available to more people, we believe these deferments will slow. However, continued movement toward high-deductible health plans may help temper the overall rate of spending growth.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

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TAX - MISSISSIPPI

Booneville Collision Repair, Inc. v. City of Booneville

Supreme Court of Mississippi - December 4, 2014 - So.3d - 2014 WL 6843483

Purchaser of property that had been sold for delinquent municipal taxes brought action against county, city, and municipal tax collector for damages incurred from failure to provide notice of tax sales. The Chancery Court granted city's and collector's motion to dismiss for failure to state a claim. Purchaser appealed.

The Supreme Court of Mississippi held that:

- Issue of statutory liability was placed in issue by consent;
- Statute imposing liability on tax collectors for failure to perform duties applied to municipal tax collectors;
- Purchaser was intended claimant under statute imposing liability on tax collectors for failure to perform duties;
- Claim under statute imposing liability on tax collectors for failure to perform duties was not subject to Mississippi Tort claims Act (MTCA);
- Purchaser was not judicially estopped from asserting that MTCA did not apply;
- On issue of apparent first impression, claims did not arise out of assessment and collection of taxes within meaning of MTCA; and
- Statutory duty to file tax-sale list was ministerial, rather than discretionary, duty.

TAX - INDIANA

In re Carroll County 2013 Tax Sale

Supreme Court of Indiana - December 4, 2014 - N.E.3d - 2014 WL 6843641

In petitions to the Circuit Court, two landowners objected to their respective properties being listed for tax sale based on sewer bill delinquency and attached sewer lien. Lienholder, a non-municipal regional sewer district, intervened and requested hearing. The Circuit Court entered order in favor of landowners, finding that neither property was subject to tax sale, citing the lien foreclosure prohibition clause in statute governing the collection of regional sewer district sewer liens. Lienholder appealed and its petition requesting Supreme Court to accept jurisdiction was granted.

The Supreme Court of Indiana hold that lien foreclosure prohibition clause in statute governing the collection of regional sewer district sewer liens did not operate to prohibit a tax sale of properties owned by landowners who were delinquent in payment to lienholder, a non-municipal regional sewer district, when the sewer bill lien was the only lien on the two properties. Because lienholder employed the tax sale method and did not seek collection of landowners' unpaid sewer bills and penalties through the lien foreclosure method, the lien foreclosure prohibition clause did not apply.

Hawkins Advisory: Medicare Shared Savings Program.

Introduction

On October 24, 2014, the Internal Revenue Service ("IRS") issued Notice 2014-67 (the "Notice"), in an effort to provide interim
guidance to governmental and 501(c)(3) hospitals and health care organizations participating in the Medicare Shared Savings Program ("MSSP") described in §§ 3022 and 10307 of the Patient Protection and Affordable Care Act, Pub. L. 111- 148, 124 Stat. 119 ("Affordable Care Act"), enacted March 23, 2010. Participation in the MSSP through an "accountable care organization" ("ACO") will not result in a private business use of a facility financed with the proceeds of a tax-exempt bond issue if the guidance provided in the Notice is followed. The question of whether such participation will result in an unrelated trade or business activity in respect of the rules governing 501(c)(3) organizations is addressed in Notice 2011-16, dated April 18, 2011. The provisions of Notice 2011-16 are reflected in the interim guidance provided by the IRS in the Notice.

The Notice also addresses certain provisions of Rev. Proc. 97-13, 1997-1 C.B. 632, as amended by Rev. Proc. 2001-39, 2001-2 C.B. 38 ("Rev. Proc. 97-13"), describing management contracts with private service providers that will not result in private business use.

Continue reading the Advisory.

Hawkins Delafield & Wood LLP

12/10/14

NABL Submits Comments to IRS on Purpose Investment Valuation.

The National Association of Bond Lawyers (NABL) has submitted to the Internal Revenue Service comments on the valuation of purpose investments under the proposed arbitrage regulations published on September 16, 2013 (REG-148659-07). In the comments, NABL stated its position that purpose investments are properly valued at present value at all times. "In our view, tax policy and practical considerations pertaining to purpose investments require that such an approach continue to apply under any successor to the Existing Regulations."

The comments went further to say that "any future regulations under Code § 148 should retain the rule that purpose investments are valued at present value." If the current rule were to change, "a practical issue would arise with regard to how to establish the fair market value of the investments in the absence of an established market."

Read the letter.

TAX - MICHIGAN

Hope Network-Rehabilitation Services v. City of Kentwood

Court of Appeals of Michigan - December 2, 2014 - Not Reported in N.W.2d - 2014 WL 6778955

Hope Network–Rehabilitation Services (HNRS) appealed the Tax Tribunal's final opinion and judgment denying it a charitable institution tax exemption for its Forest Glen facility – an adult foster care facility – under MCL 211.7o for the 2010, 2011, and 2012 tax years.

The Tribunal found that the Forest Glen facility was not used solely for charitable activity since its articulated charitable efforts of writing off bad debt for insured patients whose insurance did not cover the billed costs was nothing more than a business practice.

The Court of Appeals affirmed the Tax Tribunal's judgment.

IRS EO Update: e-News for Charities & Nonprofits - December 5, 2014

1. Register for IRS webinar: Help for charities

Thursday, Dec. 18 at 2 p.m. ET

You'll learn:

- Section 501(c)(3) Exempt Purposes
- Key activities including
  Private benefit or inurement activities
  Lobbying or legislative activities
  Filing requirements
  Unrelated business income activities
  Failing to operate with an exempt purpose

Register for this event.

2. Announcement addresses realignment of technical work between TE/GE and Office of Associate Chief Counsel

Announcement 2014-34 addresses the transfer of certain technical responsibility for issues involving exempt organizations, qualified retirement plans, and individual retirement annuities and accounts (IRAs) to the Office of Chief Counsel that will occur with the realignment of the Tax Exempt and Government Entities Division (TE/GE).

3. Register for EO workshops

Register for our upcoming workshops for small and medium-sized 501(c)(3) organizations on

Dec. 9 – Austin, TX
Hosted by Austin Community College

Jan. 9 – Salt Lake City, UT
Hosted by University of Utah & the Utah Nonprofits Association

4. Modified 403(b) plan Listing of Required Modifications coming soon

In conjunction with establishing the 403(b) pre-approved plan program in 2013, the IRS issued sample plan language – 403(b) Plans Listing of Required Modifications (LRMs) – that sponsors of 403(b) pre-approved plans may use to draft their plans.

The modified 403(b) LRMs will be available before the April 30, 2015, deadline to submit a 403(b) pre-approved plan under the program. Section 403(b) pre-approved plan sponsors will have an opportunity to make changes to reflect the modified 403(b) LRMs.

Moody's: US Non-Profit Hospitals Struggle to Grow Cash Flow and Adapt to Health Care Reform.

Our negative outlook for the US not-for-profit healthcare sector in 2015 reflects the sector's historically weak operating cash flow growth and margin contraction. US hospitals are making substantial investments and operating changes to comply with the federal government's Affordable Care Act (ACA) and new reimbursement models. We expect the largest hospital systems will achieve operating cash flow growth of 3% – 4%, while cash flow at smaller hospitals will likely decline…

Purchase the Report.

TAX - UTAH

Mawhinney v. City of Draper

Supreme Court of Utah - November 25, 2014 - P.3d - 2014 UT 54

Petitioners filed petition for extraordinary writ to order city to certify petition for referendum to voters for establishment of equalized property tax for all property located within special district.

The Supreme Court of Utah held that:

- Proposed referendum was proper exercise of people's legislative authority under Utah Constitution;
- Provision of Truth in Taxation imposing notice and hearing requirements for levy of tax exceeding taxing entity's certified tax rate had no bearing on whether proposed referendum was proper exercise of legislative authority; and
- Statute allowing residents of special district to challenge laws applicable to them through referendum was permissible delegation by Legislature of its legislative authority under Utah Constitution.

Referendum on resolution approved by city council for special district to establish equalized property tax rate for all property located within district was legislative in nature, and thus, was proper exercise of people's constitutional authority. Levied tax was generally applicable to all who owned property within district, city council was required to weigh need and benefit of services to be provided to property owners in District against tax burden to be imposed, levying tax was exercise of legislative power under Constitution and was a power that Legislature had traditionally exercised.

TAX - ILLINOIS

Bank of Camden v. Village of West Dundee

United States District Court, N.D. Illinois, Eastern Division - November 21, 2014 - Not Reported in F.Supp.3d - 2014 WL 6655892

In 2008, Village set up a Tax Increment Financing (TIF) District in order to provide Springhill Shopping Center with $4 million in initial funding for renovations at the Shopping Center. By 2009, the Shopping Center was facing economic problems with the renovations. Springhill then asked the Village to establish some other mechanism to provide additional funding for renovations.

This time, the Village decided to establish a "special service area" pursuant to the SSA Act. The SSA Act generally allows a municipality to levy additional property taxes in a specific geographic area for the purpose of providing special services not otherwise available to the entire municipality. On December 7, 2009, the Village adopted Ordinance 09–27 proposing the establishment of a special service area (SSA #6) and the issuance of SSA bonds in an amount not to exceed $2.95 million (later reduced to $1.5 million). The SSA bonds for SSA #6 were to be repaid through a levy of property taxes for the properties in the SSA.

The Shopping Center contains approximately 180,000 square feet of retail space. F.A.S.T. owns approximately 60,000 square feet of that space (the "East Property"). The remaining 120,000 square

feet of the center lies west of the East Property (the "West Property").

Notwithstanding the $1.5 million bond amount in the ordinance, the taxes assessed upon the East Property were based on the original amount of $2.95 million. So far, $866,423 of the $1.5 million in proceeds from the bonds has been spent. Of that $866,423, only $16,255 benefitted the East Property. The Bank or any subsequent owner of the East Property must continue paying its share of the additional property taxes through 2029.

In 2013, the East Property, which takes up 33% of the total square footage of SSA #6, was responsible for 44% of the SSA tax burden and did not receive any SSA distributions. The East Property was also encumbered with a tax rate increase associated with the SSA #6 bonds within the TIF which devalued the East Property by $500,000.

Foreclosed Assets Sales and Transfer Partnership (F.A.S.T.) and its "authorized agent" – Bank of Camden – filed suit against the Village and Springhill alleging that the Village was disproportionately distributing funds from the SSA in violation of the SSA Act and the local ordinance enacted thereunder. Plaintiffs also alleged that the Village improperly enacted a moratorium and ordinance preventing the issuance of a business license to one of their potential tenants. Additionally, plaintiffs alleged that the Village was improperly paying legal fees related to this litigation out of SSA funds.

The District Court held that:

- Bank of Camden lacked standing;
- Although it had not paid any of the property taxes associated with the East Property, including the SSA or TIF taxes, F.A.S.T. had standing due to the alleged injury with respect to the resale value of the East Property;
- The SSA Act does not mandate that taxpayers within a SSA receive equal amounts of the SSA proceeds or amounts equal to the SSA taxes they paid, and thus plaintiff's allegations that SSA #6 disproportionately benefitted the owner of the West Property to the detriment of the East Property failed to state a claim;
- Plaintiffs were not entitled to a mandamus for the court to order the Village Clerk to issue a business license to the Salvation Army to occupy and lease space in the East Property;
- Ambiguity existed within the documents regarding whether the Village was entitled to pay its attorneys' fees from the SSA #6 improvement fund, precluding summary judgment on this issue.

Georgia Caps Tax Rate It Hasn't Raised in 30 Years: Muni Credit.

This month, Georgia became the first U.S. state to make raising its income-tax rate unconstitutional, a move that could hamstring its ability to raise revenue in tough economic times.

Voters approved a ballot measure Nov. 4 that caps the top rate at its current 6 percent, forbidding lawmakers from even temporarily raising the levy that accounts for about half of Georgia's revenue.

Georgia's fiscal management has earned it top bond grades and borrowing costs among the lowest of states tracked by Bloomberg. Yet the experience of the recession that ended in June 2009 shows the risk of writing off any fiscal tool: Most states resorted to tax increases to balance budgets during the crisis, according to the Tax Policy Center.

"It's like taking a weapon out of your revenue-raising arsenal," said Brenda Ojendyk, a senior

research analyst for Chicago-based Nuveen Asset Management. “You don’t want to do that if you don’t have to.”

The tax cap adds Georgia to a list of Republican-dominated governments pushing cuts and limits for income, business and estate taxes paid disproportionately by the rich. The reductions create risks for budgets: In Kansas, a 2013 law reduced income-tax revenue by almost one-third, according to Moody’s Investors Service.

Georgia Alone

In locking a cap into its constitution, Georgia has taken it further than most, said Dan Close, a senior vice president at Nuveen who manages two Georgia bond funds with $388 million in assets.

“This is the first voter-approved constitutional amendment limiting income taxes in the country,” Close said.

Moody’s also flagged the cap as a challenge, because it bans the state from raising its biggest revenue source. Levies on individual income account for 47 percent of Georgia’s $19.7 billion general fund for fiscal 2015, it said in a report. The state also gets revenue from sales, corporate and excise taxes.

Eric Kim, an analyst with Fitch Ratings, said the limit is more hypothetical than real, since the state hasn’t increased income taxes in decades. The top rate hasn’t changed since at least 1980, said Nick Genesi, a Revenue Department spokesman.

Limiting Response

The concept of using a constitution to freeze income taxes hasn’t arisen in other states, which is a good thing, said Michael Leachman, director of state fiscal research in Washington for the Center on Budget and Policy Priorities, which analyzes the ways fiscal decisions affect the poor.

“It’s a terrible idea, just really awful fiscal management,” he said. “When recessions hit, you want to be able to respond with all the tools available.”

Thirty-three states raised taxes either temporarily or permanently in response to the 18-month recession, according to the Tax Policy Center, a joint venture of the Urban Institute and Brookings Institution.

Georgia responded by cutting education and other spending and by tapping reserves, which dropped from $1.5 billion in 2007 to $116 million in 2010, according to the Atlanta-based Georgia Budget and Policy Institute, which opposed the tax cap.

Pleasing Business

None of the biggest credit-rating companies have changed their outlook on Georgia’s $10.8 billion in debt because of the cap, although Moody’s warned that Kansas and North Carolina faced challenges after cutting income-tax rates. In North Carolina, tax collections on individual income fell 6.2 percent in fiscal 2014, while the revenue dropped 32 percent in Kansas.

Georgia’s borrowing costs are on a par with benchmark rates. The state’s 10-year tax-exempt debt yields about 2.3 percent, data compiled by Bloomberg show. Only North Carolina and Virginia boast lower yields among the 20 states followed by Bloomberg.

Republican State Senate President Pro Tem David Shafer sponsored the bill putting the tax cap on the November ballot, where it was approved by 74 percent of voters.

In an e-mailed statement, Shafer said the cap will bring jobs to a state with the nation's highest unemployment rate, at 7.7 percent in October, compared with a national average of 5.8 percent.

"Leading economists have told us that the business certainty promised by the constitutional amendment will encourage existing businesses to expand here and new businesses to locate here," the statement said.

No Panacea

Backers included the Georgia Chamber of Commerce and Christine Ries, an economist at the Georgia Institute of Technology in Atlanta, who said the cap will force Georgia to rely more on sales taxes, which she said business prefers.

"What this is saying is not that we will never raise taxes," Ries said. "It means if they do raise taxes it will be on consumption, not income. A signal like this is extremely important in attracting new companies."

Opponents call the move a stunt, since no one was proposing raising the income tax, anyway.

Republican lawmakers put it on the ballot "so they can go back to the constituents and say they did something to limit taxes," said Senate Democratic Leader Steve Henson.

They also say jobs claims are exaggerated.

"This idea that it's going to be some big boon to the economy is just self-evidently, wildly overblown," said Leachman of the Washington-based budget and policy center.

Emory University economist Paul Rubin, who backed the limit, also said benefits will be moderate.

"It will add a little bit of certainty but it's not a world-breaker, because taxes weren't that high," Rubin said.

"People aren't going to say, 'Ah, let's move to Georgia because they capped their taxes,'" he said.

BLOOMBERG

By Margaret Newkirk Nov 25, 2014 5:00 PM PT

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TAX - NEW YORK

Maimonides Medical Center v. U.S.

United States District Court, E.D. New York - September 19, 2014 - F.Supp.3d - 114 A.F.T.R.2d 2014-6060

Not-for-profit corporation brought action against the United States to recover overpayments of employment taxes. After agreeing that a refund was owed and on amount of refund, both parties filed motions for summary judgment on issue of applicable interest rate.

The District Court held that:

- Corporation was a business entity within meaning of "check-the-box" regulations;
- Corporation could not elect to classify itself as a partnership; and
- As matter of apparent first impression, corporate interest rate applied to the refund.

TAX - PENNSYLVANIA

Friends of Pennsylvania Leadership Charter School v. Chester County Bd. of Assessment Appeals

Supreme Court of Pennsylvania - September 24, 2014 - A.3d - 2014 WL 4745702

Domestic nonprofit corporation affiliated with public charter school appealed from order of the Court of Common Pleas denying its claim for refund of real estate taxes paid to county. The Commonwealth Court affirmed. Corporation petitioned for allowance of appeal.

The Supreme Court of Pennsylvania held that statute granting retroactive real estate tax exemption to charter schools and nonprofit entities affiliated with charter schools violated constitutional doctrine of separation of powers, and thus was invalid, since it interfered with valid final judgment of Commonwealth Court, which had determined that nonprofit corporation associated with charter school was not exempt from real estate taxes as a purely public charity.

NABL: Senate Subcommittee Holds Hearing on Disaster Tax Relief.

The Senate Finance Committee Subcommittee on Taxation and IRS Oversight held a hearing this week on "Tax Relief after a Disaster" and discussed, among other things, the effectiveness of disaster bonds and the possibility of a permanent tax relief program available for FEMA-designated disaster areas. Steve Ellis, vice president of Taxpayers for Common Sense, told members of the subcommittee that tax-exempt bonds issued for disaster relief in the past have been "blunt instruments" that "reward much reinvestment that would happen regardless and may create subsidies that are out of proportion to the losses incurred when other federal, state, and charitable programs are taken into account."

When asked by Senator Mike Enzi (R-WY) if he has seen tax changes provide relief outside the scope of the affected disaster areas, Mr. Ellis specifically mentioned GO Zone Bonds, telling the subcommittee that the states generally allocated the GO Zone private activity bonds and the additional advance refunding authority on a first-come, first-serve basis and for the most part did not focus their allocations on helping with recovery in the areas that were most damaged by the hurricanes. He urged the committee to require more accountability from communities who have access to tax relief after a disaster.

You can watch the hearing and read witness testimony here.

IRS EO Update: e-News for Charities & Nonprofits.

1. Register for IRS webinar: Introduction to tax-exempt status

Thursday, Nov. 20 at 2 p.m. ET

You will learn how to:

- Differentiate between the terms “nonprofit” and “tax exempt”
- List some of the common types of exempt organizations
- Understand the requirements for exemption under 501(c)(3)
- Apply for recognition of exemption
- Identify some of the ongoing compliance issues for exempt organizations

Register for this event.

2. Register for EO workshops

Register for our upcoming workshops for small and medium-sized 501(c)(3) organizations on:

Dec. 9 – Austin, TX
Hosted by Austin Community College

Jan. 9 – Salt Lake City, UT
Hosted by University of Utah & the Utah Nonprofits Association

3. PTIN renewal season underway

The renewal fee is $63. The fee for a new PTIN application is $64.25.

The easiest way to renew is online. It takes about 15 minutes. There is a new October 2014 version of the paper Form W-12 available on IRS.gov for those who prefer to use it. However, it takes 4-6 weeks to process.

4. In 2015, various tax benefits increase due to inflation adjustments

For tax year 2015, the IRS announced recently annual inflation adjustments for more than 40 tax provisions, including the tax rate schedules, and other tax changes. Revenue Procedure 2014-61 provides details about these annual adjustments.

Inflation adjusted items of interest to exempt organizations affect the:

- Treatment of dues paid to agricultural or horticultural organizations
- Insubstantial benefit limitations for contributions associated with charitable fund-raising campaigns
- Reporting exception for certain exempt organizations with nondeductible lobbying expenditures

Read news release.

5. IRS announces tax guidance related to Ebola outbreak in Guinea, Liberia and Sierra Leone

The IRS recently issued two items of guidance in response to the need for charitable and other relief due to the Ebola outbreak in Guinea, Liberia and Sierra Leone. One provides special relief intended to support leave-based donation programs to aid victims who have suffered from the Ebola outbreak in those countries. The other designates the Ebola outbreak in those countries as a qualified disaster for federal tax purposes.

Read news release.

6. Notice 2014-67 issued

Notice 2014-67 provides guidance for determining whether a state or local government entity or a 501(c)(3) organization will be considered to have private business use of its tax-exempt bond-financed facilities due to its participation in an "accountable care organization" and guidance regarding certain management contracts that do not result in private business use.

Notice 2014-67 appeared in IRB 2014-46 dated Nov. 10, 2014.

Texas Court Rules Natural Gas Destined For Interstate Commerce Properly Subject To Local Property Tax.

The Texas First Court of Appeals has ruled that the owner of natural gas stored in a Texas reservoir was properly assessed local property tax, regardless of whether the gas was sold in interstate commerce.1 Rejecting the taxpayer's contention that the "dormant" U.S. Constitution Commerce Clause rendered the assessment unconstitutional, the Court concluded that the tax did not fail any of the four prongs of the substantial nexus test established in Complete Auto.2

Background

ETC Marketing, Ltd. (ETC) is a marketer of natural gas with offices and employees in Texas. ETC buys, sells, and markets natural gas to customers located outside Texas, but is not in any way restricted from selling to Texas customers. Its affiliate, Houston Pipeline Company (Houston Pipeline), operates an intrastate natural gas pipeline and a reservoir for the storage of natural gas in Texas.

ETC buys natural gas destined for sale to interstate purchasers from multiple sellers, and "immediately entrusts" the product to Houston Pipeline for storage. ETC's storage agreement with Houston Pipeline allows it to purchase gas and "time the market" by holding the gas for delivery at a later date in order to maximize the sale price.3 Because natural gas is considered to be fungible, the points of transfer from ETC to Houston Pipeline and ultimately to ETC's customers do not necessarily relate to a physical location associated with the seller's gas, as gas owned by various marketers is physically commingled in the pipeline system which includes both intrastate and interstate pipeline. Distinct volumes of gas are segregated by paper allocation, but due to the fungible nature of the product, cannot be separately identified and tracked by the owners.

Since the reservoir where ETC stores its natural gas is located in Harris County, Texas, the Harris County Appraisal District (HCAD) appraised the value of approximately 33 billion cubic feet of natural gas owned by ETC and stored in the reservoir for calendar year 2010, and assessed related ad valorem taxes. While ETC conceded that it was the owner of the natural gas, it contended that all of the gas stored in the reservoir was exempt from property tax under the Commerce Clause of the U.S. Constitution because the gas was destined to be sold in interstate commerce. HCAD countered

that the sale of gas was not in interstate commerce, but even if the sale were considered to be in interstate commerce, it would still be subject to tax under the Complete Auto test. The 127th District Court rejected ETC's summary judgment motion and rendered final judgment for HCAD, holding that the stored gas was subject to ad valorem taxation as the gas was not in interstate commerce.4 ETC appealed the decision to the Court of Appeals.

Application of Complete Auto to Ad Valorem Tax

Texas law provides that all tangible personal property is subject to property tax if it is located in a taxing unit for longer than a temporary period, unless forbidden by law.5 In addition, property exempt from ad valorem taxation by federal law is exempt from taxation.6 Noting that the federal exemption applies only to activities related to interstate commerce, the Court accepted that the natural gas at issue was in the stream of interstate commerce. To decide whether an applicable exemption was available under federal law, the Court focused its attention on whether the application of property tax to the natural gas failed any of the prongs of the dormant Commerce Clause test established in Complete Auto. The Court considered each of the four factors necessary to allow a local government to tax goods in interstate commerce: (i) substantial nexus to the taxing state; (ii) fair apportionment; (iii) no discrimination against interstate commerce; and (iv) a fair relation to state-provided services.7 Importantly, the Court noted that the burden of proof is on the taxpayer to show that the tax fails to meet at least one of the prongs.8

Substantial Nexus

First, to survive constitutional scrutiny, a tax must apply to an activity that has a substantial nexus with the taxing state. ETC argued that physical presence alone does not satisfy the substantial nexus prong in ad valorem cases. The Court disagreed, referencing both federal and Texas cases in which physical presence was found to be sufficient to meet this part of the test.9 The Court focused on ETC's physical presence in Harris County and other parts of Texas, including its offices, employees and stored natural gas, in finding a substantial nexus between the activity being taxed and Texas.

Fair Apportionment

The second prong of the Complete Auto test is whether the tax is fairly apportioned (i.e., each state taxes only its fair share of an interstate transaction). In order for the requirements of this prong to be met, a tax must be both internally and externally consistent.10

A tax is considered to be internally consistent when it is structured so that if every state were to impose an identical tax, multiple taxation would not result.11 The Court quickly dismissed this requirement, noting that because ETC was not attempting to store gas in two states at the same time, there was no risk of multiple taxation.

The external consistency test examines whether the state has taxed only the portion of revenue from the interstate activity which reasonably reflects the in-state component of the activity being taxed.12 ETC argued that the ad valorem tax at issue was externally inconsistent because it would be impossible to determine, at any given time, the actual physical location of each molecule of its owned natural gas. However, because ETC had conceded its ownership of 33 billion cubic feet of natural gas stored in the reservoir located in Harris County, the Court rejected this contention. Accordingly, the Court found the ad valorem tax to be fairly apportioned.

Discrimination Against Interstate Commerce

The Court subsequently considered whether the ad valorem tax discriminated against interstate

commerce. Noting that the U.S. Supreme Court had previously determined that "ad valorem tax of general application … is of necessity non-discriminatory,"13 the Court concluded that this particular tax was valid.

Fair Relation to State-Provided Services

The final prong of the Complete Auto test considers whether the tax is fairly related to services provided by the state. The Court noted that no detailed accounting of the services provided to a taxpayer was necessary to prove this fact, but instead "police and fair protection, along with the usual and usually forgotten advantages conferred by the State's maintenance of a civilized society, are justifications enough."14

ETC argued that this prong was not satisfied because the gas was entrusted to Houston Pipeline, which pays property taxes on the reservoir and related equipment. Also, ETC argued that Houston Pipeline had complete and exclusive control over the activity being taxed, which was storage of gas in the reservoir. Finding that ETC had not met its burden of proof on this issue, the Court noted that ETC retained control over the disposition of the gas in the reservoir, as indicated in the evidence provided during the district court's decision. While the gas is stored in the reservoir, the Court found that ETC "enjoys the benefit of public services which facilitate gas storage, which in turn allows it to accomplish its business objective of buying natural gas and holding it for sale at some later point in time." Thus, the Court concluded that the ad valorem tax was fairly related to the services provided by Texas.

In ruling against ETC, the Court reiterated that it was not necessary to resolve the dispute between ETC and the HCAD regarding whether the natural gas was sold in interstate commerce to evaluate the validity of the tax. The ad valorem tax was properly imposed because ETC stored the gas in Texas for the business purpose of selling the gas at a higher price at a later time.

Commentary

The interstate commerce exemption is especially significant for taxpayers engaged in the oil and gas industry in Texas because it is one of the few exemptions potentially applicable to ad valorem taxes on oil and natural gas. Three general exemptions from Texas ad valorem taxes are available for tangible personal property: (i) the freeport exemption; (ii) the goods-in-transit exemption; and (iii) the interstate commerce exemption. The freeport exemption applies when certain types of property are transported outside Texas within 175 days,15 but is not available for oil, natural gas or other petroleum products. Similarly, the goods-in-transit exemption does not apply to oil, natural gas, or petroleum products.16 Thus, businesses in the oil and gas industry generally must rely solely on the interstate commerce exemption for relief from Texas property taxation.

This decision is distinguishable from two recent Texas appellate court decisions that were favorable to the taxpayer and addressed the same constitutional concerns.17 Both cases involved petroleum products being stored in Texas that were later to be transported out of state. In Peoples Gas, the Sixth District Court of Appeals, which sits in Texarkana, held that the natural gas could not be taxed locally because there was insufficient nexus.18 In BP America, the Eleventh District Court of Appeals, which sits in Eastland, held that an ad valorem tax could not be imposed on crude oil stored in a tank farm that is an integral part of an interstate pipeline system.19 The Texas Supreme Court has yet to rule in either of these cases. It is interesting to note that the dissenting opinion in ETC cited Peoples Gas as indistinguishable on the substantial nexus issue.20

The issue of whether property tax properly applies to stored oil and natural gas has been highly litigated in recent years, both in Texas and in other states. For example, both the Oklahoma and

Kansas State Supreme Courts found against taxpayers in recent decisions, finding that property tax was validly assessed.21 The United States Supreme Court has refused to hear both the Oklahoma and the Kansas cases,22 despite the fact that the Solicitor General of the United States was requested to file a brief expressing the views of the federal government on this issue.23

The Court's insightful analysis reflects the far-reaching effect of the Complete Auto precedent.24 In practice, Complete Auto's four-prong test continues to lessen the practical effect of the Dormant Commerce Clause, and defenses based upon the concept, with respect to interstate commerce (in contrast to foreign commerce).

Finally, it is important to note that ETC is an appellate court decision that is binding in the area of the court's jurisdiction,25 but is not binding in other parts of Texas. The taxpayer will still have an opportunity to appeal to the Texas Supreme Court.26

Footnotes

1 ETC Marketing, Ltd. v. Harris County Appraisal District, Texas Court of Appeals, First District, No. 01-12-00264-CV, Oct. 2, 2014.

2 Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). The test addresses whether the entity has substantial nexus under the Commerce Clause, thereby allowing a state to impose a tax.

3 ETC has historically stored gas in the reservoir for several months at a time, buying it during warmer months and selling it to northern markets in the winter months. The length of time the gas is stored depends on the volume, time of year, and demand for natural gas.

4 Harris County Appraisal District v. ETC Marketing, Ltd., 127th District Court, No. 2010-71360.

5 TEX. TAX CODE ANN. § 11.01.

6 TEX. TAX CODE ANN. § 11.12.

7 Barclays Bank PLC v. Franchise Tax Board, 512 U.S. 298, 310-11 (1994).

8 Vinmar, Inc. v. Harris County Appraisal District, 947 S.W.2d 554, 555 (Tex. 1997).

9 Relying upon Quill Corp. v. North Dakota, 50 U.S. 298 (1992), which reaffirmed that physical presence satisfies the first prong of the Complete Auto test for sales and use tax purposes. Several Texas cases reached the same conclusion with respect to ad valorem taxes. See, for example, Rylander v. 3 Beall Bros. 3, Inc., 2 S.W.3d 562, 570 (Tex. Ct. App. 1999), cert. denied, 538 U.S. 1013 (2003) and Peoples Gas, Light, and Coke Co. v. Harrison Central Appraisal District, 270 S.W.3d 208 (Tex. Ct. App. 2008), cert. denied, 131 S. Ct. 2097 (2011).

10 Goldberg v. Sweet, 488 U.S. 252 (1989).

11 Id.

12 Id.

13 Japan Line, Ltd. v. Los Angeles County, 441 U.S. 434, 445 (1979).

14 Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 200 (1995).

15 TEX. CONST. art. VIII, §1-j.

16 TEX. TAX CODE ANN. §11.253(a)(2)(D).

17 See Peoples Gas, Light & Coke v. Harrison Central Appraisal District, 270 S.W.3d 208 (Tex. Ct. App. 2008), in which the Court held that a tax assessment on stored natural gas was invalid because of a lack of substantial nexus; Midland Central Appraisal District v. BP America Production Co., 282 S.W.3d 215 (Tex. Ct. App. 2009), in which ad valorem tax was found to be improperly assessed on oil passing in interstate commerce through an interstate pipeline, but temporarily held in Texas.

18 The majority in ETC distinguishes Peoples Gas by saying the natural gas marketer's "only connection to Texas was through the 'structure and location' of the separately owned pipeline which made the decision about where to store the gas and paid its own ad valorem taxes on the facility and equipment used for storage of natural gas in Texas. In contrast, ETC Marketing had a physical presence in Harris County including employees, offices, and – most significantly – natural gas that it had specifically contracted to store with Houston Pipeline. Unlike the pipeline at issue in Peoples Gas, Houston Pipeline's facilities are located entirely within Texas, including the Bammel reservoir in Harris County. There was no evidence that the gas was already bound for another state when it was committed to Houston Pipeline."

19 The majority distinguishes BP from ETC because the oil in the BP case "was not held in the tank farm for storage purposes or for any business purpose of the owner other than its transmission through the pipeline."

20 ETC Marketing, No. 01-12-00264-CV (Keyes – dissenting) pg. 9.

21 In re Assessment of Personal Property Taxes, 234 P.3d 938 (Okla. 2008); In the Matter of the Appeals of Various Applicants from a Decision of the Division of Property Valuation of the State of Kansas for Tax Year 2009 Pursuant to K.S.A. 74-2438, 313 P.3d 789 (Kan. 2013).

22 Certiorari was denied for the Kansas case on Oct. 6, 2014, while certiorari in the Oklahoma case was denied on Mar. 1, 2010.

23 In her brief to the Court, the Solicitor General argued that the Oklahoma Supreme Court had correctly rejected the dormant Commerce Clause challenge.

24 In comparison, this is the precedential effect some commentators thought, and some tax practitioners wished, the U.S. Supreme Court decision in the Quill case (Quill Corp. v. North Dakota, 504 U.S. 298, 309 (1992)) had. The precedential effect of Quill has, however, been relied upon sparingly by the courts.

25 Counties served by the First Court of Appeals are Austin, Brazoria, Chambers, Colorado, Fort Bend, Galveston, Grimes, Harris, Waller and Washington.

26 The taxpayer filed a motion for rehearing with the Court of Appeals on October 20. If the Court refuses to rehear the case, the taxpayer will have 45 days from that refusal to file a petition for review with the Texas Supreme Court. Indeed, there might be increased incentive for the Texas Supreme Court to take this case (if appealed) to resolve a perceived split in the Courts of Appeals between ETC on one side, and BP America and Peoples Gas on the other.

Last Updated: November 6 2014

Article by John LaBorde, P.J. Olzen, Don Lippert Jr., Pat McCown, Terry Gaul, Jamie C. Yesnowitz and Lori Stolly

Grant Thornton LLP

Firm Forwards Amicus Brief on Hospital Community Benefit Reporting.

Catherine Livingston of Jones Day, on behalf of the American Hospital Association, has provided Treasury with a copy of an amicus brief the firm filed with the Supreme Court in Perez v. Mortgage Bankers Association, describing how the IRS changed its position retroactively on hospital community benefit reporting without notice or explanation.

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October 17, 2014

Ms. Emily McMahon
Deputy Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3120
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Dear Emily:

I am writing on behalf of our client, the American Hospital Association ("AHA") to provide you with a copy of the brief we have filed with the Supreme Court of the United States as amici curiae in Perez v. Mortgage Bankers Association, describing how the IRS changed its position retroactively on the reporting of hospital community benefit without notice or explanation. You will recall that AHA and other stakeholders were deeply concerned by the change to the Schedule H form instructions made abruptly last December, not only because the substantive position was problematic but also because the process that was followed was so flawed.

The rules for reporting community benefit expenditures are contained exclusively in the instructions for Form 990 Schedule H (Hospital). Notwithstanding their status as form instructions, they function as rules given the penalties that can apply for failure to file a complete and accurate return and given the lack of any other guidance on measuring community benefit through expenditures. From 2008 when the instructions were first issued through 2012, the instructions for Schedule H consistently treated all hospital expenditures for research funded by the government or another tax-exempt entity as community benefit expenditures that were to be included in computing the hospital's net community benefit percentage. In December of 2013, the IRS issued draft instructions reversing that position and excluding research expenditures for projects specifically funded by grants from government or tax-exempt entities from net community benefit expenditures. The IRS finalized these instructions eleven days later, never explaining the change. AHA and others submitted comments in December of 2013 objecting to the change as it had the nonsensical effect of treating most medical research as something other than a community benefit activity. AHA also met with Ms. Tamera Ripperda, Director of Exempt Organizations, and other IRS representatives on June 9, 2014 to express its concerns. The IRS has never issued a public explanation for the change.

As explained in the brief, the lack of transparency and explanation is entirely counter to the open process that was followed in developing Schedule H and its instructions. The community benefit standard was created in revenue rulings, and there is no published guidance whatsoever on measuring community benefit through expenditures. The process for developing Schedule H and its

instructions respected those facts and provided notice and comment. Moreover, the substantive position adopted in the draft instructions is illogical and contrary to the considered position on the same issue that was adopted in 2008 after notice and comment.

The substantial majority of medical research funding in this country comes from the federal government. It does not have the infrastructure or talent to perform all the medical research the public is seeking. Therefore, the federal government funds research performed in hospitals and universities all over the country that invest in the infrastructure and recruit and support the scientists needed to perform the research. The Schedule H instructions appear to take the position that hospitals are not providing a community benefit when they conduct research projects to find new ways to delay and prevent type 1 diabetes or to find new therapies for Alzheimer's disease because the instructions treat most of the dollars spent on these activities as not being net community benefit expenditures. That makes no sense. The hospital's research infrastructure and scientific personnel are critical to converting the grant dollars into research activities. The research is a public good, not a service to a particular patient where it may be relevant whether the hospital or a third party payor is covering the cost. The relevant consideration for exemption is the amount of community benefit generated by the hospital. The change to the Schedule H instructions was certainly not propelled by changes to the law as section 501(c)(3) has not changed since 2008, and the enactment of section 501(r) does not change the community benefit standard or the treatment of medical research as an activity that promotes the health of the community as a whole.

The IRS issued draft instructions for the 2014 Schedule H last month and retained the language used in the 2013 Schedule H instructions with respect to the reporting of research expenditures for purposes of determining net community benefit expenditures. On behalf of AHA, I would like to reiterate the concerns with this language and the continuing lack of sound rationale or explanation for the change and ask that the language adopted after the 2008 notice and comment process be reinstated.

Sincerely,

Catherine E. Livingston
Jones Day
Washington, DC

Enclosure

Group Seeks Removal of New Community Benefit Reporting Rule.

Edward Goodman of VHA Inc. has expressed concerns about a policy change that was made by the IRS without adequate notice or public comment in the 2013 instructions to Schedule H (Form 990), "Hospitals," urging the IRS to remove a new rule treating restricted grants as "direct offsetting revenue" for community benefit reporting purposes.

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October 21, 2014

The Honorable John A. Koskinen
Commissioner
Internal Revenue Service

1111 Constitution Ave, N.W.
Washington, DC 20224

Dear Commissioner Koskinen:

On behalf of VHA Inc. ("VHA"), we are writing to express our concern about a policy change that was made by the IRS without adequate notice or public comment in the 2013 Instructions to Schedule H of the Form 990. As described in a recently-filed amicus curiae brief submitted by the American Hospital Association (AHA) to the United States Supreme Court,1 this ill-considered change appears likely to have serious tax consequences for a wide array of tax-exempt hospitals and represents a significant departure from longstanding IRS rulings that were recently reaffirmed by Congress when it enacted new Code section 501(r).

VHA is a national health care network that serves more than 1,500 not-for-profit hospitals nationwide. VHA is dedicated to the success of nonprofit community-based health care. VHA has participated for many years with the Catholic Health Association of the United States (CHA) in developing resources to help community hospitals fulfill their mission and maintain their tax-exempt status.

AHA's amicus brief, a copy of which is enclosed for ease of reference, recounts how the IRS first developed reporting rules for measuring community benefit in consultation with the hospital community, and then precipitously altered a significant aspect of the rules retroactively with only 10 days' notice and no meaningful opportunity for comment. The amicus brief also discusses the negative impact that the rule change is likely to have on the tax status of medical research hospitals.

VHA shares AHA's concerns about the flawed administrative process by which this key rule was changed (i.e., lack of public notice and comment) as well as its adverse impacts on academic medical centers. Further, VHA believes the following factors should be considered:

- The new IRS rule will likely have a negative impact not only on research hospitals, but also on community hospitals (including critical access hospitals operating under significant financial constraints) to the extent that such hospitals' community benefit expenditures are funded in whole or part through designated grants and contributions.
- The new IRS rule is inconsistent with health care accounting principles and best practices developed by the Health Care Financial Management Association (HFMA) for the purpose of accurately measuring hospitals' provision of community benefits, including charity care.
- The new IRS rule is not only at odds with longstanding IRS revenue rulings, but also runs contrary to Congressional intent as expressed in the legislative history of new Code section 501(r).

In light of these significant procedural and substantive deficiencies, VHA urges the Commissioner to immediately withdraw the new rule and revert to the well-reasoned former rule, which excluded both restricted and unrestricted grants from the definition of "direct offsetting revenue."

The New Rule Announced in IRS Form Instructions

The new rule, imposed by a change in IRS Form Instructions first announced on December 9, 2013 and finalized on December 20, 2013, treats "restricted grants" as "direct offsetting revenue" for community benefit reporting purposes. As such, it would prevent tax-exempt hospitals that rely on grant funding to extend their reach into the communities they serve from being able to fully and accurately report their community benefit expenditures.

From the inception of the new Schedule H in 2008 through the first 11 months of 2013, the

Instructions for Schedule H provided as follows:

"Direct offsetting revenue" means revenue from the activity during the year that offsets the total community benefit expense of that activity, as calculated on the worksheets for each line item. "Direct offsetting revenue" includes any revenue generated by the activity or program, such as payment or reimbursement for services provided to program patients. ***Direct offsetting revenue does not include restricted or unrestricted grants or contributions that the organization uses to provide a community benefit.***

However, in the final 2013 Instructions released on December 20, 2013, the IRS included a sentence that states the opposite, specifically that "[d]irect offsetting revenue also includes restricted grants or contributions that the organization uses to provide a community benefit, such as a restricted grant to provide financial assistance or fund research." The same sentence is included in the recently released 2014 Draft Schedule H Instructions along with a statement advising hospitals that "Organizations may describe any inconsistencies from reporting in prior years in Part VI."

Negative Impacts of IRS Rule Reversal

The new reporting regime imposed by the IRS form will artificially depress many hospitals' community benefit expenditure percentages — in particular, those community hospitals and academic medical centers that rely on foundation and government grants to help fund their community benefit expenditures (including research, community health improvement initiatives, and charity care).

VHA is particularly concerned about the new rule's adverse impact on financially struggling community hospitals that pro-actively extend their community benefit reach by partnering with community organizations and foundations. While the IRS in its new community health needs assessment rules encourages hospitals to partner with other hospitals, community health organizations and local, state and federal health agencies, the new Schedule H reporting rule will unfairly penalize hospitals funding community benefit expenditures with grant funds derived from most charitable or government grants. Although the reporting rule would allow full credit for expenditures made with "unrestricted" grants, the reality of institutional grant-making is that the majority of grants made to hospitals (whether for research or community health programs) are "restricted" grants.

Inconsistency of New Rule with HFMA Charity Care Valuation Principles

According to guidelines developed by the HFMA on calculating charity care and community benefit, the concept of subtracting out **"direct offsetting revenue"** was intended to make sure that hospitals did not inflate the value of charity care by including "any patient-related revenue" in the amount counted as charity care. The subtraction of "direct offsetting revenue" was not intended to create disincentives for charitable hospitals to use grants to fund community benefit initiatives. For that reason, Statement 15 of the HFMA Principles & Practices (P&P) Board Statement on Valuation of Charity Care by Health Care Providers (" Statement 15 ") (issued Dec. 2006) only stipulates that health care providers subtract out patient-related revenue in determining the net cost of charity care. Further, Section 7.1 of Statement 15 explains the accounting principle as follows: "The goal of charity care disclosure is to identify the net cost related to charity care, as determined by the total cost of charity care services **less any patient-related revenue** due to sliding scale payments or other patient-specific sources." HFMA recognized that charity care is frequently funded by external sources (such as grants, contributions and special taxes) as well as by hospital surplus revenues.

The IRS's rule reversal deviates from these common-sense principles. It would allow hospitals

funding charity care or other community benefit with their own surplus operating revenues to fully report such community benefit expenditures, while discounting the community benefit expenditures of those financially struggling or low-margin hospitals that solicit and receive grants to help fully fund their programs. Consequently, the IRS's proposed treatment of most hospital grants as "Direct Offsetting Revenue" will result in reporting distortions and the creation of perverse incentives.

Inconsistency of the New Rule with IRS Rulings Recently Affirmed By Congress

When it passed the Affordable Care Act (ACA), Congress imposed new requirements on tax-exempt hospitals, including the following:

- Section 9007(a) of the ACA added new statutory requirements that must be met by all hospitals seeking exemption from federal income tax and other tax benefits as 501(c)(3) organizations. These provisions, now contained in new Internal Revenue Code ("Code") Section 501(r), require hospitals to — prepare a community health needs assessment (CHNA) every three years, — adopt a financial assistance policy to provide charity care and emergency medical services, — abide by a limitation on charges for medical care provided to needy patients, and — refrain from engaging in certain types of collection efforts
- Section 9007(b) added a new penalty excise tax (new Code section 4959) to help enforce the new CHNA requirements.
- Section 9007(c) mandates IRS review of each 501(c)(3) hospital and its community benefit activities at least once every three years.
- Section 9007(d) imposes new reporting and disclosure requirements on 501(c)(3) hospitals filing the annual information return known as the IRS Form 990.

The new ACA requirements are entitled, "Additional Requirements for Section 501(c)(3) Hospitals," and the legislative history of the ACA makes it clear that the new requirements are in addition to, and not in lieu of, the requirements otherwise applicable to 501(c)(3) organizations.2 In fact, the legislative history of the ACA describes in great detail the prevailing IRS standard for tax-exemption as follows:

Since 1969, the IRS has applied a "community benefit" standard for determining whether a hospital is charitable. According to Revenue Ruling 69-545, community benefit can include, for example: maintaining an emergency room open to all persons regardless of ability to pay; having an independent board of trustees composed of representatives of the community; operating with an open medical staff policy, with privileges available to all qualifying physicians; providing charity care; and utilizing surplus funds to improve the quality of patient care, expand facilities, and advance medical training, education and research.3

As emphasized by the AHA amicus brief, this longstanding IRS community standard has never required hospitals to discount their community benefit expenditures by the amount of restricted grants they receive.

Conclusion

In 2008, the IRS, in consultation with the Treasury Department and the hospital community, promulgated a definitional rule that made sense. In 2013, the IRS unilaterally and retroactively replaced the rule with one that is inconsistent with recognized accounting practices, published revenue rulings and the intent of Congress. In view of these inconsistencies and the negative impact of the rule on both research and community hospitals, the IRS should immediately withdraw the new rule and replace it with the former rule.

If you have any questions about VHA's comments or have further questions, please contact VHA's Senior Director, Governmental Relations, Cidette Perrin at (202) 354-2608 or at cperrin@vha.com.

Sincerely,

Edward N. Goodman
Vice President, Public Policy
VHA, Inc.
901 New York Avenue, N.W.
Washington, D.C. 20001

cc:
Chairman Dave Camp and Ranking Member Sander S. Levin,
Committee on Ways and Means, United States House of Representatives

Assistant Secretary (Tax Policy) Mark J. Mazur,
United States Treasury Department

Kathleen M. Nilles, Holland & Knight LLP

FOOTNOTES

1 The amicus brief was filed in Perez v. Mortgage Bankers Association, Nos. 13-1041, 13-1052. See Brief for the American Hospital Association, Association of American Medical Colleges, and Healthcare Financial Management Association as Amici Curiae Supporting Respondent, 2014 WL 5299417 (2014).

2 See S. Rep. No. 111-89, at 346-348 (2009). See also Staff of the Joint Committee on Taxation, 111th Cong., Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as amended, in combination with the "Patient Protection and Affordable Care Act" ("Technical Explanation), at 78 (J. Comm. Print. 2010) (citing Rev. Rul. 69-545, 1969-2 C.B. 117).

3 S. Rep. No. 111-89 at 346.

IRS LTR: Extension Granted to Elect Period for Low-Income Housing Credit.

The IRS granted a property owner an extension to elect when to start the credit period for its qualified low-income building.

Citations: LTR 201444013

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *, ID No. * * *
Telephone Number: * * *

Index Number: 9100.01-00, 42.00-00
Release Date: 10/31/2014
Date: July 29, 2014

Refer Reply To: CC:PSI:B5 – PLR-108988-14

LEGEND:

Taxpayer = * * *
Address = * * *
BIN = * * *
Agency = * * *
Accounting Firm = * * *
Year 1 = * * *
Year 2 = * * *

Dear * * *:

This letter responds to a letter dated February 26, 2014, submitted on behalf of Taxpayer by Taxpayer's authorized representative requesting an extension of time to make an election under § 42(f)(1) of the Internal Revenue Code pursuant to § 301.9100-3 of the Procedure and Administration Regulations.

According to the information submitted, Taxpayer owns and operates a low-income housing building located at Address and identified by BIN. The building was placed in service in Year 1. In Year 2, Taxpayer received a Form 8609 for the building from the Agency, and provided the form to Accounting Firm to complete Part II of the form. Taxpayer intended to start the credit period for the building in Year 2, the year following the year the building was placed in service. However, Accounting Firm inadvertently checked the "No" box on line 10a of the Form 8609 for the building indicating that the credit period for the building was to begin in Year 1, the year the building was placed in service. Consistent with its intent, Taxpayer seeks an extension of time to make the election under § 42(f)(1) to start the credit period for the building in Year 2.

Section 42(f)(1) defines "credit period" to mean, with respect to any building, the period of 10 taxable years beginning with the taxable year in which the building is placed in service, or at the election of the taxpayer, the succeeding taxable year, but in either case only if the building is a qualified low-income building as of the close of the first year of such period. The election, once made, is irrevocable.

Section 301.9100-8(b) provides that the election under § 42(f)(1) generally must be made for the taxable year in which the building is placed in service, or the succeeding taxable year if the § 42(f)(1) election is made to defer the start of the credit period, and must be made in the certification required to be filed pursuant to § 42(l)(1) and (2). Section 301.9100-8(a)(4)(i) provides that the election under § 42(f)(1) is irrevocable.

Section 1.42-1(h) provides, in part, that unless otherwise provided in forms or instructions, a completed Form 8609 (or any successor form) must be filed by the building owner with the IRS. The requirements for completing the Form 8609 are provided in the instructions to the form.

Sections 301.9100-1(b) through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election.

Section 301.9100-1(b) defines the term "regulatory election" as including an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

Under § 301.9100-1(c), the Commissioner has discretion to grant a reasonable extension of time

under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than six months except in the case of a taxpayer who is abroad), under all subtitles of the Code, except E, G, H, and I.

Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

Requests for relief under § 301.9100-3(a) will be granted when the taxpayer provides evidence (including affidavits described in § 301.9100-3(e)) to establish that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government.

In the instant case, based solely on the facts submitted and the representations made, we conclude that the requirements of §§ 301.9100-1 and 301.9100-3 have been met. Accordingly, Taxpayer is granted an extension of time to make the § 42(f)(1) election on Form 8609 to treat the credit period for the building located at Address and identified by BIN, as beginning in Year 2. The election must be made by filing within 120 days from the date of this letter an amended Form 8609 that includes this intended election. The amended Form 8609 (along with a copy of this letter) is to be sent to the following address:

Department of the Treasury
Internal Revenue Service Center
Philadelphia, PA 19255-0549

A copy of this letter is enclosed for this purpose.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. Specifically, we express no opinion on whether the building located at Address and identified by BIN otherwise qualifies for credit under § 42.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Associate Chief Counsel
(Passthroughs & Special Industries)

By: Christopher J. Wilson
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):
Copy of this letter

Copy for § 6110 purposes

Foley: IRS Releases Favorable Private Business Use Rules For Facilities Financed With Tax-Exempt Bonds.

On October 24, 2014, the IRS released Notice 2014-67, which establishes more favorable safe harbors for types of service contracts and other arrangements using property financed with tax-exempt bonds. The Notice also provides helpful guidance of more limited scope regarding the treatment of Accountable Care Organizations under the Medicare Shared Savings Program.

The more favorable rules generally can be applied retroactively, and are of immediate practical importance.

Notice 2014-67 is available here.

Highlights of the New Rules

- The Notice includes a very significant expansion of the safe harbors for service contracts that are not treated as resulting in "private business use" previously set forth in IRS Revenue Procedures 97-13 and 2001-39.
- The Notice establishes a new safe harbor for contracts with a 5-year term. In practice, this new more favorable safe harbor in most instances displaces the existing safe harbors for 2-year, 3-year and 5-year contracts.
- 5-year contracts qualifying for the safe harbor do not need to be terminable by the qualified user (that is, the issuer or borrower) before the end of the 5-year term.
- Many, but not all, types of compensation are permitted for the 5-year safe harbor. To qualify for the 5-year safe harbor all compensation for services must be 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). In addition, for this purpose, a tiered productivity award as described in the Notice will be treated as a stated amount or a periodic fixed fee, as appropriate.
- The new rules expand the types of permitted productivity awards. The Notice provides that a productivity award 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.

Highlights of New Rules for Certain Accountable Care Organizations

- The Notice provides helpful, but limited guidance on whether a State or local government entity or 501(c)(3) organization that benefits from tax-exempt financing will be considered to have private business use of its facilities as a result of participation in the Medicare Shared Savings Program through an "accountable care organization" ("ACO").
- The Notice provides that the participation of a nonprofit hospital organization (or other "qualified

user") in the Medicare Shared Savings Program through an ACO will not result in private business use of the tax-exempt bond financed facility if all of the following conditions are met: (1) the terms of the qualified user's participation in the Medicare Shared Savings Program through the ACO (including its share of Shared Savings Program payments or losses and expenses) are set forth in advance in a written agreement negotiated at arm's length; (2) the Centers for Medicare and Medicaid Services has accepted the ACO into, and has not terminated the ACO from, the Medicare Shared Savings Program; (3) the qualified user's share of economic benefits derived from the ACO (including its share of Medicare Shared Savings Program payments) is proportional to the benefits or contributions the qualified user provides to the ACO; if the qualified user receives an ownership interest in the ACO, the ownership interest received is proportional and equal in value to its capital contributions to the ACO and all ACO returns of capital, allocations, and distributions are made in proportion to ownership interests; (4) the qualified user's share of the ACO's losses (including its share of Medicare Shared Savings Program losses) does not exceed the share of ACO economic benefits to which the qualified user is entitled; (5) all contracts and transactions entered into by the qualified user with the ACO and the ACO's participants, and by the ACO with the ACO's participants and any other parties, are at fair market value; and (6) the qualified user does not contribute or otherwise transfer the property financed with tax-exempt bonds to the ACO unless the ACO is an entity that is a governmental person, or, in the case of qualified 501(c)(3) bonds, either a governmental person or a 501(c)(3) organization.

Practical Consequences of the New Rules

The following is a list of certain of the most important consequences of the new IRS rules. Because the rules may be applied to outstanding bond issues and contracts, many of these consequences may apply immediately.

- Borrowers and issuers of tax-exempt bonds (including particularly nonprofit hospital organizations) generally will need to revise bond compliance procedures to reflect the new, more favorable rules.
- In many instances, it is possible that "carve outs" for new financings and refundings to address private business use compliance (that is, reduction in the size of tax-exempt bond issues) could be reduced or eliminated under the new, more favorable rules.
- Borrowers and issuers of tax-exempt bonds and service providers may request, or consider, amendment of existing contracts (or renewals of existing contracts on different terms). This may arise in particular in cases where the private business use rules prevented service contract provisions with business terms otherwise desired by both parties.
- Nonprofit organizations that have reported the amount of private business use of bond issues in Form 990, Schedule K, may be able to reduce the amount of private business use reported. The proposed resolution of voluntary closing agreement requests to the IRS, and IRS examinations of tax-exempt bonds, which involve service contracts may be affected by this development.

Further Discussion

Tax-exempt bonds that benefit State and local governments and section 501(c)(3) organizations are subject to "private business tests" under sections 141 and 145 of the Internal Revenue Code that restrict the use of bond-financed facilities. These rules include restrictions on the "private business use" of bond-financed facilities.

The main impetus for publication of the Notice appears to have been to provide helpful guidance for certain accountable care organizations. In practice, however, the new rules in the Notice for service contracts are a more significant development that has widespread significance for issuers and borrowers of tax-exempt bonds, and also service providers to those issuers and borrowers. The Notice is the most significant IRS guidance on the treatment of service contracts involving facilities

financed with tax-exempt bonds since the publication of IRS Rev. Proc. 97-13 in 1997.

For the most part, the new safe harbor for 5-year contracts displaces the existing Rev. Proc. 97-13 safe harbors for 2-year, 3-year and 5-year contracts. Each of those safe harbors requires that the qualified user (generally, the issuer or borrower) have the right to terminate the contract without penalty or cause after a 1-year, 2-year or 3-year period, respectively. The new 5-year safe harbor does not require any such termination provision. The types of compensation arrangements permitted by the new 5-year safe harbor are broad, but do not include all types of compensation arrangements. It is possible that, in some cases, issuers and borrowers may seek to continue to use an existing 2-year, 3-year or 5-year safe harbor; the existing safe harbors are not affected, and may still be relied upon.

The new rules set forth safe harbors, not requirements. The IRS has issued many private letter rulings providing that certain service contracts that do not technically meet all of the requirements of a Rev. Proc. 97-13 safe harbor, but are nonetheless sufficiently consistent with the principles of a published safe harbor, may still be favorably treated as not giving rise to private business use. Accordingly, it can be expected that many interpretive questions will arise regarding whether contracts that do not exactly meet all of the requirements of the new safe harbor for 5-year contracts, but are consistent with the spirit of the new safe harbor, may receive similar favorable treatment.

Use of the new 5-year safe harbor for service contracts may heighten the need to consider and review the general requirements of Rev. Proc. 97-13, as amended, and other federal tax and regulatory requirements for service contracts. For example, the safe harbors of Rev. Proc. 97-13, and the rules under section 501(c)(3) of the Internal Revenue Code, generally require that all such service contracts be entered into at fair market value. The longer term contracts permitted under the new rules may heighten the need to consider how to best establish and document that a contract is entered into a fair market value. As another example, the regulations continue to provide that a service contract generally results in private business use if the contract provides for compensation based, in whole or in part, on a share of net profits from operation of the facility. The new 5-year safe harbor may heighten the need to consider and review whether the compensation arrangement meets this requirement.

The new rules may be applied immediately, but are not required to be applied until on or after January 22, 2015. The Notice states that the provisions relating to ACOs under the Medicare Shared Savings Program apply to bonds sold on or after January 22, 2015, but may be applied to bonds sold before that date. The Notice states that the provisions relating to service contracts apply to contracts entered into, or materially modified or extended (other than pursuant to a renewal option) on or after January 22, 2015, but may be applied to contracts entered into, modified or extended before or after that date.

The favorable treatment for ACOs entered into under the Medicare Shared Savings Program is similar to the approach taken in IRS Notice 2011-20, which provided similar favorable treatment for purposes of section 501(c)(3) of the Internal Revenue Code. Guidance regarding the treatment of the many other types of ACOs is not provided in this Notice, although nonprofit organizations and their counsel may look to Notice 2014-67 for helpful benchmarks for the analysis of treatment of other ACO arrangements. In other words, particularly because participation in the Medicare Shared Savings Program is limited, the portion of Notice 2014-67 that concerns ACOs represents only a helpful “toe in the water” towards providing broader needed guidance on the treatment of ACOs.

The Notice concerns only “short-end” safe harbors for service contracts (that is, contracts having a term not longer than 5 years). The existing Rev. Proc. 97-13 also sets forth safe harbors for longer

term contracts (10-year, 15-year and 20-year), which are not directly affected by the Notice. In general, the safe harbors for the “short-end” have more significance in certain sectors (particularly including health care) than others. Public comments have also been submitted to the IRS for additional safe harbors on the “long-end”. For example, more flexible long-term safe harbors could be particularly helpful for governmental utility systems, convention centers, and similar facilities financed with tax-exempt bonds. It is possible that the release of the favorable guidance for the “short-end” increases the possibility of future favorable guidance on the “long-end” as well.

Last Updated: October 29 2014

Article by Michael G. Bailey, David Y. Bannard, Chauncey W. Lever, Richard F. Riley, Jr. 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.

Philadelphia 2010 Water Bonds’ Tax-Exemption Under IRS Scrutiny.

Philadelphia water and wastewater revenue bonds sold in 2010 are being audited by the Internal Revenue Service to verify they meet tax-exempt requirements, the city said in a filing.

The city received a notice from the agency around Oct. 8 that the $396 million issue is being examined because of “concern that the debt issuance may fail one or more provisions” of the code regarding tax-free securities, according to a posting on the Municipal Securities Rulemaking Board’s website.

Proceeds from the debt went toward refinancing 2003 securities and funding a $48.8 million payment to terminate a swap agreement, bond documents show.

Philadelphia reviewed the IRS matter and will provide the information requested, Treasurer Nancy Winkler said by telephone.

“We don’t see anything that should cause a problem,” she said. “We have not identified anything that would lead us to believe that the bonds fail to meet the applicable requirements.”

Winkler said the city has undergone five audits on debt issues in the past four years without any action taken.

Ubon Mendie, an IRS spokesman in Washington, declined to comment on the Philadelphia case.

Bloomberg

By Romy Varghese Oct 27, 2014 7:56 AM PT

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IRS Rules on Tax Consequences of Plan Contributions, Transfers.

The IRS ruled that some employer contributions, including picked-up contributions, to a city's defined contribution plan aren't includable in the employee's gross income until distributed and that trustee-to-trustee transfers from a participant's account in the plan to purchase service credit will not be included in their gross income.

Citations: LTR 201443035

Uniform Issue List: 414.00-00, 414.09-00

Date: July 28, 2014

Refer Reply To: T:EP:RA:T3

LEGEND:

City A = * * *
State B = * * *
Plan C = * * *
Plan D = * * *
Plan E = * * *
Board F = * * *
Class G Employees = * * *
Class H Employees = * * *

Dear * * *:

This letter is in response to correspondence dated April 22, 2005, as supplemented by correspondence dated February 29, 2008, January 28, 2009, February 3, 2009, August 17, 2009, August 31, 2009, April 15, 2013, May 7, 2013, November 22, 2013, March 6, 2014, March 25, 2014, and May 15, 2014, submitted on behalf of City A by its authorized representatives, in which a request for a letter ruling was submitted with respect to the federal tax consequences of certain contributions to, and trustee-to-trustee transfers from, Plan C, as established effective December 20, 2004, and as most recently amended and restated as of January 1, 2014.

The following facts and representations are submitted under penalties of perjury in support of your request:

City A is a municipal corporation and a political subdivision of State B. Pursuant to a certain ordinance enacted effective December 20, 2004, City A established Plan C, a defined contribution retirement plan for eligible employees of City A. Plan C is intended to be a tax-qualified retirement plan under section 401(a) of the Internal Revenue Code ("Code"), and is represented to be a governmental plan under section 414(d) of the Code. Plan C has been amended from time to time and, on December 19, 2013, Plan C was amended and restated in its entirety, effective January 1, 2014. A First Amendment to Plan C, as amended and restated effective January 1, 2014, was adopted by City A on March 14, 2014 (such Amendment hereinafter referred to as the "First Amendment"). In addition, City A proposes to adopt a Second Amendment, also effective January 1, 2014 (such Amendment hereinafter referred to as the "Second Amendment"),

Two categories of employees eligible to participate in Plan C are Class G Employees and Class H

Employees. Other categories of City A employees are eligible to participate in Plan C as determined by City A's Personnel Department.

Effective March 1, 2014, section 1.1 of Plan C defines the term "Accumulated Leave Time Value" as the value of an employee's accumulated sick leave at retirement determined by multiplying the applicable percentage, based on the collective bargaining agreement or City A policy to which the employee is subject, by the amount of Plan-eligible accumulated sick leave available for conversion under such collective bargaining agreement or City A policy.

Section 1.1 of Plan C defines the term "Supplemental Contributions" as mandatory contributions made pursuant to section 3.1(d) of Plan C.

Pursuant to the Second Amendment, section 3.1(a)(2) of Plan C provides that, on and after April 1, 2014, City A shall automatically make an "Accumulated Leave Contribution" to Plan C on behalf of a Class G Employee equal to his or her Accumulated Leave Time Value at retirement. Section 3.1(a)(2) of Plan C, as set forth in the Second Amendment, further provides that no Class G Employee eligible for such an Accumulated Leave Contribution may receive any portion of his or her Accumulated Leave Time Value in cash.

Under the Second Amendment, section 3.1(a)(4) of Plan C provides that, on and after April 1, 2014, City A shall automatically make an Accumulated Leave Contribution to Plan C on behalf of a Class H Employee equal to his or her Accumulated Leave Time Value at retirement. Section 3.1(a)(4) of Plan C, as set forth in the Second Amendment, further provides that no Class H Employee eligible for such an Accumulated Leave Contribution may receive any portion of his or her Accumulated Leave Time Value in cash.

Section 3.1(b)(1) of Plan C provides that certain "Nonelective Employer Contribution Amounts" shall be contributed by City A to Plan C. Different classifications of eligible employees under Plan C are entitled to different Nonelective Employer Contribution Amounts in accordance with a specified Appendix of Plan C. Section 3.1(b)(1) of Plan C further states that no employee may elect to receive any portion of such Nonelective Employer Contribution Amounts in cash.

Pursuant to the Second Amendment, section 3.1(d)(1)(A) of Plan C provides that certain eligible classifications of City A employees hired on or after January 1, 2014, may make an election to have "Supplemental Contributions" made to Plan C. Under section 3.1(d)(1)(A), eligible employees may irrevocably elect salary reduction in the amount of a designated percentage (from among the available percentages set forth in a specified Appendix of Plan C, as amended from time to time) of the compensation otherwise payable to him or her on or after January 1, 2014 to be paid by City A into Plan C. Section 3.1(d)(1)(A) of Plan C further provides that such payment by City A into Plan C shall be a "pick up contribution" pursuant to section 414(h)(2) of the Code. Under section 3.1(d)(1)(A) of Plan C, such election must be made no later than the eligible employee's first becoming eligible under any plan or arrangement of City A. Furthermore, section 3.1(d)(1)(A) says that, pursuant to such election, City A will pick up and pay the elected amount directly to Plan C, and the eligible employee will not have the option of choosing to receive the elected amount directly instead of having it paid by City A to Plan C. Section 3.1(d)(1)(A) also provides that no employee eligible for such a "pick up contribution" shall be permitted to make contributions of any portion of his or her compensation directly to Plan C.

Section 3.1(d)(1)(C) of Plan C provides that an eligible employee described in section 3.1(d)(1)(A) of Plan C who fails to make the election specified in that section shall be deemed to have irrevocably elected to have 0% of the compensation otherwise payable to him or her contributed to Plan C. Section 3.1(d)(1)(D) provides that the election made by an eligible employee to make (or not make)

Supplemental Contributions is irrevocable and remains in place in the event the employee transfers to a position under the same or different employee classification (or terminates employment with City A and is subsequently reemployed under the same or different employee classification).

City A also established and maintains Plan D, which is represented to be a governmental plan within the meaning of section 414(d) of the Code, and is intended to be a qualified plan under section 401(a) of the Code. Plan D is a defined benefit plan. Plan D will accept transfers from Plan C for the purchase of service credit. Plan D contains distribution restrictions on any transferred amounts it receives that are at least as restrictive as the distribution restrictions of Plan C.

State B established and maintains Plan E, which is represented to be a governmental plan within the meaning of section 414(d) of the Code, and is intended to be a qualified plan under section 401(a) of the Code. Plan E is a defined benefit plan. Plan E will accept transfers from Plan C for the purchase of service credit. Plan E contains distribution restrictions on any transferred amounts it receives that are at least as restrictive as the distribution restrictions of Plan C.

Section 6.3 of Plan C provides that, if authorized by Board F (or its designee), and to the extent permitted by applicable law, Plan C shall allow participants to make voluntary plan-to-plan transfers directly to Plan D or Plan E, or another qualified defined benefit plan from which the participant is entitled to a benefit and which allows for such transfers (hereinafter "transferee plan"), for the purchase of service credit under such transferee plan. Under section 6.3 of Plan C, a participant may not request a transfer of an amount that exceeds 100% of the actuarial cost of the service credit being purchased, as determined by the transferee plan. Further, a participant must request a transfer to purchase service credit under section 6.3 of Plan C before his or her termination of employment with City A or retirement.

Based on the above facts and representations, you request the following rulings:

1. The employer contributions of Accumulated Leave Time Value made to Plan C on and after January 1, 2014, for Class G Employees in accordance with section 3.1(a)(2), and for Class H Employees in accordance with section 3.1(a)(4), are not contributions under a cash or deferred arrangement and are not includible in the gross income of the employee, because these mandatory, non-elective leave contributions are employer contributions to a qualified plan, subject to the limits on annual additions to a qualified plan,

2. The Nonelective Employer Contributions made to Plan C for eligible employees in accordance with section 3.1(b) are not includible in the gross income of the employee because these contributions are employer contributions to a qualified plan, subject to the limits on annual additions to a qualified plan.

3. The Supplemental Contributions made to Plan C for eligible employees in accordance with section 3.1(d) and which are (i) made pursuant to an irrevocable election of each eligible employee hired on or after January 1, 2014, upon first becoming eligible under any plan or arrangement of City A, and (ii) picked up by City A pursuant to section 414(h)(2) of the Code, are not includible in the gross income of each such employee, subject to the limits on annual additions to a qualified plan.

4. Trustee-to-trustee transfers made pursuant section 6.3 of Plan C from a participant's account in Plan C to Plan D for the purchase of service credit will not be included in the gross income of the participant under section 402 of the Code and are not subject to withholding under section 3405 of the Code or tax reporting under section 6047 of the Code. Furthermore, such transferred amounts are not annual additions under section 415(c) of the Code, and the benefit attributable to the transferred amounts is not subject to the limitation on benefits under section 415(b) of the Code. In

addition, section 415(n) of the Code is not applicable to the transferred amounts and the transferred amounts are not subject to limitation under section 415 of the Code at the time of transfer.

With respect to your first two requested rulings, section 401(a) of the Code provides that a trust created or organized in the United States and forming a part of a qualified stock bonus, pension, or profit sharing plan of an employer constitutes a qualified trust only if the various requirements set out in section 401(a) of the Code are met.

Section 401(k)(1) of the Code provides that a profit sharing or stock bonus plan, pre-ERISA money purchase pension plan, or a rural cooperative plan shall not be considered as not satisfying the requirements of section 401(a) of the Code merely because the plan includes a qualified cash or deferred arrangement as defined in section 401(k)(2) of the Code.

Section 401(k)(4)(B)(ii) of the Code provides that "a cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof." Section 1116(f)(2)(B)(i) of the Tax Reform Act of 1986, P.L. 99-514, provides a transition rule pursuant to which the prohibition of section 401(k)(4)(B)(ii) of the Code does not apply to any cash or deferred arrangement adopted by a State or local government (or political subdivision thereof) before May 6, 1986. Thus, if a governmental employer maintains a qualified defined contribution plan, the plan cannot generally include a qualified cash or deferred arrangement within the meaning of section 401(k), unless the cash or deferred arrangement was adopted before May 6, 1986.

Section 1.401(k)-1(a)(2) of the Income Tax Regulations ("Regulations") provides that, subject to certain exceptions, which are inapplicable in this case, a cash or deferred arrangement is an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of section 401(a) of the Code.

Section 1.401(k)-1(a)(3) of the Regulations generally defines a cash or deferred election as any direct or indirect election (or modification of an earlier election) by an employee to have the employer either: (1) provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available, or (2) contribute an amount to a trust, or provide an accrual or other benefit under, a plan deferring the receipt of compensation.

Section 402(a) of the Code generally provides that any amount actually distributed to any recipient by any employees' trust described in section 401(a) of the Code, which is exempt from tax under section 501(a) of the Code, shall be taxable to the recipient, in the taxable year of the distribution, under section 72 of the Code (relating to annuities).

Section 1.402(a)-1(a)(1)(i) of the Regulations provides that if an employer makes a contribution for the benefit of an employee to a trust described in section 401(a) of the Code for the taxable year of the employer which ends within or with a taxable year of the trust for which the trust is exempt under section 501(a) of the Code, the employee is not required to include such contribution in his or her income except for the year or years in which such contribution is distributed or made available to him or her.

Section 415(a)(1)(B) of the Code provides that a defined contribution plan is not a qualified plan if contributions and other additions made to the plan with respect to any participant in a taxable year exceed the limitation of section 415(c) of the Code.

In the present case, pursuant to section 3.1(a)(2) and section 3.1(a)(4) of Plan C, on and after

January 1, 2014, City A automatically contributes an amount equal to an eligible employee's Accumulated Leave Time Value to Plan C on behalf of the employee at the time of the employee's retirement. Under the terms of Plan C, no such eligible employee may receive any portion of his or her Accumulated Leave Time Value in cash.

Accordingly, no eligible employee is permitted a cash or deferred election with respect to his or her Accumulated Leave Time Value, as the employee cannot elect to receive any portion of such amount in the form of cash (or some other taxable benefit) rather than to have such amount contributed by City A to Plan C on the employee's behalf pursuant to section 3.1(a)(2) or section 3.1(a)(4) of Plan C. Therefore, contributions under section 3.1(a)(2) and section 3.1(a)(4) of Plan C are treated as employer contributions for purposes of section 1.402(a)-1(a(1))(i) of the Regulations, and not as contributions made pursuant to a cash or deferred arrangement within the meaning of section 1.401(k)-1(a)(2) of the Regulations.

Similarly, no employee is allowed a cash or deferred election with respect to contributions made by City A to Plan C of Nonelective Employer Contribution Amounts pursuant to section 3.1(b) of Plan C. Section 3.1(b) of Plan C explicitly states that no employee may elect to receive any portion of such Nonelective Employer Contribution Amounts in cash rather than having such amounts contributed to Plan C.

Pursuant to section 415(a)(1)(B) of the Code, the contributions made on behalf of an eligible employee under section 3.1(a)(2), section 3.1(a)(4), and section 3.1(b) of Plan C, and any other contributions and additions made to Plan C with respect to any participant, are subject to the limitation of section 415(c) of the Code. Additionally, in accordance with section 1 402(a)-1(a)(1)(i) of the Regulations, employer contributions made by City A to Plan C on behalf of an employee pursuant to section 3.1(a)(2), section 3.1(a)(4), and section 3.1(b) of Plan C are not required to be included in the taxable income of the employee until such time as such amounts are distributed or made available to him or her.

Therefore, with respect to ruling request 1, we conclude that the employer contributions of Accumulated Leave Time Value made to Plan C on and after January 1, 2014, for Class G Employees in accordance with section 3.1(a)(2), and for Class H Employees in accordance with section 3.1(a)(4), are not contributions under a cash or deferred arrangement and are not includible in the gross income of the employee until such time as such amounts are distributed to the employee, because these mandatory, non-elective leave contributions are employer contributions to a qualified plan, subject to the limits on annual additions to a qualified plan.

With respect to ruling request 2, we also conclude that the Nonelective Employer Contributions made to Plan C for eligible employees in accordance with section 3.1(b) of Plan C are not includible in the gross income of the employee until such time as such amounts are distributed to the employee because these contributions are employer contributions to a qualified plan, subject to the limits on annual additions to a qualified plan.

With respect to your third requested ruling, section 1.401(k)-1(a)(3)(v) of the Regulations provides that a cash or deferred arrangement does not include certain one-time irrevocable elections. Under section 1.401(k)-1(a)(3)(v), such an election must be made no later than the employee's first becoming eligible under the plan or any other plan or arrangement of the employer. The election must be to have contributions equal to a specified amount or percentage of the employee's compensation made by the employer on the employee's behalf to the plan and a specified amount or percentage divided among all other plans or arrangements of the employer. Furthermore, pursuant to section 1.401(k)-1(a)(3)(v), such an election must be for the duration of the employee's employment with the employer.

Section 414(h)(1) of the Code provides that any amount contributed to an employees' trust described in section 401(a) of the Code shall not be treated as having been made by the employer if it is designated as an employee contribution.

Section 414(h)(2) of the Code provides that, for purposes of section 414(h)(1), in the case of any plan established by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing, or a governmental plan described in the last sentence of section 414(d) (relating to plans of Indian tribal governments), where the contributions of employing units are designated as employee contributions but where any employing unit picks up the contributions, the contributions so picked up shall be treated as employer contributions.

The federal income tax treatment to be afforded contributions that are picked up by the employer within the meaning of section 414(h)(2) of the Code has been developed in a series of revenue rulings. In Revenue Ruling 77-462, 1977-2 C.B. 358, the employer school district agreed to assume and pay the amounts employees were required by state law to contribute to a state pension plan. Revenue Ruling 77-462 concluded that the school district's picked-up contributions to the plan were excluded from the employees' gross income until such time as they were distributed to the employees. The revenue ruling further held that, under the provisions of section 3401(a)(12)(A) of the Code, the school district's contributions to the plan were excluded from wages for purposes of the collection of income tax at the source on wages. Therefore, no withholding was required for federal income tax purposes from the employees' salaries with respect to such picked-up contributions.

Revenue Ruling 81-35, 1981-1 C.B. 255, and Revenue Ruling 81-36, 1981-1 C.B. 255, established that the following two criteria must be met: (1) the employer must specify that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee; and (2) the employee must not be given the option of choosing to receive the contributed amounts directly instead of having them paid by the employer to the pension plan.

Revenue Ruling 87-10, 1987-1 C.B. 136, provides that the required specification of designated employee contributions must be completed before the period to which such contributions relate. If not, the designated employee contributions paid by the employer are actually employee contributions paid by the employee and recharacterized at a later date. The retroactive specification of designated employee contributions as paid by the employing unit (i.e., the retroactive pick-up of designated employee contributions by a governmental employer), is not permitted under section 414(h)(2) of the Code. Thus, employees may not exclude from current gross income designated employee contributions to a qualified plan that relate to compensation earned for services rendered prior to the date of the last governmental action necessary to effect the pick-up.

Revenue Ruling 2006-43, 2006-35 I.R.B. 329, amplifying and modifying Revenue Ruling 81-35, Revenue Ruling 81-36, and Revenue Ruling 87-10, describes the actions required for a state or political subdivision of a state, or an agency or instrumentality of either, to pick-up employee contributions to a plan qualified under section 401(a) of the Code so that the contributions are treated as employer contributions pursuant to section 414(h)(2). Specifically, Revenue Ruling 2006-43 provides that a contribution to a qualified plan established by an eligible employer (i.e., a governmental employer) will be treated as picked-up by the employing unit under section 414(h)(2) of the Code if two conditions are satisfied:

1. First, the employing unit must specify that the contributions, although designated as employee contributions, are being paid by the employer. For this purpose, the employing unit must take formal action to provide that the contributions on behalf of a specific class of employees of the employing

unit, although designated as employee contributions, will be paid by the employing unit in lieu of employee contributions. A person duly authorized to take such action with respect to the employing unit must take such action. The action must apply only prospectively and be evidenced by a contemporaneous written document (e.g., minutes of a meeting, a resolution, or ordinance).

2. Second, the pick-up arrangement must not permit a participating employee from on and after the effective date of the pick-up to have a cash or deferred election right within the meaning of section 1.401(k)-1(a)(3) of the Regulations with respect to designated employee contributions. Thus, for example, no participating employee may be given the right to opt out of the pick-up arrangement described in section 414(h)(2) of the Code, or to receive the contributed amounts directly instead of having them paid by the employing unit to the plan.

Revenue Ruling 2006-43 states that the pick-up rules expressed in Revenue Ruling 81-35 and Revenue Ruling 81-36 apply even if the employer picks up contributions through a reduction in salary or through an offset against future salary increases.

In this case, the Supplemental Contributions made under section 3.1(d) of Plan C on behalf of certain eligible classifications of City A employees hired on or after January 1, 2014, are made pursuant to "one-time irrevocable elections" within the meaning of section 1.401(k)-1(a)(3)(v) of the Regulations. Each eligible employee's election to have salary reduction contributions made under section 3.1(d) by City A to Plan C on the employee's behalf in the amount of a designated percentage of the compensation otherwise payable to the employee, must be irrevocable and for the duration of the employee's employment with the employer, and must be made no later than the employee's first becoming eligible under Plan C or any other plan or arrangement of the employer. Consequently, pursuant to section 1.401(k)-1(a)(3)(v), the one-time irrevocable election offered under section 3.1(d) with respect to Supplemental Contributions does not constitute a cash or deferred arrangement within the meaning of section 1.401(k)-1(a)(2) of the Regulations. Since such a one-time irrevocable election is not a cash or deferred arrangement, it follows that it is also not a cash or deferred election within the meaning of section 1.401(k)-1(a)(3) of the Regulations.

Furthermore, consistent with the requirements stated in Revenue Ruling 81-36, Revenue Ruling 81-36, and Revenue Ruling 2006-43, with respect to a valid pick-up arrangement under section 414(h)(2) of the Code, Plan C, as formally adopted by City A, explicitly states that the Supplemental Contributions under section 3.1(d) described immediately above, although designated as elective, employee contributions, shall be paid by City A into Plan C. Section 3.1(d)(A) of Plan C provides that such payments by City A to Plan C shall be pick-up contributions pursuant to section 414(h)(2) of the Code. In further satisfaction of the requirements of Revenue Ruling 81-35, Revenue Ruling 81-36, and Revenue Ruling 2006-43, section 3.1(d)(A) of Plan C provides that no employee eligible for such a pick-up contribution has the option of choosing to receive the elected amount directly instead of having it paid by City A to Plan C. Moreover, since City A's formal commitment to pick up the Supplemental Contributions on behalf of an employee exists under Plan C before the employee earns any compensation for Plan C purposes, there can be no retroactive pick-up of designated employee contributions by City A in contravention of Revenue Ruling 87-10 Additionally, as mandated by Revenue Ruling 2006-43, and for the reasons stated earlier, we find that section 3.1(d) of Plan C does not permit a participating employee from on and after the effective date of the pick-up of Supplemental Contributions by City A to have a cash or deferred election right within the meaning of section 1.401(k)-1(a)(3) of the Regulations with respect to designated employee contributions.

Accordingly, with respect to ruling request 3, we conclude that the Supplemental Contributions made to Plan C for eligible employees in accordance with section 3.1(d), and which are made pursuant to an irrevocable election of each eligible employee hired on or after January 1, 2014, upon first becoming eligible under any plan or arrangement of City A, shall be treated for federal income

tax purposes as employer contributions pursuant to section 414(h)(2) of the Code. Therefore, in accordance with Revenue Ruling 77-462, we further conclude that, subject to the limits on annual additions to a qualified plan of section 415(c) of the Code, such picked-up contributions to Plan C are not includible in the gross income of each such employee until such time as such amounts are distributed to the employee.

With respect to your fourth requested ruling, section 415(a)(1)(A) of the Code provides that a defined benefit plan is not a qualified plan if the plan provides for the payment of benefits with respect to a participant which exceed the limitation of section 415(b) of the Code.

Section 1.415(b)-1(b)(1)(ii) of the Regulations provides that an annual benefit, for purposes of determining the section 415(b) limitation, does not include the annual benefit attributable to either employee contributions or rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16) of the Code), determined pursuant to the rules of section 1.415(b)-1(b)(2) of the Regulations. Section 1.415(b)-1(b)(1)(ii) further provides that the treatment of transferred benefits is determined under the rules of section 1.415(b)-1(b)(3) of the Regulations.

Section 1.415(b)-1(b)(2)(iii) of the Regulations provides that, in the case of mandatory employee contributions, as defined in section 411(c)(2)(C) of the Code and section 1.411(c)-1(c)(4) of the Regulations (or contributions that would be mandatory employee contributions if section 411 applied to the plan), the annual benefit attributable to those contributions is determined by applying the factors applicable to mandatory employee contributions, as described in sections 411(c)(2)(B) and (C) of the Code and regulations promulgated under section 411, to those contributions to determine the amount of a straight life annuity commencing at the annuity starting date, regardless of whether the requirements of sections 411 and 417 of the Code apply to that plan,

Section 1.415(b)-1(b)(2)(v) of the Regulations provides that the annual benefit attributable to rollover contributions from an eligible retirement plan, as defined in section 402(c)(8)(B) of the Code (for example, a contribution received pursuant to a direct rollover under section 401(a)(31)(A) of the Code), is determined in the same manner as the annual benefit attributable to mandatory employee contributions if the plan provides for a benefit derived from the rollover contribution (other than a benefit derived from a separate account to be maintained with respect to the rollover contribution and actual earnings and losses thereon). Thus, in the case of rollover contributions from a defined contribution plan to a defined benefit plan to provide an annuity distribution, the annual benefit attributable to those rollover contributions for purposes of section 415(b) is determined by applying the rules of section 411(c) as described in section 1.415(b)-1(b)(2)(iii) of the Regulations, regardless of the assumptions used to compute the annuity distribution under the plan and regardless of whether the plan is subject to the requirements of sections 411 and 417 of the Code. Accordingly, in such a case, if the plan uses more favorable factors than those specified in section 411(c) to determine the amount of annuity payments arising from rollover contributions, the annual benefit under the plan would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c).

Section 1.415(b)-1(b)(3)(ii) of the Regulations provides that if there is an elective transfer of a distributable benefit to a defined benefit plan from either a defined contribution plan or a defined benefit plan, the amount transferred is treated as a benefit paid from the transferor plan, and the annual benefit provided by the transferee defined benefit plan does not include the annual benefit attributable to the amount transferred (determined as if the transferred amount were a rollover contribution subject to the rules of section 1.415(b)-1(b)(2)(v) of the Regulations). Section 1.415(b)-1(b)(3)(ii) further states that the rule described in the preceding sentence applies regardless of whether the requirements of section 411 of the Code apply to the plan and, in the case of a transfer

from a defined contribution plan that is not subject to the requirements of section 411 (such as a governmental plan) to a defined benefit plan, the rule applies even if the participant's benefits are not distributable from the defined contribution plan at the time of the transfer.

Section 415(n) of the Code generally provides that if a participant makes one or more contributions to a defined benefit governmental plan (within the meaning of section 414(d) of the Code) to purchase permissive service credit under such plan, then the requirements of section 415 of the Code shall be treated as met only if —

1. The requirements of section 415(b) of the Code are met, determined by treating the accrued benefit derived from all such contributions as an annual benefit for purposes of section 415(b); or

2. The requirements of section 415(c) of the Code are met, determined by treating all such contributions as annual additions for purposes of section 415(c).

Section 415(n)(3) defines "permissive service credit" as service credit —

1. recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,

2. which such participant has not received under such governmental plan, and

3. which such participant may receive only by making a voluntary additional contribution, in an amount determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.

Revenue Ruling 67-213, 1967-2 C.B. 149, involves the transfer of funds attributable to employer contributions directly from the trust forming a part of a qualified pension plan to the trust forming part of a qualified stock bonus plan. The revenue ruling provides, in part, that if funds are transferred from one qualified plan to another, without being made available to the participants, no taxable income will be recognized by the participants by reason of such a transfer. The revenue ruling further provides that since the funds are not considered as having been made available to the participants, they continue to be funds derived from employer contributions and do not constitute employee contributions even though they are fully vested.

In this case, section 6.3 of Plan C provides that, if authorized by Board F (or its designee), and to the extent permitted by applicable law, Plan C shall allow participants to make voluntary plan-to-plan transfers directly to Plan D (or another qualified defined benefit plan from which the participant is entitled to a benefit and which allows for such transfers) for the purchase of service credit under such transferee plan. Pursuant to Revenue Ruling 67-213, the plan-to-plan transfers from Plan C to Plan D will not be treated as a distribution from Plan C followed by an employee contribution to Plan D. Therefore, the trustee-to-trustee transfers made pursuant to section 6.3 of Plan C from a participant's account in Plan C to Plan D for the purchase of service credit will not be included in the gross income of the participant at the time of such transfer under section 402 of the Code.

As discussed above, section 415(n) of the Code provides that, in order to meet the requirements of section 415 of the Code, if a participant makes voluntary additional contributions to a defined benefit plan for the purchase of permissive service credit, the plan must either: (1) treat the accrued benefit derived from all such contributions as an annual benefit for purposes of section 415(b); or (2) all such contributions must be treated as annual additions for purposes of section 415(c).

In the present case, the voluntary plan-to-plan transfers from Plan C to Plan D, in accordance with section 6.3 of the Plan, do not constitute voluntary additional contributions made by a participant to

Plan D. Since section 415(n) of the Code applies to voluntary additional contributions made by a participant to purchase permissive service credit, and the transferred amounts are not voluntary additional contributions made by a participant, we find that section 415(n) does not apply to the transferred amounts.

As stated earlier, section 1.415(b)-1(b)(3)(ii) of the Regulations provides that if an elective transfer of a benefit is made from a governmental defined contribution plan to a defined benefit plan, the amount transferred is treated, for purposes of applying the section 415 limitations, as a benefit paid from the transferor plan. Section 1.415(b)-1(b)(3)(ii) further states that, for purposes of section 415, the annual benefit provided by the defined benefit plan does not include the annual benefit attributable to the amount transferred (determined as if the transferred amount were a rollover contribution subject to the rules of section 1.415(b)-1(b)(2)(v) of the Regulations).

In the present case, in accordance with section 1.415(b)-1(b)(2)(v) of the Regulations, the annual benefit attributable to the plan-to-plan transfers from Plan C to Plan D, for purposes of section 415(b), is determined by applying the rules of section 411(c) as described in section 1.415(b)-1(b)(2)(iii) of the Regulations. Therefore, if Plan D uses the factors specified in section 411(c) of the Code to calculate the annual benefit under the plan, then, for purposes of the limitation of section 415(b), as provided in section 1.415(b)-1(b)(3)(ii) of the Regulations, the annual benefit provided under Plan D does not include the annual benefit attributable to the amounts transferred from Plan C for the purchase of service credit. However, pursuant to section 1.415(b)-1(b)(2)(v) of the Regulations, if Plan D uses more favorable factors than those specified in section 411(c) of the Code to determine the amount of annuity payments arising from the transferred amounts, the annual benefit under Plan D, for purposes of the limitation of section 415(b), would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c).

Based on the foregoing, with respect to ruling request 4, we conclude that trustee-to-trustee transfers made pursuant to section 6.3 of Plan C from a participant's account in Plan C to Plan D for the purchase of service credit will not be included in the gross income of the participant under section 402 of the Code. We further conclude, with respect to ruling request 4, that such transferred amounts are not annual additions under section 415(c) of the Code, and the benefit attributable to the transferred amount is not subject to the limitation on benefits under section 415(b) of the Code; provided, however, if Plan D uses more favorable factors than those specified in section 411(c) of the Code to determine the amount of annuity payments arising from the transferred amounts, the annual benefit under Plan D would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c). In addition, with respect to ruling request 4, we conclude that section 415(n) of the Code is not applicable to the transferred amounts and the transferred amounts are not subject to limitation under section 415 of the Code at the time of transfer.

No opinion is expressed as to the federal tax consequences of the transactions described above under any other provisions of the Code.

This ruling is based on the assumption that Plan C, Plan D, and Plan E satisfy the qualification requirements set forth in section 401(a) of the Code, and constitute governmental plans within the meaning of section 414(d) of the Code, at all relevant times.

This ruling is directed only to the specific taxpayers that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to

your authorized representatives.

Should you have any questions or concerns regarding this ruling, please contact * * * (I.D. Number * * * at * * *. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager
Employee Plans Technical Group 3
Enclosures:
Deleted copy of this letter
Notice of Intention to Disclose

cc:
* * *

IRS Issues Guidance on Facilities Financed With Tax-Exempt Bonds.

The IRS has provided guidance (Notice 2014-67) for determining whether a state or local government entity or an exempt organization that benefits from tax-exempt bond financing will be considered to make private business use of its bond-financed facilities as a result of participating in the Medicare shared savings program through an accountable care organization (ACO).

Section 103 provides that gross income generally does not include interest on any state or local bond, but the exclusion does not apply to any private activity bond that is not a qualified bond. A private activity bond is defined in section 141(a) as any bond issued as part of an issue (1) that meets the private business use test and private security or payment test, or (2) that meets the private loan financing test. A bond issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use.

An ACO is a legal entity established by two or more healthcare providers or suppliers to coordinate and improve care for some Medicare beneficiaries and reduce costs. Under the Medicare shared savings program, an ACO that meets quality performance standards and satisfies specified cost savings benchmarks is eligible to receive payment of a portion of the total savings generated. Both for-profit entities and organizations exempt from tax under section 501(c)(3) may participate in an ACO. Notice 2014-67 is in part a response to governmental entities and tax-exempt hospitals that asked whether participating in an ACO with a for-profit entity will result in private business use of facilities financed with tax-exempt bonds.

According to Notice 2014-67, participation by a user of a healthcare facility financed with tax-exempt bonds in the shared savings program through an ACO that includes participants that are nongovernmental persons must be structured to not result in private business use of the facility. Also, any section 501(c)(3) organization using a facility financed with tax-exempt bonds must structure its participation in an ACO so that it neither jeopardizes its exempt status nor causes it to be engaged in an unrelated trade or business under section 513(a). Notice 2014-67 specifies six conditions under which the participation of a qualified user in the shared savings program through an ACO in itself will not result in private business use of the bond-financed facility.

Similarly, Notice 2014-67 provides that management contracts between qualified users of hospitals or other healthcare facilities that are financed with tax-exempt bonds and nongovernmental persons

to provide healthcare services at the facilities must be structured to avoid private business use. Notice 2014-67 amplifies the permitted productivity rewards and the types of permissible arrangements described in Rev. Proc. 97-13 that do not result in private business use, provided all other requirements of the revenue procedure are met. The notice also solicits public comments on further guidance needed to facilitate participation in the shared savings program.

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Notice 2014-67; 2014-46 IRB 1

Private business use of tax-exempt bond financed facilities

Part III — Administrative, Procedural, and Miscellaneous

SECTION 1. INTRODUCTION

The Internal Revenue Service (IRS) is considering the application of the provisions of the Internal Revenue Code (Code) governing tax-exempt bonds to arrangements entered into by hospitals or other health care organizations participating in the Medicare Shared Savings Program (Shared Savings Program) described in §§ 3022 and 10307 of the Patient Protection and Affordable Care Act, Pub. L. 111-148, 124 Stat. 119 (Affordable Care Act), enacted March 23, 2010. This notice provides interim guidance for determining whether a State or local government entity or an organization described in § 501(c)(3) of the Code that benefits from tax-exempt bond financing will be considered to have private business use of its bond-financed facilities under § 141 or § 145(a)(2)(B) of the Code as a result of its participation in the Share Savings Program through an "accountable care organization" (ACO). In addition, this notice amplifies Rev. Proc. 97-13, 1997-1 C.B. 632, as amended by Rev. Proc. 2001-39, 2001-2 C.B. 38 (cited herein as "Rev. Proc. 97-13"), regarding certain management contracts that do not result in private business use. This notice also solicits public comments on this interim guidance and on further guidance needed to facilitate participation in the Shared Savings Program.

SECTION 2. BACKGROUND

ACOs and the Shared Savings Program

Section 3022 of the Affordable Care Act amended Title XVIII of the Social Security Act (SSA) (42 U.S.C. 1395 et seq.) by adding a new § 1899, which directs the Secretary of the Department of Health and Human Services (HHS) to establish a Medicare shared savings program that promotes accountability for care of Medicare beneficiaries, improves the coordination of Medicare fee-fo--service items and services, and encourages investment in infrastructure and redesigned care processes for high quality and efficient service delivery. Under § 1899(b)(1) of the SSA, groups of health care service providers and suppliers that have established a mechanism for shared governance and that meet criteria specified by HHS are eligible to participate as ACOs under the program.

Section 1899(b)(1) of the SSA provides examples of groups of service providers and suppliers that may form an ACO, including (i) physicians and other health care practitioners (ACO professionals) in a group practice, (ii) a network of individual practices, (iii) a partnership or joint venture arrangement between hospitals and ACO professionals, and (iv) a hospital employing ACO professionals. ACOs eligible to participate in the Shared Savings Program will manage and coordinate care for their assigned Medicare fee-for-service beneficiaries. Health care service providers and suppliers participating in an ACO will continue to receive Medicare fee-for-service

payments in the same manner as such payments would otherwise be made. In addition, an ACO that meets quality performance standards established by HHS and demonstrates that it has achieved savings against an appropriate benchmark of expected average per capita Medicare fee-for-service expenditures will be eligible to receive payments for Medicare shared savings (Shared Savings Program payments) under § 1899(d)(2) of the SSA. Section 1899(i) of the SSA also authorizes the use of other payment models that the HHS Secretary determines will improve the quality and efficiency of items and services for Medicare.

Section 1899(b)(2) of the SSA establishes the following requirements for an ACO to participate in the Shared Savings Program:

(1) The ACO shall be willing to become accountable for the quality, cost, and overall care of the Medicare fee-for-service beneficiaries assigned to it.

(2) The ACO shall enter into an agreement with the HHS Secretary to participate in the Shared Savings Program for not less than a 3-year period.

(3) The ACO shall have a formal legal structure that would allow the organization to receive and distribute Shared Savings Program payments to participating providers of services and suppliers.

(4) The ACO shall include primary care ACO professionals that are sufficient for the number of Medicare fee-for-service beneficiaries assigned to the ACO under § 1899(c). At a minimum, the ACO shall have at least 5,000 such beneficiaries assigned to it under § 1899(c) to be eligible to participate in the Shared Savings Program.

(5) The ACO shall provide the HHS Secretary with such information regarding ACO professionals participating in the ACO as the Secretary determines necessary to support the assignment of Medicare fee-for-service beneficiaries to an ACO, the implementation of quality and the other reporting requirements under § 1899(b)(3), and the determination of Shared Savings Program payments.

(6) The ACO shall have in place a leadership and management structure that includes clinical and administrative systems.

(7) The ACO shall define processes to promote evidence-based medicine and patient engagement, report on quality and cost measures, and coordinate care, such as through the use of telehealth, remote patient monitoring, and other such enabling technologies.

(8) The ACO shall demonstrate to the HHS Secretary that it meets patient-centeredness criteria specified by the Secretary, such as the use of patient and caregiver assessments or the use of individualized care plans.

On November 2, 2011, the Centers for Medicare & Medicaid Services (CMS), the agency within HHS that administers the Medicare program, published final regulations addressing § 1899 of the SSA (76 FR 67802). The regulations contain specific eligibility criteria for entities to qualify as ACOs under the Shared Savings Program and describe quality measures, reporting requirements, and monitoring by CMS. The regulations require the ACO to be a legal entity formed under applicable State, Federal, or Tribal law, identified by a taxpayer identification number, and authorized in each State in which it operates for purposes of (1) receiving and distributing shared savings; (2) repaying shared losses or other monies determined to be owed to CMS; (3) establishing, reporting, and ensuring provider compliance with health care quality criteria, including quality performance standards; and (4) fulfilling other ACO functions identified in the regulations. The regulations

require an ACO to provide for meaningful participation in the composition and control of the ACO's governing body by ACO participants (or their designated representatives). In addition, the regulations generally require that the ACO's governing body include a Medicare beneficiary representative(s) served by the ACO who does not have a conflict of interest with the ACO.

The regulations require an ACO seeking to participate in the Shared Savings Program to submit a written application to CMS describing how the ACO plans to use and distribute any Shared Savings Program payments and how that plan would contribute to achieving the specific goals of the Shared Savings Program and the general aims of better care for individuals, better health for populations, and lower growth in expenditures.

Finally, consistent with the authorization in § 1899(i) of the SSA of alternative payment models, the regulations provide a "two-sided model" under which participating ACOs not only would be eligible to share in cost savings at higher rates but also would be required to repay losses resulting from spending that exceeds a benchmark of expected average per capita Medicare fee-for-service expenditures (Shared Savings Program losses).

Private Business Use of Tax-Exempt Bonds

Section 103(a) of the Code provides that, except as provided in § 103(b) of the Code, gross income does not include interest on any State or local bond. Section 103(b)(1) of the Code provides that § 103(a) of the Code shall not apply to any private activity bond that is not a qualified bond (within the meaning of section 141 of the Code).

Section 141(a) of the Code provides that the term "private activity bond" means any bond issued as part of an issue (1) that meets the private business use test and private security or payment test, or (2) that meets the private loan financing test.

Section 141(b)(1) of the Code provides generally that an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(6) of the Code defines "private business use" as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For this purpose, any activity carried on by a person other than a natural person must be treated as a trade or business use.

Section 1.141-3(a) of the Income Tax Regulations provides, in part, that the 10 percent private business use test of § 141(b)(1) of the Code is met if more than 10 percent of the proceeds of an issue is used in a trade or business of a nongovernmental person. For this purpose, the use of financed property is treated as the direct use of proceeds. Section 1.141-1(b) defines a nongovernmental person as a person other than a governmental person. Pursuant to § 1.141-1(b), a governmental person means a State, territory, a possession of the United States, the District of Columbia, or any political subdivision thereof, or any instrumentality of the foregoing. The United States and any agencies and instrumentalities thereof are not governmental persons.

Section 1.141-3(b)(1) provides that both actual and beneficial use by a nongovernmental person may be treated as private business use. In most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user as a result of ownership; actual or beneficial use of property pursuant to a lease, a management contract, or an incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract. Section 1.141-3(b)(7) provides that any other arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to the special legal entitlements described above results in private business use.

Section 1.141-3(b)(4)(i) provides generally that a management contract with respect to financed property may result in private business use of that property, based on all of the facts and circumstances. A management contract with respect to financed property generally results in private business use of that property if the contract provides for compensation for services rendered with compensation based, in whole or in part, on a share of net profits from the operations of the facility.

Section 1.141-3(b)(4)(ii) defines "management contract" as a management, service, or incentive payment contract between a governmental person and a service provider under which the service provider provides services involving all, a portion, or any function, of a facility. For example, a contract for the provision of management services for an entire hospital, a contract for management services for a specific department of a hospital, and an incentive payment contract for physician services to patients of a hospital are each treated as a management contract.

Section 1.141-3(b)(4)(iii) provides that certain arrangements described therein generally are not treated as management contracts that give rise to private business use. The described arrangements include (A) 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); and (B) 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 the hospital's facilities.

Section 141(e) of the Code provides, in part, that the term "qualified bond" includes a qualified 501(c)(3) bond if certain requirements stated therein are met.

Section 145(a) of the Code provides generally that the term "qualified 501(c)(3) bond" means any private activity bond issued as part of an issue if (1) all property that is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and (2) such bond would not be a private activity bond if (A) 501(c)(3) organizations were treated as governmental units with respect to their activities that do not constitute unrelated trades or businesses, determined by applying § 513(a) of the Code, and (B) §§ 141(b)(1) and (2) of the Code were applied by substituting "5 percent" for "10 percent" each place it appears and by substituting "net proceeds" for "proceeds" each place it appears. Section 150(a)(4) of the Code defines the term "501(c)(3) organization" to mean any organization described in § 501(c)(3) and exempt from tax under § 501(a) of the Code.

Section 1.145-2 provides that, with certain exceptions and modifications, §§ 1.141-0 through 1.141-15 apply to § 145(a) of the Code. Section 1.145-2(b) provides that, in applying §§ 1.141-0 through 1.141-15 to § 145(a), (1) references to governmental persons include 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under § 513(a) of the Code; (2) references to "10 percent" and "proceeds" in the context of the private business use test and the private security or payment test mean "5 percent" and "net proceeds", respectively; and (3) references to the private business use test in §§ 1.141-2 and 1.141-12 include the ownership test of § 145(a)(1) of the Code.

Rev. Proc. 97-13 sets forth conditions under which a management contract between a qualified user and a service provider does not result in private business use under § 141(b) of the Code. Rev. Proc. 97-13 also applies to determinations of the effect of such a management contract on whether a bond meets the test in § 145(a)(2)(B) of the Code. Section 3.07 of Rev. Proc. 97-13 defines "qualified user" as any State or local governmental unit as defined in § 1.103-1 or any instrumentality thereof. The term also includes a 501(c)(3) organization if the financed property is not used in an unrelated trade or business under § 513(a) of the Code. The term does not include the United States or any agency

or instrumentality thereof.

Section 5.01 of Rev. Proc. 97-13 provides that if the requirements of section 5 of Rev. Proc. 97-13 are satisfied a management contract does not itself result in private business use. In addition, the use of financed property, pursuant to a management contract meeting these requirements, is not private business use if that use is functionally related and subordinate to that management contract and that use is not, in substance, a separate contractual agreement (for example, a separate lease of a portion of the financed property).

Under section 5.02(1) of Rev. Proc. 97-13, the management 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(2) of Rev. Proc. 97-13 provides, for purposes of § 1.141-3(b)(4)(i) and Rev. Proc. 97-13, that compensation based on (a) a percentage of gross revenues (or adjusted gross revenues) of a facility or a percentage of expenses from a facility, but not both; (b) a capitation fee; or (c) a per-unit fee is generally not considered to be based on a share of net profits.

Section 5.02(3) of Rev. Proc. 97-13 provides, for purposes of § 1.141-3(b)(4)(i) and Rev. Proc. 97-13, that 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.

Section 5.03 of Rev. Proc. 97-13 provides that the management contract must be described in section 5.03(1), (2), (3), (4), (5), or (6). Section 5.03(4) describes periodic fixed fee and capitation fee arrangements in certain 5-year contracts. Section 5.03(5) describes per-unit fee arrangements in certain 3-year contracts. Section 5.03(6) describes percentage of revenue or expense fee arrangements in certain 2-year contracts.

SECTION 3. INTERIM GUIDANCE

01. Participation by Governmental Persons or Section 501(c)(3) Organizations in the Shared Savings Program through ACOs

The IRS understands that governmental persons (as defined in § 1.141-1(b)) and 501(c)(3) organizations typically will be participating in the Shared Savings Program through ACOs with nongovernmental persons. The IRS further understands that this participation may take a variety of forms, including membership in a nonprofit membership corporation, ownership of shares in a corporation, ownership of a partnership interest in a partnership, and ownership of a membership interest in an LLC.

Under the private business use test described above, participation by a user of a health care facility financed with tax-exempt bonds in the Shared Savings Program through an ACO that includes participants that are nongovernmental persons must be structured so as not to result in private business use of the facility. In addition, any 501(c)(3) organization using a facility financed with tax-exempt bonds must structure its participation in an ACO so that its participation neither jeopardizes its 501(c)(3) status nor causes it to be engaged in an unrelated trade or business under § 513(a) of the Code.

The participation of a qualified user (as defined in section 3.07 of Rev. Proc. 97-13) in the Shared

Savings Program through an ACO in itself will not result in private business use of the tax-exempt bond financed facility if all of the following conditions are met:

The terms of the qualified user's participation in the Shared Savings Program through the ACO (including its share of Shared Savings Program payments or losses and expenses) are set forth in advance in a written agreement negotiated at arm's length.

CMS has accepted the ACO into, and has not terminated the ACO from, the Shared Savings Program.

The qualified user's share of economic benefits derived from the ACO (including its share of Shared Savings Program payments) is proportional to the benefits or contributions the qualified user provides to the ACO. If the qualified user receives an ownership interest in the ACO, the ownership interest received is proportional and equal in value to its capital contributions to the ACO and all ACO returns of capital, allocations, and distributions are made in proportion to ownership interests.

The qualified user's share of the ACO's losses (including its share of Shared Savings Program losses) does not exceed the share of ACO economic benefits to which the qualified user is entitled.

All contracts and transactions entered into by the qualified user with the ACO and the ACO's participants, and by the ACO with the ACO's participants and any other parties, are at fair market value.

The qualified user does not contribute or otherwise transfer the property financed with tax-exempt bonds to the ACO unless the ACO is an entity that is a governmental person, or in the case of qualified 501(c)(3) bonds, either a governmental person or a 501(c)(3) organization.

.02 Management Contracts

It is anticipated, further, that qualified users of hospitals or other health care facilities that are financed with tax-exempt bonds will enter into management contracts (as defined in § 1.141-3(b)(4)(ii)) with nongovernmental persons to provide health care services at the qualified users' facilities that will take into account the quality performance standards and Medicare fee-for-service expenditures relevant to participation in the Shared Savings Program. Under the private business use test described above, a qualified user must structure its management contracts with respect to those facilities to avoid private business use.

This notice amplifies the permitted productivity rewards and the types of permissible arrangements described in Rev. Proc. 97-13 that do not result in private business use, provided all other requirements of section 5 of Rev. Proc. 97-13 are met.

(1) Section 5.02(3) of Rev. Proc. 97-13 is amplified to add the following text at the end:

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:

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

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.

(2) Section 5.03 of Rev. Proc. 97-13 is amplified to revise the first sentence and add new section 5.03(7) at the end as follows:

.03 Permissible Arrangements. The management contract must be described in section 5.03(1), (2), (3), (4), (5), (6), or (7).
* * * * *

(7) Arrangements in certain 5-year contracts. 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.

SECTION 4. REQUEST FOR PUBLIC COMMENTS

The IRS expects to issue guidance concerning management contracts for purposes of §§ 141 and 145(a)(2)(B) of the Code. That guidance may address issues relevant to participation in the Shared Savings Program. To help inform that guidance, the Treasury Department and the IRS solicit comments on the guidance that is described in section 3 of this notice and on further guidance needed to facilitate participation in the Shared Savings Program by qualified users of tax-exempt bond financed facilities through ACOs.

Public comments should be submitted in writing on or before January 22, 2015. Comments should be sent to the following address:

Internal Revenue Service
CC:PA:LPD:PR (Notice 2014-67)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
Comments may be hand delivered to:

CC:PA:LPD:PR (Notice 2014-67)
Courier’s Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Comments may also be sent electronically to notice.comments@irscounsel.treas.gov. Please include “Notice 2014-67” in the subject line.
All comments will be available for public inspection.

SECTION 5. APPLICABILITY DATES

Section 3.01 of this notice applies to bonds subject to § 141 or § 145(a)(2)(B) of the Code sold on or after January 22, 2015. Section 3.01 may be applied to bonds sold before January 22, 2015 that are subject to § 141 or § 145(a)(2)(B) of the Code.

Section 3.02 of this notice applies to contracts entered into, materially modified, or extended (other than pursuant to a renewal option) on or after January 22, 2015. Section 3.02 may be applied to contracts entered into before January 22, 2015.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97-13 is amplified by this notice.

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Johanna Som de Cerff of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice contact Johanna Som de Cerff on (202) 317-6980 (not a toll-free call).

IRS Issues Guidance on Facilities Financed With Tax-Exempt Bonds.

The IRS has provided guidance for determining whether a state or local government entity or an exempt organization that benefits from tax-exempt bond financing will be considered to have private business use of its bond-financed facilities as a result of participating in the Medicare Shared Savings Program through an accountable care organization.

IRS Issues Guidance on ACOs.

The Internal Revenue Service today released Notice 2014-67, which provides guidance for determining whether a State or local government entity or a 501(c)(3) organization will be considered to have private business use of its tax-exempt bond-financed facilities due to its participation in an “accountable care organization” and guidance regarding certain management contracts that do not result in private business use.

IRS Notice 2014-67 on Private Business Use of Tax-Exempt Bond Financed Facilities can be seen here.

IRS LTR: Income Exempt as Exercise of Essential Government Function.

The IRS ruled that the income of an authority that was formed by a county and a state political subdivision and that receives revenues from the sale of electrical energy is derived from the exercise of an essential governmental function and that the authority is a constituted authority under reg. section 1.103-1(b).

Citations: LTR 201442037

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *, ID No. * * *
Telephone Number: * * *

Index Number: 115.00-00, 103.02-02
Release Date: 10/17/2014
Date: July 11, 2014

Refer Reply To: CC:FIP:05 – PLR-146092-13

LEGEND:

Act = * * *
Agreement = * * *
Authority = * * *
State = * * *
County = * * *
Agency = * * *
Project = * * *
Statutes = * * *
x = * * *

Dear * * *:

This letter is in response to your request for rulings that (1) the Authority's income is derived from the exercise of an essential governmental function and will accrue to the State or a political subdivision thereof for purposes of § 115(1) of the Internal Revenue Code; and (2) the Authority is a constituted authority within the meaning of § 1.103-1(b) of the Income Tax Regulations.

FACTS AND REPRESENTATIONS

The County is a political subdivision of the State. The Agency was created by the Act as a body politic and corporate. The Agency is empowered by the Act to undertake any lawful act necessary to ensure sufficient water for the present and future beneficial use of the land and inhabitants within County. The Authority represents that Agency is a political subdivision of the State.

The Agency owns the Project, which consists of hydroelectric power plants, dams, tunnels, and public recreational facilities. The Agency operates the Project pursuant to a license issued by the Federal Energy Regulatory Commission (FERC).

Pursuant to the Statutes, the County and the Agency entered into the Agreement creating the Authority. The Agreement authorizes the Authority to exercise the powers of each of the County and the Agency. The purpose of the Authority is to provide financing for costs required by the FERC licensing process, to approve electrical energy and related services contracts, and to distribute revenues from those contracts. Among the powers the Authority can exercise in furtherance of these purposes are the powers to acquire, to lease, and to sell property. The Agreement and the Statutes authorize the Authority to issue bonds.

The County and the Agency are the sole members of the Authority. The Authority is governed by a x member board of directors. Half of those directors are members of the County's board of directors, and half are members of the Agency's board of directors.

The Agreement provides that the Authority receives all revenues from the sale of electrical energy produced by the Project. The Agreement also establishes priorities for the expenditure and distribution of those revenues. Under the Agreement, revenues must first be spent on basic operation and maintenance of the Project, compliance with contractual and regulatory requirements, maintenance of operating reserves, and repayment of debt. After those costs are paid, revenues

must then be spent on additions and betterments, such as major improvements, emergency reserves, and sinking funds for replacements. Finally, any remaining revenues may be distributed equally to the County and the Agency. Upon dissolution, the Authority's property will be divided between the County and the Agency.

LAW AND ANALYSIS

Income under § 115

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

In Revenue Ruling 77-261, 1977-2 C.B. 45, income from an investment fund, established by a state under a written declaration of trust for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling explains that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct.

In Revenue Ruling 90-74, 1990-2 C.B. 34, the income of an organization formed, funded, and operated by political subdivisions to pool various risks arising from their obligations regarding public liability, workers' compensation, or employees' health was excludable from gross income under § 115. In this ruling, private interests did not participate in the organization, nor did they benefit more than incidentally from the organization.

The Authority reviews and approves contracts for the sale of electrical energy generated by the Project, distributes revenues from those contracts, and provides financing for costs required by the FERC licensing process. Engaging in such activities on behalf of the County and the Agency constitutes the performance of essential governmental functions. See Rev. Rul. 90-74 and Rev. Rul. 77-261.

All of the Authority's income accrues to the County and the Agency, which are political subdivisions of the State. Revenues exceeding amounts necessary for the operation, maintenance, and support of the Project and for additions and betterments to the Project are distributed to the County and the Agency. Upon the Authority's dissolution, all of its property will be divided between the County and the Agency. No private interests participate in, or benefit more than incidentally from, the operation of the Authority, other than as providers of goods or services or purchasers of electrical energy. See Rev. Rul. 90-74. We conclude, therefore, that the Authority's income is derived from the exercise of an essential governmental function and will accrue to the State or a political subdivision thereof for purposes of § 115(1).

Constituted Authority

Section 103(a) provides that gross income does not include interest on any state or local bond. Treas. Reg. § 1.103-1(a) provides in part that interest upon obligations of a state, territory, possession of the United States, the District of Columbia, or any political subdivision thereof is not includable in gross income. Treas. Reg. § 1.103-1(b) provides in part that obligations issued by or on

behalf of any such governmental unit by a constituted authority empowered to issue such an obligation are the obligations of such a unit.

Revenue Ruling 57-187, 1957-1 C.B. 65, holds that bonds issued by an entity are considered issued on behalf of a political subdivision of the state under the following conditions: (1) the issuance of bonds is authorized by a specific state statute; (2) the bond issuance has a public purpose; (3) the governing body of the entity is controlled by the political subdivision; (4) the entity has the power to acquire, lease, and sell property and issue bonds in furtherance of its purposes; (5) earnings do not inure to the benefit of private persons; and (6) upon dissolution, title to all bond-financed property reverts to the political subdivision.

The Agreement and the Statutes authorize the Authority to issue bonds, and its issuances are for the public purpose of financing costs required by the FERC licensing process. The County and the Agency, which are political subdivisions, control the Authority's governing board. The Agreement empowers the Authority to acquire, lease, and sell property and to issue bonds in furtherance of its public purposes. Earnings of the Authority inure solely to the benefit of the County and the Agency. Upon the Authority's dissolution, all of its property reverts to the County and the Agency. We conclude, therefore, that the Authority is a constituted authority within the meaning of Treas. Reg. § 1.103-1(b).

CONCLUSION

Based on the information submitted and representations made, we conclude that (1) the Authority's income is derived from the exercise of an essential governmental function and will accrue to the State or a political subdivision thereof for purposes of § 115(1); and (2) the Authority is a constituted authority within the meaning of Treas. Reg. § 1.103-1(b).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James A. Polfer
Branch Chief
(Financial Institutions & Products)

IRS LTR: Historic Preservation Charity's Agreement Won't Jeopardize Exemption.

The IRS ruled an historic preservation charity's tax-exempt status won't be adversely affected as a result of its preservation agreement with a section 501(c)(7) organization for the restoration of a building.

Citations: LTR 201442066

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *

UIL: 501.03-00
Release Date: 10/17/2014
Date: July 24, 2014

Employer Identification Number: * * *

LEGEND:

Club = * * *
Building = * * *

Dear * * *:

This is in response to your letter dated December 6, 2013 in which you requested certain rulings with respect to I.R.C. § 501(c)(3).

BACKGROUND

You have been recognized as a publicly supported charitable organization exempt under § 501(c)(3) of the Code and classified within the meaning of §§ 509(a)(1) and 170(b)(1)(A)(vi). Your Articles of Incorporation list your specific charitable and educational purposes as dedicated to preserving and memorializing the history and architecture of the city in which you are located; to research, restore and insure the preservation of buildings, land, homes or other articles which may relate to the history and architecture of the city.

The Club is a private social club that has been recognized as an organization exempt under § 501(c)(7). The Club currently owns and occupies the Building, which is located within the city, which has been recognized as a historic building, and which has been listed on the National Register of historic buildings and landmarks. The Building is over 150 years old and occupies one square block. You executed a written Preservation Agreement with the Club, under which you raised public funds to be used for the restoration of the Building in accordance with the Secretary of the interior's Standards for the Treatment of Historic Properties and the Secretary of the Interior's Guidelines for Preserving, Rehabilitating, Restoring and Restructuring Historic Buildings (hereinafter, "The Secretary of the Interior's Standards and Guidelines."). Any restoration or projects using your funds on the Building would require your prior approval before such projects could be started.

You represent that currently the interior of the Building, including the Designated Interior Historic Spaces, are primarily accessible only to Club members, with the Building primarily used by the Club. Scholars and other educational or architectural groups interested in the Building's historic character have access to the interior portions of the Building only when sponsored by a Club member or holders of privilege cards (spouses and widows/widowers of deceased members). However, persons who attend seminars, meetings, receptions and cultural events in the Building, which are scheduled pursuant to approval by the Club, have access to the interior portions of the Building during these

events.

You represent that the Preservation Agreement would increase public access to the Designated Interior Historic Spaces. Specifically, the Amended Agreement as modified by your submission provides for increased public access in the following manner:

The general public will be given the opportunity to tour the Designated Historic Spaces on a given day twice every month throughout the year

Organizations of architects, engineers, historians or others whose professional or academic pursuits are concerned with the creation, preservation or restoration of historic buildings may arrange to tour the Designated Historic Spaces at a time mutually agreed to by the Club and the organizations.

No member sponsorship will be required to participate in the tours described above. The Club will accept reservations for such tours by telephone or on the Internet.

In addition, the Club agrees to make virtual tours available through the Internet via video and photographs. These tours will consist of interactive tours, whereby viewers will have full control of the viewing of a majority of the rooms and the rooms will contain a voice over tour to accompany the images.

This availability of these viewings will be displayed prominently on your web site, along with the ability for the public to make reservations for tours either via your web site or via telephone. Also in your submission, you make it clear that there will be an unlimited number of tours for professional groups interested in historic preservation and restoration.

Finally, your Agreement with Club constitutes a Covenant on this property that will run with the land for any future purchasers of the Building. You have recorded this Covenant in the local property Register.

RULING REQUESTED

Your agreement to the terms of the Preservation Agreement, your performance of those terms, and the Club's acceptance of contributions to be utilized to defray the costs of the preservation and restoration in a manner consistent with the Preservation Agreement will not adversely affect your tax exemption under § 501(c)(3).

LAW

I.R.C. § 501(c)(3) provides, in part, for the exemption from Federal income tax of organizations that are organized and operated exclusively for charitable purposes, provided no part of the net earnings of the organization inures to the benefit of any private individual or shareholder.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides, in part, that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such purposes described in § 501(c)(3), but will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides, in part, that an organization is not operated exclusively for exempt purposes "unless it serves a public, rather than a private, interest," Thus, it is necessary for an organization to establish that "it is not operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term charity includes, but is not limited to, "erection or maintenance of public buildings, monuments or works."

Rev. Rul. 75-470, 1975-2 C.B. 207, describes a nonprofit organization that was formed to promote an appreciation of history through the acquisition, restoration, and preservation of buildings having special historical or architectural significance. After restoration was completed, the buildings were open to the general public for viewing. The organization was financed with admission fees to the restored buildings. The Service held that "[t]he organization is carrying on activities similar to those of a museum and is educational and charitable within the meaning of § 501(c)(3)."

Rev. Rul. 86-49, 1986-14 I.R.B. 7, describes an organization that was formed for the purpose of preserving the historical and/or architectural character of a community through the acquisition, restoration, and subsequent sale of historically and/or architecturally significant properties, subject to restrictive covenants. The Service held that the organization would qualify as an organization that is organized and operated exclusively for charitable or educational purposes under § 501(c)(3). The organization sold the properties to private parties in arms-length transactions subject to restrictive covenants designed to ensure public access to the properties; thereby, preserving the properties for the public's benefit. Where the properties were not visible from the public right of way "the organization provides in the restrictive covenants that visual access to the property will be made available to the public on a regular basis and the terms of the restrictive covenants contain prescribed conditions for such access, under the requirements set forth in Treas. Reg. § 1.170A-14(d)(5)(iv)."

In Better Business Bureau v. United States, 326 U.S. 279, 66 S.Ct. 112, (1945), the Supreme Court ruled that an organization that is tax-exempt as an educational institution must be devoted to educational purposes exclusively, and the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes.

In Columbia Park and Recreation Association v. Commissioner, 88 T.C. 1 (1987), an organization that was organized to develop and operate utilities, systems, services and facilities for the common good and the social welfare of the homeowner's association within the planned community, sought tax-exempt status under § 501(c)(3) of the Code. The Tax Court found that the majority of services and facilities the organization provided were only offered to association members, with only a small fraction of those services actually offered to the general public, with the public paying higher rates than association members for the same services. The Tax Court held that the organization was not organized or operated as charitable within the meaning of § 501(c)(3).

ANALYSIS

You intend to engage in the activities outlined in your Preservation Agreement and expend public funds for the repair, restoration and preservation of certain interior spaces of the Club's Building that have been labeled as "Designated Historic Interior Spaces." The issue therefore arises whether the public is given substantial access to the Designated Interior Historic Spaces to justify your expenditures of public monies to restore these spaces, which are currently owned and utilized by a private social club, so as not to violate your tax-exempt status under § 501(c)(3) of the Code. If the public does not have substantial access to these areas for viewing, then you would have expended public funds for the private benefit of the Club and its members, in violation of your tax-exempt status under § 501(c)(3).

Under § 501(c)(3), an organization that is exempt from Federal income tax must be both organized and operated exclusively for charitable or educational purposes, and must provide that no part of the

net earnings of the organization inures to the benefit of any private shareholder or individual. The term charity includes, but is not limited to, "erection or maintenance of public buildings, monuments or works." Section 1.501(c)(3)-1(d)(2).

An organization is not organized and operated exclusively for charity "unless it serves a public rather than a private interest" Section 1.501(c)(3)-1(d)(1)(ii). The presence of private benefit, if substantial in nature, will destroy the organization's tax-exempt status regardless of whether the organization has other charitable purposes or activities; however, where private benefit is incidental to the accomplishment of an organization's charitable or educational purposes, it will not prevent the organization from being described in § 501(c)(3) of the Code. See Section 1.501(c)(3)-1(c)(1); Better Business Bureau, 326 U.S. 279.

Several court cases and revenue rulings have focused on the issue of whether the public's access to an organization's facilities is substantial. In Columbia Park and Recreation, 88 T.C. 1, the Tax Court denied an organization's 501(c)(3) status on the grounds that the public's access to the organization's facilities were not substantial. The Court found that only a small percentage of the organization's total assets, and a rather limited percentage of the organization's total budget, were actually spent on facilities and services that were open to the public, with the remainder of the organization's assets and budget spent on facilities only open to the organization's members. This is contrasted with Rev. Rul. 75-470, supra, in which the organization's facilities were deemed to be substantially open to the public. In Rev. Rul. 75-470, an organization qualified for tax-exemption under § 501(c)(3) for its activities of acquiring and restoring buildings having historical and/or architectural significance. After restoration was completed, the buildings were open to the public for viewing. The Service found that the public's access to the interiors of the buildings was substantial because the organization was operating the buildings as museum exhibits, which were open regularly for public viewing. Furthermore, in Rev. Rul. 86-49, supra, the Service held that an organization that was formed for the purpose of restoring historical and/or architecturally significant buildings and subsequently selling the same buildings was sufficient to qualify the organization under § 501(c)(3) because the buildings were sold with restrictive covenants that permitted substantial public access to the buildings.

In Rev. Rul. 86-49, supra, the charitable organization sold properties subject to restrictive covenants designed exclusively to preserve and to allow for public viewing of the historical and/or architecturally significant properties. Where the properties were not visible from the public right of way "the organization provides in the restrictive covenants that visual access to the property will be made available to the public on a regular basis and the terms of the restrictive covenants contain prescribed conditions for such access, under the requirements set forth in section 1.170A-14(d)(5)(iv)." Id. Specifically, § 1.170A-14(d)(5)(iv) provides the following:

Where the historic land area or certified historic structure which is the subject of the donation is not visible from a public way (e.g., the structure is hidden from view by a wall or shrubbery, the structure is too far from the public way, or interior characteristics and features of the structure are the subject of the easement), the terms of the easement must be such that the general public is given the opportunity on a regular basis to view the characteristics and features of the property which are preserved by the easement to the extent consistent with the nature and condition of the property.

Factors to be considered in determining the type and amount of public access required under paragraph (d)(5)(iv)(A) of this section include the historical significance of the donated property, the nature of the features that are the subject of the easement, the remoteness or accessibility of the site of the donated property, the possibility of physical hazards to the public visiting the property (for example, an unoccupied structure in a dilapidated condition), the extent to which public access

would be an unreasonable intrusion on any privacy interests of individuals living on the property, the degree to which public access would impair the preservation interests which are the subject of the donation, and the availability of opportunities for the public to view the property by means other than visits to the site.

As a result of these restrictive covenants, the Service held in Rev. Rul. 86-46, supra, that the public was ensured substantial access to the historical and/or architecturally significant buildings, resulting in the organization's purpose qualifying for tax-exemption under § 501(c)(3).

Rev. Rul. 86-49, supra, references § 1.170A-14(d)(5)(iv) to determine whether the public's access to the property is substantial, given the nature and condition of the property. Although § 1.170A-14(d)(5)(iv) pertains to the issue of public benefit from the standpoint of whether the donor of a constructive easement in a historic and/or architecturally significant building has permitted substantial public access to the building to allow the donor a charitable deduction, these same factors, according to Rev. Rul. 86-49, are germane to the evaluation of public benefit from the standpoint of a tax-exempt organization that receives the donated conservation easement and is required to expend public funds to repair, restore, and maintain the historical and/or architecturally significant buildings comprising the conservation easement. In Rev. Rul. 86-49, the buildings were sold to private owners with restrictive covenants, consistent with § 1.170A-14(d)(5)(iv), to guarantee substantial public access. Absent these restrictive covenants guaranteeing public access, it would be difficult for the organization to claim that it was fulfilling a charitable purpose if public funds were used to restore historical and/or architecturally significant buildings primarily for the private benefit of the property owners.

Section 1.170A-14(d)(5)(iv) references Example (1) as an example of what facts constitute substantial public access to the exterior and interior facade of a building. Example (1) describes a donation by A of an easement to the exterior and interior of his Victorian period home that he and his family live in. The view of A's home is obscured by a high stone wall. The easement provides that the house may be opened to the general public from 10:00 a.m. to 4:00 p.m. on one Sunday in May and one Sunday in November each year for house and garden tours. The donee organization is given the right to photograph the exterior and interior of the house for use in publications and to permit persons affiliated with educational organizations, professional architectural associations, and historical societies to make appointments to study the property. In this example, the regulations concluded that the two opportunities for public visits per year, when combined with both the ability of the general public to view the subject of the easement through photography and the opportunity for scholarly study of the property on a reasonable basis, coupled with the fact that the house is used as a family residence, enabled the donation to satisfy the requirement of public access.

The transaction you wish to engage in pursuant to the Preservation Agreement is similar to Example (1) in § 1.170A-14(d)(5)(iv). The subject of your Preservation Agreement is the "Designated Interior Historic Spaces" of the Building. As in Example (1), your Preservation Agreement provides that persons affiliated with educational organizations, professional architectural associations, and historical societies have unlimited opportunities to make appointments to study the Building's interior. Furthermore, as in Example (1), your Preservation Agreement provides the public the opportunity to view images of the Building's interior via a virtual tour available on the Club's internet website. However, in several respects, your Preservation Agreement goes beyond the public access described in Example (1). Expanding on Example (1), which provided public access to the historic building twice a year as part of house and gardens tours, your Preservation Agreement provides the public with the opportunity to view the interior of the Building twice a month throughout the year. Furthermore, your Preservation Agreement establishes both a telephone and an internet reservation system, expediting the public's ability to schedule visits to gain access to the

interior of the Building. Furthermore, as in Rev. Rul. 86-49, supra, you also provide that the provision of funds by you is subject to a restrictive covenant that will be recorded in the local registry. As such, these conditions create sufficient public access to the Designated Interior Historic Spaces of the Building, with any private benefit to the Club and its members being incidental.

RULING

Your agreement to the terms of the Preservation Agreement, your performance of those terms, and the Club's acceptance of contributions to be utilized to defray the costs of the preservation and restoration in a manner consistent with the Preservation Agreement will not adversely affect your tax exemption under § 501(c)(3).

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Specifically, this ruling does not reach any conclusion as to the qualifying distribution status of your proposed transfer under § 4942(g)(3). Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager, Exempt Organizations

Technical
Enclosure
Notice 437

IRS LTR: Nonprofit Corporation's Retirement Plan Is a Church Plan.

The IRS ruled that a retirement plan established by a tax-exempt nonprofit corporation that maintains a residential center for girls as a ministry of a religious order is a church plan under section 414(e).

Citations: LTR 201442072

U.I.L 414.08-00

Date: July 21, 2014

Refer Reply To: SE:T:EP:RA:T3

Attention: * * *

LEGEND:

Religious Order A = * * *
Leader B = * * *
Church C = * * *
Board D = * * *
Entity E = * * *
State F = * * *
Plan X = * * *
Directory Z = * * *

Dear * * *:

This is in response to your request dated September 30, 2013, as supplemented by correspondence dated February 4, 2014, April 14, 2014, and May 7, 2014, submitted on behalf of Entity E by its authorized representative, concerning whether Plan X qualifies as a church plan under section 414(e) of the Internal Revenue Code (Code).

The following facts and representations have been submitted under penalty of perjury in support of the ruling requested:

Entity E is a non-profit corporation organized under the laws of State F. Entity E is a ministry of Religious Order A and maintains a residential center for girls. Religious Order A is a pontifical/apostolic order directly under the jurisdiction of the highest levels of authority of Church C. Religious Order A's constitution is filed with the highest level of authority of Church C, and the organization serves in a diocese at the pleasure of the local bishop of Church C. The primary apostolate of Religious Order A is to work with women in need. As such, its ministries include providing shelter to victims of domestic abuse; counseling for troubled teenaged girls; day care for children and adults; nursing and rehabilitative care for the ill, elderly, and people with AIDS. It also provides teaching and religious education in English and Spanish-speaking parishes.

Entity E is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). Entity E is listed in Directory Z, the directory for Church C.

Entity E was founded by Religious Order A. Under its Articles of Incorporation, the sole member of Entity E is Leader B, a top official of Religious Order A. Entity E has a two-tier management structure. It's board of directors is elected by Religious Order A, and consists only of members of Religious Order A. Entity E also has a local board of trustees which oversees Entity E's daily operations. Entity E's board of trustees, Board D, is either appointed or approved by Leader B, with any vacancies filled by the board itself from a pool of potential trustees approved by Leader B. Leader B also has the authority to remove members of Board D. Leader B has the authority to adopt the bylaws of Entity E, and to establish and change the purposes, mission statement and other values statements of Entity E. Leader B also has the authority to approve various types of corporate actions, including the budget, expenditures over a certain amount, and the purchase, sale, lease, or encumbrance of real estate.

Effective November 1, 1987, Board D of Entity E established Plan X, a retirement plan. Plan X has been amended and restated from time to time thereafter. All benefit accruals under the Plan were frozen effective February 1, 2005. Entity E is the only participating employer and it is the administrator of Plan X. You represented that Entity E currently funds Plan X but Religious Order A may also fund if necessary.

You represented that no election has been made at any time under Section 410(d) of the Code. You also represented that none of the employees of Entity E are or can be considered employed in connection with one or more unrelated trades or businesses within the meaning of Section 513 of the Code.

On April 2, 2014, Board D established a Pension Committee to administer Plan X and to serve as trustee of the plan. The Pension Committee is appointed by Board D, and consists primarily of members of Religious Order A. The Pension Committee's principal purpose is the administration of Plan X.

In accordance with Revenue Procedure 2011-44, 2011-39 I.R.B. 446, notice to Plan participants and other interested persons with reference to Plan X was provided on July 26, 2013. This notice explained to participants of Plan X and other interested persons the consequences of church plan status.

Based on the above facts and representations, you request a ruling that Plan X qualifies as a church plan under section 414(e) of the Code.

Section 414(e)(1) of the Code generally defines a church plan as a plan established and maintained for its employees (or their beneficiaries) by a church or a convention or association of churches which is exempt from taxation under section 501 of the Code.

Section 414(e)(2) of the Code provides, in part, that the term "church plan" does not include a plan that is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513); or if less than substantially all of the individuals included in the plan are individuals described in section 414(e)(1) or section 414(e)(3)(B) (or their beneficiaries).

Section 414(e)(3)(A) of the Code provides that a plan established and maintained for its employees (or their beneficiaries) by a church or a convention or association of churches includes a plan maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association churches, if such organization is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(B) of the Code generally defines "employee" of a church or a convention or association of churches to include a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry, regardless of the source of his or her compensation, and an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501, and which is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(C) of the Code provides that a church or a convention or association of churches which is exempt from tax under section 501 shall be deemed the employer of any individual included

as an employee under subparagraph (B).

Section 414(e)(3)(D) of the Code provides that an organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

Section 414(e)(4)(A) of the Code provides that if a plan, intended to be a church plan, fails to meet one or more of the church plan requirements and corrects its failure within the correction period, then that plan shall be deemed to meet the requirements of this subsection for the year in which the correction was made and for all prior years. Section 414(e)(4(C)(i) of the Code provides, in pertinent part, that the term "correction period" means the period ending 270 days after the date of mailing by the Secretary of a notice of default with respect to the plan's failure to meet one or more of the church plan requirements.

Revenue Procedure 2011-44, 2011-39 I.R.S. 446, supplements the procedures for requesting a letter ruling under section 414(e) of the Code relating to church plans. The revenue procedure requires that plan participants and other interested persons receive a notice in connection with a letter ruling request under section 414(e) for a qualified plan, requires that a copy of the notice be submitted to the Internal Revenue Service (IRS) as part of the ruling request, and provides procedures for the IRS to receive and consider comments relating to the ruling request from interested persons.

In order for an organization that is not itself a church or convention or association of churches to have a qualified church plan, it must establish that its employees are employees or deemed employees of a church or convention or association of churches under section 414(e)(3)(B) of the Code by virtue of the organization's control by or association with the church or convention or association of churches. Employees of any organization maintaining a plan are considered to be church employees if the organization: 1) is exempt from tax under section 501 of the Code; 2) is controlled by or associated with a church or convention or association of churches; and 3) provides for administration or funding (or both) of the plan by an organization described in section 414(e)(3)(A) of the Code. To be described in section 414(e)(3)(A) of the Code, an organization must have as its principal purpose the administration or funding of the plan and must also be controlled by or associated with a church or convention or association of churches.

Entity E is a section 501(c)(3) organization established by Religious Order A. Religious Order A is a religious order directly under the jurisdiction of the highest level of authority of Church C. Religious Order A's constitution is filed with the highest levels of authority of Church C, and it serves in a diocese at the pleasure of the local bishop of Church C.

The leader of Religious Order A (Leader B) is the sole member of Entity E. The board of directors of Entity E is elected by Religious Order A, and the members of such board are all members of Religious Order A. Leader B retains control of Entity E's purposes and mission statement. The members of Board D, which oversees Entity E's daily operations, are either appointed or approved by Leader B, and Leader B must approve certain actions by Entity E, including its budget and expenditures over a certain amount. Entity E is a sponsored ministry of Religious Order A, and is committed to accepting and implementing the teachings of Church C. Entity E's staff and board members must conform to Church C's standards of ethics. Entity E is listed in Directory Z, the directory of Church C.

We therefore conclude that Entity E shares common religious bonds and convictions with Church C, and is thus associated with Church C. Entity E's employees are thus deemed to be employees of Church C for purposes of section 414(e).

Plan X is administered by a Pension Committee, which consists primarily of members of Religious Order A. The Pension Committee's principal purpose and function is the administration of Plan X. The members of the Pension Committee are appointed by Board D, whose members are either appointed or approved by Leader B, the head of Religious Order A. Religious Order A is a pontifical/apostolic order directly under the jurisdiction of the highest levels of authority of Church C, and which serves in the relevant diocese at the pleasure of the local bishop of Church C. Board D reports annually to Leader B and Leader B has the power to remove the members of Board D.

We therefore conclude that the Pension Committee is an organization associated with Church C, whose principal purpose or function is the administration of Plan X for the provision of retirement benefits for the deemed employees of a church or convention or association of churches. The Pension Committee thus constitutes an organization described in section 414(e)(3)(A) of the Code.

The Pension Committee was formally established on April 2, 2014. As provided under section 414(e)(4)(A) of the Code, where a plan fails to meet one or more of the church plan requirements and corrects its failure within the correction period, then that plan shall be deemed to meet the requirements of section 414(e) of the Code for the year in which the correction is made and for all prior years. The formal establishment of the Pension Committee to administer the Plan on April 2, 2014 was within the correction period of Plan X.

Therefore, with respect to your ruling request, we conclude that Plan X, is maintained by an Entity described in section 414(e)(3)(A) for the deemed employees of a church or convention or association of churches. Plan X thus qualifies as a church plan pursuant to section 414(e) of the Code.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations which may he applicable thereto.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representative. If you have any questions regarding this letter, please contact * * *, SE:T:EP:RA:T3, at * * *.

Sincerely yours,

Laura B. Warshawsky, Manager
Employee Plans Technical Group 3

Enclosures:
Deleted copy of ruling letter
Notice of Intention to Disclose

Proposed Regs Remove 36-Month Nonpayment Testing Period Rule.

The IRS has published proposed regulations (REG-136676-13) removing a rule under section 6050P that provides that the 36-month nonpayment testing period is an identifiable event requiring information reporting for discharge of indebtedness by some financial institutions and governmental entities.

Section 6050P generally requires an applicable entity to issue an information return if $600 or more of indebtedness is discharged during a calendar year. The applicable regulation lists eight identifiable events that trigger a reporting obligation, including the expiration of a 36-month nonpayment testing period. Under the 36-month rule, a rebuttable presumption arises that an identifiable event has occurred if a creditor does not receive a payment within the 36-month testing period.

Treasury and the IRS have expressed concerns that the rule creates confusion for taxpayers and doesn't increase tax compliance by debtors or give the IRS valuable third-party information that may be used to ensure taxpayer compliance. In November 2012 the IRS requested comments (Notice 2012-65) on whether to remove or modify the 36-month rule as an identifiable event for purposes of information reporting under section 6050P. All comments suggested removing or revising the 36-month rule. Several commentators expressed concern that the expiration of a 36-month nonpayment testing period doesn't necessarily coincide with an actual discharge of the indebtedness, which may confuse the debtor and, in some cases, create uncertainty for the creditor regarding whether it may lawfully continue to pursue the debt. Other commentators noted that the IRS's ability to collect tax on discharge of indebtedness income may be undermined if the actual discharge occurs in a different year from the year of information reporting.

In the preamble to the proposed regs, Treasury and the IRS said they agree that information reporting under section 6050P should generally coincide with the actual discharge of a debt and described the potential problems with reporting under the 36-month rule. Accordingly, the proposed regs remove the 36-month rule. The IRS declined to adopt suggested changes to the rule, explaining that they don't alleviate problems caused by the rule to debtors, creditors, and the IRS. The rule is proposed to be removed when final regs are published in the Federal Register. Comments and public hearing requests are due by January 13, 2015.

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Removal of the 36-month Non-payment Testing Period Rule

[4830-01-p]

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

RIN 1545-BM01

AGENCY: Internal Revenue Service (IRS), Treasury.
ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that will remove a rule that a deemed discharge of indebtedness for which a Form 1099-C, "Cancellation of Debt," must be filed occurs at the expiration of a 36-month non-payment testing period. The Department of the Treasury and the IRS are concerned that the rule creates confusion for taxpayers and does not increase tax compliance by debtors or provide the IRS with valuable third-party information that may be used to ensure taxpayer compliance. The proposed regulations will affect certain financial institutions and governmental entities.

DATES: Comments and requests for a public hearing must be received by January 13, 2015.
ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-136676-13), room 5203, Internal Revenue

Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:PR (REG-136676-13), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224. Alternatively, taxpayers may submit comments electronically via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-136676-13).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Hollie Marx, (202) 317-6844; concerning the submission of comments and requests for a public hearing, Oluwafunmilayo Taylor, (202) 317-6901 (not toll-free calls).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations to amend certain Income Tax Regulations (26 CFR Part 1) issued under section 6050P of the Internal Revenue Code (Code), which provide that the 36-month non-payment testing period is an identifiable event triggering an information reporting obligation for discharge of indebtedness by certain entities. The proposed regulations would remove the 36-month non-payment testing period as an identifiable event.

Statutory Provisions

Section 61(a)(12) provides that income from discharge of indebtedness is includible in gross income. Section 6050P was added to the Code by section 13252 of the Omnibus Budget Reconciliation Act of 1993, Public Law 103-66 (107 Stat. 312, 531-532 (1993)). Section 6050P was enacted in part "to encourage taxpayer compliance with respect to discharged indebtedness" and to "enhance the ability of the IRS to enforce the discharge of indebtedness rules." H.R. Rep. No. 103-111, at 758 (1993). As originally enacted, section 6050P generally required applicable financial entities (generally financial institutions, credit unions, and Federal executive agencies) that discharge (in whole or in part) indebtedness of $600 or more during a calendar year to file information returns with the IRS and to furnish information statements to the persons whose debt is discharged. In addition to other information prescribed by regulations, an applicable financial entity is required to include on the information return the debtor's name, taxpayer identification number, the date of the discharge, and the amount discharged. See 26 U.S.C. 6050P(a) (1994).

The Debt Collection Improvement Act of 1996 (1996 Act), Public Law 104-134 (110 Stat. 1321, 1321-368 through 1321-369 (1996)) was enacted on April 26, 1996. Section 31001(m)(2)(B)(i) and (ii) of the 1996 Act amended section 6050P to expand the reporting requirement to cover "applicable entities," which includes any executive, judicial, or legislative agency, not just federal executive agencies, and any previously covered applicable financial entity. Effective for discharges of indebtedness occurring after December 31, 1999, section 533(a) of the Ticket to Work and Work Incentives Improvement Act of 1999 (1999 Act), Public Law 106-170 (113 Stat. 1860, 1931 (1999)), added subparagraph (c)(2)(D) to section 6050P, to further expand entities covered by the reporting requirements to include any organization the "significant trade or business of which is the lending of money."

On April 4, 2000, the IRS released Notice 2000-22 (2000-1 CB 902) to provide penalty relief to organizations that were newly made subject to section 6050P by the 1999 Act (organizations with a significant trade or business of lending money and agencies other than Federal executive agencies). The relief applied to penalties for failure to file information returns or furnish payee statements for discharges of indebtedness occurring before January 1, 2001. On December 26, 2000, the IRS released Notice 2001-8 (2001-1 CB 374) to extend the penalty relief for organizations described in

Notice 2000-22 for discharges of indebtedness that occurred prior to the first calendar year beginning at least two months after the date that appropriate guidance is issued.

Regulatory History

On December 27, 1993, temporary regulations under section 6050P relating to the reporting of discharge of indebtedness were published in the Federal Register (TD 8506) (58 FR 68301). The temporary regulations provided that an applicable financial entity must report a discharge of indebtedness upon the occurrence of an identifiable event that, considering all the facts and circumstances, indicated the debt would never have to be repaid. The temporary regulations provided a non-exhaustive list of three identifiable events that would give rise to the reporting requirement under section 6050P: (1) a discharge of indebtedness under title 11 of the United States Code (Bankruptcy Code); (2) an agreement between the applicable financial entity and the debtor to discharge the indebtedness, provided that the last event to effectuate the agreement has occurred; and (3) a cancellation or extinguishment of the indebtedness by operation of law. These regulations were effective for discharges of indebtedness occurring after December 31, 1993.

A concurrently published notice of proposed rulemaking (IA-63-93) (58 FR 68337) proposed to adopt those and other rules in the temporary regulations. Written comments were received in response to the notice of proposed rulemaking, and testimony was given at a public hearing held on March 30, 1994. In response to the comments and testimony, the IRS provided, in Notice 94-73 (1994-2 CB 553), interim relief from penalties for failure to comply with certain of the reporting requirements of the temporary regulations for discharges of indebtedness occurring before the later of January 1, 1995, or the effective date of final regulations under section 6050P.

On January 4, 1996, prior to the amendments made by the 1996 Act, final regulations relating to the information reporting requirements of applicable financial entities for discharges of indebtedness were published in the Federal Register (TD 8654) (61 FR 262) (1996 final regulations). The final regulations were generally effective for discharges of indebtedness occurring after December 21, 1996, although applicable financial entities at their discretion could apply the final regulations to any discharge of indebtedness occurring on or after January 1, 1996, and before December 22, 1996. Further, the preamble to these regulations provided that the temporary regulations and the interim relief provided in Notice 94-73 remained in effect until December 21, 1996. Finally, the 36-month non-payment testing period identifiable event would not occur prior to December 31, 1997. See § 1.6050P-1(b)(2)(iv)(C) of the 1996 final regulations.

In response to objections by commenters, the 1996 final regulations did not adopt the facts and circumstances test to determine whether a discharge of indebtedness had occurred and information reporting was required. Instead, the 1996 final regulations provided that a debt is deemed to be discharged for information reporting purposes only upon the occurrence of an identifiable event specified in an exhaustive list under § 1.6050P-1(b)(2), whether or not an actual discharge has occurred on or before the date of the identifiable event. See § 1.6050P-1(a)(1).

Section 1.6050P-1(b)(2) of the 1996 final regulations listed eight identifiable events that trigger information reporting obligations on the part of an applicable financial entity: (1) a discharge of indebtedness under the Bankrutpcy Code; (2) a cancellation or extinguishment of an indebtedness that renders the debt unenforceable in a receivership, foreclosure, or similar proceeding in a federal or state court, as described in section 368(a)(3)(A)(ii) (other than a discharge under the Bankruptcy Code); (3) a cancellation or extinguishment of an indebtedness upon the expiration of the statute of limitations for collection (but only if, and only when, the debtor’s statute of limitations affirmative defense has been upheld in a final judgment or decision in a judicial proceeding, and the period for appealing it has expired) or upon the expiration of a statutory period for filing a claim or

commencing a deficiency judgment proceeding; (4) a cancellation or extinguishment of an indebtedness pursuant to an election of foreclosure remedies by a creditor that statutorily extinguishes or bars the creditor's right to pursue collection of the indebtedness; (5) a cancellation or extinguishment of an indebtedness that renders a debt unenforceable pursuant to a probate or similar proceeding; (6) a discharge of indebtedness pursuant to an agreement between an applicable entity and a debtor to discharge indebtedness at less than full consideration; (7) a discharge of indebtedness pursuant to a decision by the creditor, or the application of a defined policy of the creditor, to discontinue collection activity and discharge debt; (8) the expiration of a 36-month non-payment testing period.

The first seven identifiable events are specific occurrences that typically result from an actual discharge of indebtedness. The eighth identifiable event, the expiration of a 36-month non-payment testing period, may not result from an actual discharge of indebtedness. The 36-month non-payment testing period was added to the final regulations in 1996 as an additional identifiable event in response to concerns of creditors that the facts and circumstances approach taken in the temporary and proposed regulations was unclear regarding the effect of continuing collection activity. Creditors proposed (among other things) that the final regulations require reporting after a fixed time period during which there had been no collection efforts.

Section 1.6050P-1(b)(2)(iv) of the 1996 regulations sets forth the 36-month non-payment testing period rule (the 36-month rule). Under that rule, a rebuttable presumption arises that an identifiable event has occurred if a creditor does not receive a payment within a 36-month testing period. The creditor may rebut the presumption if the creditor engaged in significant bona fide collection activity at any time within the 12-month period ending at the close of the calendar year or if the facts and circumstances existing as of January 31 of the calendar year following the expiration of the non-payment testing period indicate that the indebtedness has not been discharged. A creditor's decision not to rebut the presumption that an identifiable event has occurred pursuant to the 36-month rule is not an indication that it has discharged the debt. Concluding that the debts have, in fact, been discharged, some taxpayers may include in income the amounts reported on Forms 1099-C even though creditors may continue to attempt to collect the debt after issuing a Form 1099-C as required by the 36-month rule. See § 1.6050P-1(a)(1) and (b)(iv).

On October 25, 2004, final regulations reflecting the amendments to section 6050P(c) were published in the Federal Register (TD 9160) (69 FR 62181). These regulations describe circumstances in which an organization has a significant trade or business of lending money and provide three safe harbors under which organizations will not be considered to have a significant trade or business of lending money.

On November 10, 2008, final and temporary regulations were published in the Federal Register (TD 9430) (73 FR 66539) (2008 regulations) to amend the regulations under section 6050P to exempt from the 36-month rule entities that were not within the scope of section 6050P as originally enacted (organizations with a significant trade or business of lending money and agencies other than Federal executive agencies). The changes made by the 2008 regulations reduced the burden on these entities and protected debtors from receiving information returns that reported discharges of indebtedness from these entities before a discharge had occurred. The 2008 regulations also added § 1.6050P-1(b)(2)(v), which provided that, for organizations with a significant trade or business of lending money and agencies other than federal executive agencies that were required to file information returns pursuant to the 36-month rule in a tax year prior to 2008 and failed to file them, the date of discharge would be the first identifiable event, if any, described in § 1.6050P-1(b)(2)(i)(A) through (G) that occurs after 2007. On September 17, 2009, final regulations were published in the Federal Register (TD 9461) (74 FR 47728-01) adopting the 2008 regulations without change.

Notice 2012-65

Even after the amendments to the regulations in 2008 and 2009, concerns continued to arise about the 36-month rule, and taxpayers remained confused regarding whether the receipt of a Form 1099-C represents cancellation of debt that must be included in gross income. To address those concerns, in Notice 2012-65 (2012-52 IRB 773 (Dec. 27, 2012)), the Treasury Department and the IRS requested comments from the public regarding whether to remove or modify the 36-month rule as an identifiable event for purposes of information reporting under section 6050P. Ten comments were received, all recommending removal or revision of the 36-month rule. Several commenters generally expressed concerns that the expiration of a 36-month non-payment testing period does not necessarily coincide with an actual discharge of the indebtedness, leading to confusion on the part of the debtor and, in some instances, uncertainty on the part of the creditor regarding whether it may lawfully continue to pursue the debt. Additionally, commenters noted that the IRS's ability to collect tax on discharge of indebtedness income may be undermined if the actual discharge occurs in a different year than the year of information reporting.

Explanation of Provisions

The Treasury Department and the IRS agree that information reporting under section 6050P should generally coincide with the actual discharge of a debt. Because reporting under the 36-month rule may not reflect a discharge of indebtedness, a debtor may conclude that the debtor has taxable income even though the creditor has not discharged the debt and continues to pursue collection. Issuing a Form 1099-C before a debt has been discharged may also cause the IRS to initiate compliance actions even though a discharge has not occurred. Additionally, § 1.6050P-1(e)(9) provides that no additional reporting is required if a subsequent identifiable event occurs. Therefore, in cases in which the Form 1099-C is issued because of the 36-month rule but before the debt is discharged, the IRS does not subsequently receive third-party reporting when the debt is discharged. The IRS's ability to enforce collection of tax for discharge of indebtedness income may, thus, be diminished when the information reporting does not reflect an actual cancellation of indebtedness. After considering the public comments and the effects on tax administration, the Treasury Department and the IRS propose to remove the 36-month rule.

In addition to the comments recommending removal of the 36-month rule, commenters made other suggestions to change this rule, which were not adopted. One commenter suggested that the rule should be revised to require information reporting after 24 months of non-payment, without regard to the creditor's collection efforts. The commenter suggested that most debts are not collectible after 24 months of non-payment and that requiring information reporting after 24 months would allow the IRS time to assess. This commenter also suggested that the Form 1099-C should be revised to clarify that the issuance of a Form 1099-C does not mean that the debt is discharged, and that creditors should be required to issue corrected Forms 1099-C if they receive payments after the first Form 1099-C is issued.

The revisions proposed by the commenter do not alleviate the problems to debtors, creditors, and the IRS caused by the 36-month rule. There is no indication that merely shortening the time before a Form 1099-C is required to be issued more closely comports with the actual discharge of indebtedness. For example, even if the debt has actually been discharged, the amount reported on the Form 1099-C may not be the same as the amount that the taxpayer is required to report as income because, for instance, the taxpayer may be entitled to claim an exclusion or an exemption. In addition, the Instructions for Debtor on Form 1099-C already explain that the issuance of a Form 1099-C does not necessarily mean that the debtor must include the cancellation of debt in gross income. As a result, such revisions would fail to address the fact that issuance of a Form 1099-C pursuant to the 36-month rule does not necessarily coincide with a discharge of indebtedness. Also,

the commenter's suggestion that creditors be required to issue a corrected Form 1099-C if they later receive a payment from the debtor would not reduce the debtor's confusion about what receipt of a Form 1099-C issued pursuant to the 36-month rule means. The issuance of a corrected Form 1099-C after the debtor has already reported discharge of indebtedness income with respect to the discharge that is reported on the corrected Form 1099-C could require the debtor to file amended returns to report the reduced amount of cancellation indebtedness and the debtor may be entitled to a refund. Issuance of a corrected Form 1099-C would increase, not decrease, the debtor's confusion regarding how to proceed.

One commenter suggested that the rule should be retained because it eliminates the possibility of a "permanent deferral" of information reporting of a discharged debt. This commenter noted two recent Tax Court cases, Kleber v. Commissioner, T.C. Memo. 2011-233, and Stewart v. Commissioner, T.C. Sum. Op. 2012-46, in which the court used the 36-month rule to determine the year in which a debt was discharged. In both cases, the court determined that the statute of limitations for assessment had expired before a Form 1099-C was issued. The commenter stated that confusion could result if the 36-month rule is eliminated for information reporting purposes, but the court continues to use it to determine whether there has been an actual discharge. The commenter viewed this as a reason to retain the rule in a modified form. The commenter suggested that the Treasury Department and the IRS modify the 36-month rule and § 1.6050P-1(b)(2)(i)(G) by: (1) treating a creditor's decision to discontinue collection activities as an identifiable event, whether or not that decision coincides with an actual discharge; (2) placing a 36-month time limit on a creditor's defined policy for discharging a debt under § 1.6050P-1(b)(2)(i)(G); (3) prohibiting creditors from issuing Forms 1099-C while collection activities are ongoing or while the creditor is considering selling the debt; and (4) requiring creditors to issue corrected Forms 1099-C if they engage in subsequent collection activities or receive a payment on the debt.

Because the revisions suggested by this commenter would not require information reporting only upon an actual discharge of indebtedness, the revisions would not eliminate the problems associated with issuance of Forms 1099-C under the 36-month rule. Adopting these changes could increase, not decrease, confusion, because they would modify another identifiable event, § 1.6050P-1(b)(2)(i)(G), to require that a debtor's policy for discharging debt incorporate a 36-month discharge rule. Additionally, as explained in this preamble, requiring creditors to issue corrected Forms 1099-C would neither improve tax compliance nor reduce debtors' confusion. Eliminating the 36-month rule for information reporting purposes, moreover, is likely to lead courts to cease using it as an identifiable event for purposes of determining when an actual discharge occurs, thereby eliminating the issue of the IRS being precluded from assessing tax on discharge of indebtedness before the information return has been issued.

Effective Date

Sections 1.6050P-1(b)(2)(i)(H), 1.6050P-1(b)(2)(iv), and 1.6050P-1(b)(2)(v) would be removed on the date these regulations are published as final regulations in the Federal Register. Conforming amendments to § 1.6050P-1(h)(1) necessary as a result of the removal of the above-referenced sections would be effective on the same date.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act

(5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at www.regulations.gov or upon request.

A public hearing will be scheduled if requested by any person who timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the Federal Register.

Drafting Information

The principal author of these proposed regulations is Hollie Marx of the Office of Associate Chief Counsel (Procedure and Administration).

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6050P-1 is amended by:

a. Removing paragraphs (b)(2)(i)(H), (b)(2)(iv), and (b)(2)(v).

b. Revising paragraph (h).

The revision reads as follows:

§ 1.6050P-1 Information reporting for discharge of indebtedness by certain entities.

* * * * *

(h) Effective/applicability date. The rules in this section apply to discharges of indebtedness after December 21, 1996, except paragraphs (e)(1) and (3) of this section, which apply to discharges of indebtedness after December 31, 1994, and except paragraph (e)(5) of this section, which applies to discharges of indebtedness occurring after December 31, 2004.

John Dalrymple,
Deputy Commissioner for Services
and Enforcement.

[FR Doc. 2014-24392 Filed 10/14/2014 at 8:45 am; Publication Date: 10/15/2014]

IRS LTR: Plan Is a Qualified Governmental Excess Benefit Arrangement.

The IRS ruled that an excess benefit plan is a qualified governmental excess benefit arrangement under section 415(m) and the benefits payable under the plan will be includable in gross income for the tax year in which they are paid or otherwise made available to a participant or participant's beneficiary in accordance with the terms of the plan.

Citations: LTR 201441034

Uniform Issue List: 415.00-00
Date: July 17, 2014

Refer Reply To: SE:T:EP:RA:T3

Attention: * * *

LEGEND:

System X = * * *
State S = * * *
Plan X = * * *
Excess Plan X = * * *
Board B = * * *

Dear * * *:

This is in response to correspondence dated September 24, 2009, as supplemented by correspondence dated September 10, 2010, January 3, 2011, February 27, 2013, and June 24, 2014, submitted on behalf of System X by its authorized representatives, in which a request for a letter ruling was submitted with respect to the applicability of section 415(m) of the Internal Revenue Code (Code) to an excess benefit plan (Excess Plan X) and the tax consequences related thereto.

The following facts and representations have been submitted under penalty of perjury in support of the rulings requested.

State S has established Plan X on behalf of its eligible employees, who are members of the General Assembly of State S. Your authorized representatives have represented that Plan X is a defined benefit plan and a governmental plan as described in section 414(d) of the Code, and is intended to meet the qualification requirements of section 401(a) of the Code.

System X, an instrumentality of State S, is the administrator of Plan X. Board B, a board comprised of officials of State S, is the Trustee of Plan X.

Contributions to Plan X are mandatory for participating employees and are equal to a fixed percentage of each participant's compensation. Plan X allows participants to make pre-tax elective contributions to Plan X to buy years of service credit in Plan X for eligible prior service in other specified public employment. These purchases of years of service credit may also be made by after-tax contributions, rollovers, or trustee-to-trustee transfers.

State S statutes provide for the establishment of qualified excess benefit arrangements within the meaning of section 415(m) of the Code. Pursuant to this authority, on September 23, 2009, Board B adopted and is planning to implement Excess Plan X for the benefit of employees of State S who participate in Plan X. Excess Plan X will operate in accordance with section 415(m) of the Code as a qualified governmental excess benefit arrangement. Employees who participate in Plan X will become eligible for benefits from Excess Plan X if their benefits calculated under the benefit formula are limited by section 415(b) of the Code as that section applies to government plans. Participation in Excess Plan X is mandatory and automatic for all participants in Plan X whose retirement benefits from Plan X are limited by section 415 of the Code.

Section 4.01 of Excess Plan X provides that a participant will receive a benefit equal to the amount of retirement income that would have been payable to, or with respect to, a Participant that could not be paid by Plan X because of the application of the limitations on his retirement income under section 415(b) of the Code. An excess benefit under Excess Plan X will be paid only if and to the extent the participant is receiving retirement benefits from Plan X. Section 4.01 of Excess Plan X will be amended to provide that no portion of benefits in excess of the Code section 415(b) limit paid to a participant can be attributable to service credit purchases made with picked-up employer contributions.

Excess Plan X will be administered by System X. Board B has established a separate trust fund for segregation of the assets related to Excess Plan X. The trust fund was established solely for the purpose of holding employer contributions intended to pay excess benefits to affected Excess Plan X participants. The trustees of this separate trust fund will be members of Board B. Your authorized representatives have represented in the correspondence dated February 27, 2013 that the trust fund is designed to constitute a grantor trust under state law and for federal income tax purposes. Under the represented facts, Excess Plan X participants will receive no property right or interest in the trust assets, and the trust assets are subject to the claims of State S's general creditors in the event of insolvency.

Excess Plan X will be funded on a pay as you go basis. Board B will determine the amount necessary to pay the excess benefits under Excess Plan X for each plan year. The required contribution will be the aggregate of the excess benefits payable to all affected participants for such plan year in an amount determined by Board B to be a necessary and reasonable expense of administering Excess Plan X. The amount so determined will be paid by State S and deposited into the trust fund. Any contributions not used to pay the excess benefits for a current year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administrative expenses will be used to fund administrative expenses or excess benefits of participants in future years.

Benefits under Excess Plan X will be paid only if and to the extent the participant is receiving benefits from Plan X. Participation in Excess Plan X will cease for any Plan Year in which the participant's benefit under Plan X does not exceed the requisite limitations of section 415(b) of the Code, or if all benefit obligations under Excess Plan X to the member, retiree or beneficiary have been satisfied. The form of the benefits paid to a participant from Excess Plan X will be the same form as the participant's retirement benefit under Plan X. A participant in Excess Plan X will be paid the amount of the benefit that would otherwise have been payable to the participant under Plan X except for the limitations of section 415(b) of the Code. The excess benefit to which a participant is entitled under Excess Plan X will be paid commencing during or with the month in which all monthly payments of retirement benefits under Plan X are paid. Under no circumstances will the participant be given any election to defer compensation under Excess Plan X, either directly or indirectly. In addition, under the represented facts, there will be no employee contributions to Excess Plan X.

Although Excess Plan X is a part of Plan X, no assets of Plan X will be used to pay any benefits under Excess Plan X. Excess Plan X is intended to grant a participant no more than a mere contractual right to payment of benefits under Excess Plan X. Employer contributions to Excess Plan X's related trust may not be commingled with assets of Plan X's related trust, nor may Excess Plan X receive any transfers from Plan X. Under no circumstances will employer contributions to fund the excess benefits under Excess Plan X be credited to Plan X.

Based upon the facts and representations stated above, the following rulings are requested:

1. Excess Plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.

2. The benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.

3. Income accruing to Excess Plan X is exempt from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

Section 415(b) of the Code and section 1.415(b)-1 of the Income Tax Regulations ("Regulations") set forth the limitations on annual benefits for participants in defined benefit plans.

Section 415(m)(1) of the Code provides that, in determining whether a governmental plan (as defined in section 414(d) of the Code) meets the benefit limitations of section 415 of the Code, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Section 415(m)(1) of the Code also states that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115 of the Code.

Section 415(m)(2) of the Code describes the tax treatment of benefits payable under a qualified governmental excess benefit arrangement. Under section 415(m)(2) of the Code, the taxable year or years for which amounts in respect of a qualified excess benefit arrangement are includable in gross income by a participant, and the treatment of such amounts when so includible by the participant, are determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation that is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401 of the Code.

Section 415(m)(3) of the Code defines a qualified governmental excess benefit arrangement as a portion of a governmental plan that meets the following three requirements:

(A) Such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by section 415 ("excess benefits");

(B) Under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation; and

(C) Excess benefits are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.

With respect to your first requested ruling, Excess Plan X was adopted by Board B as a part of Plan

X. It has been represented that Plan X is a governmental plan as described in section 414(d) of the Code. It has also been represented that the only purpose of Excess Plan X is to provide affected employees who are participants in Plan X that portion of their benefits that would otherwise be payable under the terms of Plan X except for the limitations on benefits imposed by section 415(b) of the Code, as applicable to governmental plans. The terms of Excess Plan X limit participation to participants in Plan X for whom benefits would exceed the limits of section 415 of the Code. Therefore, we have determined that Excess Plan X is a portion of a governmental plan which is maintained solely for the purpose of providing to State S employees who participate in Plan X that part of the participants' benefits otherwise payable under the terms of Plan X that exceed the section 415 limits, and, as such, meets the requirements of section 415(m)(3)(A) of the Code.

Your authorized representatives have stated that participation in Excess Plan X is mandatory and automatic, and that there are no employee contributions to Excess Plan X. Your representatives also assert that no direct or indirect election to defer compensation is provided to any participant in Excess Plan X. Thus, we have determined that no direct or indirect election is provided at any time to participants to defer compensation, and accordingly, the requirements of section 415(m)(3)(B) of the Code are met.

Section 415(m)(3)(C) of the Code requires that the trust from which the excess benefits are paid must not form a part of the governmental plan which contains the excess benefit arrangement, unless such trust is maintained solely for the purpose of providing such benefits. In this case, Excess Plan X will be funded on a pay-as-you-go basis. Board B established a trust fund for the segregation of assets related to Excess Plan X which is maintained separately from Plan X. This trust fund was established solely for the purpose of holding employer contributions intended to pay excess benefits to affected Plan X participants. Contributions to the trust fund will consist only of the amounts required to pay the excess benefits and administrative expenses for the plan year. Any contributions not used to pay the excess benefits for a current plan year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administrative expenses will be used to fund excess benefits of participants or pay administrative expenses in future years. Therefore, we have determined that the requirements of section 415(m)(3)(C) of the Code are met.

Since Excess Plan X satisfies all of the requirements of section 415(m)(3) of the Code, we conclude, with respect to your first ruling request, that Excess plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.

Your second ruling request asks whether the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X. In response to your first ruling request, we determined that Excess Plan X meets the legal requirements of section 415(m) of the Code and, therefore, constitutes a qualified governmental excess benefit arrangement. Accordingly, under section 415(m)(2) of the Code, the tax treatment of the amounts distributed under Excess Plan X to the participants is determined as if such qualified governmental excess benefit arrangement were a plan for the deferral of compensation which is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401 of the Code.

Section 83(a) of the Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Regulations provides that for purposes of Code section 83, the term "property" includes real and personal property other than money or an unfunded and unsecured promise to pay money or property in the future. Property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors, for example, in a trust or escrow account.

Section 402(b) of the Code provides that contributions made by an employer to an employee's trust that is not exempt from tax under section 501(a) are included in the employee's gross income in accordance with section 83, except that the value of the employee's interest in the trust will be substituted for the fair market value of the property in applying section 83. Under section 1.402(b)-1(a)(1) of the Regulations, an employer's contributions to a nonexempt employee's trust are included as compensation in the employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested, as defined in the Regulations under section 83 of the Code.

Section 451(a) of the Code and section 1.451-1(a) of the Regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under section 1.451-2(a) of the Regulations, income is constructively received in the taxable year during which it is credited to a taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw on it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situations 1-3, 1960-1 C.B. 174, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Under the economic benefit doctrine, an employee has currently includible income from an economic or financial benefit received as compensation, though not in cash form. Economic benefit applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952), Rev. Rul. 60-31, Situation 4. Rev. Rul. 72-25, 1972-1 C.B. 127, and Rev. Rul. 68-99,1968-1 C. B. 193, holds that an employee does not receive income as a result of the employer's purchase of an insurance contract to provide a source of funds for deferred compensation because the insurance contract is the employer's asset, subject to claims of the employer's creditors.

Based on the foregoing, with respect to the second ruling request, we conclude that the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.

With respect to your third requested ruling, section 415(m)(1) of the Code provides that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement will constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) will be exempt from tax under section 115 of the Code. We have determined, in connection with your first ruling request, that Excess Plan X meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements. Therefore, under section 415(m)(1) of the Code, with respect to your third requested ruling, we conclude that income accruing to Excess Plan X is exempt

from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

No opinion is expressed as to the tax treatment of the transactions described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

No opinion is expressed as to whether the trust fund established for the purpose of holding employer contributions intended to pay excess benefits to affected Excess Plan X participants constitutes a grantor trust under Rev. Proc. 92-64, 1992-33 I.R.B. 11. No opinion is expressed as to the tax treatment of the transactions described herein with respect to the trust holding the contributions under the provisions of any other section of either the Code or regulations which may be applicable thereto.

This letter assumes that Plan X is and was a governmental plan as described in section 414(d) of the Code, is and was qualified under section 401 of the Code, and its related trust is and was exempt from tax under section 501(a) of the Code at all relevant times thereto.

This ruling is contingent upon the adoption of the amendments to Article III and Section 4.01 of Excess Plan X, as stated in the correspondence dated September 10, 2010 and June 24, 2014.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this ruling letter is being sent to your authorized representatives.

If you wish to inquire about this ruling, please contact * * * at * * *. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager
Employee Plans Technical Group 3

Enclosures:
Deleted copy of letter ruling
Notice of Intention to Disclose

cc
* * *

IRS LTR: Plan Is a Qualified Governmental Excess Benefit Arrangement.

The IRS ruled that an excess benefit plan is a qualified governmental excess benefit arrangement under section 415(m) and the benefits payable under the plan will be includable in gross income for the tax year in which they are paid or otherwise made available to a participant or participant’s beneficiary in accordance with the terms of the plan.

Citations: LTR 201441033

Uniform Issue List: 415.00-00

Date: July 17, 2014

Refer Reply To: T:EP:RA:UK

Attention: * * *

LEGEND:

System X = * * *
State S = * * *
Plan X = * * *
Excess Plan X = * * *
Board B = * * *

Dear * * *:

This is in response to correspondence dated September 24, 2009, as supplemented by correspondence dated September 10, 2010, January 3, 2011, February 27, 2013, and June 24, 2014, submitted on behalf of System X by its authorized representatives, in which a request for a letter ruling was submitted with respect to the applicability of section 415(m) of the Internal Revenue Code (Code) to an excess benefit plan (Excess Plan X) and the tax consequences related thereto.

The following facts and representations have been submitted under penalty of perjury in support of the rulings requested.

State S has established Plan X on behalf of its eligible employees, who are certain police officers, firefighters, peace officers or certain state agencies, probate judges, magistrates and coroners of State S. Your authorized representatives have represented that Plan X is a defined benefit plan, a governmental plan as described in section 414(d) of the Code, and is intended to meet the qualification requirements of section 401(a) of the Code.

System X, an instrumentality of State S, is the administrator of Plan X. Board B, a board comprised of officials of State S, is the Trustee of Plan X.

Contributions to Plan X are mandatory for participating employees and are equal to a fixed percentage of each participant's compensation. Plan X allows participants to make pre-tax elective contributions to Plan X to buy years of service credit in Plan X for eligible prior service in other specified public employment. These purchases of years of service credit may also be made by after-tax contributions, rollovers, or trustee-to-trustee transfers.

State S statutes provide for the establishment of qualified excess benefit arrangements within the meaning of section 415(m) of the Code. Pursuant to this authority, on September 23, 2009, Board B adopted and is planning to implement Excess Plan X for the benefit of employees of State S who participate in Plan X. Excess Plan X will operate in accordance with section 415(m) of the Code as a qualified governmental excess benefit arrangement. Employees who participate in Plan X will become eligible for benefits from Excess Plan X if their benefits calculated under the benefit formula are limited by section 415(b) of the Code as that section applies to government plans. Participation in Excess Plan X is mandatory and automatic for all participants in Plan X whose retirement benefits from Plan X are limited by Code section 415 of the Code.

Section 4.01 of Excess Plan X provides that a participant will receive a benefit equal to the amount of retirement income that would have been payable to, or with respect to, a Participant that could not be paid by Plan X because of the application of the limitations on his retirement income under

section 415(b) of the Code. An excess benefit under Excess Plan X will be paid only if and to the extent the participant is receiving retirement benefits from Plan X. Section 4.01 of Excess Plan X will be amended to provide that no portion of benefits in excess of the Code section 415(b) limit paid to a participant can be attributable to service credit purchases made with picked-up employer contributions.

Excess Plan X will be administered by System X. Board B has established a separate trust fund for segregation of the assets related to Excess Plan X. The trust fund was established solely for the purpose of holding employer contributions intended to pay excess benefits to affected Excess Plan X participants. The trustees of this separate trust fund will be members of Board B. Your authorized representatives have represented in the correspondence dated February 27, 2013 that the trust fund is designed to constitute a grantor trust under state law and for federal income tax purposes. Under the represented facts, Excess Plan X participants will receive no property right or interest in the trust assets, and the trust assets are subject to the claims of State S's general creditors in the event of insolvency.

Excess Plan X will be funded on a pay as you go basis. Board B will determine the amount necessary to pay the excess benefits under Excess Plan X for each plan year. The required contribution will be the aggregate of the excess benefits payable to all affected participants for such plan year in an amount determined by Board B to be a necessary and reasonable expense of administering Excess Plan X. The amount so determined will be paid by State S and deposited into the trust fund. Any contributions not used to pay the excess benefits for a current year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administrative expenses will be used to fund administrative expenses or excess benefits of participants in future years.

Benefits under Excess Plan X will be paid only if and to the extent the participant is receiving benefits from Plan X. Participation in Excess Plan X will cease for any Plan Year in which the participant's benefit under Plan X does not exceed the requisite limitations of section 415(b) of the Code, or if all benefit obligations under Excess Plan X to the member, retiree or beneficiary have been satisfied. The form of the benefits paid to a participant from Excess Plan X will be the same form as the participant's retirement benefit under Plan X. A participant in Excess Plan X will be paid the amount of the benefit that would otherwise have been payable to the participant under Plan X except for the limitations of section 415(b) of the Code. The excess benefit to which a participant is entitled under Excess Plan X will be paid commencing during or with the month in which all monthly payments of retirement benefits under Plan X are paid. Under no circumstances will the participant be given any election to defer compensation under Excess Plan X, either directly or indirectly. In addition, under the represented facts, there will be no employee contributions to Excess Plan X.

Although Excess Plan X is a part of Plan X, no assets of Plan X will be used to pay any benefits under Excess Plan X. Excess Plan X is intended to grant a participant no more than a mere contractual right to payment of benefits under Excess Plan X. Employer contributions to Excess Plan X's related trust may not be commingled with assets of Plan X's related trust, nor may Excess Plan X receive any transfers from Plan X. Under no circumstances will employer contributions to fund the excess benefits under Excess Plan X be credited to Plan X.

Based upon the facts and representations stated above, the following rulings are requested:

1. Excess Plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.

2. The benefits payable under Excess Plan X will be includible in gross income for the taxable year or

years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.

3. Income accruing to Excess Plan X is exempt from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

Section 415(b) of the Code and section 1.415(b)-1 of the Income Tax Regulations ("Regulations") set forth the limitations on annual benefits for participants in defined benefit plans.

Section 415(m)(1) of the Code provides that, in determining whether a governmental plan (as defined in section 414(d) of the Code) meets the benefit limitations of section 415 of the Code, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Section 415(m)(1) also states that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115 of the Code.

Section 415(m)(2) of the Code describes the tax treatment of benefits payable under a qualified governmental excess benefit arrangement. Under section 415(m)(2) of the Code, the taxable year or years for which amounts in respect of a qualified excess benefit arrangement are includable in gross income by a participant, and the treatment of such amounts when so includible by the participant, are determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation that is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401 of the Code.

Section 415(m)(3) of the Code defines a qualified governmental excess benefit arrangement as a portion of a governmental plan that meets the following three requirements:

(A) Such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by section 415 ("excess benefits");

(B) Under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation; and

(C) Excess benefits are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.

With respect to your first requested ruling, Excess Plan X was adopted by Board B as a part of Plan X. It has been represented that Plan X is a governmental plan as described in section 414(d) of the Code. It has also been represented that the only purpose of Excess Plan X is to provide affected employees who are participants in Plan X that portion of their benefits that would otherwise be payable under the terms of Plan X except for the limitations on benefits imposed by section 415(b) of the Code, as applicable to governmental plans. The terms of Excess Plan X limit participation to participants in Plan X for whom benefits would exceed the limits of section 415 of the Code. Therefore, we have determined that Excess Plan X is a portion of a governmental plan which is maintained solely for the purpose of providing to State S employees who participate in Plan X that part of the participants' benefits otherwise payable under the terms of Plan X that exceed the section 415 limits, and, as such, meets the requirements of section 415(m)(3)(A).

Your authorized representatives have stated that participation in Excess Plan X is mandatory and

automatic, and that there are no employee contributions to Excess Plan X. Your representatives also assert that no direct or indirect election to defer compensation is provided to any participant in Excess Plan X. Thus, we have determined that no direct or indirect election is provided at any time to participants to defer compensation, and accordingly, the requirements of section 415(m)(3)(B) are met.

Section 415(m)(3)(C) of the Code requires that the trust from which the excess benefits are paid must not form a part of the governmental plan which contains the excess benefit arrangement, unless such trust is maintained solely for the purpose of providing such benefits. In this case, Excess Plan X will be funded on a pay-as-you-go basis. Board B established a trust fund for the segregation of assets related to Excess Plan X which is maintained separately from Plan X. This trust fund was established solely for the purpose of holding employer contributions intended to pay excess benefits to affected Plan X participants. Contributions to the trust fund will consist only of the amounts required to pay the excess benefits and administrative expenses for the plan year. Any contributions not used to pay the excess benefits for a current plan year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administrative expenses will be used to fund excess benefits of participants or pay administrative expenses in future years. Therefore, we have determined that the requirements of section 415(m)(3)(C) of the Code are met.

Since Excess Plan X satisfies all of the requirements of section 415(m)(3) of the Code, we conclude, with respect to your first ruling request, that Excess plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.

Your second ruling request asks whether the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant’s beneficiary in accordance with the terms of Excess Plan X. In response to your first ruling request, we determined that Excess Plan X meets the legal requirements of section 415(m) of the Code and, therefore, constitutes a qualified governmental excess benefit arrangement. Accordingly, under section 415(m)(2) of the Code, the tax treatment of the amounts distributed under Excess Plan X to the participants is determined as if such qualified governmental excess benefit arrangement were a plan for the deferral of compensation which is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401 of the Code.

Section 83(a) of the Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Regulations provides that for purposes of Code section 83, the term “property” includes real and personal property other than money or an unfunded and unsecured promise to pay money or property in the future. Property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor’s creditors, for example, in a trust or escrow account.

Section 402(b) of the Code provides that contributions made by an employer to an employee’s trust that is not exempt from tax under section 501(a) are included in the employee’s gross income in accordance with section 83, except that the value of the employee’s interest in the trust will be substituted for the fair market value of the property in applying section 83. Under section 1.402(b)-1(a)(1) of the Regulations, an employer’s contributions to a nonexempt employee’s trust are included

as compensation in the employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested, as defined in the Regulations under section 83 of the Code.

Section 451(a) of the Code and section 1.451-1(a) of the Regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under section 1.451-2(a) of the Regulations, income is constructively received in the taxable year during which it is credited to a taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw on it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situations 1-3, 1960-1 C.B. 174, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Under the economic benefit doctrine, an employee has currently includible income from an economic or financial benefit received as compensation, though not in cash form. Economic benefit applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952), Rev. Rul. 60-31, Situation 4. Rev. Rul. 72-25, 1972-1 C.B. 127, and Rev. Rul. 68-99,1968-1 C.B. 193, holds that an employee does not receive income as a result of the employer's purchase of an insurance contract to provide a source of funds for deferred compensation because the insurance contract is the employer's asset, subject to claims of the employer's creditors.

Based on the foregoing, with respect to the second ruling request, we conclude that the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.

With respect to your third requested ruling, section 415(m)(1) of the Code provides that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement will constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) will be exempt from tax under section 115 of the Code. We have determined, in connection with your first ruling request, that Excess Plan X meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements. Therefore, under section 415(m)(1) of the Code, with respect to your third requested ruling, we conclude that income accruing to Excess Plan X is exempt from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

No opinion is expressed as to the tax treatment of the transactions described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

No opinion is expressed as to whether the trust fund established for the purpose of holding employer contributions intended to pay excess benefits to affected Excess Plan X participants constitutes a grantor trust under Rev. Proc. 92-64, 1992-33 I.R.B. 11. No opinion is expressed as to the tax treatment of the transactions described herein with respect to the trust holding the contributions under the provisions of any other section of either the Code or regulations which may be applicable

thereto.

This letter assumes that Plan X is and was a governmental plan as described in section 414(d) of the Code, is and was qualified under section 401, and its related trust is and was exempt from tax under section 501(a) at all relevant times thereto.

This ruling is contingent upon the adoption of the amendments to Article III and Section 4.01 of Excess Plan X, as stated in the correspondence dated September 10, 2010 and June 24, 2014.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this ruling letter is being sent to your authorized representatives.

If you wish to inquire about this ruling, please contact * * * at * * *. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager
Employee Plans Technical Group 3

Enclosures:
Deleted copy of letter ruling
Notice of Intention to Disclose

IRS LTR: Plan Is a Qualified Governmental Excess Benefit Arrangement.

The IRS ruled that an excess benefit plan is a qualified governmental excess benefit arrangement under section 415(m) and the benefits payable under the plan will be includable in gross income for the tax year in which they are paid or otherwise made available to a participant or participant’s beneficiary in accordance with the terms of the plan.

Citations: LTR 201441032

Uniform Issue List: 415.00-00
Date: July 17, 2014

Refer Reply To: T:EP:RA:T3

Attention: * * *

LEGEND:

System X = * * *
State S = * * *
Plan X = * * *
Excess Plan X = * * *
Board B = * * *

Dear * * *:

This is in response to correspondence dated September 24, 2009, as supplemented by correspondence dated September 10, 2010, January 3, 2011, February 27, 2013, and June 24, 2014 submitted on behalf of System X by its authorized representatives, in which a request for a letter ruling was submitted with respect to the applicability of section 415(m) of the Internal Revenue Code (Code) to an excess benefit plan (Excess Plan X) and the tax consequences related thereto.

The following facts and representations have been submitted under penalty of perjury in support of the rulings requested.

State S has established Plan X on behalf of its eligible employees, who are certain state employees, public school employees, public higher education institution personnel, and employees of participating cities, counties and other local subdivisions of government. Your authorized representatives have represented that Plan X is a defined benefit plan, a governmental plan as described in section 414(d) of the Code, and is intended to meet the qualification requirements of section 401(a) of the Code.

System X, an instrumentality of State S, is the administrator of Plan X. Board B, a board comprised of officials of State S, is the Trustee of Plan X.

Contributions to Plan X are mandatory for participating employees and are equal to a fixed percentage of each participant's compensation. Plan X allows participants to make pre-tax elective contributions to Plan X to buy years of service credit in Plan X for eligible prior service in other specified public employment. These purchases of years of service credit may also be made by after-tax contributions, rollovers, or trustee-to-trustee transfers.

State S statutes provide for the establishment of qualified excess benefit arrangements within the meaning of section 415(m) of the Code. Pursuant to this authority, on September 23, 2009, Board B adopted and is planning to implement Excess Plan X for the benefit of employees of State S who participate in Plan X. Excess Plan X will operate in accordance with section 415(m) of the Code as a qualified governmental excess benefit arrangement. Employees who participate in Plan X will become eligible for benefits from Excess Plan X if their benefits calculated under the benefit formula are limited by section 415(b) of the Code as that section applies to government plans. Participation in Excess Plan X is mandatory and automatic for all participants in Plan X whose retirement benefits from Plan X are limited by section 415 of the Code.

Section 4.01 of Excess Plan X provides that a participant will receive a benefit equal to the amount of retirement income that would have been payable to, or with respect to, a Participant that could not be paid by Plan X because of the application of the limitations on his retirement income under section 415(b) of the Code. An excess benefit under Excess Plan X will be paid only if and to the extent the participant is receiving retirement benefits from Plan X. Section 4.01 of Excess Plan X will be amended to provide that no portion of benefits in excess of the Code section 415(b) limit paid to a participant can be attributable to service credit purchases made with picked-up employer contributions.

Excess Plan X will be administered by System X. Board B has established a separate trust fund for segregation of the assets related to Excess Plan X. The trust fund was established solely for the purpose of holding employer contributions intended to pay excess benefits to affected Excess Plan X participants. The trustees of this separate trust fund will be members of Board B.

Your authorized representatives have represented in the correspondence dated February 27, 2013

that the trust fund is designed to constitute a grantor trust under state law and for federal income tax purposes. Under the represented facts, Excess Plan X participants will receive no property right or interest in the trust assets, and the trust assets are subject to the claims of State S's general creditors in the event of insolvency.

Excess Plan X will be funded on a pay as you go basis. Board B will determine the amount necessary to pay the excess benefits under Excess Plan X for each plan year. The required contribution will be the aggregate of the excess benefits payable to all affected participants for such plan year in an amount determined by Board B to be a necessary and reasonable expense of administering Excess Plan X. The amount so determined will be paid by State S and deposited into the trust fund. Any contributions not used to pay the excess benefits for a current year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administrative expenses will be used to fund administrative expenses or excess benefits of participants in future years.

Benefits under Excess Plan X will be paid only if and to the extent the participant is receiving benefits from Plan X. Participation in Excess Plan X will cease for any Plan Year in which the participant's benefit under Plan X does not exceed the requisite limitations of section 415(b) of the Code, or if all benefit obligations under Excess Plan X to the member, retiree or beneficiary have been satisfied. The form of the benefits paid to a participant from Excess Plan X will be the same form as the participant's retirement benefit under Plan X. A participant in Excess Plan X will be paid the amount of the benefit that would otherwise have been payable to the participant under Plan X except for the limitations of section 415(b) of the Code. The excess benefit to which a participant is entitled under Excess Plan X will be paid commencing during or with the month in which all monthly payments of retirement benefits under Plan X are paid. Under no circumstances will the participant be given any election to defer compensation under Excess Plan X, either directly or indirectly. In addition, under the represented facts, there will be no employee contributions to Excess Plan X.

Although Excess Plan X is a part of Plan X, no assets of Plan X will be used to pay any benefits under Excess Plan X. Excess Plan X is intended to grant a participant no more than a mere contractual right to payment of benefits under Excess Plan X. Employer contributions to Excess Plan X's related trust may not be commingled with assets of Plan X's related trust, nor may Excess Plan X receive any transfers from Plan X. Under no circumstances will employer contributions to fund the excess benefits under Excess Plan X be credited to Plan X.

Based upon the facts and representations stated above, the following rulings are requested:

1. Excess Plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.

2. The benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.

3. Income accruing to Excess Plan X is exempt from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

Section 415(b) of the Code and section 1.415(b)-1 of the Income Tax Regulations ("Regulations") set forth the limitations on annual benefits for participants in defined benefit plans.

Section 415(m)(1) of the Code provides that, in determining whether a governmental plan (as defined in section 414(d) of the Code) meets the benefit limitations of section 415 of the Code,

benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Section 415(m)(1) also states that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115 of the Code.

Section 415(m)(2) of the Code describes the tax treatment of benefits payable under a qualified governmental excess benefit arrangement. Under section 415(m)(2) of the Code, the taxable year or years for which amounts in respect of a qualified excess benefit arrangement are includable in gross income by a participant, and the treatment of such amounts when so includible by the participant, are determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation that is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401 of the Code.

Section 415(m)(3) of the Code defines a qualified governmental excess benefit arrangement as a portion of a governmental plan that meets the following three requirements:

(A) Such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by section 415 ("excess benefits");

(B) Under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation; and

(C) Excess benefits are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.

With respect to your first requested ruling, Excess Plan X was adopted by Board B as a part of Plan X. It has been represented that Plan X is a governmental plan as described in section 414(d) of the Code. It has also been represented that the only purpose of Excess Plan X is to provide affected employees who are participants in Plan X that portion of their benefits that would otherwise be payable under the terms of Plan X except for the limitations on benefits imposed by section 415(b) of the Code, as applicable to governmental plans. The terms of Excess Plan X limit participation to participants in Plan X for whom benefits would exceed the limits of section 415 of the Code. Therefore, we have determined that Excess Plan X is a portion of a governmental plan which is maintained solely for the purpose of providing to State S employees who participate in Plan X that part of the participants' benefits otherwise payable under the terms of Plan X that exceed the section 415 limits, and, as such, meets the requirements of section 415(m)(3)(A).

Your authorized representatives have stated that participation in Excess Plan X is mandatory and automatic, and that there are no employee contributions to Excess Plan X. Your representatives also assert that no direct or indirect election to defer compensation is provided to any participant in Excess Plan X. Thus, we have determined that no direct or indirect election is provided at any time to participants to defer compensation, and accordingly, the requirements of section 415(m)(3)(B) are met.

Section 415(m)(3)(C) of the Code requires that the trust from which the excess benefits are paid must not form a part of the governmental plan which contains the excess benefit arrangement, unless such trust is maintained solely for the purpose of providing such benefits. In this case, Excess Plan X will be funded on a pay-as-you-go basis. Board B established a trust fund for the segregation of assets related to Excess Plan X which is maintained separately from Plan X. This trust fund was

established solely for the purpose of holding employer contributions intended to pay excess benefits to affected Plan X participants. Contributions to the trust fund will consist only of the amounts required to pay the excess benefits and administrative expenses for the plan year. Any contributions not used to pay the excess benefits for a current plan year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administrative expenses will be used to fund excess benefits of participants or pay administrative expenses in future years. Therefore, we have determined that the requirements of section 415(m)(3)(C) of the Code are met.

Since Excess Plan X satisfies all of the requirements of section 415(m)(3) of the Code, we conclude, with respect to your first ruling request, that Excess Plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.

Your second ruling request asks whether the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X. In response to your first ruling request, we determined that Excess Plan X meets the legal requirements of section 415(m) of the Code and, therefore, constitutes a qualified governmental excess benefit arrangement. Accordingly, under section 415(m)(2) of the Code, the tax treatment of the amounts distributed under Excess Plan X to the participants is determined as if such qualified governmental excess benefit arrangement were a plan for the deferral of compensation which is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401 of the Code.

Section 83(a) of the Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Regulations provides that for purposes of Code section 83, the term "property" includes real and personal property other than money or an unfunded and unsecured promise to pay money or property in the future. Property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors, for example, in a trust or escrow account.

Section 402(b) of the Code provides that contributions made by an employer to an employee's trust that is not exempt from tax under section 501(a) are included in the employee's gross income in accordance with section 83, except that the value of the employee's interest in the trust will be substituted for the fair market value of the property in applying section 83. Under section 1.402(b)-1(a)(1) of the Regulations, an employer's contributions to a nonexempt employee's trust are included as compensation in the employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested, as defined in the Regulations under section 83 of the Code.

Section 451(a) of the Code and section 1.451-1(a) of the Regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under section 1.451-2(a) of the Regulations, income is constructively received in the taxable year during which it is credited to a taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw on it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situations 1-3, 1960-1 C.B. 174, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Under the economic benefit doctrine, an employee has currently includible income from an economic or financial benefit received as compensation, though not in cash form. Economic benefit applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952), Rev. Rul. 60-31, Situation 4. Rev. Rul. 72-25, 1972-1 C.B. 127, and Rev. Rul. 68-99, 1968-1 C.B. 193, holds that an employee does not receive income as a result of the employer's purchase of an insurance contract to provide a source of funds for deferred compensation because the insurance contract is the employer's asset, subject to claims of the employer's creditors.

Based on the foregoing, with respect to the second ruling request, we conclude that the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.

With respect to your third requested ruling, section 415(m)(1) of the Code provides that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement will constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) will be exempt from tax under section 115 of the Code. We have determined, in connection with your first ruling request, that Excess Plan X meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements. Therefore, under section 415(m)(1) of the Code, with respect to your third requested ruling, we conclude that income accruing to Excess Plan X is exempt from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

No opinion is expressed as to the tax treatment of the transactions described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

No opinion is expressed as to whether the trust fund established for the purpose of holding employer contributions intended to pay excess benefits to affected Excess Plan X participants constitutes a grantor trust under Rev. Proc. 92-64, 1992-33 I.R.B. 11. No opinion is expressed as to the tax treatment of the transactions described herein with respect to the trust holding the contributions under the provisions of any other section of either the Code or regulations which may be applicable thereto.

This letter assumes that Plan X is and was a governmental plan as described in section 414(d) of the Code, is and was qualified under section 401, and its related trust is and was exempt from tax under section 501(a) at all relevant times thereto.

This ruling is contingent upon the adoption of the amendments to Article III and Section 4.01 of Excess Plan X, as stated in the correspondence dated September 10, 2010 and June 24, 2014.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this ruling letter is being sent to your authorized representatives.

If you wish to inquire about this ruling, please contact * * * at * * *. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager
Employee Plans Technical Group 3

Enclosures:
Deleted copy of letter ruling
Notice of Intention to Disclose

IRS LTR: Extension Granted to Make Low-Income Housing Election.

The IRS granted an entity an extension to make an election under section 42(g)(3)(D) to treat all buildings in a low-income housing project as part of a single, multiple-building project.

Citations: LTR 201441002

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *, ID No. * * *
Telephone Number: * * *

Index Number: 42.00-00, 9100.00-00
Release Date: 10/10/2014
Date: June 5, 2014

Refer Reply To: CC:PSI:B5 – PLR-103340-14

LEGEND:

Taxpayer = * * *
Project = * * *
BINs = * * *
N = * * *
Agency = * * *

Dear * * *:

This letter responds to Taxpayer's authorized representative's letter dated January 1, 2014, and subsequent correspondence, requesting an extension of time pursuant to § 301.9100-1 of the Procedure and Administration Regulations to elect to treat all of the buildings in Project identified by BINs as part of a single, multiple-building project under § 42(g)(3)(D) of the Internal Revenue Code on Taxpayer's IRS Forms 8609, Low-Income Housing Credit Allocation and Certification.

According to information submitted, Taxpayer intended that Project consist of N buildings identified by BINs. Taxpayer, through inadvertence, failed to elect to treat all N buildings in Project identified

by BINs for which Forms 8609 were issued by Agency as part of a single, multiple-building project under § 42(g)(3)(D).

Section 42(g)(3)(D) provides that a project will consist of only one building unless, prior to the end of the first calendar year in the project period (as defined in § 42(h)(1)(F)(ii)), each building that will comprise the project is identified in the form and the manner that the Secretary provides.

Section 42(l)(1) sets forth the certifications for the first year of the credit period regarding any qualified low-income building that a taxpayer must certify to the Secretary (at such time and in such manner as the Secretary prescribes). Section 1.42-1(h) of the Income Tax Regulations requires that a building owner (i.e., taxpayer) must file a completed Form 8609 with the Service in accordance with the form instructions. The election to treat under § 42(g)(3)(D) a building as part of a multiple-building project is made on Part II of Form 8609 and requires the inclusion of an accompanying informational statement.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-1(b) defines the term "regulatory election" as including an election whose due date is prescribed by regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

Under § 301.9100-1(c), the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than six months except in the case of a taxpayer who is abroad), under all subtitles of the Code, except E, G, H, and I. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

Requests for relief under § 301.9100-3(a) will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government.

In the instant case, based solely on Taxpayer's facts submitted and its representations made, we conclude that the requirements of §§ 301.9100-1 and 301.9100-3 have been met. Accordingly, Taxpayer is granted an extension of time to elect to treat under § 42(g)(3)(D) all N buildings in Project identified by BINs as part of a single, multiple-building project by filing within 120 days from the date of this letter amended Forms 8609, and accompanying information statement(s), that include this intended election. The amended Forms 8609 and statement(s) (along with a copy of this letter) are to be filed with the Philadelphia Service Center at the address provided for the Service Center in that form. A copy of this letter is enclosed for this purpose.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. Specifically, we express no opinion on whether the Forms 8609 for the N buildings in Project identified by BINs were timely or correctly filed, the effect of Taxpayer's election to treat under § 42(g)(3)(D) the N buildings as a single, multiple-building project for any closed year, or whether the N buildings in Project otherwise qualify for low-income housing tax credits under § 42.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Associate Chief Counsel
(Passthroughs & Special Industries)

By: Christopher J. Wilson
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure (2):
Copy of this letter
Copy for section 6110 purposes

IRS Requests Comments on Tax-Exempt Bond Arbitrage Regs.

The IRS has requested public comment on information collections under final regulations (T.D. 8801) on arbitrage restrictions that apply to tax-exempt bonds issued by state and local governments. Comments are due by December 8, 2014.

Read the Request.

The E-Mail Caveat Is Dead! Long Live the E-Mail Caveat!

Kip Dellinger discusses recent revisions to Circular 230 that removed the covered opinion provisions promulgated in 2004 that led to the "you can't rely on this advice" statements so common in the e-mails of law and accounting firms. He also comments on protective engagement letter language regarding tax advice.

* * * * *

On June 12 tax professionals were finally required — not merely allowed — to dump the Circular 230 e-mail caveat.1 One would think everyone would be quite pleased. After all, slogging through a string of e-mail tax advice disclaimers embedded in a conversation can be an aggravating task (we stopped reading them ages ago). This is particularly true when the e-mail is simply coordinating a lunch or planning a trip to the ballpark.

No sooner had the e-mail removal directive arrived than many practitioners decided they loved their e-mail caveats and related disclaimers — presumably, if not primarily, because it allowed them to avoid any responsibility to the recipients of less-than-formal written advice (as in protection from malpractice claims). Many in tax practice upper management positions also surely believe that the caveats insulate them from responsibility under the supervisory provisions of Circular 230 for any "wrong" e-mail or similar advice provided by lower-level tax personnel. CPAs and accounting firms across the country sought guidance in this area from their errors and omissions insurance carriers.

Never Required on E-Mail Communications

The original e-mail caveat was never a requirement for tax practitioners. It was a defense

mechanism to opt out regarding two of six specific types of tax opinions2 described in section 10.35 of Circular 230 — a reliance opinion and a marketed opinion — which labeled them as covered opinions.3 If written advice of any type (formal, informal, e-mail, text, or crayon on a napkin) was actually furnished4 regarding any of the other four types of opinion, technically, the requirements of section 10.35 would apply, and the opt-out would be useless.

Those four types of opinions concerned (1) a listed transaction; (2) a tax strategy whose principal purpose was the evasion or avoidance of a federal tax when that purpose was clearly unintended by Congress in enacting the law relied upon; (3) a tax strategy requiring confidentiality (the "if you tell anyone, I'll shoot you" approach5); and (4) a tax strategy that provided contractual protection of some type.6 Interestingly, the manner in which the caveat appeared on countless e-mails wasn't even sufficient to opt out of marketed opinion advice.

Yet somehow, the larger tax profession of attorneys and CPAs took comfort that they were shielded from IRS discipline for any tax advice contemplated in section 10.35 because their e-mails said you can't rely on our advice for penalty protection. In fact, that outcome sounded so cool that at least some practitioners apparently became enamored with the idea that if they didn't put their tax advice in formal legal writing (whatever that is), they'd have no exposure to malpractice claims of any type regarding that advice.

Today's Tax Advice Rules

To change the topic for just a moment, written tax advice is now governed under section 10.37 of Circular 230. For years before the covered opinion provisions, section 10.37 was the pertinent provision under Circular 230, and it remained so following the addition of section 10.357 for advice other than covered opinions. It has been revised and expanded to govern all written advice provided by Circular 230 practitioners (attorneys, CPAs, and enrolled agents for purposes of written advice). So, under the written advice provisions of Circular 230, a practitioner should:

- base her advice on reasonable factual and legal assumptions (including assumptions about future events8);
- reasonably consider all relevant facts and circumstances that she knows or reasonably should know;
- use reasonable efforts to identify and determine the facts relevant to written advice on each federal tax matter;9
- not rely on representations, statements, findings, or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance on them would be unreasonable;10 and
- not, in evaluating a federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.

One later, critical provision in Circular 230 states:

In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing, or recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, *with emphasis given to the additional risk caused by* the practitioner's lack of knowledge of the taxpayer's particular circumstances, when determining whether a practitioner has failed to comply with this section.11 [Emphasis added.]

Some practitioners may contend that those Office of Professional Responsibility folks are out to trap us. And the IRS doesn't provide a stitch of guidance regarding that directive. How do we deal with that lack of guidance?

Well, one suggestion is to simply save and follow as guidance the requirements of "old" section 10.35. It's actually a nice guide for what tax opinions that address uncertain areas of the law (or facts) should contain. Following the principles set forth in that provision would surely go a long way toward satisfying OPR that the heightened standard was met by the tax opinion writer.

The New (Improved?) E-Mail Caveat

Once any reason (or excuse) for including e-mail tax advice disclaimers — for example, "to ensure compliance with Treasury Department Circular 230" — disappeared, much of the practice community apparently concluded that they enjoyed the seeming malpractice insulation provided by a caveat that states, "We take no responsibility for bad outcomes with the IRS based on the advice contained in this communication." Thus began the "save the e-mail legend" movement for written tax advice.

Of course, an obvious problem faced by lawyers and CPAs is that they provide all kinds of e-mail (and other informal) advice. Law firms may offer advice on securities, contract, family, environmental, regulatory, and myriad other areas of the law. CPA firms may offer advice in accounting treatment, tax matters, and an endless list of consulting-type matters. Yet, both professions had generally been stating that it's only written e-mail tax advice that the recipient can't rely on. As was pointed out to one malpractice insurance provider, it would look a little silly for a CPA or lawyer to use an e-mail caveat that stated:

Any tax advice contained in this communication, including attachments and enclosures, is not intended as a thorough, in-depth analysis of specific issues, nor is it a substitute for a formal opinion, nor is it sufficient to avoid tax-related penalties.

In fact, what that language would surely imply is that the recipient can rely on e-mail advice in any communications that don't involve tax advice.

Consequently, we are now treated to this type of e-mail legend:

Any accounting, business, or tax advice contained in this communication, including attachments and enclosures, is not intended as a thorough, in-depth analysis of specific issues, nor is it a substitute for a formal opinion, nor is it sufficient to avoid tax-related penalties. [Lawyers would substitute "legal" for "accounting."]

Note that the reference to tax-related penalties is retained in this version, whose phrasing is very close to language suggested by the insurer. Also note that with the appendage of this caveat to e-mails, little has been done to save the forests when e-mails are printed out (or to save thumbs when they are scrolled on a device).

Misguided Reliance on the New Caveat

Beside the belief that the caveat provides a defense in a malpractice case about tax advice, CPAs have expressed to me that the caveat provides insulation from discipline under Circular 230 when the advice of people they supervise (partners, associates, or employees) is incorrect. That's nonsense. And this was a problem — essentially ignored — under Circular 230 before the recent amendments that included the elimination of the covered opinion rules.

Section 10.36, “Procedures to Ensure Compliance,” states:

Any individual subject to the provisions of this part who has (or individuals who have or share) principal authority and responsibility for overseeing a firm’s practice governed by this part, including the provision of advice concerning Federal tax matters and preparation of tax returns, claims for refund, or other documents for submission to the Internal Revenue Service, must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with subparts A, B, and C of this part, as applicable.

Section 10.22, “Diligence as to Accuracy,” states:

A practitioner must exercise due diligence . . . in determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

Taken together, the leadership of tax practice can opt out in e-mails all day long and not avoid OPR’s reach regarding erroneous advice given by subordinates. Yes, there is a willful, incompetent, or grossly negligent requirement for discipline concerning supervisory responsibility. It would appear that simply branding out of responsibility for e-mail advice and nothing more — for example, reviewing or monitoring all forms of significant tax advice contemporaneously or within some reasonable time frame — would be grossly negligent, if not a willful failure to supervise. The supervising tax professional and tax practice leaders should keep this in mind.

Return Prep Engagements

One concept floating around the CPA profession is a suggestion to add to return preparation (rather than tax planning or representation) engagement letter language such as:

While we are, of course, available to provide you with [accounting, tax, and business planning] services, it is our policy to put all advice on which a client might rely into a written memorandum before you rely on that advice. We believe this is necessary to avoid confusion and to clarify the specific nature of our advice. You should not rely on any advice that has not been put into writing for you.

This type of language in most tax advice engagement letters for lawyers would likely be recommended, appropriate, and acceptable since the lawyer rarely prepares the tax return regarding which the advice is given. This would be similarly true for the large CPA firm that provides advice outside the return preparation engagement (or, in fact, for any CPA firm that provides tax planning advice under separate, specific engagement agreements).

However, providing in a return preparation engagement letter that a client (taxpayer) may rely only on written advice (a memorandum, e-mail, letter, or otherwise) would appear to go a step too far. It certainly would not insulate the preparer from the return preparer penalty imposed under section 6694(a) for advising on tax positions of which the preparer has or should have knowledge.

And it is unlikely that a return preparer who has taken a position on a tax return during the preparation process (after perhaps analyzing documents or having discussions with the taxpayer) could later raise the defense that she didn’t provide the client written advice regarding the tax treatment that led to the client suffering a significant accuracy-related penalty under section 6662.

In fact, such language in a return preparation engagement letter might be cited by a plaintiff’s lawyer — perhaps successfully — as intentional bad faith on the part of the preparer, who would

raise it as defense in a malpractice case for recovery of the penalty and other damages.

However, an interesting take on the quoted engagement letter language was recently noted in a course I was teaching on tax practice conduct. A CPA had given a long-standing return preparation client oral advice that the client had misunderstood, and the CPA admittedly failed to fully answer the client's question by explaining how a subsequent act might invalidate the first act.

Too often return preparers provide planning advice or answer client questions throughout the year when the only understanding (contract) with the client is the return preparation engagement letter. Clearly, when a tax planning engagement letter exists, a caveat that the reliance may only be on written advice would likely be a valid defense for the preparer. As noted, it becomes problematic when the written reliance exception is included without qualification in a return preparation engagement letter.

However, the return preparation engagement letter could include language like the following to provide the preparer some protection regarding oral or similar informal periodic advice to the client during the rest of the year:

In addition to our tax preparation services and our advice regarding return preparation, we are, of course, available to provide you with tax advice during the year. For planning or similar tax advice, it is our policy to put all advice on which a client might rely into a written memorandum before you rely on that advice. We believe this is necessary to avoid confusion and to clarify the specific nature of our advice. You should not rely on any planning or similar advice that has not been put into writing for you.

While that language is not dramatically different from what was quoted earlier, it appears to insulate the preparer from the type of incorrect or incomplete advice that causes most malpractice claims, while recognizing that the preparer is generally responsible for tax positions taken on a return regardless of whether she provided the client a written communication about the chosen tax treatment. This is as it should be if the practitioner is a professional in the Circular 230 sense.

Meanwhile, it appears that the e-mail caveat isn't going to die a quiet death. Trees are weeping.

FOOTNOTES

1 See Kip Dellinger, "For the New Year: Dump the E-Mail Caveat," Tax Notes, Jan. 9, 2012, p. 235 2012 TNT 8-7: Viewpoint; and William R. Davis, "OPR Will Tell Practitioners to Remove Circular 230 Disclaimers," Tax Notes, June 23, 2014, p. 1360 2014 TNT 117-5: News Stories.

2 The types of tax advice that section 10.35 sought to regulate were clearly developed from a reading of the myriad tax opinions provided (many of them pilfered, expanded, revised, or embellished by subsequent tax opinion writers — not unlike Wikipedia articles). The primary problem with the rule was the lack of a definition for "significant purpose." Thus, many in the practitioner community interpreted that language far too broadly. See Dellinger, "Circular 230: How Broad Is the Scope of 'Significant Purpose'?" Tax Notes, June 26, 2006, p. 1503-1509 2006 TNT 123-32: Viewpoint.

3 See Dellinger, supra note 1.

4 Presumably and realistically, just saying "no, don't" or stating that one cannot provide advice would not subject the writer to the requirements of section 10.35.

5 Some of these transactions apparently appeared mysteriously on Lee A. Sheppard's doorstep at

various times.

6 For the uninitiated: Yes, there were insurance companies that actually offered protection against an IRS disallowance of a tax shelter strategy.

7 Section 10.35 now provides a general competency requirement for all Circular 230 practitioners. See Dellinger, "Here We Go Again: Hand-Wringing Over Circular 230," Tax Notes, Mar. 25, 2013, p. 1461-1463 2013 TNT 57-9: Viewpoint.

8 Suppose one PowerPoint slide refers to your seven-year investment program, and the next one says that 50 days later you contribute your long and short positions to an S corporation. The next slide says you close your positions, and the following slide probably doesn't even address your seven-year investment diversification program.

9 The parsers of tax language might really think about the intent of this language for a while. It's always been part of the written advice requirements and, game playing aside, it should be taken seriously.

10 This is amusing in that one should not take seriously any representation spoon-fed to the client from the tax adviser. The bottom of page 1 through page 2 (and sometimes 3) of most of the late-'90s and early-2000-era tax shelters contained "client" representations that were the handiwork of the opinion draftsman and had little to do with the client's business or investment objectives.

11 Note the presence of the phrase "recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code." Here we have that same troublesome language that many practitioners concluded brought just about every type of tax advice, no matter how benign, into the realm of old section 10.35. See Dellinger, "Hand-Wringing Over Circular 230 and E-Mail Caveats," Tax Notes, Oct. 15, 2012, p. 301 2012 TNT 199-10: Viewpoint; see Dellinger, supra note 2.

END OF FOOTNOTES

Kip Dellinger is a CPA in Santa Monica, California. He is a former chair of the American Institute of Certified Public Accountants Tax Division's Tax Practice Responsibilities Committee, and he writes and teaches in the areas of tax practice, quality control, and ethics. He is also the recipient of the 2013-2014 Award for Instructor Excellence from the Education Foundation of the California Society of Certified Public Accountants.

IRS LTR: Arrangement With For-Profit Won't Jeopardize Group's Exempt Status.

The IRS ruled that an agreement between a tax-exempt research organization and a for-profit company under which the company will pay the organization for the results of its research will not jeopardize the organization's exemption and will not constitute an unrelated trade or business.

Citations: LTR 201440023

Contact Person: * * *

Identification Number: * * *
Telephone Number: * * *

Uniform Issue List Numbers: 501.03-08, 513.00-00
Release Date: 10/3/2014
Date: July 8, 2014

Employer Identification Number: * * *

LEGEND:

b = * * *
c = * * *
d = * * *
M = * * *
O = * * *
P = * * *

Dear * * *:

This responds to your request for rulings on the effect of the Agreement (described below) on your status as an organization described in §§ 501(c)(3), 509(a)(1), and 170(b)(1)(A)(vi) of the Internal Revenue Code (the "I.R.C.") and on your liability for unrelated business income tax under §§ 511 through 513.

FACTS

You are exempt from federal income tax under § 501(c)(3) of the Internal Revenue Code. You are not a private foundation within the meaning of § 509(a) because you are described in §§ 509(a)(1) and 170(b)(1)(A)(vi). Your mission is to inform and educate the American public about b, to advocate for c, and conduct research on d. You attempt to disseminate the results of your research as broadly as possible. You distribute your research results primarily through your website, O, and through the media, including print, radio, television, and online media. You maintain an archive of d data known as your P product. The P product can be accessed over your website, O, for non-commercial purposes. You may allow commercial use of the P product for a fee.

You have entered into an agreement (the "Agreement") with M, a for-profit, major media organization. The Agreement has an initial term of three years, subject to certain early termination and renewal rights. Under the Agreement, you agree to provide substantial portions of the results of your research (the "Information") to M, and M agrees to pay a periodic fixed fee to you and to make the Information available to users of its electronic products and services.

The Agreement defines the Information as current data delivered on a monthly basis and a historical file of data going back several years. The Information shall consist of your entire P product.

Specifically, you agree to collect, code and process the Information, and to deliver the Information to M in a format and at the delivery frequency specified in the Agreement. You grant M a nonexclusive, worldwide right to use, store, reproduce, create derivative works from, display, and deliver the Information or any part thereof. In addition, M has the right to use the Information for internal business purposes, to market and sell its services, for research and reporting by its multimedia news operation, in its generic, "fair value", composite or theoretical prices or ratings, or other similar pricing or rating models, and the development and distribution of its proprietary and descriptive databases, and for educational purposes. During the term of the Agreement, you agree not to deliver

all or a substantial portion (i.e., 25 percent or more) of the Information to any of the twelve companies listed on a schedule of the Agreement. M acknowledges that substantial portions of the Information are in the public domain and that you do not purport to grant to M any intellectual property rights in such information that is in the public domain. M represents, warrants and covenants that it will use commercially reasonable efforts to incorporate the Information into its product so as to support your objective of broadly disseminating the Information.

If M exercises its right to terminate the Agreement (other than for cause) before the expiration of the initial term, it is obligated to pay you a fixed "termination fee." In addition, upon termination of the Agreement, M has an option to purchase, for a separate fee, a perpetual license to use the information previously provided to it during the Agreement's term.

RULINGS REQUESTED

You have requested the following rulings:

1. Your performance of the Agreement and receipt of fees thereunder will not jeopardize your status as an organization exempt from tax under § 501(c)(3) or as an organization that is not a private foundation.

2. Your performance of the Agreement is not an unrelated trade or business.

3. The periodic and termination fees that are or may be payable to you under the Agreement are not royalties.

LAW

I.R.C. § 501(a) exempts from federal income taxation organizations described in § 501(c).

I.R.C. § 501(c)(3) describes organizations organized and operated for charitable, educational, and other enumerated exempt purposes.

I.R.C. § 511 imposes a tax on the unrelated business taxable income of organizations described in § 501(c).

I.R.C. § 512(a)(1) defines the term "unrelated business taxable income" as the gross income derived from any unrelated trade or business (as defined in § 513) regularly carried on, less certain allowable deductions that are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

I.R.C. § 512(b)(2) excludes all royalties from unrelated business taxable income.

I.R.C. § 513(a) defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, to be exempt as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated

exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3).

Treas. Reg. § 1.501(c)(3)-1(d)(1)(i) includes "educational" among the list of purposes for which an organization described in § 501(c)(3) may be exclusively organized and operated.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized and operated exclusively for one or more of the purposes specified in subdivision (i), above, unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) provides that the term "educational," as used in § 501(c)(3) relates to: (a) the instruction or training of the individual for the purpose of improving or developing his capabilities; or (b) the instruction of the public on subjects useful to the individual and beneficial to the community.

Treas. Reg. § 1.513-1(d)(1) provides, in general, that gross income derives from unrelated trade or business, within the meaning of § 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question — the activities, that is, of producing or distributing the goods or performing the services involved — and the accomplishment of the organization's exempt purposes.

Treas. Reg. § 1.513-1(d)(2) provides that a trade or business is related to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is substantially related, for purposes of § 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Rev. Rul. 70-186, 1970-1 C.B. 129, concerns an organization that was formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features. It is financed by contributions from lake front property owners, from members of the community adjacent to the lake, and from municipalities bordering the lake. The organization's principal activity is to treat the water, to remove algae, and to otherwise improve the condition of the water for recreational purposes. These activities constitute charitable activities insofar as they insure the continued use of the lake for public recreational purposes. The benefits to be derived from the organization's activities flow principally to the general public through the maintenance and improvement of public recreational activities. Any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without

providing benefits to the lake front property owners. Accordingly, it is held that the organization is exempt from Federal income tax under § 501(c)(3).

Rev. Rul. 75-196, 1975-1 C.B. 155, concerns an organization, the principal activity of which is to maintain a law library that is located in the same building as the headquarters of the local bar association, an organization described in § 501(c)(6). The organization's support is derived primarily from contributions by the local bar association. The rules of the library provide that the facilities are available for use only by members of the local bar association. Membership in the bar association is open to all members of the legal profession in good standing with an office or residence in the municipality. The fact that access to and use of the library facilities are limited to a designated class of persons is not necessarily a bar to recognition of exemption under § 501(c)(3). What is of importance is that the class benefited be broad enough to warrant a conclusion that the educational facility or activity is serving a broad public interest rather than a private interest, and is therefore exclusively educational in nature. The library facilities are available to a significant number of people. The fact that attorneys who use the library may derive personal benefit in the practice of their profession from the information garnered thereby is incidental to this purpose and is, in most instances, a logical by-product of an educational process. Therefore, the limitation of the use of the facilities is reasonable and does not prejudice the exclusively educational nature and purpose of the facility. Accordingly, the organization qualifies for exemption under § 501(c)(3).

Rev. Rul. 80-295, 1980-2 C.B. 194, concerns an organization that was created as a national governing body for amateur athletics to promote systematic physical exercise and education, and foster interest in amateur sports among the public at large, and to encourage widespread public participation in athletics and recreational sports. The organization sponsors, supervises, and regulates programs in a number of different amateur sports. It also arranges for and coordinates open competition for amateur athletics at the local, state, regional, and national levels. The organization receives income each year from the sale of exclusive television and radio broadcasting rights to an independent producer, who contracts with a commercial network to broadcast many of the athletic events sponsored, supervised, and regulated by the organization. The broadcasting of the athletic events promotes the various amateur sports, fosters widespread public interest in the benefits of its nationwide amateur athletic program, and encourages public participation. Therefore, the organization's sale of broadcasting rights and the resultant broadcasting of its athletic events contributes importantly to the accomplishment of its exempt purposes, is substantially related to the purposes constituting the basis for the organization's exemption, and, therefore, is not unrelated trade or business within the meaning of § 513.

Section 8.01 of Rev. Proc. 2014-4, 2014-1 I.R.B. 125, states that "[t]he Service may decline to issue a letter ruling or a determination letter when appropriate in the interest of sound tax administration or on other grounds whenever warranted by the facts or circumstances of a particular case."

ANALYSIS

Issue 1A: Whether the performance of the Agreement and the receipt of fees thereunder would jeopardize your status as an organization exempt from tax under § 501(c)(3)

To be described in § 501(c)(3), an organization must be operated exclusively for an exempt purpose. Treas. Reg. § 1.501(c)(3)-1(a)(1). An organization is regarded as "operated exclusively" of exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes. Treas. Reg. 1.501(c)(3)-1(c)(1). Exempt purposes include "educational" purposes. Treas. Reg. § 1.501(c)(3)-1(d)(1)(f). The term "educational" relates to the instruction of the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3).

Your exempt educational purpose is to inform and educate the American public about b and to advocate for c. You achieve this purpose by tracking, assembling and disseminating unbiased information regarding d. Your performance of the Agreement serves to disseminate the Information more broadly and thus helps to accomplish your educational purposes.

However, the Agreement also benefits M by allowing it to use the Information to market and sell its services, for research and reporting by its news operations, and to develop and distribute its proprietary databases. Although an organization's operations may be deemed to be beneficial to the public, if they also serve private interests other than incidentally, the organization is not entitled to exemption under § 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(c)(1); Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). The word "incidental" in this context has both qualitative and quantitative connotations. To be "incidental" in the "qualitative" sense, the private benefit must be a necessary concomitant of the activity which benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefiting certain private individuals. A benefit is quantitatively insubstantial only if it is insubstantial as measured in the context of the overall public benefit conferred by the activity. See Rev. Rul. 70-186.

Under the circumstances, we conclude that the benefit conferred on M under the Agreement is both qualitatively and quantitatively incidental. It is qualitatively incidental because the benefits under the Agreement flow primarily to the general public by enabling you to disseminate the Information to a wider audience, i.e., the subscribers to M's services. M does not have an exclusive right to, or exclusive use of, the Information, which is otherwise available to the general public for free over your website. M is merely a means by which to broaden the dissemination of the Information and thereby to accomplish your exempt purposes more effectively. In addition, the benefit conferred on M is quantitatively incidental because the benefit derived by M in being able to include the Information in its package of services is insubstantial in comparison with the benefit obtained by the users of those services.

In addition, the Agreement does not confer an impermissible private benefit on M's subscribers. By their nature, exempt educational activities serve public purposes by providing direct benefits to private parties. The public policy sought to be effected necessitates the dissemination of information and training to individuals, whose increased capabilities may generally serve to improve the public welfare. Further, in an educational context, an organization may be determined to be operating for public purposes even if the general public does not have the same direct access to the educational program as does some smaller, restricted group. See Rev. Rul. 75-196. Although the Agreement will benefit only subscribers to M's services, the population served is broad enough to warrant a conclusion that the Agreement serves a broad public interest.

Therefore, your performance of the Agreement and your receipt of fees thereunder furthers your exempt purpose, serves a public and not a private interest, and, consequently, will not jeopardize your status as an organization described in § 501(c)(3).

Issue 1B: Whether the performance of the Agreement and the receipt of fees thereunder would jeopardize your status as an organization that is not a private foundation.

We decline to rule on whether the performance of the Agreement and the receipt of fees thereunder would jeopardize your status as an organization that is not a private foundation because of the factual nature of the issue. See Rev. Proc. 2014-4, 2014-1 I.R.B. 125, section 8.01.

Issue 2: Whether the performance of the Agreement is an unrelated trade or business

For purposes of the tax imposed under § 511 on an exempt organization's unrelated business taxable

income (as defined in § 512), an “unrelated trade or business” is a trade or business the conduct of which is not substantially related to the organization’s performance of its exempt functions. I.R.C. § 513(a). A trade or business is “substantially related” to exempt purposes if the production or distribution of the goods or the performance of the services from which the gross income is derived contributes importantly to the accomplishment of the organization’s exempt purposes. Treas. Reg. § 1.513-1(d)(2).

Your exempt educational purpose is to inform and educate the American public about b and to advocate for c. You accomplish this purpose by disseminating unbiased information on the subject of d over your website and through various media outlets. M is a global news and media organization with a large subscriber base for its information services. The performance of the Agreement will enable you to disseminate the Information to M’s subscribers, thus making the Information more widely available and contributing importantly to the accomplishment of your exempt purpose of informing and educating the American public about b and c. See Rev. Rul. 80-295. Consequently, the performance of the Agreement is substantially related to your exempt purpose and not an unrelated trade or business.

Issue 3: Whether the fees that are payable to you under the Agreement constitute royalties within the meaning of § 512(b)(2).

I.R.C. § 511 imposes a tax on the unrelated business taxable income of organizations described in § 501(c)(3). I.R.C. § 512(a)(1) defines “unrelated business taxable income” as gross income derived from an unrelated trade or business. I.R.C. § 512(b)(2) excludes all royalties from unrelated business taxable income. Thus, the issue of whether the fees payable to you under the Agreement constitute royalties would be relevant only if such fees were gross income derived from an unrelated trade or business. Since we have concluded that the performance of the Agreement is not an unrelated trade or business, the fees payable under the Agreement are not gross income derived from an unrelated trade or business. Consequently, there is no need to address this issue.

RULINGS

Accordingly, based on the information submitted, we rule as follows:

1A. Your performance of the Agreement and receipt of fees thereunder will not jeopardize your status as an organization exempt from tax under § 501(c)(3) of the Code.

1B. Because of the factual nature of the issue, we decline to rule on whether your performance of the Agreement and receipt of fees thereunder would jeopardize your status as an organization that is not a private foundation.

2. Your performance of the Agreement is not an unrelated trade or business within the meaning of § 513(a) of the Code.

3. Insofar as the periodic and termination fees payable to you under the Agreement are not gross income derived from an unrelated trade or business, there is no need to rule on whether such fees are royalties.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager
Exempt Organizations, Technical

Enclosure
Notice 437

IRS TE/GE Advisory Committee Requests Applications.

The IRS has requested (IR-2014-96) applications for members to serve on its Advisory Committee on Tax Exempt and Government Entities, which will have vacancies as of June 2015. Applications are due by November 3, 2014.

October 2, 2014

WASHINGTON — The Internal Revenue Service is seeking applications for vacancies on the Advisory Committee on Tax Exempt and Government Entities (ACT). The committee provides a venue for public input on relevant areas of tax administration.

Vacancies exist in the following customer segments:

Employee Plans — two vacancies
Exempt Organizations — two vacancies
Indian Tribal Governments — one vacancy
Tax Exempt Bonds — two vacancies

Members are appointed by the Department of the Treasury and serve two-year terms, beginning in June 2015. Applications will be accepted through Nov. 3, 2014.

The ACT is an organized public forum for the IRS and representatives who deal with employee plans, exempt organizations, tax-exempt bonds, and federal, state, local and Indian tribal governments. The ACT allows the IRS to receive regular input on administrative policy and procedures of the Tax

Exempt and Government Entities Division (TE/GE).

Applications can be made by completing an ACT member application form. Applications should reflect the proposed member's qualifications. Members of the ACT may not be federally registered lobbyists. A notice published in the Federal Register, dated Oct. 2, contains more details about the ACT and the application process.

Applications should be sent by:

Email to Mark.F.O'Donnell@irs.gov,
Fax: 877-801-7395, or
U.S. mail to Mark O'Donnell, TE/GE Communications and Liaison Director, Internal Revenue Service, 1111 Constitution Ave., NW, SE:T:CL, NCA 676, Washington, DC 20224.

EO Update: e-News for Charities & Nonprofits - October 2, 2014

1. Register for IRS Phone Forum: Helping 501(c)(3) organizations with charitable contributions (a primer)

Thursday, Oct. 23 at 2 p.m. ET

Topics include:

- Examples of qualified and nonqualified organizations
- Charitable donations allowed by IRS
- Acceptable non-cash contributions
- Rules involving vehicle donations
- Required written acknowledgement for donation
- When significant intervening use applies
- Donors' recordkeeping responsibilities
- A brief summary on disaster relief

Register for this event.

2. Register for EO workshops

Register for our upcoming workshops for small and medium-sized 501(c)(3) organizations on:

Oct.29-30 – Eau Claire, WI
Hosted by University of Wisconsin – Eau Claire

Dec. 9 – Austin, TX
Hosted by Austin Community College

IRS LTR: Utility's Rate Base Reduction Inconsistent with ACRS Rules.

The IRS ruled that the reduction of a public utility company's rate base by the full amount of its accumulated deferred income tax account balance unreduced by the balance of its account balance

relating to net operating loss carryovers would be inconsistent with the requirements of section 168(i)(9) for use of the accelerated cost recovery system.

Citations: LTR 201438003

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *, ID No. * * *
Telephone Number: * * *

Index Number: 167.22-01
Release Date: 9/19/2014
Date: June 12, 2014

Refer Reply To: CC:PSI:B06 – PLR-104157-14

LEGEND:

Taxpayer = * * *
Parent = * * *
State A = * * *
Commission A = * * *
Commission B = * * *
Year A = * * *
Year B = * * *
Year C = * * *
Year D = * * *
Date A = * * *
Date B = * * *
Date C = * * *
Date D = * * *
Case = * * *
Director = * * *

Dear * * *:

This letter responds to the request, dated January 24, 2014, and additional submission dated May 19, 2014, submitted on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated, investor-owned public utility incorporated under the laws of State A primarily engaged in the business of supplying electricity in State A. Taxpayer is subject to the regulatory jurisdiction of Commission A and Commission B with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer’s rates are established on a rate of return basis.

Taxpayer is wholly owned by Parent, and Taxpayer is included in a consolidated federal income tax return of which Parent is the common parent. Taxpayer employs the accrual method of accounting and reports on a calendar year basis.

Taxpayer filed a rate case application on Date A (Case). In its filing, Taxpayer used as its starting

point actual data from the historic test period, calendar Year A. It then projected data for Year B through Year C. Taxpayer updated, amended, and supplemented its data several times during the course of the proceedings. Rates in this proceeding were intended to, and did, go into effect for the period Date B through Date C.

In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized and were not flowed thru to ratepayers.

In its rate case filing, Taxpayer anticipated that it would claim accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation was available in all years for which data was provided. Additionally, Taxpayer forecasted that it would incur a net operating loss (NOL) in Year D. Taxpayer anticipated that it had the capacity to carry back a portion of this NOL with the remainder producing a net operating loss carryover (NOLC) as of the end of Year D.

On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries — a "deferred tax asset" and a "deferred tax expense" — that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an NOLC.

In the setting of utility rates in State, a utility's rate base is offset by its ADIT balance. In its rate case filing and throughout the proceeding, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced as of the end of Year D by its federal ADIT balance net of the deferred tax asset account attributable to the federal NOLC. It based this position on its determination that this net amount represented the true measure of federal income taxes deferred on account of its claiming accelerated tax depreciation deductions and, consequently, the actual quantity of "cost-free" capital available to it. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules Testimony by another participant in Case argued against Taxpayer's proposed calculation of ADIT.

Commission A, in an order issued on Date D, held that it is inappropriate to include the NOL in rate base for ratemaking purposes. Commission A further stated that it is the intent of the Commission that Taxpayer comply with the normalization method of accounting and tax normalization regulations. Commission noted that if Taxpayer later obtains a ruling from the IRS which affirms Taxpayer's position, Taxpayer may file seeking an adjustment. Commission A also held that to the extent tax normalization rules require recording the NOL to rate base in the specified years, no rate of return is authorized.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1.

LAW AND ANALYSIS

Section 168(f)(2) of the Code provides that the depreciation deduction determined under section 168 shall not apply to any public utility property (within the meaning of section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that-would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under section 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(l)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.

Section 1.167(l)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess

(computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a subsection (1) method for purposes of determining the taxpayer's reasonable allowance under section 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under section 167(a) using a subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under section 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under section 167(a).

Section 1.167(l)-1(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.

Section 1.167(l)-1(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under section 1.167(l)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so. Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

Regarding the first issue, § 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization

method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission A is not in accord with the normalization requirements.

Regarding the second issue, § 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Section 1.167(l)-1(h)(1)(iii) provides generally that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. While that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the third issue, assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would, in effect, flow the tax benefits of accelerated depreciation deductions through to rate payers. This would violate the normalization provisions.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.
Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer,
Branch 6
(Passthroughs & Special Industries)
cc:
* * *

NABL Urges Aggregate Treatment of Partnerships.

NABL has submitted comments to the Treasury and the IRS regarding treating a partnership of private businesses and governmental persons (or section 501(c)(3) organizations for qualified 501(c)(3) bonds) as an aggregate of its partners where there is a fixed allocation of all partnership items for the entire measurement period for the bonds or the entire period that the person is a partner. NABL believes that the policies of I.R.C. §§ 141 and 145 are not in any way impaired by permitting aggregate treatment of public-private partnerships in cases where the attributes of ownership in the partnership are fixed for at least as long as any tax-advantaged bonds will remain outstanding.

The comments were prepared by an ad hoc task force led by Matthias Edrich of Greenberg Traurig and approved by NABL's Board of Directors. These comments supplement NABL's submissions to the Department of the Treasury and the Internal Revenue Service on December 22, 2006, and February 15, 2008, relating to the proposed allocation and accounting regulations published in the Internal Revenue Bulletin on October 30, 2006 (REG-140379-02; REG-142599-02). To view the September 17, 2014 comments, click here.

Chamber of Commerce Argues Court Erred in Work Product Analysis.

The Chamber of Commerce of the United States of America filed an amicus brief in the Second Circuit arguing that a district court erred when it held that the work product doctrine didn't apply to documents sought from Ernst & Young LLP in an IRS summons, arguing that the decision conflicts with Second Circuit precedent.

GEORG F.W. SCHAEFFLER, INA-HOLDING SCHAEFFLER GMBH & CO. KG,
SCHAEFFLER HOLDING GMBH & CO. KG, AND SCHAEFFLER HOLDING, LP,
Petitioners — Appellants,
v.
UNITED STATES OF AMERICA,
Respondent-Appellee.

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES
AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

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September 12, 2014

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rules of Appellate Procedure 26.1, the Chamber of Commerce of the United States of America (the Chamber) is a non-profit, tax-exempt organization incorporated in the District of Columbia. The Chamber has no parent company and no publicly held company has ten percent or greater ownership in the Chamber.

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STATEMENT OF INTEREST

The Chamber of Commerce of the United States of America (the "Chamber") is the nation's largest federation of business companies and associations, with underlying membership of more than 3,000,000 businesses and professional organizations of every size and in every sector and

geographic region of the country. A principal function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files amicus curiae briefs in cases raising issues of concern to the nation's business community.1

This case presents such an issue. The district court has interpreted the attorney work product doctrine in a way that effectively denies protection to documents created in the context of complex business transactions, even when the documents are created because of anticipated litigation and reveal mental impressions and opinions of counsel. The district court's decision is at odds with this Court's decision in United States v. Adlman, 134 F.3d 1194, 1195 (2d Cir. 1998), which holds that "a document created because of anticipated litigation, which tends to reveal mental impressions, conclusions, opinions, or theories concerning the litigation, does not lose work product protection merely because it is intended to assist in the making of a business decision influenced by the likely outcome of the anticipated litigation." As in Adlman¸ the district court's decision in this case presents companies with an "untenable choice." 134 F.3d at 1200. If a company obtains a thorough and candid analysis "reflecting the company's litigation strategy and its assessment of its strengths and weaknesses," it will be prejudiced when that analysis is turned over to its litigation adversaries. Id. If, on the other hand, the company "scrimps on candor and completeness to avoid prejudicing its litigation prospects, it subjects itself . . . to ill-informed decisionmaking." Id. In this case, as in Adlman, "nothing in the policies underlying the work-product doctrine or the text of the Rule itself" justifies "subjecting a litigant to this array of undesirable choices." Id.

SUMMARY OF THE ARGUMENT

1. The district court misapplied this Court's decision in Adlman. The district court acknowledged that litigation was highly probable and that the document at issue contained legal strategy and analysis. The district court nevertheless denied work protection by leaping much too quickly from a determination that the company would have sought legal advice even if it had not anticipated litigation to an unjustified conclusion that the advice would have taken the same form regardless of whether litigation was anticipated.

2. The district court's holding is contrary to the policy goals underlying the work product doctrine, as set forth in Adlman and Hickman v. Taylor, 329 U.S. 495 (1947). The court reasoned that the complexity of the transaction at issue, as well as the novel legal issues it raised, necessarily meant that the company would have sought detailed and lengthy tax advice from outside counsel even if it did not anticipate litigation. If these factors were sufficient to eliminate work product protection, legal advice concerning complex commercial transactions would virtually always go unprotected, effectively eliminating the protection of the work product doctrine in the arena in which it is most needed.

The district court's decision is also likely to have an adverse effect on the quality of legal advice. As both Hickman and Adlman recognize, a basic purpose of the protection is to provide lawyers with a zone of privacy in which they may freely develop their case. Under the district court's holding, however, lawyers will hesitate to give candid guidance for fear that their work product will later be revealed to opposing counsel. As a result, businesses will make commercial decisions without the full benefit of uninhibited legal advice, hurting their interests as well as those of their customers.

ARGUMENT

I. THE DISTRICT COURT'S APPROACH TO THE WORK PRODUCT DOCTRINE IS CONTRARY TO THIS COURT'S DECISION IN ADLMAN.

A. The District Court's Analysis Departs From Adlman.

1. The Second Circuit Has Adopted A "Because Of" Litigation Test.

The work product doctrine, recognized in Hickman v. Taylor, 329 U.S. 495 (1947), and codified in Federal Rule of Civil Procedure 26(b)(3), provides a qualified protection against disclosure for documents prepared by an attorney in anticipation of litigation. The doctrine is designed "to preserve a zone of privacy in which a lawyer can prepare and develop legal theories and strategy 'with an eye toward litigation,' free from unnecessary intrusion by his adversaries." Adlman, 134 F.3d at 1196 (quoting Hickman, 329 U.S. at 510-11). The principal focus is on encouraging careful and thorough preparation by the attorney and preventing the attorney's efforts from redounding to the benefit of the opposing party. Hickman, 329 U.S. at 511.

This Court has held that the work product doctrine applies to all documents prepared "because of" litigation. In United States v. Adlman, 134 F.3d 1194 (2d Cir. 1998), the Circuit rejected a narrower formulation of the doctrine under which documents would be protected only if they are prepared "primarily to assist in" litigation, and not if the "primary, ultimate, or exclusive purpose is to assist in making a business decision." See Adlman, 134 F.3d at 1198. In rejecting that narrower formulation, this Court joined other courts in holding that "[w]here a document is created because of the prospect of litigation . . ., it does not lose protection under this formulation merely because it is [also] created in order to assist with a business decision." Id. at 1203. Thus, for example, the work product doctrine protects a report concerning the company's litigation prospects that is written to inform a bank's lending policy to a company, as well as a memorandum prepared for an independent auditor to determine the amount of reserves for projected litigation. See id. at 1200.

As the Court noted in Adlman, the work product protection is not absolute. Although a document that satisfies the "because of" litigation test is eligible for protection, this shield may be overcome if a district court determines that the opposing party has shown a substantial need for the document and is unable to obtain its contents elsewhere without undue hardship. Id. at 1195. In addition, the court may find that only certain sections of a document require protection. Id. The Court explained, however, that "opinion work product" (documents that tend to reveal the attorney's mental processes) "receive special protection not accorded factual material," because a "core" purpose of the work product doctrine is to "shelter[ ] the mental processes of the attorney, providing a privileged area within which he can analyze his client's case." Adlman, 134 F.3d at 1197 (quoting United States v. Nobles, 422 U.S. 225, 238 (1975)).

2. The District Court's Approach Conflicts With the "Because Of" Test.

Under Adlman, the key issue is whether a document was prepared "because of" anticipated litigation. In the instant case, the district court recognized "that Schaeffler believed that litigation was highly probable in light of the significant and difficult tax issues that were raised by the planned refinancing and restructuring." Op. at 28. In addition, the court acknowledged that a tax memorandum prepared by Ernst & Young (the "EY Tax Memo") set forth the legal issues and analyzed the potential arguments that could be made by the parties should the IRS audit the company's return. Op. at 27. Based on these determinations, the court should have concluded that the work product doctrine applied to the EY Tax Memo.

Instead, the court applied a two-part test, based upon the statement in Adlman that work protect protections do not extend to "documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation." 134 F.3d at 1202. First, the district court considered whether the company would have sought out the type of tax advice provided by Ernst and Young if it had not anticipated an audit or litigation. Op. at 29. Second,

the court asked whether the advice given would have been different in content or form had the company known that no audit or litigation would ensue. Op. at 30.

As Appellant explains in its brief, this analysis departs from Adlman, which specifically provided that, "[w]here a document is created because of the prospect of litigation . . ., it does not lose protection under this formulation merely because it is [also] created in order to assist with a business decision." 134 F.3d at 1203. Thus, the Court's reference to documents that "would have been created in essentially similar form irrespective of the litigation" simply refers to documents that, while potentially prepared with litigation on the horizon, are not core work product; i.e., documents that do not "reveal mental impressions, conclusions, opinions, or theories concerning . . . litigation." Id. at 1195 (emphasis added).

B. The District Court Failed To Properly Analyze Whether the Legal Advice Would Have Taken the Same Form Absent Litigation.

In addition to applying the wrong standard in determining the application of work product protection, the district court also erred by denying work product protection based on factors that will be present in virtually any complex business transaction. After determining that the company would have sought tax advice even if had not anticipated an audit or litigation, the court jumped far too readily to the conclusion that the tax advice would have been essentially identical in form and content even if litigation not been anticipated. In determining whether a document "would have been created in essentially similar form irrespective of the litigation," courts must require more than the district court required in this case, or this single phrase in Adlman will effectively negate the work product rule in complex transactions.

The court noted that "the complexity of the tax issues surrounding the relevant transactions engendered the need to hire outside attorneys and advisors as well as the need to generate the lengthy and detailed analysis contained in the EY Tax Memo." Op. at 29. The district court then asserted that all legal advice considers the relevant legal authorities and analyzes how those authorities would be applied to a particular set of facts. On this basis, the court reasoned that it is of "no significance" that the EY Tax Memo evaluates the chances that specific tax positions will succeed in litigation, and specifically identifies and evaluates arguments that the IRS might advance. Op. at 31.

The district court's reasoning ignores the reality that the breadth and depth of an attorney's legal and factual analysis can vary considerably depending upon whether litigation is anticipated. To be sure, it may be difficult to determine what an attorney's opinion would have looked like in a counterfactual scenario that did not include a risk of litigation. That is particularly true in a case such as this one, where the factors the district court relied on — the size, complexity, and novelty of the transaction — created a prospect of litigation. But such difficulties cut against any conclusive determination that work product would have taken "essentially similar form" absent a prospect of litigation. The purpose of the work product doctrine is to protect the attorney's specific "mental impressions, conclusions, opinions, or theories concerning . . . litigation." 134 F.3d at 1195. Given this purpose, a court should not eliminate the work protection absent convincing evidence that substantially the same impressions, conclusions, opinions, or litigation theories would have been conveyed even if litigation had not been anticipated.

Rather than engaging in an analysis of the EY Tax Memo's detailed identification of significant issues and examination of potential arguments and counter-arguments, the district court effectively assumed that the complex nature of the transaction vitiated the work product protection. Under the district court's approach, only specific signifiers, such as a discussion of "actions particular to the litigation process" or a section on settlement strategies, would be sufficient to demonstrate that a

document was prepared "because of" litigation. By this logic, documents addressing the practical steps of a court case will receive protection, while those considering the core of any litigation — the legal theories and arguments — will be disclosed to adversaries on demand. That would eliminate the heart of the work product doctrine — surely not a result this Court intended to endorse in Adlman.

C. The District Court's Conclusion Is Based On A Misunderstanding Of Tax Practice.

In concluding that all tax advice regarding a complex transaction would be created in essentially the same form regardless of litigation, the district court relied on a quotation from Circular 230 that prohibits tax practitioners from taking the possibility of audit into account when providing tax advice. Op. at 30 (citing 31 C.F.R. § 10.37(c)(3)(iii) (2014)). The court's reliance on this language reflects a basic misconception about the practice of tax law. The federal income tax system depends on self-assessment. For this reason, tax practitioners are not permitted to provide advice that would circumvent the self-assessment system by suggesting to taxpayers that the determination of whether to assess should turn not on whether the tax is properly assessable, but instead on whether the client is likely to get caught if it wrongly carries out its self-assessment duties.

This requirement — that advice be provided without regard to the likelihood that the facts underlying the assessment question at issue would be discovered — is irrelevant when considering the prospect of litigation. For example, an advisor may expect that certain items, if not assessed by the taxpayer, will never be discovered on audit and never give rise to litigation, but nonetheless quite clearly are assessable. On the other hand, other items may be certain to be discovered on audit but never give rise to litigation or controversy because the IRS would agree that assessment would be improper. Finally, in some situations an advisor may expect that if an item is discovered on audit (which may be likely or unlikely), controversy may ensue. In short, Circular 230 standards do not imply that all tax advice by definition is prepared for controversy, but only that the self-assessment system duty requires that tax issues be considered on their merits and not on the basis of whether the taxpayer will get caught.

Even if the Court were to assume, contrary to fact, that all tax advice is prepared in anticipation of controversy or litigation, that premise would not imply that no tax advice is protected by the work product doctrine. Indeed, subject to a compelling need analysis, exactly the opposite conclusion would be appropriate — namely, that all tax advice would qualify for the protection. Neither bright-line test makes sense, however, because advice on tax law, like other legal advice, may be prepared to provide the recipient a basis by which a legal duty may be determined, but may also may be prepared as part of the process of preparing for an anticipated controversy. A categorical rule that all tax advice is necessarily given as if litigation were contemplated cannot be squared with reality. And a rule that excludes all tax advice from the work product protection is equally untenable.

II. THE DISTRICT COURT'S APPROACH IS CONTRARY TO THE POLICIES UNDERLYING THE WORK PRODUCT DOCTRINE.

A. The District Court's Holding Removes Work Product Protection For Complex Transactions.

The district court's approach to the work product doctrine effectively eliminates work product protection for tax opinions provided for complex transactions. As a result, businesses selected for audit by the IRS would be placed at a significant disadvantage in the process if their legal counsel's mental impressions and strategies were disclosed to the government.

The court relied on the fact that the EY Tax Memo concerned "enormously complex transactions" raising "'complex' and 'novel' federal tax issues" as support for its conclusion that the company

would have sought tax advice even absent the threat of litigation. Op. at 29. Most businesses, especially sophisticated businesses, however, seek advance guidance before entering into significant transactions that raise complex and novel issues. Thus, the district court's reasoning effectively strips work product protection from tax advice given in the context of complicated transactions.

This outcome is contrary to the basic purposes of the work product doctrine. See Adlman, 134 F.3d at 1500 ("Discovery was hardly intended to enable a learned profession to perform its functions either without wits or on wits borrowed from the adversary." (quoting Hickman, 329 U.S. at 516 (Jackson, J., concurring))). Moreover, the mental impressions of taxpayer's counsel need not be shared in order for the IRS to prepare its case and the taxpayer's assessment to be adjudicated fairly. The IRS has nearly 90,000 employees, including a host of talented highly specialized tax law experts.2 It is capable of doing its job without relying on the mental impressions of opposing counsel. Indeed, the district court's approach could hinder an efficient and productive audit process. A tax opinion may identify legal theories and litigation strategies that the IRS would not have otherwise asserted. In some cases, counsel may believe that the theories lack merit. Nevertheless, an IRS agent, after reading these theories, may choose to investigate or even argue these positions, slowing the process and delaying a final assessment. This unnecessary conflict is a classic example of the government seeking to build its case on the wits of opposing counsel. As a matter of public policy, barriers should not be erected to taxpayers having full access to all the potential issues associated with a tax return position before exercising their duties as the primary assessors of the income tax.

As the Court recognized in Adlman, the policies underlying the work-product doctrine and the text of Rule 26(b)(3) strongly support application of the doctrine in this context. The government imposes on taxpayers a duty to apply and interpret an extraordinarily complicated set of rules and laws to myriad complex transactions, but would limit access to candid advice of counsel by seeking to obtain that advice and turn it against the taxpayer. Where advice is provided to evaluate a taxpayer's defenses and strategies in litigation, revealing it to litigation adversaries undermines the basic purpose of the work product doctrine. In appropriate cases, the needs of the government may outweigh these policy concerns, but here the government has not asserted such needs. As the government would have it, a taxpayer must ascertain the law, which is often uncertain, and commit to a position on a tax return, choosing either to guess as to how it would defend the position in litigation or to reveal in advance its defense strategy to the government. As in Adlman, neither the purpose nor the text of the work product doctrine counsels in favor of such a result.

The adverse consequences of the district court's formulation of the work product doctrine extend beyond the tax realm. In denying protection to the EY Tax Memo, the court asserted that businesses had reasons other than the prospect of litigation to obtain legal advice, including a desire to lower their tax bills. Op. at 29-30. As a result, the court concluded that the company would have sought out the same type of advice even in the absence of anticipated litigation. Op. at 30. This rationale could operate to deny protection to many forms of prospective legal advice received by businesses. For example, a business that collects consumer data and is the victim of a data breach may revise its data security procedures to prevent further breach while also complying with Section 5 of the Federal Trade Commission Act. See 15 U.S.C. § 45. In addressing such a breach, the business will likely seek the advice of counsel to assess its data security procedures. Although this legal guidance may be provided in anticipation of litigation with the FTC, the business would also have other incentives to obtain advice, such as maintaining good customer service. Under the district court's approach, however, the fact that advice prepared in anticipation of litigation may benefit a company in other arenas will weigh against such advice being protected from disclosure.

B. The District Court's Holding Creates Perverse Incentives for Legal Advisors.

The district court's opinion significantly narrows the scope of work product protection for tax opinions. This narrowing of the protection will create pressure to shift the standard practice of those providing tax advice. If work product has little or no chance of qualifying for protection, tax practitioners will face pressure to be less candid in counseling their clients. Because their memos and opinions may be disclosed to adversaries, they may refrain from "showing their work" in reaching their conclusions and may choose not to discuss litigation strategies should they conclude that a transaction is likely to be challenged.

Such perverse incentives are not limited to the tax arena. In other contexts, such as the data security context described above, attorneys may also withhold their candid assessment.

Adlman recognized the potential for such negative effects and specifically noted this possibility as a reason for the test it adopted:

If the company declines to [candidly discuss litigation strategies, appraisal of the likelihood of success, and the feasibility of reasonable settlement] or scrimps on candor and completeness to avoid prejudicing its litigation prospects, it subjects itself and its co-venturers to ill-informed decisionmaking. On the other hand, a study reflecting the company's litigation strategy and its assessment of its strengths and weaknesses cannot be turned over to litigation adversaries without serious prejudice to the company's prospects in litigation. . . . We perceive nothing in the policies underlying the work — product doctrine or the text of [Rule 26(b)(3)] itself that would justify subjecting a litigant to this array of undesirable choices.

Adlman, 134 F.3d 1194, 1200 (2d Cir. 1998) (citing Hickman, 329 U.S. at 516). Adlman adopted a test that ensures attorneys a zone in which they can consider the facts, analyze the authorities, and formulate a legal strategy. To uphold the district court's interpretation of the doctrine would significantly constrict that space in a manner that would be "demoralizing" to attorneys, Hickman, 329 U.S. at 512, and injurious to clients.

CONCLUSION

The decision of district court should be reversed.
Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I CERTIFY, pursuant to Federal Rules of Appellate Procedure 29(d) and 32(a)(7) that the foregoing

Brief contains 3,751 words, excluding the parts of the Brief exempted under Federal Rule of Appellate Procedure 32. In accordance with Federal Rule of Appellate Procedure 32(a)(5)-(6), this Brief has been prepared in 14-point Times New Roman font.

Dated: September 12, 2014

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CERTIFICATE OF SERVICE

I CERTIFY that on this 12th day of September, 2014, a true and correct copy of the foregoing Brief was served on all counsel of record via CM/ECF pursuant to Local Rule 25.1(h).

Dated: September 12, 2014

Robert A. Long
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FOOTNOTES

1 Pursuant to Federal Rule of Appellate Procedure 29, the Chamber certifies that no party's counsel authored this brief in whole or in part, no party's counsel contributed money that was intended to fund preparing or submitting this brief, and no person, other than the Chamber, its members, or its counsel, contributed money that was intended to fund preparing or submitting this brief. All parties have consented to the filing of this brief.

2 Table 30, Internal Revenue Service Data Book 2013, available at http://www.irs.gov/pub/irs-soi/13databk.pdf.

END OF FOOTNOTES

IRS Issues Guidance on Changes to Pension Funding Stabilization Rules.

The IRS has issued guidance (Notice 2014-53) on changes to the funding stabilization rules for single-employer pension plans under the tax code and ERISA that were made by the Highway and Transportation Funding Act of 2014 (HTFA).

The interest rates used for purposes of minimum funding requirements are a set of three segment rates. Section 430(h)(2)(C)(iv) provides that each of the three segment rates for a plan year is adjusted to fall within a specified range that is determined based on an average of the corresponding segment rates for the 25-year period ending on September 30 of the calendar year preceding the plan year's first day. For plan years beginning in 2012, each segment rate is adjusted so that it is between 90 and 110 percent of the corresponding 25-year average segment rate. Before HTFA, this range was scheduled to gradually increase for later plan years so that the segment rates for plan years beginning after 2015 would have been between 70 and 130 percent of the corresponding 25-year average segment rates.

HTFA extends the period during which the narrowest range of the 25-year average segment rates applies when determining the segment rates that are used to apply sections 430 and 436. Thus, for

plan years beginning in 2012 through 2017, each segment rate is adjusted so that it is between 90 and 110 percent of the corresponding 25-year average segment rate. For later plan years, this range is scheduled to gradually increase so that the segment rates for plan years beginning after 2020 are between 70 and 130 percent of the corresponding 25-year average segment rates.

HTFA also provides that the limitation on interest rates based on the corresponding 25-year average segment rates does not apply for purposes of section 436(d)(2) regarding limitations on accelerated benefit distributions for a plan sponsored by an employer in bankruptcy. Changes to section 430(h)(2)(C)(iv) apply for plan years beginning after December 31, 2012. Under HTFA, a plan sponsor can elect not to have the changes to section 430 apply to any plan year beginning in 2013, either for all purposes or solely when determining the plan's adjusted funding target attainment percentage for that plan year.

Notice 2014-53 provides procedures for electing to defer use of the HTFA segment rates until the 2014 plan year; rules for elections and designations regarding the minimum funding requirements applicable to a plan for a plan year beginning in 2013; and the reporting requirements if the HTFA segment rates apply to the 2013 plan year. The guidance also provides special rules on the application of the benefit restrictions under section 436 and related rules for a plan year beginning after December 31, 2012, and before October 1, 2014, for a plan for which the HTFA changes are applied when determining its adjusted funding target attainment percentage for the plan year.

Guidance on Pension Funding Stabilization under the
Highway and Transportation Funding Act of 2014 (HATFA)

I. PURPOSE

This notice provides guidance on the changes to the funding stabilization rules for single-employer pension plans under the Internal Revenue Code (Code) and the Employee Retirement Income Security Act of 1974 (ERISA)1 that were made by section 2003 of the Highway and Transportation Funding Act of 2014 (HATFA), Pub. L. No. 113-159, which was enacted on August 8, 2014.

II. BACKGROUND

Section 430 specifies the minimum funding requirements that generally apply to singleemployer defined benefit pension plans pursuant to § 412. Section 430(h)(2) specifies interest rates that are used for purposes of calculating the minimum required contribution. The interest rates that are used for this purpose are a set of three segment rates described in § 430(h)(2)(C)(i), (ii) and (iii), or, alternatively, a full yield curve described in § 430(h)(2)(D)(i).

Section 430(h)(2)(C)(iv), which was added by the Moving Ahead for Progress in the 21st Century Act of 2012 (MAP-21), Pub. L. No.112-141, provides that each of the three segment rates described in § 430(h)(2)(C)(i), (ii) and (iii) for a plan year is adjusted as necessary to fall within a specified range that is determined based on an average of the corresponding segment rates for the 25-year period ending on September 30 of the calendar year preceding the first day of that plan year. For plan years beginning in 2012, each segment rate is adjusted so that it is no less than 90% and no more than 110% of the corresponding 25-year average segment rate. Under § 430(h)(2)(C)(iv)(II) as in effect prior to its modification by HATFA, this range was scheduled to gradually increase for later plan years, so that the segment rates for plan years beginning after 2015 would have been no less than 70% and no more than 130% of the corresponding 25-year average segment rates.

Notice 2012-61, 2012-42 I.R.B. 479, provides guidance regarding the changes to the minimum funding requirements and related rules made by MAP-21. Notice 2012-61 includes general guidance relating to the application of the modified segment rates (referred to in Notice 2012-61 and this notice as the MAP-21 segment rates), measurements for which the modified segment rates do not apply, transition issues, elections, reporting, and other issues.

HATFA extends the period during which the narrowest range around the 25-year average segment rates applies for purposes of determining the segment rates that are used to apply §§ 430 and 436. Under the modifications to § 430(h)(2)(C)(iv) made by HATFA, for plan years beginning in 2012 through 2017, each segment rate is adjusted so that it is no less than 90% and no more than 110% of the corresponding 25-year average segment rate. For later plan years, this range is scheduled to gradually increase, so that the segment rates for plan years beginning after 2020 are no less than 70% and no more than 130% of the corresponding 25-year average segment rates. The segment rates as modified by HATFA are referred to in this notice as the HATFA segment rates.

Section 436 sets forth a series of limitations on the accrual and payment of benefits under an underfunded plan. These limitations are applied during a plan year based on the plan's adjusted funding target attainment percentage (AFTAP). Section 2003(c) of HATFA provides that the limitation on interest rates based on the corresponding 25-year average segment rates does not apply for purposes of § 436(d)(2) (relating to limitations on accelerated benefit distributions for a plan sponsored by an employer in bankruptcy).

Section 2003(e)(1) of HATFA provides that the modifications to § 430(h)(2)(C)(iv) apply with respect to plan years beginning after December 31, 2012. Under section 2003(e)(2) of HATFA, a plan sponsor can elect not to have the modifications to § 430 apply to any plan year beginning in 2013, either for all purposes or solely for purposes of determining the plan's AFTAP for that plan year (which is used to apply the benefit restrictions under § 436).

This notice provides guidance on certain issues relating to HATFA. Notice 2012-61 continues to apply except to the extent the statutory provisions have changed.

III. ELECTION TO DEFER USE OF HATFA SEGMENT RATES UNTIL THE 2014 PLAN YEAR

This section III sets forth the procedures for elections made pursuant to section 2003(e)(2) of HATFA that relate to a plan year beginning in 2013.

A. Procedure for electing to defer use of HATFA segment rates

Except as provided in section III.B of this notice (which provides for a deemed election to defer the use of the HATFA segment rates for purposes of both §§ 430 and 436 based on the filing of Form 5500 under some circumstances), a plan sponsor elects to defer the use of the HATFA segment rates, either for all purposes or solely for purposes of § 436, until the first plan year beginning on or after January 1, 2014, by providing written notice to the enrolled actuary for the plan and to the plan administrator. The notice must specify the name of the plan, employer identification number and plan number, and whether the use of the HATFA segment rates is deferred for all purposes or only for determination of the AFTAP used to apply benefit restrictions under § 436.

The election described in this section III.A is irrevocable, and must be made no later than the later of: (1) the deadline for filing the Form 5500, Form 5500-SF or Form 5500-EZ (including extensions) for the plan year beginning in 2013; or (2) December 31, 2014.

B. Deemed election to defer use of the HATFA segment rates for purposes of both §§ 430 and 436

through filing of Form 5500, Form 5500-SF or Form 5500-EZ

With respect to a plan year beginning in 2013, if, on or before December 31, 2014, the Form 5500, Form 5500SF or Form 5500EZ is filed and the Schedule SB reflects the MAP-21 segment rates, then an election to defer use of the HATFA segment rates for purposes of both §§ 430 and 436 until the first plan year beginning on or after January 1, 2014 is deemed made. If an election is deemed made pursuant to this section III.B, the election is permitted to be revoked by filing, no later than December 31, 2014, an amended Form 5500, Form 5500-SF, or Form 5500-EZ for the plan year, with a revised Schedule SB that reflects the use of the HATFA segment rates. Alternatively, the deemed election is permitted to be revoked by either providing written notice of the revocation (which includes the name of the plan, employer identification number and plan number) to the enrolled actuary for the plan and to the plan administrator or by making the election described in section III.A of this notice to defer the use of HATFA segment rates only for purposes of § 436, but only if (1) a copy of the notice of the revocation or of the election is e-mailed to the Pension Benefit Guaranty Corporation (PBGC) at revoke.deemed.HATFA.election@pbgc.gov on or before December 31, 2014 (including in the subject line of the e-mail the plan sponsor's employer identification number, the plan number, and the name of the plan), and (2) at the time of the revocation of the deemed election, the plan sponsor is not a debtor in a case under title 11, United States Code, or similar federal or state law. If the plan sponsor revokes the deemed election using this alternative method, then an amended Form 5500, Form 5500-SF, or Form 5500-EZ2 for the plan year must be filed no later than the date on which Form 5500, Form 5500-SF or Form 5500-EZ is timely filed for the following plan year, and the revised Schedule SB must reflect the use of the HATFA segment rates.

If the plan sponsor revokes the deemed election, the plan sponsor can also elect to defer use of the HATFA segment rates only for purposes of § 436 under the rules of section III.A of this notice. An election that is deemed made pursuant to this section III.B is irrevocable if it is not revoked in the time and manner set forth in this section III.B.

IV. SECTION 430 ELECTIONS AND REDESIGNATIONS AVAILABLE FOR THE 2013 PLAN YEAR

This section IV sets forth rules regarding elections and designations relating to the minimum funding requirements applicable to the plan for the plan year beginning in 2013. Any action otherwise permitted in this section IV is not permitted to the extent it (1) would result in the imposition of benefit restrictions under § 436 for the plan year beginning in 2013 or 2014 that would otherwise not be imposed, or (2) would result in an unpaid minimum required contribution for any plan year beginning before 2014. The procedural and timing rules governing the acts permitted under this section IV are in section IV.E of this notice.

A. Reversal of an election to reduce funding balances

A plan sponsor is permitted to elect to reverse all or part of any election under § 1.430(f)-1(e) to reduce the plan's funding standard carryover balance or prefunding balance as of the first day of a plan year beginning in 2013 if (i) the HATFA segment rates apply for purposes of determining the minimum required contribution for that plan year, and (ii) the reduction election was made on or before September 30, 2014. It is expected that the regulations under § 430(f) will be revised to permit this exception to the general rule that any election to reduce the plan's funding standard carryover balance or prefunding balance is irrevocable.

Under § 1.436-1(a)(5), there may have been deemed elections to reduce the funding standard carryover balance or prefunding balance to avoid or remove benefit restrictions under § 436 for the plan year beginning in 2013. If the HATFA segment rates are applied retroactively for purposes of §

436 for a plan year beginning in 2013, the election to reverse a reduction under this section IV.A also applies to such a deemed election that was made in conjunction with a certification of the plan's AFTAP for the plan year. However, any reduction election that was made to avoid or remove benefit restrictions under § 436 during the period before the date of the original AFTAP certification for the 2013 plan year cannot be reversed even if the HATFA segment rates apply retroactively for purposes of § 436 for the plan year. This is because the AFTAP based on the HATFA segment rates will not apply to that portion of the plan year and therefore the reversal of any reduction election that was made to avoid or remove benefit restrictions under § 436 during that period would result in the imposition of new restrictions.

B. Late elections to add excess contributions for the 2013 plan year to the prefunding balance

If the HATFA segment rates apply for purposes of determining the minimum required contribution for a plan year beginning in 2013, the plan sponsor is permitted to make (or increase) the election under § 1.430(f)-1(b)(1)(ii) to add excess contributions for that plan year to the plan's prefunding balance as of the first day of the following plan year. It is expected that the regulations under § 430(f) will be revised to permit this extension of time to make this election.

C. Redesignation of a section 436 contribution

If the HATFA segment rates are applied retroactively for purposes of § 436 for a plan year beginning in 2013, any section 436 contribution within the meaning of § 1.436-1(j)(7) that was made in connection with the certified AFTAP for that plan year is applied toward the minimum required contribution for that plan year to the extent the contribution is no longer required to avoid or remove the benefit restriction. However, no change is permitted with respect to section 436 contributions that were made in connection with a presumed AFTAP before the AFTAP was certified for the plan year.

D. Redesignation of a contribution originally designated for 2013

Despite the general position of the IRS that a contribution designated for a particular plan year cannot be redesignated to apply for another plan year after the Schedule SB is filed, the plan sponsor may choose to redesignate all or a portion of a contribution that was originally designated as applying to the plan year beginning in 2013 to apply to a plan year that begins in 2014. This rule applies only to contributions made after the end of the 2013 plan year and on or before September 30, 2014 and applies only if the original designation is on a Schedule SB for the 2013 plan year that is filed on or before December 31, 2014.3

E. Procedural and timing rules

Any reversal of an election, election made after the generally applicable deadline, or redesignation of contributions under this section IV is made by the plan sponsor by providing written notification to the plan's enrolled actuary and plan administrator, and must be made no later than the last day of the plan year beginning in 2014. The written notification must specify the name of the plan, the employer identification number and plan number, and must set forth the relevant details, including the specific dollar amount involved. A conditional or formula-based election does not satisfy this requirement.

V. REPORTING REQUIREMENTS IF THE HATFA SEGMENT RATES APPLY TO THE 2013 PLAN YEAR

With respect to the plan year beginning in 2013, if the plan uses the segment rates and the plan

sponsor has not elected to defer the use of the HATFA segment rates in accordance with section III.A or III.B of this notice, then the Schedule SB for that plan year must reflect the use of the HATFA segment rates.

VI. APPLICATION OF § 436 AND RELATED RULES FOR A PLAN YEAR BEGINNING AFTER DECEMBER 31, 2012 AND BEFORE OCTOBER 1, 2014

This notice provides special rules relating to the application of the benefit restrictions under § 436 and related rules for a plan year beginning after December 31, 2012 and before October 1, 2014 for a plan for which the modifications made by HATFA to § 430(h)(2)(C)(iv) are applied for purposes of determining the plan's AFTAP for the plan year. A plan year to which this section VI applies is referred to in this section VI as an applicable plan year.

A. Presumptions apply based on prior year AFTAP

The benefit restrictions under § 436 for an applicable plan year are applied based on the presumed AFTAP before the date, if any, that the AFTAP is certified for that applicable plan year. Thus, the application of the HATFA segment rates does not affect the application of the presumption rules under § 436(h) for the first plan year for which those rates apply to the plan for purposes of § 436 (but affects the application of those presumption rules for the subsequent plan year).

B. Rules if first certification uses HATFA segment rates

If the first AFTAP certification for an applicable plan year (which may be a range certification pursuant to § 1.436-1(h)(4)(ii)) is made using the HATFA segment rates, the benefit restrictions under § 436 apply based on that AFTAP in accordance with the rules of §§ 1.4361(g) and (h).

C. Rules if first certification uses MAP-21 segment rates

If, on or before September 30, 2014, the AFTAP for an applicable plan year is certified using the MAP-21 segment rates, the AFTAP for that applicable plan year must be determined using the HATFA segment rates. If the change in the AFTAP using the HATFA segment rates rather than the MAP-21 segment rates results in a material change to the AFTAP, then the AFTAP must be recertified. In such a case, the plan sponsor can choose to apply any resulting change in the application of the benefit restrictions under § 436 either (i) prospectively, as described in section VI.D of this notice or (ii) retroactively to the date that the AFTAP was originally certified, as described in section VI.E of this notice. If the HATFA segment rates are applied to determine the certified AFTAP for the plan year beginning in 2013, then the option to apply any change in the application of § 436 as a result of recertification of the AFTAP using the HATFA segment rates prospectively is not available for the plan year beginning in 2014. For the first plan year for which the HATFA segment rates apply for purposes of § 436, if the AFTAP using the HATFA segment rates is certified before the end of the plan year, then in the absence of an affirmative election to apply the changes retroactively as described in section VI.E of this notice, the plan sponsor will be treated as having elected to apply any changes prospectively as described in section VI.D of this notice. All plan operations and elections must be consistent with this choice of whether to apply the AFTAP using the HATFA segment rates retroactively or prospectively, and any plan operations that were inconsistent with this choice must be corrected as described in section VI.F of this notice.

If any AFTAP certification for an applicable plan year using the MAP-21 segment rates is made after September 30, 2014, then the rules regarding a change in the AFTAP set forth in § 1.436-1(h)(4)(iii) and (iv) apply with respect to the determination of the AFTAP for that plan year that must be made using the HATFA segment rates.

D. Prospective application of change in benefit restrictions reflecting HATFA segment rates

If the AFTAP is certified for an applicable plan year using the MAP-21 segment rates, then any subsequent change to that certification (including a certification based on the HATFA segment rates) is subject to the rules regarding a change in the AFTAP set forth in §1.436-1(h)(4)(iii) and (iv).

Section 1.436-1(h)(4)(iii) sets forth rules relating to changes in certified AFTAPs and provides a special rule that deems a change in the AFTAP attributable to certain events as "immaterial," even if the change would otherwise be a material change. The effect of having an event for which the change in AFTAP is deemed immaterial is that a plan administrator can reflect the event on a prospective basis beginning with the date of the event, provided that the AFTAP is recertified as soon as practicable thereafter. It is expected that § 1.436-1(h)(4)(iii)(C) will be amended to provide that additional events can be added to the list of deemed immaterial events in guidance of general applicability.

If (1) on or before September 30, 2014, the AFTAP is certified for an applicable plan year using the MAP-21 segment rates, (2) a certification for that applicable year is subsequently made using the HATFA segment rates, and (3) the plan sponsor does not choose to apply any change in those restrictions retroactively as described in section VI.E of this notice; then the change in AFTAP attributable to the use of the HATFA segment rates for an applicable plan year under this section VI.D is treated as a deemed immaterial change. The date of the event is October 1, 2014 (or the date of the revised AFTAP certification, if earlier). Accordingly, if the plan sponsor chooses to apply any changes in the § 436 restrictions prospectively for an applicable plan year as described in this section VI.D, any change in benefit restrictions resulting from the updated AFTAP determination using the HATFA segment rates must be effective as of the earlier of (1) October 1, 2014, or (2) the date the AFTAP for the applicable plan year is recertified using the HATFA segment rates.

The requirement that the AFTAP be recertified to reflect the HATFA segment rates as soon as practicable after the event giving rise to the deemed immaterial change will not be satisfied if the recertification occurs later than December 31, 2014.

E. Retroactive application of change in benefit restrictions reflecting HATFA segment rates

If (1) on or before September 30, 2014, the AFTAP is certified for an applicable plan year using the MAP-21 segment rates, (2) a certification for that applicable plan year is subsequently made using the HATFA segment rates, and (3) the plan sponsor elects to apply the AFTAP determined using the HATFA segment rates retroactively as described in this section VI.E; then the operations of the plan must be conformed to that updated AFTAP for the period beginning when the AFTAP for the plan year was originally certified. In addition, if the HATFA segment rates apply for purposes of determining the AFTAP for the plan year beginning in 2013, then operations of the plan during the plan year beginning in 2014 must be conformed to apply the rules of § 1.436-1(g) and (h) using the redetermined 2013 AFTAP as the AFTAP for the preceding plan year, during the period beginning on the first day of the plan year beginning in 2014 and ending when the AFTAP for that plan year was originally certified.

F. Reversal of an election to reduce funding balances and redesignation of section 436 contributions for the 2014 plan year

Sections IV.A and IV.C of this notice permit the reversal of an election to reduce a funding balance and the redesignation of a section 436 contribution for an applicable plan year beginning in 2013. Under this section VI.F, a reversal of an election made on or before October 1, 2014 to reduce a funding balance or a redesignation of a section 436 contribution made on or before October 1, 2014

is permitted for the plan year beginning in 2014.

Any reversal of an election or redesignation of a section 436 contribution under this section VI.F is not permitted to the extent it would result in the imposition of benefit restrictions under § 436 for the plan year beginning in 2014 that would otherwise not be imposed. Accordingly, if the plan year beginning in 2014 is the first applicable plan year, any reduction election that was made to avoid or remove benefit restrictions under § 436 during the period before the date of the original AFTAP certification for that plan year cannot be reversed. This is because the AFTAP based on the HATFA segment rates will not apply to that portion of the plan year and therefore the reversal of any reduction election that was made to avoid or remove benefit restrictions under § 436 during that period would result in the imposition of new restrictions. Similarly, if the plan year beginning in 2014 is the first applicable plan year, no change is permitted with respect to section 436 contributions that were made in connection with a presumed AFTAP before the AFTAP was certified for the plan year.

G. Corrections

Once a plan's AFTAP for an applicable plan year has been certified using the HATFA segment rates, the plan administrator must take any corrective actions necessary to conform plan operations to this certified AFTAP, if applying this certified AFTAP would have changed the application of the § 436 restrictions for the period (1) beginning with the date of the immaterial event described in section VI.D of this notice (if the AFTAP certification applying the HATFA segment rates applies prospectively under section VI.D) or (2) beginning with the date the AFTAP for the year was first certified, as applicable (if the AFTAP certification applying the HATFA segment rates applies retroactively under section VI.E). If the plan year beginning in 2013 is an applicable plan year, the period for potential correction also includes the period during the 2014 plan year before the AFTAP for that plan year beginning in 2014 was originally certified.

If the corrective actions described in this section VI.G are taken to reflect the application of the new certified AFTAP, then the plan's operations are treated as having been consistent with the provisions of the plan document relative to the requirements of § 436. For this purpose, the provisions of the Employee Plans Compliance Resolution System (EPCRS), as set forth in Rev. Proc. 2013-12, 2013-4 I.R.B. 313, apply, except that a plan is eligible for self-correction under sections 7, 8, and 9 of Rev. Proc. 2013-12 without regard to the requirements of sections 4.03 (requiring a favorable IRS determination letter) and 4.04 (requiring certain established practices and procedures) of that revenue procedure.

Consistent with § 1.436-1(a)(4)(iii), if unpredictable contingent event benefits due to an event occurring during a plan year beginning in 2013 or 2014 are not permitted to be paid because of restrictions under § 436(b), but are later permitted to be paid as a result of a new certification of the AFTAP for the plan year reflecting the HATFA segment rates, then those unpredictable contingent event benefits must become payable, retroactive to the period those benefits would have been payable under the terms of the plan (other than plan terms implementing the requirements of § 436(b)).

Consistent with § 1.436-1(a)(4)(iv), if a plan amendment with an effective date during a plan year beginning in 2013 or 2014 does not take effect because of the limitations of § 436(c), but is later permitted to take effect as a result of a new certification of the AFTAP for the plan year reflecting the HATFA segment rates, then the plan amendment must automatically take effect as of the first day of that plan year (or, if later, the original effective date of the amendment).

For any prohibited payment that was not permitted to be paid during a plan year beginning in 2013

or 2014 because of the restrictions under § 436(d), but is permitted to be paid as a result of a new certification of the AFTAP reflecting the HATFA segment rates, the plan has taken adequate corrective action if it makes the prohibited payment available to participants or beneficiaries who would have been eligible for the prohibited payment (including a prohibited payment that is available on a restricted basis under § 436(d)(3)) on or after the dates described in the first paragraph of this section VI.G.

For any accruals that were not permitted to accrue during a plan year beginning in 2013 or 2014 because of restrictions under § 436(e), but are permitted to accrue as a result of a new certification of the AFTAP reflecting the HATFA segment rates, the plan has taken adequate corrective action if it restores benefits that accrue during the period that begins on the date described in the first paragraph of this section VI.G.

In the case of a participant or beneficiary who, as a result of any of the changes described in this section VI.G is entitled to increased benefits, to benefits payable at a special early retirement date, or to benefits payable in a different form of payment (and who elects such different form of payment, with spousal consent, if applicable), the required correction is to provide the benefit payments in the increased amount or other form of payment commencing with a new prospective annuity starting date. However, if payments have already commenced, the correction is to provide the participant with (1) future benefit payments that are paid in the same manner and amount as if the participant had begun receiving the corrected payment at his or her original annuity starting date, and (2) a make-up for past underpayments. The make-up for past underpayments is equal to the aggregate difference between the past payments actually received and the amounts that would have been received had the benefit commenced in the correct form of payment at the participant's original annuity starting date, plus interest to the date of the correction (in accordance with EPCRS), and may be paid as either (i) a single-sum payment, or (ii) an actuarially equivalent increase in the amount of future benefit payments.

VII. PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545-2095.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this notice are in sections III, IV, and VI of this notice. The collections of information are required to implement the application of the funding relief under section 2003 of HATFA. The collections of information are mandatory for those plan sponsors making various elections when applying the amendments made by HATFA to a plan and any plan sponsor of a plan for which the 2014 AFTAP was certified using MAP-21 segment rates.

For the collections in section III of this notice (relating to the election and possible amendment of Schedule SB for the 2013 plan year), the estimated total number of respondents is 39,600 plans. The estimated annual burden per respondent varies from 15 minutes to 1 hour and 45 minutes, depending on individual circumstances, with an estimated average of 23 minutes. The estimated total annual reporting and/or recordkeeping burden is 15,200 hours.

For the collections in sections IV and VI of this notice (relating to elections regarding the application of benefit restrictions under § 436), the estimated total number of respondents is 37,000 plans. The estimated annual burden per respondent varies from 15 minutes to 45 minutes, depending on

individual circumstances, with an estimated average of 37 minutes. The estimated total annual reporting and/or recordkeeping burden is 22,800 hours.

Estimates of the annualized cost to respondents are not relevant, because each collection of information in this notice is a one-time collection.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by § 6103.

VIII. DRAFTING INFORMATION

The principal authors of this notice are Tonya B. Manning and Carolyn E. Zimmerman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans taxpayer assistance answering service at 1-877-8-9-5500 (a toll free number) or e-mail Ms. Manning or Ms. Zimmerman at RetirementPlanQuestions@irs.gov.

FOOTNOTES

1 Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713) and section 3002(c) of ERISA, the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed in this notice for purposes of ERISA, as well as the Code. Thus, the provisions of this notice pertaining to §§ 430 and 436 of the Code also apply for purposes of sections 303 and 206(g) of ERISA.

2 Schedule SB is not required to be filed for plans for which Form 5500-EZ is filed and certain plans for which Form 5500-SF is filed. For these plans, the Schedule SB must be completed (including being signed by the enrolled actuary) and delivered to the plan administrator, who must retain it. With respect to these plans, references in section III.B of this notice to the filing of an amended Form 5500, Form 5500-SF, or Form 5500-EZ with a revised Schedule SB are applied by substituting the completion and delivery of the revised Schedule SB for the filing of the amended form.

3 With respect to a plan for which the Schedule SB need not be filed, as described in footnote 2 of this notice, the reference to filing of the Schedule SB is replaced by the completion and delivery of the Schedule SB.

END OF FOOTNOTES

The State of Nonprofit Governance.

This report provides a snapshot of nonprofit governance policies and practices among operating public charities. Using IRS Form 990 data, we find that many public charities have good governance policies and practices in place. In 2010, more than 60 percent of organizations had a conflict of interest policy, an independent audit and a compensation review and approval process for their chief executive. We also find that organizational characteristics such as size, type of organization, government funding, age, board size and board independence all appear related to whether or not a public charity chooses to adopt these recommended practices.

Read the Report.

Amy Blackwood, Nathan Dietz, Thomas H. Pollak
September 11, 2014

IRS LTR: Utility Not Violating Normalization Rules.

The IRS ruled that a public utility would violate normalization rules by using any depreciation methodology other than the one it is using or by imputing incremental accumulated deferred income tax on account of reliability plant adjustment rules.

Citations: LTR 201436038

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *, ID No. * * *
Telephone Number: * * *

Index Number: 167.22-01
Release Date: 9/5/2014
Date: May 22, 2014

Refer Reply To: CC:PSI:B06 – PLR-148311-13

LEGEND:

Taxpayer = * * *
Parent = * * *
State A = * * *
State B = * * *
State C = * * *
Commission A = * * *
Commission B = * * *
Commission C = * * *
Year A = * * *
Year B = * * *
Date A = * * *
Date B = * * *
Date C = * * *
Date D = * * *
Date E = * * *
Case = * * *
Director = * * *

Dear * * *:

This letter responds to the request, dated November 25, 2013, of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated public utility incorporated in State A and State B. It is wholly owned, through a limited liability company, by Parent. Taxpayer is engaged in the transmission, distribution, and supply of electricity in State A and State C. Taxpayer also provides natural gas and natural gas transmission services in State A. Taxpayer is subject to the regulatory jurisdiction of Commission A, Commission B, and Commission C with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer's rates are established on a rate of return basis. Taxpayer takes accelerated depreciation, including "bonus depreciation" where available and, for each year beginning in Year A and ending in Year B, Taxpayer individually (as well as the consolidated return filed by Parent) has or expects to, produce a net operating loss (NOL). On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries — a "deferred tax asset" and a "deferred tax expense" — that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an net operating loss carryover (NOLC). Taxpayer, for normalization purposes, calculates the portion of the NOLC attributable to accelerated depreciation using a "with or without" methodology, meaning that an NOLC is attributable to accelerated depreciation to the extent of the lesser of the accelerated depreciation or the NOLC.

Taxpayer filed a general rate case with Commission B on Date A (Case). The test year used in the Case was the 12 month period ending on Date B. In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized in accordance with Commission B policy and were not flowed thru to ratepayers. The data originally filed in Case was updated in the course of proceedings. In establishing the rate base on which Taxpayer was to be allowed to earn a return Commission B offset rate base by Taxpayer's ADIT balance, using a 13-month average of the month-end balances of the relevant accounts. Taxpayer argued that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Testimony by various other participants in Case argued against Taxpayer's proposed calculation of ADIT.

On Date C, a settlement agreement was filed with Commission B, incorporating the Taxpayer's proposed treatment of the tax consequences of its NOLC. In an order issued on Date D, Commission B issued an order approving the settlement agreement and also ordered Taxpayer to seek a ruling on the effects of an NOLC on ADIT. Rates went into effect on Date E.

Taxpayer proposed, and Commission B accepted, that it be permitted to annualize, rather than average, its reliability plant additions and to extend the period of anticipated reliability plant additions to be included in rate base for an additional eight months. Taxpayer also proposed, and Commission B accepted, that no additional ADIT be reflected as a result of these adjustments inasmuch as any additional book and tax depreciation produced by considering these assets would simply increase Taxpayer's NOLC and thus there would be no net impact on ADIT.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis

would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

LAW AND ANALYSIS

Section 168(f)(2) of the Code provides that the depreciation deduction determined under section 168 shall not apply to any public utility property (within the meaning of section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that-would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under section 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(1)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.

Section 1.167(1)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of

depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a subsection (1) method for purposes of determining the taxpayer's reasonable allowance under section 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under section 167(a) using a subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Section 1.167(1)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under section 1.167(1)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under section 167(a).

Section 1.167(1)-(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.

Section 1.167(1)-(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under section 1.167(1)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so. Section 1.167(1)-(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

In Case, Commission B has reduced rate base by Taxpayer's ADIT account, as modified by the account which Taxpayer has designed to calculate the effects of the NOLC. Section 1.167(1)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Further, while that section provides no specific mandate on methods, it does provide that

the Service has discretion to determine whether a particular method satisfies the normalization requirements. Section 1.167(1)-(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission B is in accord with the normalization requirements. The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the second issue, § 1.167(1)-(h)(6)(i) provides, as noted above, that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Increasing Taxpayer's ADIT account by an amount representing those taxes that would have been deferred absent the NOLC increases the ADIT reserve account (which will then reduce rate base) beyond the permissible amount.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman

Senior Technician Reviewer,
Branch 6
(Passthroughs & Special Industries)

cc:
* * *

IRS LTR: Utility's Normalization Methodology Is Proper.

The IRS ruled that a utility company would violate section 167 normalization rules by using any depreciation methodology other than the one it is using, by increasing its accumulated deferred income tax account by specified amounts, or by reducing its tax expense element of cost of service to reflect its net operating loss carryover.

Citations: LTR 201436037

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *, ID No. * * *
Telephone Number: * * *

Index Number: 167.22-01
Release Date: 9/5/2014
Date: May 22, 2014

Refer Reply To: CC:PSI:B06 – PLR-148310-13

LEGEND:

Taxpayer = * * *
Parent = * * *
State A = * * *
State B = * * *
State C = * * *
Commission A = * * *
Commission B = * * *
Commission C = * * *
Year A = * * *
Year B = * * *
Date A = * * *
Date B = * * *
Date C = * * *
Case = * * *
Director = * * *

Dear * * *:

This letter responds to the request, dated November 25, 2013, of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated public utility incorporated in State A and State B. It is wholly owned by Parent. Taxpayer is engaged in the transmission, distribution, and supply of electricity in State A and State C. Taxpayer is subject to the regulatory jurisdiction of Commission A, Commission B, and Commission C with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer's rates are established on a rate of return basis. Taxpayer takes accelerated depreciation, including "bonus depreciation" where available and, for each year beginning in Year A and ending in Year B, Taxpayer individually (as well as the consolidated return filed by Parent) has or expects to, produce a net operating loss (NOL). On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries — a "deferred tax asset" and a "deferred tax expense" — that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an net operating loss carryover (NOLC). Taxpayer, for normalization purposes, calculates the portion of the NOLC attributable to accelerated depreciation using a "with or without" methodology, meaning that an NOLC is attributable to accelerated depreciation to the extent of the lesser of the accelerated depreciation or the NOLC.

Taxpayer filed a general rate case with Commission B on Date A (Case). The test year used in the Case was the 12 month period ending on Date B. In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized in accordance with Commission B policy and were not flowed thru to ratepayers. The data originally filed in Case included six months of forecast data, which the Taxpayer updated with actual data in the course of proceedings. In establishing the rate base on which Taxpayer was to be allowed to earn a return Commission B offset rate base by Taxpayer's ADIT balance, using a 13-month average of the month-end balances of the relevant accounts. Taxpayer argued that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Testimony by various other participants in Case argued against Taxpayer's proposed calculation of ADIT. One proposal made to Commission B was, if Commission B allowed Taxpayer to reduce the ADIT balance as Taxpayer proposed, then Taxpayer's income tax expense element of service should be reduced by that same amount.

Commission B, in an order issued on Date C, allowed Taxpayer to reduce ADIT by the amount that Taxpayer calculates did not actually defer tax due to the presence of the NOLC and ordered Taxpayer to seek a ruling on the effects of an NOLC on ADIT. Rates went into effect on Date C.

Taxpayer proposed, and Commission B accepted, that it be permitted to annualize, rather than average, its reliability plant additions and to extend the period of anticipated reliability plant additions to be included in rate base for an additional quarter. Taxpayer also proposed, and Commission B accepted, that no additional ADIT be reflected as a result of these adjustments inasmuch as any additional book and tax depreciation produced by considering these assets would simply increase Taxpayer's NOLC and thus there would be no net impact on ADIT.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full

amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

LAW AND ANALYSIS

Section 168(f)(2) of the Code provides that the depreciation deduction determined under section 168 shall not apply to any public utility property (within the meaning of section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that-would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under section 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(1)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.

Section 1.167(1)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a subsection (1) method for purposes of determining the taxpayer's reasonable allowance under section 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under section 167(a) using a subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Section 1.167(1)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under section 1.167(1)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under section 167(a).

Section 1.167(1)-(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.

Section 1.167(1)-(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under section 1.167(1)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so. Section 1.167(1)-(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary

shall prescribe the requirements of a normalization method of accounting for that section.

In Case, Commission B has reduced rate base by Taxpayer's ADIT account, as modified by the account which Taxpayer has designed to calculate the effects of the NOLC. Section 1.167(1)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Further, while that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. Section 1.167(1)-(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission B is in accord with the normalization requirements. The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the second issue, § 1.167(1)-(h)(6)(i) provides, as noted above, that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Increasing Taxpayer's ADIT account by an amount representing those taxes that would have been deferred absent the NOLC increases the ADIT reserve account (which will then reduce rate base) beyond the permissible amount.

Regarding the third issue, reduction of Taxpayer's tax expense element of cost of service, we believe that such reduction would, in effect, flow through the tax benefits of accelerated depreciation deductions through to rate payers even though the Taxpayer has not yet realized such benefits. This would violate the normalization provisions.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer,
Branch 6
(Passthroughs & Special Industries)
cc:
* * *

FASB Advisory Group Expects Challenges With New Nonprofit Rules.

An advisory group of the Financial Accounting Standards Board on September 4 expressed general support for the board's efforts to improve nonprofit organizations' financial statements but also identified challenges that could result from the significant changes being proposed.

At a meeting in Norwalk, Connecticut, members of FASB's Not-for-Profit Advisory Committee (NAC) expressed concern about the complexity associated with the board's tentative decisions on the treatment of capital donations and the proposed disclosure of those gifted assets throughout the nonprofit entity's statement of activities.

NAC member John A. Mattie of PricewaterhouseCoopers LLP said one of the primary goals of the board's project was to improve the consistency and comparability of financial reporting across the nonprofit industry. Despite those benefits, the proposed rule changes could put more pressure on financial statement preparers regarding the footnote disclosures that must support the nonprofit's accounting decisions, he said, adding that FASB's guidance should provide several illustrative examples of those disclosures.

NAC member Michael B. Tarnoff of the Jewish Federation of Metropolitan Chicago said he believes that the rule changes under discussion would motivate nonprofit organizations and their governing boards to ensure that the financial statements reflect how they behave under the policies they've adopted. "I see it as an excellent result that we're moving toward," he said.

NAC member Bennett Weiner of the Better Business Bureau Wise Giving Alliance said the proposed footnote disclosure communicating information about a nonprofit's liquidity will provide value to the organization and users of its financial statements.

According to Weiner, the proposed disclosure requirement on liquidity could bring attention to an issue that has been neglected by several nonprofits for a variety of reasons.

However, Weiner expressed concern that some of the changes to nonprofit financial statements being proposed may create differences between the information provided in audited financials and Form 990, "Return of Organization Exempt From Income Tax," or other government filings. But those differences shouldn't necessarily dictate what the boards decide because the wheels of government turn slowly, and any change to those documents would represent a significant hurdle, he added.

Jeffrey Mechanick, an assistant director at FASB, said the staff will attempt to perform outreach with some government agencies to the extent that those organizations have the time and ability to contribute, adding that the IRS Tax-Exempt and Government Entities Division could provide valuable feedback on FASB's project on nonprofit reporting.

FASB member Lawrence Smith admitted that developing accounting standards for the nonprofit sector is particularly challenging because of the wide variety of nonprofits that exist. Although some are strictly nonprofit operations, others are funded by government agencies or operate like for-profit businesses, he noted.

Smith said that while FASB should consider the views of financial statement preparers, users, and auditors when making standard setting decisions, board members must keep the statement users at the front of their minds in deciding how to address a particular accounting issue.

FASB cannot gear nonprofit financial statements toward all users that could provide contributions to an organization, Mechanick said. He added that the board receives the most feedback from grant-making foundations and surrogates for donors, such as watchdog agencies and regulatory bodies.

Concerns With Revenue Standard

At a September 5 meeting with FASB, NAC members said they anticipated that the board's transition resource group may need to address the implementation problems that nonprofits have regarding the guidance in Accounting Standards Update No. 2014-09, "Revenue From Contracts With Customers (Topic 606)." NAC members expressed particular concern about applying the new revenue standard to healthcare payments and government grants such as social impact bonds.

FASB Chair Russell Golden said the board will provide staff resources to help nonprofit organizations better interpret the revenue recognition guidance, but he advised those entities to confirm whether their implementation problems apply to the existing guidance under U.S. generally accepted accounting principles, the new standard issued in May, or both.

Mechanick added that the implementation problems of healthcare entities and nonprofit organizations also may be examined by the industry task forces that were established by the American Institute of Certified Public Accountants to assist with application of the new guidance. The AICPA Financial Reporting Executive Committee plans to provide its own accounting guide on FASB's revenue standard, he said.

Thomas Jaworski

IRS Approves Proposed Allocations of Build America Bond Proceeds.

The IRS ruled that the owner of a power plant can make allocations of Build America Bond proceeds, and the expenditure of earnings that accrue after the project period from the investment of sale

proceeds of the bonds in a reasonably required reserve to pay principal and non-capital interest will not cause the bonds to fail to be qualified bonds.

Citations: LTR 201435013

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *, ID No. * * *
Telephone Number: * * *

Index Number: 148.00-00, 148.02-00, 141.01-01, 54AA.00-00
Release Date: 8/29/2014
Date: May 21, 2014

Refer Reply To: CC:FIP:05 – PLR-148383-13

LEGEND:

Issuer = * * *
Issue 1 = * * *
Issue 2 = * * *
Issue 3 = * * *
Issue 4 = * * *
Date 5 = * * *
Date 1 = * * *
Date 2 = * * *
Date 3 = * * *
Date 4 = * * *
a = * * *
Date 6 = * * *

Dear * * *:

This letter is in response to your request for rulings that (1) the Issuer can make certain proposed allocations related to Issue 2, Issue 3, and Issue 4 under sections 1.141-6(a) and 1.148-6 of the Income Tax Regulations as described below; (2) the expenditure of earnings that accrue subsequent to the project period (within the meaning of section 1.141-1) from the investment of sale proceeds of Issue 3 and Issue 4 in a reasonably required reserve to pay principal and interest that is not a capital expenditure (non-capital interest) on an issue will not cause Issue 3 and Issue 4 to fail to be qualified bonds within the meaning of section 54AA(g)(2); and (3) section 1.148-6(d)(3)(ii)(A)(7) may be applied to account for the expenditure of proceeds of Issue 3 and Issue 4.

FACTS AND REPRESENTATIONS

The Issuer makes the following representations. The Issuer has an undivided ownership interest in an electric generating facility (the Issuer’s portion of this facility is referred to herein as the Project). The Project was not placed in service before Date 5. To finance the Project, the Issuer issued four issues of tax-advantaged bonds: (1) Issue 1, issued as tax-exempt bonds on Date 1, (2) Issue 2, issued as tax-exempt bonds on Date 2, (3) Issue 3, issued as direct pay build America bonds on Date 3, and (4) Issue 4, issued as direct pay build America bonds on Date 4 (Issue 2, Issue 3, and Issue 4 collectively, the Bonds). The Bonds are secured by a parity reserve fund which consists in part of some sale proceeds of Issue 3 and Issue 4. The Issuer represents that this parity reserve fund is a

reasonably required reserve under section 148(d) and section 1.148-2(f) with respect to the Bonds. The Issuer expects the total costs of the Project to be lower than estimated as of the issue date of Issue 4 by $a, and thus the Issuer will have unspent proceeds in this amount (the Unspent Amount).

Prior to Date 6, the Issuer had allocated its capital expenditures to proceeds of Issue 1 and the Bonds such that an amount of proceeds of Issue 4 equal to the Unspent Amount was not allocated to any capital expenditure. The Issuer proposes to revise its allocations of expenses to proceeds of the Bonds as described in the Issuer's request for this ruling (the Proposed Allocations) no later than the date that is 18 months after Date 5 and the date that is 60 days after the fifth anniversary of the issue of the Bonds to which it will allocate its expenditures. At the time that each of the expenses comprising the Proposed Allocations was actually paid, the Issuer had on hand sufficient proceeds of the specific issue of the Bonds to which the expense is allocated under the Proposed Allocations to pay the expense. The Issuer will allocate investments to proceeds of the Bonds for arbitrage and rebate purposes in a manner that is consistent with the Proposed Allocations.

The Issuer also proposes to deposit earnings that accrue subsequent to the project period, as defined in section 1.141-1(b), from the investment of sale proceeds of Issue 3 and Issue 4 in a reasonably required reserve into a bona fide debt service fund and use those earnings to pay principal or interest.

LAW AND ANALYSIS

Revision of Allocations

Section 103(a) provides that, except as provided in subsection (b), gross income does not include interest on any state or local bond. Section 103(b)(1) provides that subsection (a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of section 141). Section 103(b)(2) provides that subsection (a) shall not apply to any arbitrage bond (within the meaning of section 148).

Section 141(a) provides that the term "private activity bond" means any bond issued as part of an issue which (1) meets the private business use test of section 141(b)(1) and the private security or payment test of section 141(b)(2), or (2) meets the private loan financing test of section 141(c). Section 141(b)(1) provides, in general, that an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use.

Section 148(a) provides that the term "arbitrage bond" means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly (1) to acquire higher yielding investments, or (2) to replace funds which were used directly or indirectly to acquire higher yielding investments. Further, for purposes of section 148(a), a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described in (1) or (2).

Section 148(f) provides, in part, that a bond is an arbitrage bond unless the issuer timely rebates to the United States the excess of the amount earned on certain nonpurpose investments over the amount that would be earned on those investments had those investments had a yield equal to the bond yield, plus any income attributable to the excess.

Section 1.141-6(a) provides that for purposes of sections 1.141-1 through 1.141-15, the provisions of section 1.148-6(d) apply for purposes of allocating proceeds to expenditures. Thus, allocations generally may be made using any reasonable, consistently applied accounting method, and allocations under sections 141 and 148 must be consistent with each other.

Section 1.148-6(a)(1) provides that an issuer may use any reasonable, consistently applied accounting method to account for gross proceeds, investments, and expenditures of an issue. However, under section 1.148-6(a)(3), if an issuer fails to maintain books and records sufficient to establish the accounting method for an issue and the allocation of the proceeds of that issue, the accounting and allocation rules under section 1.148-6 are applied using the specific tracing method.

Section 1.148-6(d)(1)(iii) provides that an issuer must account for the allocation of proceeds to expenditures not later than 18 months after the later of the date the expenditure is paid or the date the project, if any, that is financed by the issue is placed in service. This allocation must be made in any event by the date 60 days after the fifth anniversary of the issue date or the date 60 days after the retirement of the issue, if earlier.

Section 54AA(d)(1) provides that, for purposes of section 54AA, the term "build America bond" means any obligation (other than a private activity bond) if (A) the interest on such obligation would (but for section 54AA) be excludable from gross income under section 103; (B) such obligation is issued before January 1, 2011, and (C) the issuer makes an irrevocable election to have section 54AA apply.

The Issuer has requested that we rule on whether it can revise its allocations related to the Bonds under sections 1.141-6(a) and 1.148-6 as provided in the Proposed Allocations. The regulations under sections 141 and 148 apply to build America bonds as well as tax-exempt bonds because section 54AA(d)(1) defines a build America bond as other than a private activity bond and requires that, but for section 54AA, the interest on build America bonds be excludable from gross income under section 103. Accordingly, build America bonds cannot be private activity bonds under section 141 or arbitrage bonds under section 148 and are subject to the regulations under those sections to the extent that the regulations do not conflict with section 54AA.

By not requiring allocations to be determined when the expenditure is paid or incurred, the arbitrage regulations acknowledge that day-to-day practicalities require some flexibility regarding the timing of an issuer's allocations. We conclude that these practicalities also require flexibility to change allocations, so long as those changes are made within the time frame provided under section 1.148-6(d)(1)(iii). Here, at the time that each of the expenses described in the Proposed Allocations was actually paid, the Issuer had on hand sufficient proceeds of the specific issue of the Bonds to which the expense is allocated under the Proposed Allocations to pay the expense. The Issuer will also allocate investments to proceeds of the Bonds for arbitrage and rebate purposes in a manner that is consistent with the Proposed Allocations.

The Issuer tentatively made the Proposed Allocations within the time frame provided in section 1.148-6(d)(1)(iii). The Project was not placed in service before Date 5, which date is fewer than 18 months prior to Date 6, the date on which the Proposed Allocations were made. Date 6 occurred before the date that is 60 days after the fifth anniversary of any of the issues of the Bonds, and none of the issues of the Bonds have been retired. We conclude that, because the time frame provided in section 1.148-6(d)(1)(iii) had not yet closed and because there were sufficient proceeds on hand when the expenditures were made, Issuer can make the Proposed Allocations under sections 1.141-6(a) and 1.148-6.

Earnings on Sale Proceeds of BABs in Reserve

Section 54AA(a) provides that if a taxpayer holds a build America bond (BAB) on one or more interest payment dates of the bond during any taxable year, there shall be allowed as a credit against income tax for the taxable year an amount equal to the sum of the credits determined under section 54AA(b) with respect to such dates. Subject to limitations under section 54AA(c), section

54AA(b) provides that the amount of the credit with respect to any interest payment date for a build America bond is 35 percent of the amount of interest payable by the issuer with respect to such date.

Section 54AA(g) provides a special rule for qualified bonds issued before January 1, 2011. In the case of a qualified bond issued before January 1, 2011, in lieu of any credit allowed under Section 54AA with respect to such bond, the issuer of such bond shall be allowed a credit as provided in Section 6431.

Section 54AA(g)(2) provides that for purposes of Section 54AA(g), the term "qualified bond" means any BAB issued as part of an issue if (A) 100 percent of the excess of (i) the available project proceeds (as defined in Section 54A) of such issue, over (ii) the amounts in a reasonably required reserve (within the meaning of Section 150(a)(3)) with respect to such issue, are to be used for capital expenditures; and (B) the issuer makes an irrevocable election to have Section 54AA(g) apply.

Section 54A(e)(4) provides that the term "available project proceeds" means (A) the excess of the proceeds from the sale of an issue, over the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds), and (B) the proceeds from any investment of the excess described in (A).

Section 150(a)(3) provides that the term "net proceeds" means, with respect to any issue, the proceeds of such issue reduced by amounts in a reasonably required reserve or replacement fund.

Section 1.141-1(b) provides that for purposes of applying sections 1.141-1 through 1.141-16, the term "project period" means the period beginning on the issue date and ending on the date that the project is placed in service.

Section 1.148-6(d)(3)(i) provides that, except as otherwise provided in paragraph (d)(3) or paragraph (d)(4), proceeds of an issue may only be allocated to working capital expenditures as of any date to the extent that those working capital expenditures exceed available amounts (as defined in paragraph (d)(3)(iii)) as of that date (i.e., a "proceeds-spent-last" method). Section 1.148-6(d)(3)(ii)(A)(7) provides that the general rule in paragraph (d)(3)(i) does not apply to expenditures to pay principal or interest on an issue paid from investment earnings on a reserve or replacement fund that are deposited in a bona fide debt service fund.

The Issuer has requested that we rule on whether the expenditure of earnings that accrue subsequent to the project period (within the meaning of section 1.141-1) from the investment of sale proceeds of Issue 3 and Issue 4 in a reasonably required reserve to pay principal and non-capital interest on an issue will not cause Issue 3 and Issue 4 to fail to be qualified bonds within the meaning of section 54AA(g)(2). It has also requested that we rule on whether section 1.148-6(d)(3)(ii)(A)(7) may be applied to account for the expenditure of proceeds of Issue 3 and Issue 4.

The plain language of section 54AA(g)(2)(A) does not answer the question of whether investment earnings on the sale proceeds of Issue 3 and Issue 4 in a reasonably required reserve may be used to pay principal and non-capital interest. The answer turns on whether such investment earnings are included in "available project proceeds" under section 54AA(g)(2)(A)(i) or in "the amounts in a reasonably required reserve" under section 54AA(g)(2)(A)(ii). Although section 54AA(g)(2)(A)(i) cross-references the definition of "available project proceeds" in section 54A(e)(4), proceeds of bonds issued under section 54A may not be used to fund a reasonably required reserve. Accordingly, the definition of "available project proceeds" in section 54A does not address investment earnings on sale proceeds deposited in a reasonably required reserve.

If earnings on sale proceeds of Issue 3 and Issue 4 in a reasonably required reserve are included in "available project proceeds" under section 54AA(g)(2)(A)(i), then the Issuer would be required to spend those earnings on capital expenditures long after the Project is complete. We conclude, instead, that the earnings on the sale proceeds of Issue 3 and Issue 4 in a reasonably required reserve that accrue after the end of the project period, as defined in section 1.141-1(b), are not "available project proceeds" within the meaning of section 54AA(g)(2)(A)(i) and, therefore, may be used to pay principal and non-capital interest without causing Issue 3 and Issue 4 to fail to be qualified bonds under section 54AA(g)(2).

As stated above, Issue 3 and Issue 4 are build America bonds and, therefore, subject to the regulations under section 148 to the extent that the regulations do not conflict with section 54AA. For example, any working capital expenditures permitted under section 54AA must be allocated for arbitrage purposes to the proceeds of Issue 3 and Issue 4 using a proceeds-spent-last method, as provided in section 1.148-6(d)(3)(i). We conclude that section 1.148-6(d)(3)(ii)(A)(7) applies to preclude application of the proceeds-spent-last method of allocation to the payment of principal or interest from earnings on sale proceeds of Issue 3 and Issue 4 in the reasonably required reserve that accrue after the end of the project period and that are first deposited in a bona fide debt service fund.

CONCLUSION

Based strictly on the information submitted and representations made, we conclude that (1) the Issuer can make the Proposed Allocations under sections 1.141-6(a) and 1.148-6; (2) the expenditure of earnings that accrue subsequent to the project period (within the meaning of section 1.141-1) from the investment of sale proceeds of Issue 3 and Issue 4 in a reasonably required reserve to pay principal and non-capital interest on an issue will not cause Issue 3 and Issue 4 to fail to be qualified bonds within the meaning of section 54AA(g)(2); and (3) section 1.148-6(d)(3)(ii)(A)(7) may be applied as provided above to account for the expenditure of proceeds of Issue 3 and Issue 4.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express no opinion on any allocations related to Issue 1, whether Issue 1 or Issue 2 are tax-exempt under section 103, or whether Issue 3 or Issue 4 are build America bonds under section 54AA.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Timothy L. Jones
Senior Counsel
(Financial Institutions & Products)

Orrick: IRS Issues Additional Guidance on "Start Of Construction" Requirement for Renewable Energy Tax Credits.

On August 8, 2014, the IRS released Notice 2014-46, which provides additional guidance on the "start of construction" requirements for the investment tax credit (ITC) and production tax credit (PTC). As discussed below, Notice 2014-46 provides additional guidance on satisfying the physical work test, the effect of transfers of a facility after construction has begun, and also modifies the five percent safe harbor.

As a result of the American Taxpayer Relief Act of 2012, to claim ITC or PTC with respect to a renewable energy project, construction must have begun before January 1, 2014. The IRS has previously issued guidance on the start of construction requirements in Notices 2013-29 and 2013-60. 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 before January 1, 2014. The other method is to pay or incur five percent or more of the total cost of a facility before January 1, 2014 (the five percent safe harbor). In addition, work on the project 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).

In Notice 2013-60, the IRS clarified Notice 2013-29 by (i) providing that the "continuous" work tests would be deemed met if a facility is placed in service before January 1, 2016, (ii) clarifying that a taxpayer could look through a master contract in certain situations for purposes of both the physical work test and the five percent safe harbor, and (iii) clarifying that the start of construction requirement can be met with respect to a facility even if the facility is later transferred to a different taxpayer who then places the facility in service.

Notice 2014-46 clarifies that there is no fixed minimum threshold amount of work that must be performed (or cost that must be paid or incurred) to satisfy the physical work test. Notice 2013-29 provided an example in which a taxpayer met the physical work test with respect to a 50 turbine wind farm by excavating foundations for 10 wind turbines (that is, 20% of the total turbines). Notice 2014-46 states that this example is not intended to indicate that there is a 20% minimum threshold amount of work that must be performed to satisfy the physical work test.

Notice 2014-46 also provides additional guidance with respect to transfers of a facility after construction has begun. The Notice provides that if a taxpayer begins construction of a facility in 2013 with the intent to develop a facility at a certain site, but thereafter transfers equipment and other components to a different site, the work performed or costs paid or incurred with respect to the first site will be taken into account in determining whether the start of construction requirement is met with respect to the facility placed in service at the second site. However, the Notice also provides that, in the case of a transfer consisting solely of tangible personal property between two unrelated parties, work performed or costs paid or incurred by the transferor will not be taken into account with respect to the transferee in determining whether the start of construction requirement is met. However, if the transferee is related to the transferor, the transferee can "piggyback" on the costs paid or work performed by the transferor. A transferor will be related to a transferee partnership if it has a more than 20% capital or profits interest in the transferee.

Finally, Notice 2014-46 modifies the five percent safe harbor by providing an exception for single projects that are comprised of multiple facilities which do not meet the overall five percent requirement. If a single project is comprised of multiple facilities (for example, a wind farm comprised of multiple wind turbines), and a taxpayer has paid or incurred at least three percent of

the total cost of the facility before January 1, 2014, then the taxpayer will be treated as satisfying the five percent safe harbor with respect to some of the individual facilities so long as the total aggregate cost of those individual facilities is not greater than twenty times the amount the taxpayer paid or incurred before January 1, 2014. The following example illustrates this rule: A taxpayer incurs $30,000 in costs prior to January 1, 2014 with respect to a five turbine wind farm. The total cost of the wind farm is $800,000 and each turbine costs $160,000. The five percent test is not met with respect to the entire wind farm because the costs incurred prior to January 1, 2014 ($30,000) are less than five percent of the total cost of the wind farm ($40,000). However, under the modified safe harbor rule in Notice 2014-46, the taxpayer is treated as satisfying the five percent safe harbor with respect to three of the turbines. The total cost of three turbines ($480,000) is less than twenty times the amount of costs incurred prior to January 1, 2014 ($600,000).

Last Updated: August 21 2014
Article by Greg R. Riddle and Wolfram Pohl
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.

NABL Issues Guidance for Certain Conduit Bond Deals.

WASHINGTON – Lawyers involved in a conduit bond financing for a charitable nonprofit organization should decide as soon as possible which of them is responsible for ensuring the tax-exempt status of the borrower, the National Association of Bond Lawyers concludes in a just-released paper.

The 24-page paper, called "The 501(c)(3) Opinion In Qualified 501(c)(3) Bond Transactions," follows a few recent cases in which the Internal Revenue Service questioned the tax-exempt status of bonds after the nonprofit borrower lost its tax-exempt status because it failed to file Form 990s, which are annual financial reports.

However, NABL president Allen Robertson, a lawyer with Robinson, Bradshaw & Hinson in Charlotte, N.C., said that while the paper talks about the loss of tax-exempt status, it wasn't prompted by anything other than a need to provide guidance where none existed.

"We've noted from our members that the predominant practice now is to rely on borrower's counsel and that's something that's been developed over the last 20 or 30 years," Robertson said.

But a lot of lawyers representing a charitable nonprofit are not used to giving opinions other than for conduit bond financings and there is no guidance for them to turn to in writing such opinions.

""There wasn't any sort of paper or treatise that borrower's counsel or bond counsel could go to to sort of learn about the opinion, how you might phrase it, what it might mean, and the diligence that you need to do to support it," Robertson said. "We felt we were really trying to fill a gap."

NABL plans to send the paper to groups that might benefit from it, such as the National Association of Health and Educational Facilities Finance Authorities and the American Hospital Association. The majority of 501(c)(3) organizations are educational and health care entities, but others exist, he said.

The paper is divided into four parts. The first summarizes how a charitable nonprofit becomes and

maintains its status as a 501(c)(3) organization. The second covers the 501(c)(3) opinion and interpretations of its core phrases and related provisions, as well as information of ancillary opinions that are sometimes needed. The third part addresses the due diligence needed to support the opinion, as well as federal tax matters that are important. The fourth part deals with additional due diligence that may be needed by either the borrower's counsel or bond counsel.

In Part I, NABL says that to qualify as a 501(c)(3) organization, an entity: must be organized and operated for certain specified exempt purposes; is prohibited from using any of its net earnings for the benefit of a private shareholder or individual; cannot engage in activities that are related to a political campaign or that attempt to influence legislation; and must file annual Form 990s, which provide information on its finances.

The paper notes that there are additional requirements for organizations operating one or more hospital facilities as well as for those organizations that must comply with provisions of the Patient Protection and Affordable Care Act.

Most charitable organizations must apply to the IRS for 501(c)(3) status, but churches and certain religiously-affiliated entities such as schools and hospitals are exempted.

In Part II, NABL says the 501(c)(3) opinion should address two points. First, it should say whether the borrower is still a 501(c)(3) organization as of the date of the opinion, meaning its tax-exempt status has not been revoked. Second, it should say whether the borrower has continued to meet all of the requirements for a 501(c)(3) organization, meaning its tax-exempt status could not be revoked.

This section describes other opinions the borrower's counsel might be asked to render. For example, the borrower's counsel might be asked to provide a Section 513 opinion that states the bond-financed project is, or will not be, used in an unrelated trade or business.

In Part III, NABL lists the issues that the borrower's counsel should investigate, such as whether the organization's documents set forth its charitable purpose and provide for distribution of assets in the event of dissolution. Counsel should find out if the organization has been recognized and is currently recognized as having 501(c)(3) status as well as whether it has operated to further its exempt purpose.

Other key questions that must be probed are whether the organization has served private interests, engaged in political campaigning or excessive lobbying, or unrelated business activity. Finally, the borrower's counsel should determine if the organization has met its Form 990 filing requirements.

NABL describes the documents that must be examined to make these determinations. It also details additional information that must be obtained for certain hospitals and health care borrowers as well requirements that must be met under the Affordable Care Act.

Part IV addresses the issue of whether bond counsel can exclusively rely on the 501(c)(3) opinion of borrower's counsel. NABL said most bond counsel relying on such opinions typically state they are doing so.

THE BOND BUYER
BY LYNN HUME
AUG 26, 2014 3:33pm ET

IRS LTR: VEBA's Settlement Amount Is Exempt Function Income.

The IRS ruled that an amount paid to a limited liability company the sole member of which is a tax-exempt voluntary employees' beneficiary association established as a result of a settlement agreement following a bankruptcy is exempt function income under section 512(a)(3)(B) and will not be treated as unrelated business taxable income.

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *

UIL: 501.09-00, 512.00-00, 512.09-03, 7701.00-00
Release Date: 8/22/2014
Date: May 30, 2014

Employer Identification Number: * * *

LEGEND:

Debtors = * * *
LLC = * * *
State = * * *
x = * * *

Dear * * *:

This responds to your ruling request dated December 9, 2013 as to the federal tax consequences of the proposed transactions under the Internal Revenue Code (I.R.C.) and the Federal Tax Regulations.

FACTS

You are a trust, a voluntary employees' beneficiary association (VEBA), recognized as tax-exempt as an organization described under § 501(c)(9).
You were established as a result of a Settlement Agreement approved by the United States Bankruptcy Court after Debtors filed voluntary petitions for relief under chapter 11 of title 11 of the Bankruptcy Code. Debtors had historically provided a number of benefits to their retired employees and the retirees' surviving spouses and eligible dependents through various welfare benefit programs ("Retiree Welfare Plans").

The Bankruptcy Court issued an order directing the Office of the United States Trustee to appoint a Retiree Committee to represent the interests of the Retiree Welfare Plans' retirees and beneficiaries. Following negotiations between Debtors and the Retiree Committee, the Bankruptcy Court issued an order approving a Settlement Agreement in which the parties mutually agreed to the termination and termination date of the Retiree Welfare Plans. As part of the Settlement Agreement, a Settlement Amount of $x would be paid to a limited liability company ("LLC") whose single member is to be you. LLC was required to hold the Settlement Amount in its account for a minimum of five business days before distributions were to be made to you in your capacity as the single member of LLC.

The Settlement Agreement further provided that the Retiree Committee intended that you provide

medical benefits to eligible retiree claim holders, based on an Apportionment Methodology.

In accordance with the terms of the Settlement Agreement, the Retiree Committee established you. Shortly thereafter, LLC was formed under the laws of State with you as the single member. No election has been made on a Form 8832, Entity Classification Election, to treat LLC as an association taxable as a corporation.

The LLC Agreement provides that the sole purpose of LLC is to function as a conduit by which the consideration payable by Debtors under the Settlement Agreement is to be contributed to you. The LLC Agreement further provides that as soon as reasonably possible following LLC's receipt of the Settlement Amount from Debtors, and after paying or making reasonable provision for any expenses, liabilities, reserves or other contingencies, LLC shall distribute all available funds to you. Moreover, upon dissolution of LLC, and after paying or making reasonable provision for creditors, all remaining funds of LLC will be distributed to you. The LLC Agreement further provides that the management of LLC shall be vested solely in you but that you have the right to delegate its management rights and powers.

Debtors paid an initial installment of the Settlement Amount to LLC shortly after LLC was formed. The following month, Debtors paid the balance of the Settlement Amount to LLC. These amounts were deposited into an interest-bearing account maintained by LLC. The next month, LLC distributed the full Settlement Amount to you, and the Retiree Welfare Plans were terminated.

Pursuant to your trust documents and the Settlement Agreement, you will use the Settlement Amount to provide healthcare reimbursement benefits to retiree participants, their spouses and their dependents, as permitted under § 501(c)(9), and based on the Apportionment Methodology as set forth in the Settlement Agreement.

RULING REQUESTED

You have requested the following ruling:

That the Settlement Amount be treated as "exempt function income" under § 512(a)(3)(B), with the further result that no portion of the Settlement Amount will be treated as "unrelated business taxable income" to you.
LAW

Section 501(a) provides that an organization described in § 501(c) (including a VEBA described in § 501(c)(9)) shall be exempt from taxation unless the exemption is denied under §§ 502 or 503.

Section 511 imposes tax on the unrelated business taxable income (as described in § 512) of organizations described in § 501(c).

Section 512(a)(3)(A) provides that, in the case of an organization described in § 501(c)(9), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the allowable deductions that are directly connected with the production of gross income (excluding exempt function income), both computed with specified modifications.

Section 512(a)(3)(B) provides that the term "exempt function income" means, for a § 501(c)(9) organization, the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing the members or their dependents or guests goods, facilities, or services in furtherance of the organization to which such income is paid. Such term also means all income (other than an amount equal to the gross income derived from any unrelated trade or business carried on by the organization) which is set aside to provide for the payment of life, sick,

accident, or other benefits, including reasonable costs of administration directly connected with the provision of such benefits.

Section 512(a)(3)(E) provides that the amounts set aside as of the close of a taxable year for the payment of life, sick, accident, or other benefits may not be taken into account for purposes of determining "exempt function income" to the extent that such amounts exceed the qualified asset limit, determined under §§ 419A(c) and 419A(f)(7), for such taxable year. In calculating the qualified asset account limit for this purpose, a reserve for post-retirement medical benefits under § 419A(c)(2)(A) is not to be taken into account. See, also Temp. Treas. Reg. § 1.512(a)-5T, Q&A-3(a), and Prop. Treas. Reg. § 1.512(a)-5.

Treas. Reg. § 1.512(a)-5T, Q&A-3(b), provides that the exempt function income of a VEBA includes certain amounts paid by members of the VEBA ("member contributions"). Member contributions include both employee contributions and employer contributions to a VEBA.

Treas. Reg. § 301.7701-1(a)(1) provides that the Code prescribes the classification of various organizations for federal tax purposes. Whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law.

Treas. Reg. § 301.7701-2(a) provides, in part, that a business entity is any entity recognized for federal tax purposes (including a disregarded entity) that is not properly classified as a trust under § 301.7701-4 or otherwise subject to special treatment under the Code. A business entity is domestic if it is created or organized in the United States, or under the law of the United States or of any State. See § 301.7701-5(a).

Treas. Reg. § 301.7701-3(a) provides, in part, that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes. An eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Treas. Reg. § 301.7701-3(b)(1)(ii) provides, in part, that unless the entity elects otherwise, a domestic eligible entity is disregarded as an entity separate from its owner if it has a single owner.

Treas. Reg. § 301.7701-2(a) provides, in part, that if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner. However, for employment and certain excise tax purposes, a disregarded entity is treated as a corporation. See § 301.7701-2(c)(2)(iv) and (v).

Announcement 99-102, 1999-43 I.R.B. 545, provides that when the owner of an eligible entity that is treated as a disregarded entity is exempt from taxation under section 501(a) of the Code, it must include, as its own, information pertaining to the finances and operation of the disregarded entity in its annual information return. Announcement 99-102 further states that "when an entity is disregarded as separate from its owner, its operations are treated as a branch or division of the owner."

ANALYSIS

Debtors contributed the Settlement Amount to LLC. Under the Settlement Agreement, LLC was required after paying or making reasonable provision for any expenses, liabilities, reserves or other contingencies, to distribute the remaining Settlement Amount to you which you will use to provide medical benefits to participants (their spouses and eligible dependents) of the Reimbursement Plan.

Pursuant to your trust documents and the Settlement Agreement, you will use the Settlement Amount specifically to provide healthcare reimbursement benefits permitted under § 501(c)(9).

Based on the information provided, you are the single member of LLC and LLC has not made an election to be treated as an association taxable as a corporation. Accordingly, LLC is disregarded as an entity separate from its owner and its activities are treated as yours. As a result, the Settlement Amount paid to LLC by Debtors is treated as if paid to you by Debtors.

Further, the retirees eligible to receive medical benefits from you had been employed by Debtors and had been eligible to receive welfare benefits under Debtors' Retiree Benefit Plans. Based on these facts, we conclude that the Settlement Amount is treated as employer contributions to you.

Pursuant to Treas. Reg. § 1.512(a)-5T, Q&A-3(b), employer contributions to a VEBA are treated as exempt function income and, therefore, excluded from the definition of "unrelated business taxable income."

Accordingly, we conclude that the Settlement Amount is exempt function income under the first sentence of § 512(a)(3)(B), with the further result that no portion of the Settlement Amount will be treated as unrelated business taxable income to you.

RULING

Based on the information submitted, representations made, and the authorities cited above, we rule that:

The Settlement Amount is treated as "exempt function income" under § 512(a)(3)(B), with the further result that no portion of the Settlement Amount will be treated as "unrelated business taxable income" to you.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.
This ruling is directed only to the organization that requested it. Section 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager, EO Technical

Enclosure
Notice 437

Citations: LTR 201434025

IRS EO Update: e-News for Charities and Nonprofits - August 20, 2014

1. Register for IRS phone forum this Thursday: Essential Information for 501(c)(8) and 501(c)(10) Fraternal Organizations

Thursday, August 21
2 pm, Eastern

Topics include:

- Explanation of types of organizations exempt under sections 501(c)(8) and 501(c)(10) of the Internal Revenue Code
- Basic requirements for exemption under each of these sections
- Differences between (c)(8) and (c)(10) organizations
- Helpful resources for exempt organizations

Register for this presentation.

2. IRS "Taxpayer Bill of Rights" Available in six languages.

Read news release.

3. Register for EO workshops

Register for our upcoming workshops for small and medium-sized 501(c)(3) organizations on:

Sept. 8 – 9 – San Francisco, CA
Hosted by the University of San Francisco LLM in Taxation Program

Sept. 17 – Blackwood, NJ
Hosted by Camden Community College

Sept. 18 – South Orange, NJ
Hosted by Seton Hall University

Oct.29-30 – Eau Claire, WI
Hosted by University of Wisconsin – Eau Claire

Dec. 9 – Austin, TX
Hosted by Austin Community College

If you have a technical or procedural question relating to Exempt Organizations, visit the Charities and Nonprofits homepage on the IRS.gov Web site.

If you have a specific question about exempt organizations, call EO Customer Account Services at 1-877-829-5500.

H.R. 5319 Would Change Manufacturing Bond Rules.

H.R. 5319, the Modernizing American Manufacturing Bonds Act, introduced by Rep. Randy Hultgren, R-Ill., would expand qualifications for small issue manufacturing bonds to include intangible property production.

113TH CONGRESS
2D SESSION

H.R. 5319

To amend the Internal Revenue Code of 1986 to modify certain rules applicable to qualified small issue manufacturing bonds.

IN THE HOUSE OF REPRESENTATIVES

JULY 31, 2014

Mr. HULTGREN (for himself and Mr. NEAL) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to modify certain rules applicable to qualified small issue manufacturing bonds.
Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Modernizing American Manufacturing Bonds Act”.

SEC. 2. MODIFICATIONS TO QUALIFIED SMALL ISSUE BONDS.

(a) MANUFACTURING FACILITIES TO INCLUDE PRODUCTION OF INTANGIBLE PROPERTY AND FUNCTIONALLY RELATED FACILITIES. — Subparagraph (C) of section 144(a)(12) of the Internal Revenue Code of 1986 is amended to read as follows:

“(C) MANUFACTURING FACILITY. — For purposes of this paragraph —

“(i) IN GENERAL. — The term ‘manufacturing facility’ means any facility which —

“(I) is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property),

“(II) is used in the creation or production of intangible property which is described in section 197(d)(1)(C)(iii), or

“(III) is functionally related and subordinate to a facility described in subclause (I) or (II) if such facility is located on the same site as the facility described in subclause (I) or (II).

“(ii) CERTAIN FACILITIES INCLUDED. — The term ‘manufacturing facility’ includes facilities that

are directly related and ancillary to a manufacturing facility (determined without regard to this clause) if —

“(I) those facilities are located on the same site as the manufacturing facility, and

“(II) not more than 25 percent of the net proceeds of the issue are used to provide those facilities.

“(iii) LIMITATION ON OFFICE SPACE. — A rule similar to the rule of section 142(b)(2) shall apply for purposes of clause (i).

“(iv) LIMITATION ON REFUNDINGS FOR CERTAIN PROPERTY. — Subclauses (II) and (III) of clause (i) shall not apply to any bond issued on or before the date of the enactment of the Modernizing American Manufacturing Bonds Act, or to any bond issued to refund a bond issued on or before such date (other than a bond to which clause (iii) of this subparagraph (as in effect before the date of the enactment of the Modernizing American Manufacturing Bonds Act applies)), either directly or in a series of refundings.”.

(b) INCREASE IN LIMITATIONS. — Paragraph (4) of section 144(a) of the Internal Revenue Code of 1986 is amended —

(1) by striking “$10,000,000” in subparagraph (A)(i) and inserting “$30,000,000”, and

(2) by striking “$10,000,000” in the heading and inserting “$30,000,000”.

(c) EFFECTIVE DATE. — The amendments made by this section shall apply to obligations issued after the date of the enactment of this Act.

Disaster-Related Guidance Suspends Some Rules on Bond-Financed Housing.

The IRS issued guidance (Rev. Proc. 2014-50) to automatically suspend some requirements under section 142(d) for qualified residential rental projects financed with exempt facility bonds issued by state and local governments under section 142.
In the year following a presidential declaration of a qualifying major disaster, the revenue procedure suspends the income requirements for units occupied by individuals displaced by the disaster and modifies other requirements of section 142(d) to accommodate the suspension. The guidance provides relief for bond projects as well as bond/low-income housing tax credit (LIHTC) projects.

Under the revenue procedure, a project operator may provide emergency housing relief for less than the designated temporary housing period. The revenue procedure explains the circumstances under which an operator may accept a displaced individual as a tenant and explains requirements for the provision of emergency housing relief.

The guidance also provides that the occupancy of a unit by a displaced individual during the temporary housing period is treated as satisfying the non-transient use requirement under reg. section 1.103-8(b)(4). Further, the guidance discusses the treatment of displaced individuals under the next-available-unit rule, the income qualifications for units in bond projects and bond/LIHTC projects during the temporary housing period, the treatment of a unit vacated by a displaced individual, and the income qualifications when the temporary housing period ends.

Rev. Proc. 2014-50 is effective for major disasters declared on or after August 21, 2014.

Citations: Rev. Proc. 2014-50; 2014-37 IRB 1

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.

(Also Part 1, §§ 142 and 42; 1.103-8)

SECTION 1. PURPOSE

In the context of a Major Disaster, this revenue procedure provides temporary relief from certain requirements of § 142(d) of the Internal Revenue Code for Issuers and Operators. This revenue procedure also provides emergency housing relief for individuals who are displaced by a Major Disaster from their principal residences in certain Major Disaster Areas. This revenue procedure provides relief for both Bond Projects and Bond/LIHTC Projects. For Bond/LIHTC Projects, see also Rev. Proc. 2014-49, I.R.B. 2014-37, which provides for emergency housing relief under § 42 in response to Major Disasters. See section 4 of this revenue procedure for definitions of certain capitalized terms appearing throughout this revenue procedure.

SECTION 2. BACKGROUND

.01 Upon issuance of the President's declaration of a Major Disaster, the Federal Emergency Management Agency (FEMA) may designate particular cities, counties, or other local jurisdictions covered by the declaration as eligible for Individual Assistance, Public Assistance, or both. With respect to some previous Presidential declarations of Major Disasters, the Internal Revenue Service (Service) issued notices providing relief from certain requirements under §§ 42 and 142(d) to facilitate emergency housing relief for Displaced Individuals without regard to the income of those Displaced Individuals.

.02 Generally, under § 103, private activity bonds that are not qualified bonds within the meaning of § 141 are not tax-exempt. Section 141(e) provides in part that the term "qualified bond" means any private activity bond if such bond is an exempt facility bond, and § 142(a) provides in part that the term "exempt facility bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide qualified residential rental projects. To be a qualified residential rental project, a residential rental housing project must meet the requirements in § 142(d). The requirements include the following rules.

(1) At all times during the qualified project period, a specified percentage of the residential units must be occupied by individuals whose income does not exceed applicable income limits (the set-aside requirements). § 142(d)(1) and (d)(6).

(2) The qualified project period begins on the first day on which 10 percent of the residential units in the Project are occupied and ends on the latest of (a) the date that is 15 years after the date on which 50 percent of the residential units in the Project are occupied, (b) the first day on which no tax-exempt private activity bond issued with respect to the Project is outstanding, or (c) the date on which any assistance provided with respect to the Project under section 8 of the United States Housing Act of 1937 terminates. § 142(d)(2)(A).

(3) Generally, if the income of an occupant of a residential unit was at or below the applicable income limits when occupancy of that unit began, the occupant's income is treated as continuing to be at or below those limits throughout that occupant's occupancy. If, however, the income of the occupant rises above a specified percentage of the applicable income limit, the occupant's income is

treated as continuing to be at or below the applicable income limit only if the next available unit in the same project that meets certain criteria is occupied by a person whose income is at or below the applicable income limit (the next-available-unit rule). § 142(d)(3)(B).

(4) The Owner may elect to treat the project as a deep rent skewed project, in which case certain modifications to the next-available-unit rule, an additional set-aside requirement, and certain rent restrictions apply. § 142(d)(4).

(5) Under regulations issued under the predecessor to § 142(d), units in a qualified residential rental project cannot be used on a transient basis. § 1.103-8(b)(4)(i) of the Income Tax Regulations.

SECTION 3. SCOPE

This revenue procedure applies when the President has declared a Major Disaster. This revenue procedure applies to Displaced Individuals and to all Projects, Issuers, and Operators both inside and outside States containing a Major Disaster Area.

SECTION 4. DEFINITIONS

The following definitions apply for this revenue procedure.

.01 Agency. With respect to a Bond/LIHTC Project, the Agency is the governmental housing credit agency that has jurisdiction over the Project.

.02 Bond Project. A Bond Project is a Project that is not subject to the low-income housing credit requirements under § 42.

.03 Bond/LIHTC Project. A Bond/LIHTC Project is a Project that is also subject to the low-income housing credit requirements under § 42.

.04 Displaced Individual. A Displaced Individual is an individual who is displaced from his or her principal residence as a result of a Major Disaster and whose principal residence was located in a Major Disaster Area designated as eligible for Individual Assistance by FEMA.

.05 Issuer. The Issuer is the entity that issued tax-exempt, exempt facility bonds for a Project under §§ 142(d) and 103.

.06 Low-Income Individual. A Low-Income Individual is an individual whose income either is at or below the applicable income limit or is treated as at or below the applicable income limit under § 142(d)(3)(B).

.07 Major Disaster. A Major Disaster is an event for which the President has declared a major disaster under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. 5121 et seq.

.08 Major Disaster Area. A Major Disaster Area is any city, county, or other local jurisdiction for which a Major Disaster has been declared by the President and which has been designated by FEMA as eligible for Individual Assistance, Public Assistance, or both.

.09 Market-Rate Unit. A Market-Rate Unit is a unit occupied by an individual that is not a Low-Income Individual.

.10 Operator. The Operator of a Project is the person to whom the Issuer or Owner delegates

responsibility for ensuring that the Project continues to meet the requirements applicable to qualified residential rental projects under §§ 142 (d) and 103. (That person may be, but does not have to be, the Owner.)

.11 Owner. An Owner is the owner of a Project.

.12 Project. A Project is a qualified residential rental project that is financed with exempt facility bonds under § 142(d), whether or not it is also subject to the low-income housing credit requirements under § 42.

.13 Temporary Housing Period. A Temporary Housing Period is the period, if any, beginning on the first day of the incident period, as determined by FEMA, and ending on the date determined by the Issuer under section 5.02 of this revenue procedure.

SECTION 5. EMERGENCY HOUSING RELIEF — REQUIREMENTS AND RESTRICTIONS

.01 Requirements for Relief. For an Operator to use the relief provided in section 6 of this revenue procedure, the conditions in this section 5 must be satisfied.

.02 Issuer Approval.

(1) The Issuer provides written approval to the Operator for use of the Project to house Displaced Individuals and specifies the date on which the Temporary Housing Period for the Project ends. The Temporary Housing Period cannot exceed 12 months from the end of the month in which the President declared the Major Disaster.

(2) Issuer approval is required even if a Bond/LIHTC Project subject to Rev. Proc. 2014-49 receives approval from the Agency (as contemplated in Section 12.02(1) of Rev. Proc. 2014-49). An Issuer that provides approval for a Bond/LIHTC Project must adopt for purposes of § 142(d) and this revenue procedure the same Temporary Housing Period that the Agency adopts for purposes of § 42 for that Bond/LIHTC Project.

.03 Protection of Existing Tenants. No existing tenant whose income is, or is treated as, at or below an applicable income limit under § 142(d) may be evicted or otherwise have his or her occupancy terminated solely to provide emergency housing relief for a Displaced Individual.

.04 Recordkeeping Requirements. The Operator complies with the recordkeeping requirements in section 7 of this revenue procedure.

.05 Rent Restrictions. If units are treated as occupied by Low-Income Individuals under section 6 of this revenue procedure because they house Displaced Individuals, then rent restrictions are applicable in deep rent skewed Projects and in Bond/LITHC Projects. In these cases, the amounts that the Displaced Individuals are charged as gross rent must satisfy §§ 142(d)(4)(B) and 42(g)(2) to the extent that those provisions are applicable.

.06 Project Meets All Remaining Requirements. Except as expressly provided in this revenue procedure, a Project meets all other rules and requirements of §§ 142(d) and 103.

SECTION 6. EMERGENCY HOUSING RELIEF — IMPLEMENTATION

.01 Discretion to Apply Relief.

(1) This revenue procedure authorizes but does not require provision of emergency housing relief to

Displaced Individuals during the Temporary Housing Period. If an Operator chooses not to provide emergency housing relief under sections 5, 6, and 7 of this revenue procedure, then all of the rules under § 142 (d) apply.

(2) If an Operator chooses to provide emergency housing relief under sections 5, 6, and 7 of this revenue procedure then —

(A) The Operator may provide emergency housing relief for less than the full Temporary Housing Period;

(B) If a Displaced Individual has demonstrated qualification as low income and the Operator wishes to accept the individual as a tenant, the Operator may either accept the Displaced Individual as a low-income tenant applying all the rules under § 142(d) or provide emergency housing relief to the Displaced Individual under sections 5, 6, and 7 of this revenue procedure; and

(C) If a Displaced Individual has not demonstrated qualification as low income and the Operator wishes to accept the individual as a tenant, the Operator may either accept the Displaced Individual as a tenant that is not a low-income tenant or provide emergency housing relief to the Displaced Individual under sections 5, 6, and 7 of this revenue procedure.

.02 Satisfaction of the Non-Transient Use Requirement. The occupancy of a unit in a Project by a Displaced Individual during the Temporary Housing Period is treated as satisfying the non-transient use requirement under § 1.103-8 (b)(4).

.03 Treatment of Displaced Individuals Under the Next-Available-Unit Rule. During the Temporary Housing Period, for purposes of determining compliance with the next-available-unit rule under § 142(d)(3)(B), an Operator disregards any unit then occupied by one or more Displaced Individuals and applies the rule based solely on occupancy by persons who are not Displaced Individuals. See sections 6.04 and 6.05 of this revenue procedure for the treatment of income of Displaced Individuals for purposes of § 142(d).

.04 Income Qualification of Units in Bond Projects During Temporary Housing Period. If a Displaced Individual begins occupancy of a unit in a Bond Project during the Temporary Housing Period, then the unit retains the status it had immediately before that occupancy. The actual income of the Displaced Individual occupying the unit is disregarded during the Temporary Housing Period for purposes of § 142(d). That is —

(1) If a unit in a Bond Project was a unit occupied by a Low-Income Individual, a Market-Rate Unit, a unit never previously occupied, or an unavailable unit, then the unit remains as such while occupied by a Displaced Individual during the Temporary Housing Period, regardless of the occupancy by, or income of, the Displaced Individual. See Rev. Proc. 2004-39, 2004-2 C.B. 49 (treating never previously occupied units as unavailable).

(2) The income of the Displaced Individual occupying the unit does not affect whether the Bond Project satisfies the set-aside requirement, including the additional set-aside requirement for deep rent skewed Projects.

.05 Income Qualification of Units in Bond/LIHTC Projects During Temporary Housing Period. During the Temporary Housing Period, a unit in a Bond/LIHTC Project then occupied by a Displaced Individual is treated for purposes of § 142(d) in a manner similar to how it is treated for purposes of § 42 under Rev. Proc. 2014-49. That is, during the Temporary Housing Period —

(1) The actual income of the Displaced Individual occupying the unit is disregarded for purposes of §

142(d);

(2) To the extent provided in Rev. Proc. 2014-49, if a Displaced Individual takes occupancy of a unit in a Bond/LIHTC Project during the first year of the credit period, the unit is treated as a unit occupied by a Low-Income Individual; and if, after the first year of the credit period, a Displaced Individual begins occupancy of a unit, that unit retains the status that it had before occupancy by the Displaced Individual, whether as a unit occupied by a Low-Income Individual, a Market-Rate Unit, a unit never previously occupied, or an unavailable unit, as the case may be.

.06 Treatment of a Unit Vacated by a Displaced Individual.

(1) If a Displaced Individual vacates a unit in a Project before the end of the Temporary Housing Period, that unit retains the status provided under section 6.04 or section 6.05 of this revenue procedure until it is occupied by the next tenant, even if the next tenant takes occupancy after the end of the Temporary Housing Period. If the next tenant is also a Displaced Individual and begins occupancy during the Temporary Housing Period, the status of the unit is determined under section 6.04 or 6.05 of this revenue procedure. If the next tenant is not a Displaced Individual or begins occupancy after the end of the Temporary Housing Period, the status of the unit is determined under § 142(d).

(2) For as long as a unit retains its status because of the application of this section 6.06, the relief provided under section 6.08 of this revenue procedure applies to that unit. In particular, the unit is disregarded for determining the start of the qualified project period.

.07 Income Qualifications when Temporary Housing Period Ends.

(1) If a Displaced Individual continues to occupy a unit in the Project at the end of the Temporary Housing Period, then except as provided in section 6.07(3) of this revenue procedure, the status of the unit occupied by the Displaced Individual and the income of that individual are re-evaluated as though the individual commenced occupancy of the unit on the day immediately following the end of the Temporary Housing Period. For example, a unit is a Market-Rate Unit beginning immediately after the end of the Temporary Housing Period if, immediately after the end of the Temporary Housing Period, the Displaced Individual’s income exceeds the applicable income limit.

(2) If the Project fails to comply with the set-aside requirement of § 142(d) solely because of continued occupancy of a unit after the Temporary Housing Period by a Displaced Individual, a 60-day period is allowed for correction.

(3) If the Displaced Individual was accepted as a low-income tenant applying all the rules under § 142(d) as permitted by section 6.01(2)(B) of this revenue procedure, then all the rules under § 142(d) apply to the Displaced individual, including § 142(d)(3)(B).

.08 Qualified Project Period.

(1) Start of the Qualified Project Period. Occupancy of a unit by a Displaced Individual during the Temporary Housing Period does not count for determining the beginning of the qualified project period under § 142(d)(2)(A). Thus, this occupancy is not used to determine the first day on which 10 percent of the residential units in a Project are occupied for purposes of § 142(d)(2)(A).

(2) End of the Qualified Project Period. Occupancy of a unit in a Project by any tenant (whether a Displaced Individual or someone who is not a Displaced Individual) counts for purposes of determining the end of the qualified project period under § 142(d)(2)(A)(i). However, solely for purposes of § 142(d)(2)(A) (iii), the Project is treated as continuing to receive assistance under

section 8 of the United States Housing Act of 1937 until the end of the Temporary Housing Period plus 180 days.

SECTION 7. EMERGENCY HOUSING RELIEF — RECORDKEEPING

.01 Operators must maintain certain information concerning each Displaced Individual temporarily housed in the Project under sections 5 and 6 of this revenue procedure. For each Displaced Individual, the records must contain the following items in a statement signed by the Displaced Individual under penalties of perjury:

(1) The name of the Displaced Individual;

(2) The address of the principal residence at the time of the Major Disaster of the Displaced Individual;

(3) The Displaced Individual's social security number; and

(4) A statement that he or she was displaced from his or her principal residence as a result of a Major Disaster and that his or her principal residence was located in a city, county, or other local jurisdiction that is covered by the President's declaration of a Major Disaster and that is designated as eligible for Individual Assistance by FEMA because of the Major Disaster.

.02 The Operator must maintain a record both of the Issuer's approval of the Project's use for Displaced Individuals and of the approved Temporary Housing Period. The Operator must report to the Issuer at the end of the Temporary Housing Period a list of the names of the Displaced Individuals and the dates the Displaced Individuals began occupancy. The Operator must also provide any dates Displaced Individuals ceased occupancy and, if applicable, the date each unit occupied by a Displaced Individual becomes occupied by a subsequent tenant.

.03 The Operator must maintain the records described in this section as part of the annual compliance monitoring process imposed under § 142(d) and provide this information to the Service upon request. For purposes of § 42, Operators of Bond/LIHTC Projects are also subject to the recordkeeping requirements of Rev. Proc. 2014-49.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for Major Disasters declared on or after August 21, 2014.

SECTION 9. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-2237.

A Federal Agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is in section 7. This information is required to enable the Service to verify whether the Operators and Displaced Individuals satisfy various requirements for the relief provided in this revenue procedure. The collection of information is required to obtain a benefit. The likely respondents are individuals, businesses, and state and local governments.

The estimated total annual recordkeeping burden is 675 hours.

The estimated annual burden per recordkeeper is approximately 30 minutes. The estimated number of recordkeepers is 1,350.

Books or records relating to a collection of information must be retained as long as their contents may become material to the administration of the internal revenue law. Generally, tax returns and tax return information are confidential, as required by § 6103.

SECTION 10. DRAFTING INFORMATION

The principal authors of this revenue procedure are Timothy L. Jones and Spence Hanemann of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact Mr. Hanemann at (202) 317-6980 (not a toll-free call).

GFOA Files Supreme Court Amicus Brief in Maryland Income Tax Case.

The GFOA joined its partner national associations on an amicus, or friend of the court, brief filed by the State and Local Legal Center before the Supreme Court in the case of Comptroller v. Wynne. In this case, the Supreme Court will determine whether the U.S. Constitution requires states to give a credit for taxes paid on income earned out-of-state.

The Wynnes of Howard County, Maryland, received S-corporation income that was generated and taxed in numerous states. While Maryland law allowed the Wynnes to receive a tax credit against their Maryland state taxes for income taxes paid to other states, it did not allow them to claim a credit against their Maryland county taxes. The Wynne's challenged Maryland law.

Maryland's highest state court held that Maryland's failure to grant a credit against Maryland's county tax violated the U.S. Constitution's dormant Commerce Clause, which denies states the power to unjustifiably discriminate against or burden interstate commerce. The Maryland Court of Appeals noted that if every state imposed a county tax without a credit, interstate commerce would be disadvantaged. Taxpayers who earn income out of state would be "systematically taxed at higher rates relative to taxpayers who earn income entirely within their home state."

The State and Local Legal Center's amicus brief challenges the Maryland Court of Appeals decision on several grounds. First, the brief argues that the power of state and local governments to tax the income of their residents, wherever earned, has been upheld repeatedly by the Supreme Court. Second, the brief maintains that the scope of the "dormant Commerce Clause" regarding individual non-resident income taxes has not been clearly defined by the court and should not now be construed to mandate credits. Third, the brief argues that taxation is a legislative matter that should not usurped by the judiciary.

The brief also discusses the difficult tax policy choices faced by state and local leaders. For example, if Maryland were required to provide a dollar-for-dollar tax credit, a neighbor with substantial out-o--state income would contribute significantly less to pay for local services than a neighbor earning the same income in-state, even though both take equal advantage of local services. To counterbalance this dollar-for-dollar tax credit, a county would need to raise some other tax, which would fall disproportionately on some other neighbor and often be more regressive. Maryland's choice to avoid these results "does not cross any constitutional line," the brief states.

Click here to read the amicus brief.

Tuesday, August 12, 2014

McDermott: IRS Issues Additional Guidance With Respect to 2013 Beginning Of Construction Rules for Wind and Other Renewable Projects.

The Internal Revenue Service (Service) issued Notice 2014-46 (Notice) on August 8, 2014, to provide further guidance on meeting the beginning of construction requirements for wind and other qualified facilities (biomass, geothermal, landfill gas, trash, hydropower, and marine and hydrokinetic facilities). The Notice addresses the requirements of the physical work test and the transfer of a facility after construction has begun, as well as the five percent safe harbor.

Background

Section 407 of the American Taxpayer Relief Act of 2012 extended until January 1, 2014, the production tax credit (PTC) and the investment tax credit (ITC) for electricity produced from qualified facilities. Congress also liberalized the timing requirement for a qualified facility so that a taxpayer may meet the January 1, 2014, deadline by "beginning construction" on the facility by such date. Previously, a taxpayer could only meet the deadline by placing the facility in service.

The Notice clarifies and modifies two prior notices (Notices 2013-29 and 2013-60, both referred to herein as the Prior Guidance), providing taxpayers with initial guidance with respect to when construction will be considered to have begun in 2013 for purposes of the PTC and ITC. The Notice was issued in response to questions from industry participants and practitioners arising from the Prior Guidance.

Notice 2013-29

Under Notice 2013-29, a taxpayer may establish that construction has begun on a qualified facility by demonstrating that "physical work of a significant nature" has begun (Physical Work Test) or by satisfying a five percent safe harbor (Safe Harbor). Notice 2013-29 lists several examples of work that meets the Physical Work Test, including, with respect to a wind energy facility, the beginning of the exaction for the foundation, the setting of anchor bolts into the ground or the pouring of the concrete pads of the foundation. Both work completed onsite or off-site may be taken into account. The Service also imposed a requirement that a "continuous program of construction," as defined in the Prior Guidance (Continuous Construction Test), be maintained after performance of physical work in 2013.

The Safe Harbor set forth in Notice 2013-29 provides that the construction of a qualified facility is considered to begin before January 1, 2014, if a taxpayer pays or incurs (within the meaning of Treas. Reg. § 1.461-1(a)(1) and (2)) five percent or more of the total cost of the facility before such date. Thereafter, the taxpayer must make continuous efforts to advance toward completion of the facility (Continuous Efforts Test) to be deemed to have begun construction.

For more information on these tests and their requirements, see McDermott's Notice 2013-29 article.

Notice 2013-60

In September 2013, the Service issued Notice 2013-60, clarifying questions left outstanding by Notice 2013-29. [See McDermott's summary in its Notice 2013-60 article.] First, Notice 2013-60 provided that a facility will be considered to satisfy the Continuous Construction Test and the Continuous Efforts Test if it is placed in service before January 1, 2016. Second, Notice 2013-60 permitted a taxpayer to claim the PTC or ITC even if the taxpayer was not the owner of the facility on the date construction began.

Notice 2014-46

The Physical Work Test

One of the primary questions raised by industry participants and practitioners with respect to the Physical Work Test described in the Prior Guidance was how much physical work is required in 2013. This question arose, in part, due to an example in section 4.04(3) of Notice 2013-29, in which the taxpayer began construction on 10 of 50 planned wind turbines before January 1, 2014, and was deemed to have begun construction on the wind facility in 2013. The example implied to some that there was a 20-percent threshold on the amount of physical work that must be performed in 2013.

The Notice clarifies that the Physical Work Test focuses on the nature of the work performed rather than the amount or cost of such work. Citing the examples in section 4.02 of Notice 2013-29, it makes clear that these examples are a non-exclusive list of activities that would satisfy the Physical Work Test because they constitute physical work "of a significant nature." The examples include beginning of the excavation for the foundation for a wind turbine, the setting of anchor bolts into the ground or the pouring of the concrete pads of the foundation. Additionally, physical work on a custom-designed transformer meets the Physical Work Test because power conditioning equipment is an integral part of the activity performed by the facility. Lastly, starting construction on roads that are integral to the activity performed at the facility is an example of physical work of a significant nature. The Notice also clarifies that the example cited above relating to construction of 10 of 50 planned wind turbines in 2013 was not intended to indicate a 20-percent minimum threshold requirement to satisfy the Physical Work Test. As provided in the Notice, assuming the work performed is of a significant nature, there is no fixed minimum amount or work or monetary or percentage threshold required to satisfy the Physical Work Test.

The Notice focuses, therefore, on whether 2013 work is "significant," and implies that such work must be with respect to property that is "integral to the facility" to qualify. While the examples cited in the Prior Guidance and the Notice do not cover all of the types of physical work that were performed on development projects in 2013, the Notice's provisions do imply that, for example, the excavation of a single turbine foundation could be sufficient, so long as the Continuous Construction Test is met after 2013. Furthermore, that Continuous Construction Test might be met even if some turbine foundations are excavated in 2013 and then no activity occurs with respect to the project for some time, so long as the project is ultimately placed in service prior to January 1, 2016. In short, while not listing or defining all of the types of property that might be considered integral to a facility, the Notice makes clear that there is no threshold level of work that must have occurred in 2013 for construction to have begun.

Transfer of a Facility After Construction Has Begun

Notice 2014-46 also reiterates that the taxpayer who begins construction of a facility and the taxpayer who places it in service need not be the same person. However, the Notice adds a requirement to transfers to unrelated parties that mimics, although described in less detail in the Notice, the requirements established by the U.S. Department of the Treasury (Treasury) in Frequently Asked Questions #23 and #24 in connection with the grant in lieu of ITC. More reading

on those requirements can be found here.

The additional requirement added by the Notice is intended to prevent taxpayers from selling bare Safe Harbor-eligible equipment or equipment that met the Physical Work Test in 2013, as opposed to transferring entire projects that are in the development stages. The Notice provides that any amount paid by a transferor to an unrelated transferee in a transfer consisting solely of tangible personal property will not be taken into account with respect to the transferee for purposes of the Physical Work Test or Safe Harbor.

Thus, the Notice imposes two alternative requirements on transfers of projects to other parties. Either that party must be "related" under Internal Revenue Code Section 197(f)(9)(C) (which generally imposes a 20 percent ownership test) to the transferor, or the transfer must be of a project on which development has commenced. The Treasury's Frequently Asked Questions referenced above may provide some guidance to taxpayers, although they are not explicitly made applicable in the Notice, as to whether development has begun. Generally, development is evidenced by activity such as acquiring land, obtaining permits and licenses, entering into a power purchase agreement, entering into an interconnection agreement or contracting with an engineering, procurement and construction contractor.

The Notice also clarifies that a taxpayer may begin construction of a facility in 2013 with the intent to develop at a certain site, but thereafter transfer equipment and other components of the facility to a different site, and the work performed or amounts paid or incurred in 2013 can be taken into account for purposes of determining whether the facility meets the Physical Work Test or Safe Harbor.

The Five Percent Safe Harbor

According to Notice 2013-29, the Safe Harbor is not satisfied if the amount a taxpayer paid or incurred before January 1, 2014, with respect to the total cost of a facility that is a single project comprised of multiple facilities is less than five percent of the total cost of the facility at the time that it is placed in service. However, the Notice modifies this rule by providing that, if a taxpayer incurred at least three percent of the total cost of such a facility before January 1, 2014, the Safe Harbor may be satisfied with respect to some (although not all) of the individual facilities that are part of this larger project. A taxpayer may claim the PTC or ITC on the individual facilities if the aggregate cost of such facilities at the time the project was placed in service is not greater than 20 times the amount the taxpayer paid or incurred before January 1, 2014.

If, with respect to a single facility that cannot be separated into individual facilities, the amount the taxpayer paid or incurred before January 1, 2014, was less than five percent of the total cost of the facility at the time it was placed in service, then the taxpayer will not satisfy the Safe Harbor with respect to any portion of the facility.

The Notice provides examples of application of these rules that indicate that a wind turbine is considered a single facility, which has been previously confirmed in other guidance issued by the Service, and that a single boiler and turbine generator in a biomass project cannot be separated into multiple facilities.

Conclusion

The Notice clarifies several issues regarding the application of the Physical Work Test and Safe Harbor. Probably most significantly, the Service has clarified that there is not a minimum amount of work required to satisfy the Physical Work Test, which may result in a fresh look at projects

previously thought not to have met this test based on the amount of physical work performed in 2013.

Last Updated: August 14 2014
Article by Madeline M. Chiampou, Chelsea E. Hess, Justin Jesse, Martha Groves Pugh and Philip Tingle
McDermott Will & Emery

H.R. 5330 Would Make Build America Bonds Permanent.

H.R. 5330, the Bringing Urgent Investment to Local Development (BUILD) Act, introduced by Rep. John Conyers Jr., D-Mich., would permanently extend the tax treatment for Build America Bonds and provide recovery zone economic development bonds for cities with significant unemployment or poverty circumstances.

113TH CONGRESS
2D SESSION

H.R. 5330

To amend the Internal Revenue Code of 1986 to make the tax treatment for certain build America bonds permanent and to provide for recovery zone economic development bonds for certain cities, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JULY 31, 2014

Mr. CONYERS (for himself, Mr. RANGEL, Ms. KAPTUR, Ms. NORTON, Ms. JACKSON LEE, Mr. MEEKS, Ms. WILSON of Florida, and Ms. LEE of California) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to make the tax treatment for certain build America bonds permanent and to provide for recovery zone economic development bonds for certain cities, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Bringing Urgent In vestment to Local Development Act” or the “BUILD Act”.

SEC. 2. BUILD AMERICA BONDS MADE PERMANENT; RECOVERY ZONE ECONOMIC DEVELOPMENT BONDS FOR CERTAIN CITIES.

(a) IN GENERAL. — Subparagraph (B) of section 54AA(d)(1) of the Internal Revenue Code of 1986 is amended by inserting “or during a period beginning on or after the date of the enactment of the Bringing Urgent Investment to Local Development Act,” after “January 1, 2011,”.

(b) REDUCTION IN CREDIT PERCENTAGE TO BOND HOLDERS. — Subsection (b) of section 54AA of such Code is amended to read as follows:

“(b) AMOUNT OF CREDIT. —

“(1) IN GENERAL. — The amount of the credit determined under this subsection with respect to any interest payment date for a build America bond is the applicable percentage of the amount of interest payable by the issuer with respect to such date.

“(2) APPLICABLE PERCENTAGE. — For purposes of paragraph (1), the applicable percentage shall be determined under the following table:

“In the case of a bond issued during calendar year:	The applicable percentage is:
2014	35
2015	32
2016	31
2017	30
2018	29
2019 and thereafter	28.”.

(c) EXTENSION OF PAYMENTS TO ISSUERS. —

(1) IN GENERAL. — Section 6431 of such Code is amended —

(A) by inserting “or during a period beginning on or after the date of the enactment of the Bringing Urgent Investment to Local Development Act,” after “January 1, 2011,” in subsection (a), and

(B) by striking “before January 1, 2011” in subsection (f)(1)(B) and inserting “during a particular period”.

(2) CONFORMING AMENDMENTS. — Subsection (g) of section 54AA of such Code is amended —

(A) by inserting “or during a period beginning on or after the date of the enactment of the Bringing Urgent Investment to Local Development Act,” after “January 1, 2011,”, and

(B) by striking “QUALIFIED BONDS ISSUED BEFORE 2011” in the heading and inserting “CERTAIN QUALIFIED BONDS”.

(d) REDUCTION IN PERCENTAGE OF PAYMENTS TO ISSUERS. — Subsection (b) of section 6431 of such Code is amended —

(1) by striking “The Secretary” and inserting the following:

“(1) IN GENERAL. — The Secretary”,

(2) by striking “35 percent” and inserting “the applicable percentage”, and

(3) by adding at the end the following new paragraph:

“(2) APPLICABLE PERCENTAGE. — For purposes of this subsection, the term ‘applicable percentage’ means the percentage determined in accordance with the following table:

“In the case of a bond issued during calendar year:	The applicable percentage is:
2014	35
2015	32
2016	31
2017	30
2018	29
2019 and thereafter	28.”.

(e) RECOVERY ZONE ECONOMIC DEVELOPMENT BONDS FOR CERTAIN CITIES. —

(1) IN GENERAL. — Section 54AA of such Code is amended by redesignating subsection (h) as sub section (i) and by inserting after subsection (g) the following:

“(h) SPECIAL RULE FOR RECOVERY ZONE ECONOMIC DEVELOPMENT BONDS FOR CERTAIN CITIES. — In the case of an economic development extension bond —

“(1) ISSUER ALLOWED REFUNDABLE CREDIT. — In lieu of any credit allowed under this section with respect to such bond, the issuer of such bond shall be allowed a credit as provided in section 6431.

“(2) APPLICABLE PERCENTAGE. — The applicable percentage under subsection (b) shall be 35 percent.

“(3) ECONOMIC DEVELOPMENT EXTENSION BOND. — For purposes of this subsection —

“(A) IN GENERAL. — The term ‘economic development extension bond’ means any build America bond issued as part of an issue if —

“(i) 100 percent of the excess of —

“(I) the available project proceeds (as defined in section 54A) of such issue, over

“(II) the amounts in a reason ably required reserve (within the meaning of section 150(a)(3)) with respect to such issue, are to be used for one or more qualified purposes, and

“(ii) the issuer makes an irrevocable election to have this subsection apply and designates such bond for purposes of this section.

“(B) QUALIFIED PURPOSES. — The term ‘qualified purposes’ means —

“(i) any qualified economic development purpose (as defined in section 1400U-2(c), applied by treating specified cities (and only specified cities) as recovery zones), and

“(ii) any refinancing of indebtedness of a specified city which is outstanding on the date of the enactment of this sub section.

“(C) SPECIFIED CITY. — The term ‘specified city’ means any principal city for a metropolitan statistical area (as determined by the Office of Management and Budget) which —

“(i) has an average unemployment rate of not less than 150 percent of the national average rate for the last calendar year ending before the date of the enactment of this section,

“(ii) has a poverty rate of not less that 150 percent of the national poverty rate for the last calendar year ending be fore the date of the enactment of this section, or

“(iii) has lost at least 20 percent of its population between calendar year 2000 and calendar year 2010.

“(D) LIMITATION ON AMOUNT OF BONDS DESIGNATED. —

“(i) IN GENERAL. — The maximum aggregate face amount of bonds which may be designated under subparagraph (A) with respect to any specified city shall not exceed the bond limitation allocated to such city under clause (ii).

“(ii) ALLOCATION. — The Secretary shall allocate bond limitation to each specified city such that the bond limitation allocated to such city bears the same proportion to $1,000,000,000 as the population of such city (as determined for purposes of the 2010 census) bears to the total population of all specified cities (as so determined).”.

(2) PAYMENTS TO ISSUERS. — Section 6431 of such Code is amended by adding at the end the following:

“(g) APPLICATION OF SECTION TO CERTAIN ECONOMIC DEVELOPMENT EXTENSION BONDS. —

“(1) IN GENERAL. — An economic development extension bond shall be treated as a qualified bond for purposes of this section.

“(2) APPLICABLE PERCENTAGE. — The applicable percentage under subsection (b) shall be 35 per cent.”.

(f) CURRENT REFUNDINGS PERMITTED. — Subsection (g) of section 54AA of such Code is amended by adding at the end the following new paragraph:

“(3) TREATMENT OF CURRENT REFUNDING BONDS. —

“(A) IN GENERAL. — For purposes of this subsection, the term ‘qualified bond’ includes any bond (or series of bonds) issued to refund a qualified bond if —

“(i) the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue,

“(ii) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and

“(iii) the refunded bond is redeemed not later than 90 days after the date of the issuance of the refunding bond.

“(B) APPLICABLE PERCENTAGE. — In the case of a refunding bond referred to in subparagraph (A), the applicable percentage with respect to such bond under section 6431(b) shall be the lowest

percentage specified in paragraph (2) of such section.

“(C) DETERMINATION OF AVERAGE MATURITY. — For purposes of subparagraph (A)(i), average maturity shall be determined in accordance with section 147(b)(2)(A).

“(D) ISSUANCE RESTRICTION NOT APPLICABLE. — Subsection (d)(1)(B) shall not apply to a refunding bond referred to in subparagraph (A).”.

(g) GROSS-UP OF PAYMENT TO ISSUERS IN CASE OF SEQUESTRATION. — In the case of any payment under section 6431(b) of the Internal Revenue Code of 1986 made after the date of the enactment of this Act to which sequestration applies, the amount of such payment shall be increased to an amount equal to —

(1) such payment (determined before such sequestration), multiplied by

(2) the quotient obtained by dividing 1 by the amount by which 1 exceeds the percentage reduction in such payment pursuant to such sequestration.

For purposes of this subsection, the term “sequestration” means any reduction in direct spending ordered in accordance with a sequestration report prepared by the Director of the Office and Management and Budget pursuant to the Balanced Budget and Emergency Deficit Control Act of 1985 or the Statutory Pay-As-You-Go Act of 2010.

(h) EFFECTIVE DATE. — The amendments made by this section shall apply to obligations issued on or after the date of the enactment of this Act.

H.R. 5347 Would Extend Qualified Zone Academy Bonds.

H.R. 5347, introduced by House Ways and Means Committee member Ron Kind, D-Wis., would extend qualified zone academy bonds for two years, reduce the private business contribution requirement, and make technical corrections.

113TH CONGRESS
2D SESSION

H.R. 5347

To amend the Internal Revenue Code of 1986
to extend qualified zone academy bonds for 2 years
and to reduce the private business contribution requirement
with respect to such bonds, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JULY 31, 2014

Mr. KIND (for himself and Mr. KELLY of Pennsylvania)
introduced the following bill;
which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to extend qualified zone academy bonds for 2 years and to reduce the private business contribution requirement with respect to such bonds, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. EXTENSION AND MODIFICATION OF QUALIFIED ZONE ACADEMY BONDS.

(a) EXTENSION. — Paragraph (1) of section 54E(c) of the Internal Revenue Code of 1986 is amended by striking “and 2013” and inserting “2013, 2014, and 2015”.

(b) REDUCTION OF PRIVATE BUSINESS CONTRIBUTION REQUIREMENT. — Subsection (b) of section 54E of such Code is amended by striking “10 percent” and inserting “5 percent”.

(c) EFFECTIVE DATE. — The amendments made by subsections (a) and (b) shall apply to obligations issued after December 31, 2013.

(d) TECHNICAL CORRECTION AND CONFORMING AMENDMENT. —

(1) IN GENERAL. — Clause (iii) of section 6431(f)(3)(A) of such Code is amended —

(A) by striking “2011” and inserting “years after 2010”, and

(B) by striking “of such allocation” and inserting “of any such allocation”.

(2) EFFECTIVE DATE. — The amendments made by this subsection shall take effect as if included in section 310 of the American Taxpayer Relief Act of 2012.

IRS LTR: Hospital Organization is Denied Exemption.

The IRS denied tax-exempt status to an organization seeking exemption as a cooperative hospital service organization because it is not organized and operated on a cooperative basis and is not organized and operated solely to perform, on a centralized basis, a service enumerated under section 501(e)(1)(A).

Citations: LTR 201433018

Contact Person: * * *
Identification Number: * * *
Contact Number: * * *
UIL Code: 501.03-00, 501.03-32
Release Date: 8/15/2014
Date: May 20, 2014
Employer Identification Number: * * *
Form Required To Be Filed: * * *
Tax Years: * * *

Dear * * *:

This is our final determination that you do not qualify for exemption from Federal income tax as an

organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, Notice of Intention to Disclose, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Tamera Ripperda
Director, Exempt Organizations
Rulings and Agreements
Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter
* * * * *

Contact Person: * * *
Identification Number: * * *
Contact Number: * * *
Fax Number: * * *

Uil Code: 501.03-00, 501.03-32
Date: March 21, 2014

Employer Identification Number: * * *

LEGEND:

Hospital 1 = * * *
Hospital 2 = * * *
Hospital 3 = * * *
Date 1 = * * *
Taxpayer = * * *
Plan = * * *
$x = * * *

Dear * * *:

We have considered your application for recognition of exemption from Federal income tax under § 501(a) of the Internal Revenue Code ("Code") as an organization described in § 501(c)(3). Based on the information provided, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

FACTS

You are organized as a nonprofit corporation under state law. Your Articles of Incorporation state that: "The purpose of the Corporation is to enhance collaboration and the development of shared services among nonprofit hospital members and any and all other purposes permitted by law." You have members, and each member must at all times be an organization described in § 501(c)(3). Your current members are three tax-exempt hospitals: Hospital 1, Hospital 2, and Hospital 3.
Each of your members has equal representation in your governance. Your Bylaws provide that "[e]ach member shall designate two individuals who may act on behalf of such member on matters submitted to the members. Each member shall have one vote on each matter submitted to the members."

The members elect your Board of Directors. The number of directors shall be equal to the number of members. Immediately prior to the election of directors by the members, each member shall designate one director candidate. Each of the members shall vote for each of the candidates. Your current Board of Directors consists of three members: your president and director is also the president of Hospital 1. Your secretary and director is the president of Hospital 2. Your treasurer and director is the president of Hospital 3. Your directors do not receive compensation for their services.

You were formed to be a cooperative hospital service organization. You are designed to evaluate and offer various shared service opportunities among your members, including cost savings possibilities and opportunities to enhance clinical, support, and management services and programs through the cooperative efforts of your members. You provide purchasing services to your member hospitals. Specifically, with the assistance of an independent actuarial, employee benefits, and human resources consulting firm, you negotiated and contracted life, disability, and dental insurance for physicians of your patron-hospitals. The contracts are group contracts specific to each of your member entities and cover or benefit both eligible physician employees and all other eligible employees of your member hospitals. At this time you do not offer any other types of services, though you may offer management services, support programs, and clinical shared services in the future. For example, you intend to share management services, including assistance between hospitals when a key or critical position is open or a project is being undertaken at one member institution and another member institution has a manager with specific expertise in that project area. You would look to share consultative services between the three member hospitals such as looking at different staffing models and how best to utilize all available resources.

On your Form 1023, you state:

In compliance with section 501(e)(2), within 8 1/2 months after the close of the Company's taxable year, the Company allocates or pays all of its net earnings to its patron-hospitals based upon the services performed for them. To date, the Company has retained its earnings to support the exploration and expansion of the services it provides to the patron-hospitals. These retained earnings have been allocated equally among the patron hospitals.

In your letter of Date 1, you state that your current retained earnings are $x, which equals your net

income for the period October 1, 2010, through September 9, 2011. You also state that these earnings are held in your account and utilized for shared services such as consultants, educational opportunities, or other expenses incurred and agreed upon by the directors, and that, thus far, no earnings have been allocated between the patron hospitals.

LAW

Section 501(c)(3) provides for the exemption from federal income tax of organizations that are organized and operated exclusively for charitable, scientific or educational purposes, or for the prevention of cruelty to children, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 501(e) provides that an organization shall be treated as an organization organized and operated exclusively for charitable purposes under section 501(c)(3) if: (1) the organization is organized and operated solely (A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in section 501(c)(3) and exempt from taxation under section 501(a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing (including the purchasing of insurance on a group basis), warehousing, billing and collection (including the purchase of patron accounts receivable on a recourse basis), food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and (B) to perform such services solely for two or more hospitals each of which is: (i) an organization described in section 501(c)(3) and exempt from tax under section 501(a), (ii) a constituent part of an organization described in section 501(c)(3) which is exempt from taxation under section 501(a) and which, if organized and operated as a separate entity, would constitute an organization described in section 501(c)(3), or (iii) owned and operated by the United States, a state, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of the foregoing; (2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8 1/2 months after the close of its tax year, all net earnings to patrons on the basis of services performed for them; and; (3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

Section 1.501(e)-1(a) of the Income Tax Regulations ("regulations") provides that section 501(e) is the exclusive and controlling section under which a cooperative hospital service organization can qualify as a charitable organization. A cooperative hospital service organization which meets the requirements of section 501(e) and this section shall be treated as an organization described in section 501(c)(3), exempt from taxation under section 501(a), and referred to in section 170(b)(1)(A)(iii). In order to qualify for tax exempt status, a cooperative hospital service organization must (1) be organized and operated on a cooperative basis; (2) perform, on a centralized basis, only one or more specifically enumerated services which, if performed directly by a tax exempt hospital, would constitute activities in the exercise or performance of the purpose or function constituting the basis for its exemption; and (3) perform such service or services solely for two or more patron-hospitals.

Section 1.501(e)-1(b)(1) provides that in order to meet the requirements of section 501(e), the organization must be organized and operated on a cooperative basis (whether or not under a specific statute on cooperatives) and must allocate or pay all of its net earnings within 8 1/2 months after the close of the taxable year to its patron-hospitals on the basis of the percentage of its services performed for each patron. To "allocate" its net earnings to its patron-hospitals, the organization must make appropriate bookkeeping entries and provide timely written notice to each patron-hospital disclosing to the patron-hospital the amount allocated to it on the books of the organization.

Section 1.501(e)-1(b)(3) provides that exemption will not be denied a cooperative hospital service organization solely because the organization, instead of paying all net earnings to its patron-hospitals, retains an amount for such purposes as retiring indebtedness, expanding the services of the organization, or for any other necessary purpose and allocates such amounts to its patrons. However, such funds may not be accumulated beyond the reasonably anticipated needs of the organization. Moreover, where an organization retains net earnings for necessary purposes, the organization's records must show each patron's rights and interests in the funds retained.

Section 1.501(e)-1(c) provides that an organization will meet the requirements of section 501(e) only if the organization performs, on a centralized basis, one or more of the following services and only such services: data processing, purchasing (including the purchasing and dispensing of drugs and pharmaceuticals to patron-hospitals), warehousing, billing and collection, food, clinical (including radiology), industrial engineering (including the installation, maintenance and repair of biomedical and similar equipment), laboratory, printing, communications, record center, and personnel (including recruitment, selection, testing, training, education and placement of personnel) services. An organization is not described in § 501(e) if, in addition to or instead of one or more of these specified services, the organization performs any other service (other than services referred to under paragraph (b)(4) that are incidental to the conduct of exempt purposes or functions).

In HCSC-Laundry v. United States, 450 U.S. 1, 6 (1981), the Supreme Court held that, as a basic principal of statutory construction, § 501(e), a specific statute, controls over a general provision such as § 501(c)(3). In addition, the court said that the legislative history showed that Congress intended § 501(e) to be exclusive and controlling for cooperative hospital service organizations.

In Florida Hospital Trust Fund v. Commissioner, 103 T.C. 140, 153 (1994), the Tax Court stated that "from our perspective, the plain meaning of the phrase 'purchasing of insurance on a group basis' denotes a commercial transaction in which a cooperative hospital service organization negotiates and executes the purchase of insurance for its membership as a group."

ANALYSIS

We have determined that you do not qualify as a cooperative hospital service organization under § 501(e) of the Code. First, you are not organized or operated on a cooperative basis. Secondly, you are not organized and operated solely to perform, on a centralized basis, a service enumerated in § 501(e)(1)(A).

Section 1.501(e)-1(b)(1) of the regulations provides that, in order to meet the requirements of § 501(e), an organization must be organized and operated on a cooperative basis (whether or not under a specific statute on cooperatives) and must allocate or pay all of its net earnings within 8 1/2 months after the close of the taxable year to its patron-hospitals on the basis of the percentage of its services performed for each patron. Your Articles of Incorporation neither mention that you are structured on a cooperative basis nor do they require you to allocate or pay, within eight and one-half months after the close of each taxable year, all of your net earnings to your patron hospitals on the basis of the percentage of your services performed for each. Thus, you are not organized on a cooperative basis as required by the regulations.

Section 1.501(e)-1(b)(3) says that a cooperative hospital service organization need not pay all its net earnings to its patron hospitals, but may retain an amount for a necessary purpose so long as it allocates such amounts to its patrons. Where the organization retains net earnings for necessary purposes, its records must show each patron's rights and interests in the funds retained. Furthermore, § 1.501(e)-1(b)(1) says that to "allocate" its net earnings to its patron-hospitals, the organization must make appropriate bookkeeping entries and provide timely written notice to each

patron-hospital disclosing to the patron-hospital the amount allocated to it on the books of the organization. In your Form 1023 (filed only three months after the close of your first taxable year), you stated without further explanation or evidence, that:

In compliance with section 501(e)(2), within 8 and one-half months after the close of the Company's taxable year, the Company allocates or pays all of its net earnings to its patron-hospitals based upon the services performed for them. To date, the Company has retained its earnings to support the exploration and expansion of the services it provides to the patron-hospitals. These retained earnings have been allocated equally among the patron hospitals [emphasis added].

However, in your letter of Date 1, and in response to our request for additional information about how you allocate earnings among your member hospitals, you stated that: "Taxpayer's earnings are held in the Taxpayer account and utilized for shared services such as consultants, educational opportunities, or other expenses incurred and agreed upon by the directors. Thus far, no earnings have been allocated between the patron hospitals [emphasis added]."

Not only do these two statements contradict each other, but by the time you submitted your Date 1 letter, you should have already made payments or allocations to your patron-hospitals for your tax years ending in 2009 and 2010. By your own admission, then, you have not complied with § 501(e)(2) and § 1.501(e)-1(b)(1).

Furthermore, to qualify as a cooperative hospital service organization, you must perform, on a centralized basis, one of the services specified in § 501(e)(1)(A), but only such services. You appear to be relying on that part of the statute that provides that a cooperative hospital service organization may engage in "the purchasing of insurance on a group basis." But it is not clear to us that your activities amount to purchasing insurance. In Florida Hospital Trust Fund v. Comm'r, 103 T.C. at 153, the Tax Court stated that "from our perspective, the plain meaning of the phrase 'purchasing of insurance on a group basis' denotes a commercial transaction in which a cooperative hospital service organization negotiates and executes the purchase of insurance for its membership as a group." In your application Form 1023, you state that you "coordinate the purchasing of life, disability, and dental insurance on a group basis," and that you have "negotiated and contracted for life, dental, and disability insurance," however you never say that you executed the purchase of insurance for your members as a group. Your Form 1023 "statement of revenues and expenses" shows expenses for "professional fees" and a small amount of unclassified expenses. A "profit and loss statement" submitted with your letter of Date 1, shows expenses for "insurance initiatives." We are uncertain whether any of these amounts went toward the purchase of insurance on a group basis.

In response to our request for copies of contracts you have negotiated, you provided a copy of three contract applications with Plan, one for each of your members. Each application lists one of your members as the "Name of Group" and the member's address as the "billing address." Under "Additional Provisions," the application states that: "This agreement is part of the Taxpayer purchasing alliance made up of [Taxpayer's patron members]. Each participating entity will have separate banking arrangements." Each application is executed by an authorized representative of the member hospital named in the application. Given this language, it is unclear to us whether you actually execute and purchase insurance on behalf of your members, or whether you merely coordinate the selection of insurance providers and negotiate the terms of the policies, but leave the execution and purchasing of the policies to the individual members. Furthermore, in the future, you intend to offer services with respect to the sharing of management services, resource and educational opportunities, and nursing and provider staff among and between your member hospitals. It is unclear whether any of these services are among the specific services enumerated in § 501(e)(1)(A). It is likewise unclear whether the sharing of such services among or between the

hospitals is the same as the performance of services “on a centralized basis.” Consequently, we cannot say that you are operated solely to perform, on a centralized basis, a permissible service (and only a permissible service) under § 501(e)(1).

Because § 1.501(e)-1(a) says, and the Supreme Court in HCSC-Laundry v. United States holds, that § 501(e) creates the exclusive means by which a separate entity that provides shared services to otherwise unrelated hospitals may qualify for exemption as an organization described in § 501(c)(3), your failure to satisfy the requirements of § 501(e) means that you also fail to satisfy the requirements of § 501(c)(3).

CONCLUSION

In light of the above, we conclude that you are not organized and operated exclusively for exempt purposes within the meaning of § 501(c)(3).
You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the IRS may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, Power of Attorney and Declaration of Representative, if you have not already done so. For more information about representation, see Publication 947, Practice before the IRS and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the IRS will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or

she received your fax.
If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Thank you for your cooperation. We have sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely,

Michael Seto
Manager,
Exempt Organizations Technical

IRS Clarifies Guidance on Construction of Energy Facilities.

The IRS has clarified (Notice 2014-46) prior guidance (Notice 2013-29, Notice 2013-60) on the construction of qualified energy facilities, addressing the application of the physical work test and the ability to transfer a facility after construction has begun. The notice also modifies the application of the 5 percent safe harbor.

Under the physical work test, a taxpayer may establish the beginning of construction by beginning physical work of a significant nature as described in Notice 2013-29 or by meeting the safe harbor in that notice. Under the safe harbor, a taxpayer must show that after the facility is placed in service, 5 percent or more of its total cost was paid or incurred before January 1, 2014. Both the physical work test and the safe harbor require that a taxpayer make continuous progress toward completion once construction has begun.

Notice 2013-60 in part clarifies that the transfer of a facility after construction has begun will not necessarily prevent a facility from qualifying for the renewable electricity production tax credit (PTC) under section 45 or the energy investment tax credit (ITC) under section 48. The notice also explains how to satisfy either the continuous construction test or the continuous efforts test for purposes of establishing continuous progress.

Notice 2014-46 clarifies the application of the physical work test and the effect that some transfers of a facility after construction has begun will have on a taxpayer’s ability to qualify for the PTC or the ITC. Specifically, a fully or partially developed facility may be transferred without losing its qualification under the physical work test or the safe harbor for purposes of the PTC or the ITC. Addressing equipment relocations, the notice explains that the taxpayer may begin construction in 2013, intending to develop it at one site, but instead transfer equipment to a different site, complete its development, and place it in service. In this case, the work performed or amount paid or incurred before January 1, 2014, may be taken into account for purposes of determining whether the facility satisfies the physical work test or the safe harbor. For transfers consisting solely of tangible personal property to an unrelated transferee, any work performed or amount paid or incurred by the transferor for that property will not count toward the transferee’s satisfaction of the physical work test or the safe harbor.

Notice 2014-46 modifies the application of the safe harbor for some facilities for which a taxpayer paid or incurred less than 5 percent, but at least 3 percent, of the total cost of the facility before January 1, 2014. The notice discusses single projects composed of multiple facilities, stating the PTC or ITC may be claimed on some but not all the individual facilities. The guidance also states that a

taxpayer won’t satisfy the safe harbor for any part of a single facility that is not a single project composed of multiple individual facilities and that cannot be separated into individual facilities if the amount the taxpayer paid or incurred before January 1, 2014, for the total cost is less than 5 percent of the total cost of the facility at the time it is placed in service. Examples illustrate these modifications and clarifications.

——————————-

Clarification and Modification of Notice 2013-29 and Notice 2013-60

Part III — Administrative, Procedural, and Miscellaneous

SECTION 1. PURPOSE

On January 2, 2013, the American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313(ATRA), modified the definition of certain qualified facilities under section 45(d) of the Internal Revenue Code (the Code) by replacing the placed in service requirement with a beginning of construction requirement. Accordingly, a taxpayer will be eligible to receive the renewable electricity production tax credit (PTC) under section 45, or the energy investment tax credit (ITC) under section 48 in lieu of the PTC, with respect to such a facility if construction of such facility began before January 1, 2014.

Notice 2013-29, 2013-1 C.B. 1085, provides two methods to determine when construction has begun on a qualified facility: (i) a “physical work” test and (ii) a five percent safe harbor. Notice 2013-60, 2013-2 C.B. 431, clarifies Notice 2013-29 regarding (i) the determination of whether a taxpayer satisfies either the continuous construction requirement or the continuous efforts requirement of those methods with respect to a facility, (ii) the applicability of the “master contract” provision, and (iii) the ability to transfer a facility after construction has begun. This notice further clarifies Notices 2013-29 and 2013-60 regarding (i) how to satisfy the physical work test and (ii) the effect of various types of transfers with respect to a facility after construction has begun. In addition, this notice modifies the application of the five percent safe harbor.

The guidance provided in this notice applies the rules of sections 45 and 48 as in effect on January 1, 2014. The Internal Revenue Service (Service) will not issue private letter rulings to taxpayers regarding the application of this notice or the application of the beginning of construction requirement under sections 45(d) and 48(a)(5) as provided in Notice 2013-29 and Notice 2013-60.

SECTION 2. BACKGROUND

A taxpayer may establish the beginning of construction by beginning physical work of a significant nature as described in section 4 of Notice 2013-29 (Physical Work Test). Alternatively, a taxpayer may establish the beginning of construction by meeting the safe harbor provided in section 5 of Notice 2013-29 (Safe Harbor). A taxpayer can satisfy the Safe Harbor with respect to a facility by demonstrating, after the facility is placed in service, that five percent or more of the total cost of the facility was paid or incurred before January 1, 2014. Both methods require that a taxpayer make continuous progress towards completion once construction has begun (as set forth in section 4.06 (Continuous Construction Test) and section 5.02 (Continuous Efforts Test) of Notice 2013-29, respectively).

In response to a significant number of questions received after the publication of Notice 2013-29, the Treasury Department and the Service issued Notice 2013-60, which in part clarifies that the transfer of a facility after construction has begun will not necessarily prevent a facility from

qualifying for the PTC or the ITC. Additionally, section 3.02 of Notice 2013-60 provides a method for taxpayers to satisfy either the Continuous Construction Test or the Continuous Efforts Test. If a taxpayer places a facility in service before January 1, 2016, the facility will be considered to satisfy the Continuous Construction Test (for purposes of satisfying the Physical Work Test) or the Continuous Efforts Test (for purposes of satisfying the Safe Harbor), regardless of the amount of physical work performed or the amount of costs paid or incurred with respect to the facility between December 31, 2013, and January 1, 2016.

After the publication of Notice 2013-60, the Treasury Department and the Service received requests for further clarification regarding how to satisfy the Physical Work Test as well as questions regarding the effect of various types of transfers with respect to a facility after construction has begun. This notice clarifies the application of the Physical Work Test and the effect that certain transfers with respect to a facility after construction has begun will have on a taxpayer's ability to qualify for the PTC or the ITC. In addition, this notice modifies the application of the Safe Harbor for certain facilities with respect to which a taxpayer paid or incurred less than five percent, but at least three percent, of the total cost of the facility before January 1, 2014.

SECTION 3. PHYSICAL WORK TEST

The Physical Work Test requires that a taxpayer begin physical work of a significant nature (as defined in section 4.02 of Notice 2013-29) prior to January 1, 2014. This test focuses on the nature of the work performed, not the amount or cost. Notice 2013-29 describes several activities that constitute physical work of a significant nature. These activities are merely examples and not an exclusive list of the activities that will satisfy the Physical Work Test. For example, section 4.02 of Notice 2013-29 provides:

[I]n the case of a facility for the production of electricity from a wind turbine, on-site physical work of a significant nature begins with the beginning of the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation.

Section 4.05(1) of Notice 2013-29 provides:

[P]hysical work on a custom-designed transformer that steps up the voltage of electricity produced at the facility to the voltage needed for transmission is physical work of a significant nature with respect to the facility because power conditioning equipment is an integral part of the activity performed by the facility.

Section 4.05(2) of Notice 2013-29 provides:

Roads that are integral to the facility are integral to the activity performed by the facility; these include onsite roads that are used for moving materials to be processed (for example, biomass) and roads for equipment to operate and maintain the qualified facility. Starting construction on these roads constitutes physical work of a significant nature with respect to the facility.

Beginning work on any one of the activities described above will constitute physical work of a significant nature.

Section 4.04(3) of Notice 2013-29 provides an example in which X, a developer of a 50 turbine wind farm, is found to satisfy the beginning of construction requirement in part based on the stated fact that, in 2013, for 10 of the 50 turbines, X excavates the site for the foundations of the wind turbines and pours concrete for the supporting pads. This example illustrates the "single project" concept set forth in section 4.04(2) of Notice 2013-29 and is not intended to indicate that there is a 20%

threshold or minimum amount of work required to satisfy the Physical Work Test. Assuming the work performed is of a significant nature, there is no fixed minimum amount of work or monetary or percentage threshold required to satisfy the Physical Work Test.

As provided in section 4.01 of Notice 2013-29 the Service will closely scrutinize a facility, and may determine that construction has not begun on a facility before January 1, 2014, if a taxpayer does not maintain a continuous program of construction as determined under section 4.06 of Notice 2013-29 and section 3.02 of Notice 2013-60.

SECTION 4. TRANSFERS WITH RESPECT TO A FACILITY

.01 In general. Certain of the definitions of a qualified facility provided in section 45(d) require that the construction of the facility begin before January 1, 2014. There is no statutory requirement that the taxpayer that places the facility in service also be the taxpayer that begins construction of the facility. See Notice 2013-60, section 5.01. Moreover, section 48(a)(5)(D) defines "qualified property" (which may be eligible for the ITC in lieu of the PTC) as certain property that is "constructed, reconstructed, erected, or acquired by the taxpayer." (Emphasis added.) Thus, except as provided in section 4.03 of this notice, a fully or partially developed facility may be transferred without losing its qualification under the Physical Work Test or the Safe Harbor for purposes of the PTC or the ITC. For example, a taxpayer may acquire a facility (that consists of more than just tangible personal property) from an unrelated developer that had begun construction of the facility prior to January 1, 2014, and thereafter the taxpayer may complete the development of that facility and place it in service. The work performed or amount paid or incurred prior to January 1, 2014, by the unrelated transferor developer may be taken into account for purposes of determining whether the facility satisfies the Physical Work Test or Safe Harbor.

.02 Relocation of equipment by a taxpayer. A taxpayer also may begin construction of a facility in 2013 with the intent to develop the facility at a certain site, but thereafter transfer equipment and other components of the facility to a different site, complete its development, and place it in service. The work performed or amount paid or incurred prior to January 1, 2014, by such a taxpayer may be taken into account for purposes of determining whether the facility satisfies the Physical Work Test or the Safe Harbor.

.03 Transfers of equipment between unrelated parties. In the case of a transfer consisting solely of tangible personal property (including contractual rights to such property under a binding written contract) to a transferee not related (defined for these purposes by reference to section 197(f)(9)(C)) to the transferor, any work performed or amount paid or incurred by the transferor with respect to such property so transferred will not be taken into account with respect to the transferee for purposes of the Physical Work Test or the Safe Harbor.

Example. Developer D intends to develop and operate Facility K at a location to be determined. Prior to January 1, 2014, Developer D pays or incurs $60,000 to have tangible personal property integral to Facility K manufactured off-site pursuant to a binding written contract. Thereafter Developer D incurs no further development costs and engages in no further development activity with respect to Facility K. In January 2014, Developer D sells the tangible personal property to Developer E, a party unrelated to Developer D. Developer E is developing and intends to operate Facility L, a facility located on a parcel of land owned by Developer E. Developer E incorporates the tangible personal property acquired from Developer D into Facility L. In October 2015, Developer E places Facility L in service on the parcel of land. The total cost of Facility L is $1,000,000.

Amounts paid or incurred by Developer D prior to January 1, 2014, for the tangible personal property will not be taken into account for purposes of satisfying the Safe Harbor with respect to

Facility L. However, if without regard to these components, Developer E has otherwise satisfied the Physical Work Test or the Safe Harbor with respect to Facility L, Developer E will be eligible to claim the PTC with respect to electricity generated by Facility L and sold to an unrelated party. In such a case, Developer E may alternatively elect to claim the ITC in lieu of the PTC.

SECTION 5. SAFE HARBOR

.01 Single project. If the amount a taxpayer paid or incurred before January 1, 2014, with respect to the total cost of a facility that is a single project comprised of multiple facilities (as described in section 4.04(2) of Notice 2013-29) is less than five percent of the total cost of the facility at the time the facility is placed in service, the Safe Harbor is not fully satisfied. However, if a taxpayer paid or incurred at least three percent of the total cost of such a facility before January 1, 2014, the Safe Harbor may be satisfied and the PTC or ITC may be claimed with respect to some, but not all, of the individual facilities (as described in section 4.04(1) of Notice 2013-29) comprising the project. In this situation, a taxpayer may claim the PTC or ITC on any number of individual facilities as long as the total aggregate cost of those individual facilities at the time the project is placed in service is not greater than twenty times the amount the taxpayer paid or incurred before January 1, 2014. The Continuous Efforts Test of section 5.02 of Notice 2013-29 must also be met to qualify for the Safe Harbor.

.02 Single facility. If the amount a taxpayer actually paid or incurred before January 1, 2014, with respect to the total cost of a single facility that is not a single project comprised of multiple individual facilities (as described in section 4.04(2) of Notice 2013-29), and that cannot be separated into individual facilities, is less than five percent of the total cost of the facility at the time the facility is placed in service, then the taxpayer will not satisfy the Safe Harbor with respect to any portion of the facility.

.03 Examples — (a) Example 1. Developer incurs $30,000 in costs prior to January 1, 2014, to construct Project M, a five-turbine wind farm, that will be operated as a single project (as described in section 4.04(2) of Notice 2013-29). In October 2015, Developer places Project M in service. The total cost of Project M is $800,000, with each turbine costing $160,000. Although Developer did not pay or incur five percent of the total cost of Project M before January 1, 2014, Developer did pay or incur at least three percent of the total cost of Project M before January 1, 2014. In addition, because Developer placed Project M in service before January 1, 2016, Developer is deemed to satisfy the Continuous Efforts Test pursuant to section 3.02 of Notice 2013-60. Accordingly, Developer will be treated as satisfying the Safe Harbor with respect to three of the turbines of Project M, as their total aggregate cost of $480,000 is not greater than twenty times the $30,000 in costs incurred by Developer prior to January 1, 2014. Thus, Developer may claim the PTC on electricity produced from three of the turbines of Project M or the ITC based on $480,000, the cost of three of the turbines of Project M.

(b) Example 2. Developer incurs $25,000 in costs prior to January 1, 2014, to construct Facility N, an open-loop biomass facility, partly comprised of one boiler and one turbine generator that are functionally interdependent. In October 2015, Developer places Facility N in service. The total cost of Facility N is $600,000. Because Developer did not pay or incur five percent of the actual total cost of Facility N before January 1, 2014, and because the boiler and turbine generator are integral parts of a single facility that is not a single project comprised of multiple facilities (as described in section 4.04(2) of Notice 2013-29), Developer will not satisfy the Safe Harbor. However, if physical work of a significant nature began (within the meaning of section 4.01 of Notice 2013-29, as clarified by section 3 of this notice) before January 1, 2014, Developer may be able to claim the PTC or the ITC with respect to Facility N.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Notice 2013-29, 2013-1 C.B. 1085, and Notice 2013-60, 2013-2 C.B. 431, are clarified and modified.

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Ms. Bernardini on (202) 317-6853 (not a toll-free call).

New IRS Form May Fuel Nonprofit Political Activity.

When it comes to political campaign activity and section 501(c)(3) compliance issues, what was old may become new again, thanks to a new IRS exemption application form, several experts told Tax Analysts recently.

The IRS has rolled out Form 1023-EZ, "Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code" 2014 TNT 127-51: Forms Watch. The form's instructions 2014 TNT 76-41: Forms Watch remind applicants that 501(c)(3) groups cannot directly or indirectly participate or intervene in any campaign at the federal, state, or local level on behalf of, or in opposition to, any candidate. But critics have said the streamlined form creates major compliance risks, effectively greenlighting potential 501(c)(3) organizations with minimal inquiry into their activities.

IRS Commissioner John Koskinen has defended the form, telling Tax Analysts in a July interview that the simpler, electronic form will allow the agency to more effectively use its resources.

The trouble is, the form is a checklist and not a "true application," said Arthur Rieman of the Law Firm for Non-Profits. The form, he said, allows organizations to claim exempt status using "the honor system." The nearly automatic exemption that Form 1023-EZ filers can get will allow those wishing to game the system to use their 501(c)(3) approval to do whatever they want, until they shut down the organization or the IRS catches them, he said.

Section 501(c)(4) social welfare organizations play a significant role in campaigns now. But thanks to the new IRS form, charities will be the next wave of politically active exempt organizations, said Marcus Owens of Caplin & Drysdale during a panel discussion in Washington in early July.

There won't be any IRS inquiry into the planned activities of an organization filing the Form 1023-EZ, and the IRS's ability to audit those groups is constrained, said Owens, who formerly served as EO director in the IRS Tax-Exempt and Government Entities Division.

"The IRS conducts audits of somewhere around 2,500 to 3,000 tax-exempt organizations a year — there are one and a half million of them," Owens said. "So your chances, once you have tax-exempt status, of losing that status in an audit are virtually nil unless you tie yourself to the door of the IRS building and proclaim you're going to violate the tax law."

Prior Political Involvement

The political use of nonprofit organizations started with the use of 501(c)(3) groups in the 1990s to push the bounds of issue advocacy, said University of Miami law professor Frances Hill. If there are

political operatives who decide it's time to again use 501(c)(3) organizations for "muscular issue advocacy" as part of an electoral strategy, they can find a way to make it happen, she said. "This is all a matter of tactical planning," Hill said. "We started out with [former Rep.] Newt Gingrich and his 501(c)(3)s, a cluster of them. I think we may be returning to that."

In 2003 the IRS restored section 501(c)(3) status to a pair of groups with ties to Gingrich — the Howard H. Callaway Foundation and the Abraham Lincoln Opportunity Foundation. The Callaway Foundation made grants to the Lincoln Foundation, whose attorney said the group was formed to allow Republicans to support charitable causes in the Denver area. Gingrich had been accused of improperly using charitable funds for political purposes.

Political campaigns have since transformed, and the most effective messaging now focuses on issues rather than candidates, Owens said. After the Supreme Court's decision in Citizens United v. FEC, 558 U.S. 310 (2010), he said, campaigns are increasingly following a structure pioneered by former Sen. Jesse Helms, who had a network of organizations working for him, including a charity that prospected for donors.

The new streamlined 501(c)(3) application paves the way for that trend to continue, Owens said. "A modern political campaign is really now a collection of different organizations," he said, adding, "A (c)(4) could, for example, talk about the various candidate positions but in a way that doesn't necessarily suggest one over the other so that it has a nonpartisan feel to it. The expedited processing procedure will make it easy to create . . . a swarm of (c)(3)s, all relatively small but very targeted in their educational efforts."

Section 501(c)(3) status allows an organization both to offer its donors the charitable contribution deduction and to create "a halo" around the message it is advocating, Owens said.

"Talking about issues like the environment, for example, or for that matter Second Amendment kinds of rights, is easily cast as an educational activity under section 501(c)(3)," he said, adding that such messaging is likely to have "a higher credibility with the viewer or the listener than a more overt political message or the same message coming from an acknowledged political source."

Pop-Up Charities and Other Fears

State and federal regulators alike may have a hard time tracking down some politically active 501(c)(3) groups. An organization can be exempt under state law and not under federal law, Hill said, adding that some states permit various types of nonprofit organizations to engage in considerably more political campaign activity. Even if some organizations ultimately lose their federal exemptions, they might keep their state tax-exempt status, she said.

Owens said that if, as he fears, a swarm of ostensibly educational but truly political 501(c)(3)s develops close to an election, those groups will likely have a lifespan of less than a year. And if they never file a Form 990, all the IRS will have to use in tracking them down is the Form 1023-EZ.

"It won't contain much information," Owens said. "It may contain an address that is a post office box somewhere."

The potential emergence of these pop-up organizations is the concern regarding the new form, Hill said. There are no safeguards against political activity in the new application process, she said, though she added that the long form exemption application for charities doesn't prevent substantial campaign activity anyway.

State regulators don't have the resources, either, to deal with pop-up organizations that disappear

before anyone has learned of them, said Douglas M. Mancino of Hunton & Williams LLP. He said he shares concerns about the potential for abusive pop-up charities, political or otherwise, to launch using the streamlined application.

Mancino said that he's interested in seeing what kind of statistical sampling the IRS comes up with to review the activities of organizations that file the streamlined form, but that developing that sampling takes time. And a lot can happen before that work is done, he said.

"Frankly, armed with a determination letter, you really can go out and do a lot of damage to the sector," Mancino said.

When the IRS released the final form on July 1, Benjamin Takis of Tax-Exempt Solutions PLLC said that unless the IRS can hold organizations accountable for inaccurate financial projections or misrepresenting their purpose or activities, there is a substantial risk of fraud and noncompliance.

Takis later expanded on those concerns, saying, "There is certainly a lot of gray area in the definition of political activity for organizations that are looking to game the system, and the Form 1023-EZ will only make it harder for the IRS to combat these tactics."

On the state-level regulation issue, Takis said, "I don't know of any legal obligation for the IRS to design forms and policies in a way that eases the burden on states, but the Form 1023-EZ certainly disrupts the balance that has developed between federal and state oversight of charities, and the effects of this disruption could be profound."

State charity regulators aren't exactly welcoming the new IRS form. In an April 30 letter 2014 TNT 144-77: IRS Tax Correspondence to the IRS, the National Association of State Charity Officials condemned the streamlined form, saying it would pave the way for fraud and increase the burden on state regulators, whose enforcement capabilities are already stretched thin.

Given the comments the state charity officials group submitted, it appears state regulators will treat use of the Form 1023-EZ as a red flag, Mancino and a colleague, Ofer Lion, wrote in a client alert posted on their firm's website. Mancino and Lion also wrote that early returns suggest that Form 1023-EZ filers are receiving determination letters within three weeks.

IRS Defends the Form

Up to 70 percent of all organizations applying for 501(c)(3) status will be eligible to file the streamlined form, the IRS said in a statement. Organizations are instructed that they must not substantially engage in activities that contradict their exempt purpose, and the agency said it will ramp up its education and outreach work to organizations eligible to file the Form 1023-EZ.

In a July 1 memo 2014 TNT 129-52: Other IRS Documents providing interim guidance on the form, Matthew Weir, IRS director of EO rulings and agreements, said IRS examiners will review submitted Forms 1023-EZ in order of submission, while ensuring all fields on the form are complete. Using a sampling plan, determinations specialists will perform a predetermination review on randomly selected cases before issuing a determination letter, the memo says.

Koskinen told Tax Analysts that this new exemption application process will allow smaller organizations to obtain approval while avoiding the same scrutiny given to larger organizations, without the IRS sacrificing its improved monitoring of all organizations. "The net result is that there will be less risk to the public," he said.

Applicants will file the new Form 1023-EZ electronically, which will allow the agency to more easily

screen applications with inconsistent answers or ones that raise questions before it issues approvals, Koskinen said. The agency will also test the accuracy of the short form by taking a statistical sampling of streamlined applications and subjecting them to the more rigorous, full exemption application, he said. The IRS will do still another sampling of Form 1023-EZ applicants a year after they're approved and audit "how they're doing and what they are doing," Koskinen said.

"We'll be better at the front end, but we'll have more resources available to check on people at the back end and see are you doing what you said you were going to do," Koskinen said. "Are you still doing the right thing? Now we'll know."

Takis interpreted the situation differently. "One challenge for the IRS will be that the Form 1023-EZ is likely to lead to many more organizations getting formed and applying for 501(c)(3) status, so it's going to be that much harder for the IRS to keep track of all these organizations and find the bad actors," he said.

David van den Berg
Tax Analysts

EO Short Form Filers Don't Have to Reveal Personal Addresses.

Organizations listing their high-level officials on the IRS's streamlined exemption application for charities may use the organizations' mailing addresses rather than the personal mailing addresses of the officials, according to the IRS.

Form 1023-EZ, "Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code," instructs those organizations eligible to use the form to list the names, titles, and mailing addresses of their officers, directors, and trustees. In the August 6 edition of its EO Update, the IRS clarified that an organization's mailing address can be used instead of an official's personal mailing address. The change has been made in the form's instructions, the IRS added.

The IRS introduced the short form July 1 following the release in April of a draft version. IRS officials have expressed hope that the streamlined application, which asks applicants for less information than the standard Form 1023, will make the application process less burdensome for small organizations. Some practitioners, however, worry that the short form does not ask for enough information about applicants' proposed operations, potentially allowing organizations to abuse the system.

Mayor Seeks Policy Changes for Infrastructure Improvements.

Terre Haute, Ind., Mayor Duke Bennett has expressed support for tax policies that promote investment in the nation's infrastructure, urging Treasury to make it easier to use public-private partnerships to address bond funding challenges stemming from the transfer of ownership or control of water and wastewater infrastructure to a private partner.

[Editor's Note: Treasury received substantially similar letters from the mayors of Wabash, Ind.; Orland Park, Ill.; and Overland, Mo.]

July 21, 2014

The Honorable Mark Mazur
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable William Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Tax Policies Supporting Infrastructure Investment: Section 141 Fix

Dear Mr. Mazur and Mr. Wilkins:

On behalf of the City of Terre Haute, I wish to express my strong support for tax policies that promote investment in the nation's infrastructure such as water, wastewater, roads, parking garages, storm water facilities, etc. The U.S. Conference of Mayors Water Council also supports such tax policies and we appreciate your help.

The U.S. Environmental Protection Agency has estimated that we must invest more than $500 billion over the next 20 years to improve or replace existing water, wastewater, and fire safety systems. This investment is necessary to bring old infrastructure into compliance with the Clean Water Act, the Safe Drinking Water Act, and other environmental statutes, to repair broken and leaking pipes that waste more than 7 billion gallons daily, and to realize the benefits of modern water conservation technologies. Addressing these dramatic needs will require focused, dedicated and robust participation by the public sector and private sectors. The financial scope of the water and wastewater infrastructure deficit is simply too great for any one sector of service providers to tackle alone.

The private sector is working closely with local governments on a wide range of public private partnerships (P3) to promote greater investment in water and waste water infrastructure. These P3s often begin a number of years after a community has made a substantial investment of its own through the issuance of tax-exempt bonds. However, when the P3 involves the transfer of ownership or control of the water infrastructure to a private partner, that partner may be required to undertake remedial actions to preserve the tax-exempt status of the bonds, such as redemption, defeasance, or re-investment of the proceeds in an approved alternate use.

As you know, redemption is often precluded by the terms of the bonds themselves. Defeasance is unnecessarily costly in the current low interest rate environment: too much capital ends up locked up in ultra-low interest Treasury securities that could otherwise be put to use addressing critical community needs. We hope the Treasury Department will take action to help reduce the defeasance penalty while the difference between rates earned by Treasuries and municipal bonds remains high. The applicable regulations were designed decades ago before P3s became popular, and represent a serious hindrance to deploying P3s to address America's water and wastewater challenges.

If you or your staff has any questions, please don't hesitate to contact me or my staff at 812.244.2303

Respectfully,

Duke A. Bennett
Mayor
City of Terre Haute
Terre Haute, IN

One Michigan Mayor Will Sue to Keep the State's Property Tax on Manufacturing Equipment.

Warren Mayor Jim Fouts said he plans to file a lawsuit Friday to overturn the passage of Proposal 1, which will phase out the personal property tax on manufacturing equipment in Michigan.

Fouts said the lawsuit will contend the ballot proposal violated state law by using wording tilted toward promoting its passage. He called the wording "confusing," "one-sided," and "blatantly unlawful," in a news release today announcing that he has directed the city attorney to file the lawsuit Friday in the Michigan Court of Claims.

"State of Michigan law is crystal-clear prohibiting slanted ballot language for any proposal," he said, adding that he was the only elected official in Michigan to oppose the question.

Proposal 1, which won handily in Tuesday's election, will phase out the tax on industrial and some commercial equipment between 2016 and 2023. It is an unpopular tax among manufacturers, of which Warren has many large industrial taxpayers. Most of the revenue from it goes to local governments.

Kelly Rossman-McKinney, communications director for Michigan Citizens for Strong and Safe Communities, which campaigned for the proposal, said the proposal was vetted by the Legislature and legal counsel and she does not expect any problems with the language. She said the Legislature debated the idea in December 2012 and in February and March of this year so Fouts "had plenty of opportunities to express his concerns."

Rossman-McKinney said she was not surprised Fouts intends to sue, but she is surprised that he's using taxpayers' dollars to do it. She said he may want "to be cautious" using city resources when a majority of Warren voters supported the proposal. Rossman-McKinney said the proposal won in every county in the state.

"I understand that he's a maverick," she said. "It's one thing to be a maverick on your own dime. It's another thing to be a maverick on the taxpayers' dime."

Fouts said he's "responding to a lot of disappointed voters," including more than 30 senior citizens he spoke with today at a senior picnic, who indicated they were confused by the proposal.

The proposal replaces lost local revenue by shifting money from the state's 6% use tax that is charged on items such as Internet and mail-order purchases, telephone service and hotel accommodations.

Fouts said wording in the proposal was a "sales pitch appealing to all voters." He cited such phrases as "helping small businesses grow and create jobs," "modernize the tax system," "police safety, fire protection, and ambulance emergency services," "aid to local school districts" and "prohibiting the

authority from increasing taxes."

He said the seniors he talked with today didn't understand the proposal, but they didn't want to vote against jobs, police and fire. He questioned the phrases, such as what does it mean to "modernize the tax system?"

Fouts said the proposal purposely avoided using words like "tax cuts for large manufacturers" because that would have caused a "voter backlash" diminishing the chances for approval.

"But tax breaks for large manufacturers is the essence of the proposal with minimal tax breaks for small businesses," Fouts said. "And state legislators conveniently left out the use tax increase in the proposal's language."

Fouts said the city of Warren is expected to lose $10 million to $11 million in 2016 and it's unclear how much it will receive from the use tax. He said many cities, such as Detroit, Pontiac and Sterling Heights, will take a hit.

Fouts said the proposal was sold to benefit small businesses that would create up to 15,000 new jobs, but large manufacturers benefit with $500 million in tax reductions. He said the average taxpayer "will be the victim with higher taxes."

Fouts said he knows he is facing "an uphill fight, but I believe the proposal was bad for cities and state taxpayers."

Fouts said he also will make a formal complaint about state legislators sending out mailings, at taxpayers' expense, expressing support for the proposal without printing opposing arguments.

"They broke state law governing fairness in franking privileges by legislators, and they should reimburse the state for that abuse," he said in his news release.

BY MCCLATCHY NEWS | AUGUST 8, 2014
By Christina Hall

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IRS Consolidates Memos on TE/GE's Expedited Application Process.

The IRS Tax-Exempt and Government Entities division has issued guidance (TEGE-07-0714-0022) consolidating into one document prior memoranda on the optional expedited process for some pending section 501(c)(4) tax-exempt applications.

July 28, 2014

Affected IRM: IRM 7.20.2
Expiration Date: July 28, 2016

MEMORANDUM FOR EXEMPT ORGANIZATIONS DETERMINATIONS UNIT AND EXEMPT ORGANIZATIONS TECHNICAL UNIT

FROM:
Matthew A. Weir
Director, Rulings and Agreements,
Exempt Organizations

SUBJECT:

Interim Guidance on Optional Expedited Process for Applicants for Section 501(c)(4) Status Who Received a Letter 5228 Before December 23, 2013

On June 25, 2013, Exempt Organizations issued Interim Guidance Memo TEGE-07-0613-08 (the "June 25, 2013 memorandum"), which provided interim administrative guidance to the Exempt Organizations Determinations Unit (EOD) and the Exempt Organizations Technical Unit (EOT) regarding an optional expedited process for applicants for section 501(c)(4) status with applications pending for more than 120 days as of May 28, 2013, that indicate the organization may be involved in political campaign intervention or issue advocacy ("identified pending applications"). The June 25, 2013 memorandum was reissued without modification as Interim Guidance Memo TEGE-07-06-4-0016.

Since the issuance of the original June 25, 2013 memorandum, other interim guidance memoranda were released that modified some portions of the process originally described in the June 25, 2013 memorandum. These memoranda included Interim Guidance Memo TEGE-07-0713-12 (July 18, 2013) (providing for the transfer of applications to EOT), Interim Guidance Memorandum TEGE-0--0913-14 (September 10, 2013) (stating that referrals will now be sent through the Exempt Organizations Examinations Classifications Unit instead of the Review of Operations Unit), and Interim Guidance Memorandum TEGE-07-0514-0012 (May 19, 2014) (providing for Office of Appeals review of proposed adverse determinations issued by EOT).

EOT has processed cases according to the procedures described in all applicable interim guidance impacting the optional expedited program as initially described in the June 25, 2013 memorandum. The purpose of this Interim Guidance is to consolidate the various interim guidance memoranda impacting the original optional expedited program described in the June 25, 2013 memorandum into a single document that clearly describes the process that Exempt Organizations has used and will continue to use in processing the identified pending applications.

This memorandum applies only to applicants for section 501(c)(4) status who received a Letter 5228 (6-2013), Application Notification of Expedited 501(c)(4) Option, before December 23, 2013. Applicants for section 501(c)(4) status who receive a Letter 5228 (9-2013) on or after December 23, 2013, are subject to the expanded optional expedited process described in TEGE-07-1213-24 (December 23, 2013) or any of its future updates. Applicants for section 501(c)(4) status who have not yet received a Letter 5228 but believe they may be eligible for the optional expedited process should also consult TEGE-07-1213-24 (December 23, 2013) or any of its future updates.

The content of this memorandum will be incorporated in IRM 7.20.2.

Please contact the Senior Manager, Rulings and Agreements, Technical with any questions regarding the application of this memorandum.

cc:
www.IRS.gov
* * * * *

Optional Expedited Process for Applicants for Section 501(c)(4) Status Who Received a Letter 5228 before December 23, 2013

Outlined below are the steps of the process for achieving expedited and fair processing of the exemption applications of those applicants for section 501(c)(4) status that received a Letter 5228, Application Notification of Expedited 501(c)(4) Option (6-2013),1 before December 23, 2013 (hereinafter, "identified pending applications"). All identified pending applications had been pending 120 or more days since filing as of May 28, 2013 and indicated the applicant may be involved in political campaign intervention or issue advocacy.

Step 1: IRS Ensures Reviews for Private Inurement

The IRS will promptly review all signed identified pending applications to ensure the case does not indicate any private inurement.

If there are no private inurement concerns, the identified pending application will proceed to step 2. If there are concerns with private inurement, the identified pending application will be transferred to EOT after completion of Step 1 for all other identified pending applications.2

If any identified pending applications are determined ready to be granted favorable status, EOD will proceed to issuing the favorable determination letter and steps 2 through 5 will not apply to such applications.

Step 2: Offering Expedited Option Process

By letter to the applicant (Letter 5228), EOD will provide an optional expedited process for all identified pending applications for which there are no indications of private inurement. The optional expedited process will permit these applicants to make representations under penalties of perjury regarding their past, current, and anticipated future political campaign intervention and social welfare activity. Applicants choosing to make the representations will receive a favorable determination letter from the IRS without further review. The favorable determination letter will be issued within two weeks of receipt of the signed representations.

This process is optional; applicants may determine whether they want to provide the representations, assuming they are able to do so, or whether they want the IRS to continue to review their application with regard to political campaign intervention or advocacy issues and requirements for section 501(c)(4) status.

Letter 5228 will request a response by the applicant within 45 days. During the period in which the applicant is considering whether to make the representations in Letter 5228, EOD will transfer the identified pending applications to EOT.3 During this period, EOT, with assistance from Chief Counsel attorneys, will review the identified pending applications for purposes of making a proposed recommendation should the applicant not provide the representations in Letter 5228. If EOT and Chief Counsel attorneys determine a favorable determination is warranted, EOT will issue a favorable determination letter4 and steps 3 through 5 will not apply to such application.5

Step 3: IRS Processing of Applications

Optional Expedited Process: Any applicant that provides the representations under penalties of perjury will receive a favorable determination from EOD or EOT6 within 2 weeks of receiving the signed representations. Like all organizations receiving a favorable determination of exempt status, the organization may be subject to examination by the IRS and the organization's exempt status may be revoked if, and as of the tax year in which, the facts and circumstances indicate exempt status is

no longer warranted. Revocation may be retroactive to the date of formation if the facts and circumstances indicate the representations were not accurate. An organization may no longer rely on the determination letter issued as part of this optional expedited process for any tax year in which its activities are no longer consistent with the representations, if the applicable legal standards change, or if the determination letter is revoked. If the organization determines that it continues to be described in section 501(c)(4) notwithstanding the fact that its activities are no longer consistent with the representations, it may continue to take the position that it is described in section 501(c)(4) and file Form 990, Return of Organization Exempt From Income Tax, but it must notify the IRS about such representations ceasing to be correct on Schedule O, Supplemental Information, of the Form 990.

An organization receiving Letter 5228 that provides the representations may be referred to the Exempt Organizations Classification Unit7 for subsequent review.

Regular Process: If an applicant received Letter 5228 and does not provide the additional representations under the optional expedited process within 45 days from the date of the letter, EOT will review and process the pending application under Steps 4 and 5.

Step 4: Reviewing the Pending Application under the Regular Process — Documenting Review and Recommendations

Review of the pending applications under the regular process will include review by EOT, Chief Counsel attorneys, and (in some cases) a second layer of review by supervisory personnel in Chief Counsel and Exempt Organizations.8

EOT and Chief Counsel attorneys will review the facts and circumstances in the pending application and any other materials to determine if the organization is operated primarily for social welfare purposes, including by evaluating the amount of political campaign intervention activity. The issues will be analyzed as quickly as possible under current law, using available resources in applying the law to the facts.

Under the regular process, EOT and Chief Counsel attorneys will document9 their review of the pending application and their recommendation regarding a favorable or adverse determination or a request for additional information.

Favorable Recommendation: If the recommendation of both EOT and Chief Counsel attorneys is for a favorable determination, EOT will issue the favorable determination. In some cases, Exempt Organizations Technical and Chief Counsel attorneys may recommend referral of a recipient of a favorable determination to the Exempt Organizations Classification Unit for subsequent review.10

Adverse Recommendation: If the recommendation of both EOT and Chief Counsel attorneys is for an adverse determination and the supervisory personnel agree with this recommendation, Chief Counsel attorneys will assist EOT in preparing the proposed adverse determination letter and EOT will follow normal processes in issuing the letter and notifying the applicant that it may file a protest and request a conference with EOT (which would be provided on an expedited basis).

Pursuant to Interim Guidance Memorandum TEGE-07-0514-0012 (May 19, 2014), applicants receiving a proposed adverse determination letter from Exempt Organizations Technical may also request review of their application by the IRS Office of Appeals. EOT will advise applicants with pending proposed adverse determination letters that they may request review by the Appeals Office.

If the organization files a protest and/or has a conference with EOT, and that protest and/or

conference results in a changed recommendation to a favorable determination, EOT will issue the favorable determination.

If the protest and/or adverse conference does not result in a changed recommendation and the applicant timely requests review by the Appeals Office, EOT will forward the case to the Appeals Office.11

If the applicant does not timely file a protest or if the applicant files a protest but the protest and/or adverse conference does not result in a changed recommendation and the applicant does not timely request Appeals Office review, EOT will issue a final adverse determination.

Additional Information: If the recommendation of both EOT and Chief Counsel attorneys is that additional information is needed to make a determination, Chief Counsel attorneys will assist EOT in preparing a letter that requests such additional information and EOT will send the letter to the applicant. If and when the applicant has provided the requested additional information, EOT and Chief Counsel attorneys will review the additional information to determine whether the organization is operated primarily for social welfare purposes under current law. EOT and Chief Counsel attorneys will then follow the process for a favorable or adverse recommendation (or for a disagreement with respect to the recommendation) described in this Step 4.

Disagreement Between Exempt Organization Technical and Chief Counsel Attorneys: If EOT and Chief Counsel attorneys disagree on their recommendation, the application will be discussed with supervisory personnel.to reach resolution on the recommendation.12

FOOTNOTES

1 All references to Letter 5228 made hereinafter are intended to refer to the Letter 5228 approved in June 2013 that was sent to certain applicants before December 23, 2013.

2 The original June 25, 2013 memorandum provided that pending applications "will be referred to Exempt Organizations Technical for technical assistance with regard to private inurement issues after completion of Step 1 for all other pending applications." The July 18, 2013 Interim Guidance Memo TEGE-07-0713-12 (the "July 18, 2013 memorandum") modified that step to provide that the "[t]hose identified pending applications raising inurement concerns (described in Step 1) have already been formally transferred to Exempt Organizations Technical."

3 The June 25, 2013 memorandum provided that, "During the period in which the applicant is considering the expedited option process, Exempt Organizations Determinations will refer the pending applications to Exempt Organizations Technical for technical assistance." This language was modified by the July 18, 2013 memorandum which instructed EOD to formally transfer the identified pending applications to EOT rather than referring them for technical assistance.

4 The June 25, 2013 memorandum provided that "Exempt Organizations Technical will instruct Exempt Organizations Determinations to issue a favorable determination letter. . . ." This language was modified by the July 18, 2013 memorandum which stated, "Because all identified pending applications have been formally transferred to Exempt Organizations Technical, the favorable determination letters described in Step 2 will be issued by Exempt Organizations Technical rather than Exempt Organizations Determinations."

5 In such cases, the favorable determination letter will include an addendum that will instruct the applicant to disregard the Letter 5228 it had received.

6 The original June 25, 2013 memorandum provided that favorable determination letters would be

“issued within two weeks of receipt of the signed representations by Exempt Organizations Determinations.” Because the July 18, 2013 memorandum stated that cases would be formally transferred to EOT during the 45-day period, favorable determination letters could also be issued by EOT.

7 The June 25, 2013 memorandum originally stated that an “organization receiving the expedited option letter that provides the representations may be referred to the Review of Operations Unit for subsequent review.” Under Interim Guidance Memorandum TEGE-07-0913-14 (September 10, 2013), the Review of Operations Unit no longer accepts referrals. Instead referrals must go through the Exempt Organizations Examinations Classification Unit

8 The June 25, 2013 memorandum said that review of pending applications would include, in some cases, review by a new Advocacy Application Review Committee (the “Review Committee”), which was to be “comprised of 3 career executives from the IRS and the Office of Chief Counsel,” which were identified in a footnote as the “Director, EO; Commissioner (TE/GE); and Division Counsel/Associate Chief Counsel (TEGE), or their delegates.” As discussed further in note 11, the process of referring cases to the Review Committee was superseded by Interim Guidance Memorandum TEGE-07-0514-0012 (May 19, 2014),

9 Documentation will be done consistently through a template; reviewer will be noted by an identifying number rather than by name.

10 The June 25, 2013 memorandum originally stated “Any level of review may note a recommendation, or review an earlier level’s recommendation, regarding referral to the Review of Operations Unit.” As noted above in note 7, referrals now go through the Exempt Organizations Classification Unit.

11 The June 25, 2013 memorandum stated that if an “adverse conference is held and does not result in a changed recommendation, the pending application will be sent to the Review Committee in Step 5.” Step 5 was superseded by Interim Guidance Memorandum TEGE-07-0514-0012 (May 19, 2014), which stated that it “supersede[d] any prior IRM section or Interim Guidance that may provide for alternative procedures, including the Interim Guidance Memoranda TEGE-07-0613-08 and TEGE-0--1213-24 which provided for an optional expedited program for certain section 501(c)(4) organizations.”

12 The June 25, 2013 memorandum said that applications would be sent to Review Committee in the event of disagreement between EOT and Chief Counsel attorneys. As discussed in note 11, the process of referring cases to the Advocacy Application Review Committee was superseded by Interim Guidance Memorandum TEGE-07-0514-0012 (May 19, 2014).

END OF FOOTNOTES

IRS: Early Registration Discount Is Available for Tax Forums

The IRS has encouraged enrolled agents, CPAs, certified financial planners, and other tax professionals to attend the next tax forum at National Harbor in Maryland, noting that those who sign up by the preregistration deadline of August 5 will pay a discounted rate.

The IRS nationwide tax forums are three-day events that provide tax professionals current information on federal and state tax issues presented by IRS experts and partner organizations. The

forums offer a chance to receive up to 18 continuing education credits through a variety of seminars and workshops. There are two remaining opportunities to attend a forum this year.

WASHINGTON — The next 2014 IRS Nationwide Tax Forum will be held at National Harbor in Maryland near Washington, D.C., and the IRS invites enrolled agents, certified public accountants, certified financial planners and other tax professionals to attend. Those who sign up by the pre-registration date of Aug. 5 will save $130 off the on-site price.

The IRS Nationwide Tax Forums are three-day events that provide tax professionals with the most up-to-date information on federal and state tax issues presented by experts from the IRS and its partner organizations through a variety of training seminars and workshops. John M. Dalrymple, IRS Deputy Commissioner for Services and Enforcement, will give the keynote speech at the National Harbor forum.

The forums previously held this summer in Chicago, San Diego and New Orleans were well attended. Including the upcoming forum at the National Harbor, there are only two remaining opportunities to attend a forum this year.

Remaining Forums

Location	Forum Dates	Pre-Registration Deadline for $225 Rate
National Harbor, Md.	Aug. 19 - 21	Aug. 5
Orlando, Fla.	Aug. 26 - 28	Aug. 12

The cost of enrollment for those who pre-register is $225 per person, a savings of $130 off the late or on-site registration price of $355. Pre-registration ends two weeks prior to the start of each forum.

More than 40 separate seminars and workshops are being offered, and enrolled agents and certified public accountants may earn up to 18 Continuing Professional Education Credits in each location. Additionally, these seminars may qualify for continuing education credit for certified financial planners, pending review and acceptance by the Certified Financial Planner Board.

A few days before the start of each forum, attendees will be able to download, print or to load onto their mobile devices slide presentations from the seminars.

National Participating Association Members

Members of the participating associations below qualify for discounted enrollment costs if they meet the pre-registration deadlines above. Members who meet the early registration deadline would pay $215 and should contact their association directly for more information:

- American Bar Association (ABA)
- American Institute of Certified Public Accountants (AICPA)
- National Association of Enrolled Agents (NAEA)
- National Association of Tax Professionals (NATP)
- National Society of Accountants (NSA)
- National Society of Tax Professionals (NSTP)

Case Resolution Room

After a one year hiatus, the IRS Case Resolution Program has returned to the Tax Forums. Between 2011 and 2012, the Case Resolution staff has worked over 2,100 cases with a resolution rate of over 97 percent. Tax professionals who plan to meet with IRS representatives about actual cases are reminded to bring a valid power of attorney.

Exhibit Hall

In addition to the seminars, the forums also feature a two-day expo with representatives from tax, financial, and business communities offering their products, services and expertise designed with the tax professional in mind.

In a survey of 2013 attendees, the forums received an overall 94 percent satisfaction rate. 2014 marks the 24th year that the IRS has hosted these forums to help educate and interact with the tax professional community.

Registration Information

For more information, or to register online, visit www.irstaxforum.com.

IRS Releases Publication for Public Charity Tax Compliance.

The IRS has released Publication 4221-PC (rev. July 2014), Compliance Guide for 501(c)(3) Public Charities, which identifies activities that could jeopardize a public charity's tax-exempt status and addresses general compliance requirements on record keeping, reporting, and disclosure for section 501(c)(3) exempt organizations.

IRS LTR: Structure Change Won't Affect Exempt Status of Electric Power Group.

The IRS ruled that the tax-exempt status of an organization formed to ensure reliable supplies of electric power and to carry out other energy-related tasks will not be jeopardized when it establishes a structure under which it will become the central counterparty to transactions consummated through the markets it administers.

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *

UIL: 501.06-00, 513.00-00
Release Date: 7/25/2014
Date: April 28, 2014

Employer Identification Number: * * *

Dear * * *:

This letter is in reference to your request from your authorized representative. You are requesting rulings whether your establishment of a central counterparty structure, pursuant to which you will become the central counterparty to transactions that take place in the markets you administer, will affect your status as an organization described in I.R.C. § 501(c)(6) or will give rise to income from an unrelated trade or business within the meaning of § 513(a).

FACTS

You are recognized as an organization exempt from federal income tax under § 501(c)(6). You are organized and operated for the purpose of improving the business conditions of the power and electricity line of business with the meaning of Treas. Reg. § 1.501(c)(6)-1. You are mandated by the Federal Energy Regulatory Committee (FERC) to ensure reliable supplies of power, adequate transmission infrastructure, and competitive wholesale prices of electricity. You are designated as a regional transmission organization (RTO) by FERC.

FERC is responsible for regulating the transmission and wholesale sale of electric energy in interstate commerce to ensure reliability of electric service, nondiscriminatory access to transmission facilities, and that rates charged are reasonable. Prior to your creation, FERC directly regulated the vertically integrated utilities that owned generation, transmission, and distribution facilities in your region.

As part of the process of deregulation and the introduction of market competition into the wholesale electricity market, FERC charged you with providing independent, open and fair access to electricity transmission systems, facilitating market-based wholesale electricity rates, and ensuring effective and reliable management and operation of the bulk power system in your region. This includes the responsibility of ensuring that rates charged for transmission and the wholesale sale of electric energy are reasonable.

In furtherance of your responsibilities, you administer markets for the wholesale purchase and sale of electric energy and related products and services. In order to cover your operating expenses, you collect fees from the producers and wholesale purchasers of electric power in your region. These fees as well as the rules and procedures for the electricity markets you administer are set forth in your tariffs, which must be approved by FERC. The contracts, agreements or transactions offered under your FERC-approved tariffs are for the wholesale purchase and sale of electric energy and related products and services (during the first calendar quarter next year, you plan to begin offering related financial transactions, which do not involve physical delivery of electricity).

Currently, you administer a real-time energy imbalance market whereby market participants can compare real-time prices from many sources to make the most cost-effective decisions to purchase or sell energy into the market. Additionally, you settle the various positions of the market participants on an aggregate basis and both collect and remit payments to the market participants on a weekly basis. While you act as the administrator of the markets, clearing and settling purchases and sales by market participants, you currently do not take title to the electric energy or related products and services purchased and sold in the markets.

Additionally, you have been approved by FERC to develop and administer additional, more advanced markets which will provide additional benefits to current and new market participants. You are currently in the development stage and have received conditional approval from FERC of tariff changes to implement your new market.

FERC monitors the credit practices of the wholesale electric markets. In its order No. 741, “Credit Reforms in Organized Wholesale Electric Markets,” (Oct. 21, 2010), 133 FERC ¶ 61.060, and its

Order No. 741-A "Credit Reforms in Organized Wholesale Electric Markets," (Feb. 17, 2011). 134 FERC ¶ 61,126, FERC raised a question about the ability of an RTO or an independent system operator (ISO), in the event of the bankruptcy or a market participant, to set off or net the market positions of the bankrupt market participant. FERC's concern is that an ISO or RTO might not satisfy the "mutuality" requirement for setoff when those obligations are based upon different purchase and sale transactions because there is potential ambiguity as to the role of the ISO and RTO in the transactions. FERC therefore directed you (as well as other ISOs and RTOs) to submit a compliance filing with a proposed tariff revision that includes one or the following options:

1. establish yourself as a central counterparty to transactions with market participants;

2. require market participants to provide a security interest in their transactions in order to establish collateral requirements based on net exposure;

3. propose another alternative, which provides the same degree of protection as the two above-mentioned methods; or

4. choose none of the three above alternatives and instead establish credit requirements for market participants based on their gross obligations.

In response to the specific FERC orders above, you intend to pursue option 1: tariff amendments proposing to establish yourself as the central counterparty to all transactions that take place in the new market you will administer. Specifically, you will take title to the electric energy and related products purchased and sold in the markets. You represent that your role as central counterparty will not affect the clearing price, because the prices you pay to providers will exactly match the prices you receive from the sellers. You concluded that option 1 is the best balance between (i) fostering market liquidity and efficiency; and (ii) minimizing the risk of defaults. All transactions in which you engage will be pursuant to a FERC-approved tariff. The revisions to the tariff establishing you as central counterparty will be filed with FERC and will go into effect only if approved by FERC.

You have represented that your proposed activities as the central counterparty to transactions in the markets you administer (i) will not require an amendment to any of your organizing documents or any change in your organization; (ii) will require only minor revisions to your FERC-approved tariff; (iii) will result in no net profit or loss to you; and (iv) will not directly affect market clearing prices for electric energy and related products and services in the wholesale electric markets you administer. You have also represented that you are not aware of any statute or law that prohibits a government from acting as or performing the functions of an RTO, and that your operations will not change materially following your assumption of the central counterparty role.

RULINGS REQUESTED

1. Your establishment and implementation of a central counterparty structure pursuant to which you will become the central counterparty to transactions consummated through the markets you administer will not adversely affect your status as an organization exempt from federal income tax under § 501(c)(6).

2. The revenues you receive by virtue of being the central counterparty to transactions consummated through the markets you administer will not be classified as income from an unrelated trade or business within the meaning of § 513(a).

LAW

I.R.C. § 501(c)(6) provides for the exemption from federal income tax of business leagues, chambers

of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.
I.R.C. § 511(a)(1) imposes a tax on the unrelated business taxable income of organizations described in § 501(c)(6).

I.R.C. § 512(a)(1) states that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in § 513) regularly carried on by it, less the applicable deductions, and computed with the modifications in § 512(b).

I.R.C. § 513(a) provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by § 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the purpose or function constituting the basis for its exemption under § 501.

Treas. Reg. § 1.501(c)(6)-1 provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Treas. Reg. § 1.513-1(d)(1) provides, in general, that gross income derives from "unrelated trade or business," within the meaning of § 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted.

Treas. Reg. § 1.513-1(d)(2) provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of § 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

ANALYSIS

Ruling 1

As an RTO for your particular region, you improve the business conditions of the power and electricity line of business by being responsible for administering the market-based regulation of the wholesale electricity market and ensuring that rates charged for transmission and sale of electric energy are reasonable. Pursuant to FERC's mandate, you ensure reliable supplies of power, adequate transmission infrastructure, and competitive wholesale prices of electricity.

Your establishment and implementation of a central counterparty structure pursuant to which you will become the central counterparty to transactions in the markets you administer, is a response to credit reforms mandated in FERC Order Nos. 741 and 741-A. Your activities as the central counterparty will not require an amendment to any of your organizing documents, though certain revisions to your FERC-approved tariff will be required for implementation of the central

counterparty structure. These revisions must be approved by FERC prior to implementation.

As central counterparty, you will take title for a brief period of time to the electric energy and related products that are the subject matter of those transactions. Your role as a central counterparty will not affect the clearing price, because the prices you pay to producers will exactly match the prices you receive from the wholesale purchasers. Apart from taking title to electric energy and related products in your capacity as central counterparty, your market administration activities will remain essentially the same. Your activities as the central counterparty will result in no net profit or loss to you.

By mandating the ISOs and RTOs revise their tariffs to implement enhanced credit practices, FERC has established how you must conduct your market administration activities to provide for the nondiscriminatory and efficient transmission of electric energy. A default by one or more market participants could lead to a larger default in the market, disrupting services and the flow of electricity as well as raising the costs of doing business in the electricity market and a corresponding increase in rates paid. By acting as the central counterparty, you will be able to offset the obligations of a defaulting participant against payments owed to that participant, reducing the impact of one participant's default on the operations of other participants. The market participants are not able to do this themselves because of the clearing price system you use and the lack of contract privity with the defaulting party. Your sole purpose in acting as a central counterparty is to reduce the disruptions caused by a participant's default and in turn fulfill your responsibility for administering the market-based regulation of the wholesale electricity market and ensuring that rates charged for transmission and sale of electric energy are reasonable, in line with your exempt purpose within the meaning of Treas. Reg. § 1.501(c)(6)-1. You will not generate any net income from the activity.

Accordingly, the implementation of the central counterparty structure, and your activities as the central counterparty to each transaction in the markets you administer, will not adversely affect your status as an exempt organization described in § 501(c)(6) as compared to your previous operations.

Ruling 2

Section 513(a) defines the term "unrelated trade or business" as any trade or business which is not substantially related to the performance of an organization's exempt purpose. Treas. Reg. § 1.513-1(d)(2) states that a trade or business in substantially related to an organization's exempt purpose if it contributes importantly to the accomplishment of that purpose. As stated above, by acting as a central counterparty you will reduce the disruptions caused by a market participant's default. This contributes importantly to the accomplishment of your exempt purpose of improving the business conditions of the power and electricity line of business by administering the market-based regulation of the wholesale electricity market and ensuring that rates charged for transmission and sale of electric energy are reasonable. Therefore, acting as a central counterparty is substantially related to your exempt purpose and will not constitute an "unrelated trade or business" within the meaning of § 513(a).

RULINGS

Accordingly, based on the facts and circumstances discussed above, we rule as follows:

1. Your establishment and implementation of a central counterparty structure pursuant to which you will become the central counterparty to transactions consummated through the markets you administer will not adversely affect your status as an organization exempt from federal income tax

under § 501(c)(6).

2. The revenues you receive by virtue of being the central counterparty to transactions consummated through the markets you administer will not be classified as income from an unrelated trade or business within the meaning of § 513(a).

These rulings are based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Any changes that may have a bearing upon your tax status should be reported to the Service. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provision of the Code.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. § 6110(k)(3) provides that it may not be used or cited as precedent.

If there are any questions about this ruling, contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Mike Seto
Manager, Exempt Organizations
Enclosure
Notice 437

Citations: LTR 201430018

IRS LTR: Change in Proposed Bond Use Meets Notice and Approval Requirements.

The IRS ruled that a taxpayer’s proposed use of bond proceeds for construction on a different site than what was published in a public notice was an insubstantial deviation and will not cause the bonds to fail to meet the public notice and approval requirements.

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *
Telephone Number: * * *

Index Number: 147.00-00, 147.06-00
Release Date: 7/25/2014
Date: April 3, 2014

Refer Reply To: CC:FIP:B05 – PLR-103353-14

LEGEND:

Authority = * * *
Borrower = * * *
State = * * *
University = * * *
Bonds = * * *
Date 1 = * * *
Date 2 = * * *
Project 1 = * * *
Project 2 = * * *
Project 3 = * * *

Dear * * *:

This is in response to your request for a ruling that the use of bond proceeds as described below will be an insubstantial deviation for purposes of the public notice and approval requirements set forth in § 147(f) of the Internal Revenue Code (the "Code") and § 5f.103-2 of the temporary Income Tax Regulations.

FACTS AND REPRESENTATIONS

You make the following factual representations. Authority is a public trust and public corporation of State, created in part to assist in financing educational services and facilities through loans to nonprofit corporations.
Borrower is a State nonprofit corporation and an organization described in § 501(c)(3). One purpose of Borrower is to plan, finance, construct, develop, maintain, and operate sports stadiums, pavilions, field houses, or other buildings, for the exclusive use of University and University's Department of Athletics.

On Date 1, Authority published a public notice (the "TEFRA Notice") in newspapers of general circulation covering State and the localities in which the projects described in such Notice were to be located. The TEFRA Notice provided the place, date, and time of the public hearing relating to the proposed issuance of the Bonds, which were issued on Date 2. The TEFRA Notice also set forth the maximum aggregate principal amount of the Bonds and indicated that the proceeds of the Bonds would be loaned to Borrower and used to finance the costs to acquire, construct, expand, install, and equip certain improvements to Project 1, Project 2, and Project 3, all athletic facilities and collectively referred to herein as the "Projects", on the campus of University.

More specifically, the TEFRA Notice provided general descriptions designed to inform the public of the location of the site for Project 1, two potential site locations for Project 2, and two potential site locations for Project 3. All sites were identified by references to street boundaries and/or proximity to well-known facilities within the campus of University. With respect to Project 3, Borrower and University have subsequently, after the publication of the TEFRA Notice and issuance of the Bonds, determined that the site of Project 3 must be relocated to a different location (the "Revised Location") on the campus of University. The Revised Location is no more than one-tenth of a mile from one of the potential sites of Project 3 described in the TEFRA Notice. The portion of the Bond proceeds available for Project 3 will be used to construct the same type of athletic facility as stated in the TEFRA Notice the same as originally approved.

LAW AND ANALYSIS

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any State or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond within the meaning of § 141. Section 141(e)(1)(A) provides, in part, that the term "qualified bond" means any private activity bond that is a qualified 501(c)(3) bond, is part of an issue that meets the applicable requirements of § 146, and meets the applicable requirements of § 147.

Section 147(f)(1) provides that a private activity bond is not a qualified bond unless it satisfies the requirements of paragraph (2). Section 147(f)(2)(A)(i) provides that a bond satisfies the requirements of paragraph (2) if the bond is issued as part of an issue that has been approved by the governmental unit that issued the bond or by the governmental unit on whose behalf the bond was issued. Section 147(f)(2)(B) treats an issue as having been approved by a governmental unit if the issue is approved by the applicable elected representative of the governmental unit after a public hearing following reasonable public notice.

Under § 5f.103-2(f)(2), a facility is within the scope of an approval if the notice of public hearing and the approval contain all of the following: (i) a general functional description of the type and use of the facility to be financed; (ii) the maximum aggregate face amount of obligations to be issued with respect to the facility; (iii) the initial owner, operator, or manager of the facility; and (iv) the prospective location of the facility by its street address or, if none, by a general description designed to inform readers of its specific location. The term "facility" as defined in § 5f.103-2(f)(4) includes a tract or adjoining tracts of land, improvements thereon and any personal property used in connection with such real property. Separate tracts of land (including improvements and connected personal property) may be treated as one facility only if they are used in an integrated operation.

Section 5f.103-(2)(f) further provides that an approval is valid with respect to any issue used to provide publicly approved facilities, notwithstanding insubstantial deviations with respect to the maximum aggregate face amount of the bonds issued under the approval for the facility, the name of its initial owner, manager, or operator, or the type or location of the facility from that described in the approval. An approval or notice of public hearing is not adequate if any of the items in § 5f.103-2(f)(2)(i) through (iv), with respect to the facility to be financed, are unknown on the date of the public notice or the date of the approval.

Section 5f.103-2(g)(2) provides, in part, that a public hearing means a forum providing a reasonable opportunity for interested individuals to express their views, both orally and in writing, on the proposed issue of bonds and the location and nature of a proposed facility to be financed. Section 5f.103-2(g)(3) provides that reasonable public notice means published notice reasonably designed to inform residents of the affected governmental units, including residents of the issuing unit and the governmental unit where a facility is to be located, of the proposed issue. The notice must state the time and date for the hearing and contain the information contained in § 5f.103-2(f)(2).

The purpose of the public notice and approval requirement of § 147(f) is to ensure that the affected members of the general public will be notified of a pending bond issue and made aware of the intended use of the proceeds. In this case, the Revised Location of Project 3 is no more than one-tenth of a mile from one of the potential sites of Project 3 described in the TEFRA Notice. The Revised Location of Project 3 remains on the campus of University. The portion of the Bond proceeds available for Project 3 will still be used for the same purpose as originally stated in the TEFRA Notice, i.e., to construct the same type of athletic facility the same as originally approved.

While the use of Bond proceeds to construct Project 3 at the Revised Location was not expected or

foreseen at the time the Bonds were issued, the Notice did not fail to put the public in the affected area on notice as to Borrower's intention to use the Bond proceeds to finance projects that consist of improvements to certain athletic facilities located on the campus of University. Thus, the TEFRA Notice originally published in newspapers of general circulation covering State and the affected localities provided the general public in those localities with all of the pertinent information regarding the Projects as required by § 147(f) and § 5f.103-2(f).

CONCLUSION

Based on the factual representations set forth above, we conclude that the proposed use of Bond proceeds to construct Project 3 at the Revised Location constitutes an insubstantial deviation from the uses of the Bond proceeds described in the TEFRA Notice, and will not cause the Bonds to fail to meet the public notice and approval requirements of § 147(f) and § 5f.103-2(f).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to Authority's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by Authority and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel
(Financial Institutions and
Products)

By: James A. Polfer
Chief
Branch 5

Citations: LTR 201430001

Water Companies Request Guidance on Public-Private Partnerships.

Michael Deane of the National Association of Water Companies has written to Treasury regarding the application of the rules on tax-exempt bonds in the context of public-private partnerships involving water and wastewater treatment systems, focusing on the possible loss of the tax exemption on outstanding debt under such arrangements.

July 11, 2014

The Honorable Mark Mazur

Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable William Wilkins
Chief Counsel
Internal Revenue Service
1111Constitution Avenue, NW
Washington, DC 20224

RE: Guidance under section 141

Dear Mr. Mazur and Mr. Wilkins:

On behalf of the National Association of Water Companies (NAWC), I am writing to follow up on our previous discussions with the Treasury tax policy staff regarding the application of the rules related to tax-exempt bonds in the context of public-private partnerships (P3s) involving water and wastewater treatment systems. In our previous meetings, we discussed a particular impediment — possible loss of the tax exemption on outstanding tax exempt debt — to the utilization of private capital in water and waste water infrastructure projects in cases where a state or local government desires to enter into a long-term lease, concession, or operating agreement with a private company under which the company would assume the operation of water facilities that have been financed with tax-exempt debt. Treasury regulations under section 141 outline several "remedial actions" that the bond issuers in such cases may take to preserve the tax-exempt status of the debt, but as we discussed in the meetings, those actions are unavailable as a practical matter in typical cases involving water facilities. To ensure that the relief intended in the Treasury regulations is, in fact, available, we request that the Treasury issue guidance, as explained below, to clarify that one of the allowable remedial actions — alternative use of disposition proceeds — applies in the case of long-term leases, concessions, and operating agreements.

Background

NAWC is the trade association for private water operating companies. Private water companies serve more than 73 million Americans, nearly one-fourth of the population. Our member companies are eager to assist in the badly needed improvement of the country's water infrastructure.

As you know, President Obama has repeatedly called the public's attention to the distressed state of the country's basic infrastructure; he has expressed support for private sector participation in infrastructure improvement. Just recently he signed the Water Resources Reform and Development Act — a measure that envisions P3s — and reiterated that the federal government must step up its efforts to bring infrastructure up to world standards by addressing the $2 trillion of deferred maintenance in the country's basic infrastructure. In addition, in his FY 2015 budget, the President proposed lifting the state-by-state volume cap on issuances of private activity bonds for water and waste water infrastructure projects, as a way attracting more private capital and private-sector managerial expertise to such projects. As the President recognizes, clean, safe and affordable water and water treatment services are fundamental and basic infrastructure needs of all Americans.

There is a growing interest among local governments today in entering into concession/lease agreement P3 transactions as a means of improving the management, financial and operational condition of their drinking and wastewater systems by upgrading water and wastewater systems and other types of infrastructure assets. These transactions generally take the form of long-term leases,

concessions, or operating agreements (referred to collectively hereafter as “concessions”), where a private company essentially leases specified infrastructure assets for a 30-40 year period. Although these arrangements do not typically transfer tax ownership of the related facilities, they generally result in the concessionaire being responsible for the operation and maintenance and capital improvements with respect to the facilities. Both the term of these concessions and the manner in which the concessionaires are compensated generally prevent these arrangements from qualifying under the safe harbors for management contracts provided under Revenue Procedure 97-13.

Private water companies currently operate over 2,000 municipally owned water and wastewater facilities under P3s — which largely were set up under a contract operations and maintenance structured agreement, rather than as a concession-lease-based agreement. P3 contractual agreements combine the skills, assets, and resources of the public and private sectors to deliver water service or maintain water facilities for the benefit of the general public. The benefits to the country of private-sector capital through P3s are clear: The country’s drinking water systems face an annual shortfall of at least $11 billion to replace aging facilities and to comply with existing and future federal water regulations (without including the growth in the demand for drinking water over the next 20 years).1 Similarly, the Environmental Protection Agency has estimated that the nation must invest more than $380 billion over the next 20 years to update or replace existing water systems and build new ones to meet increasing demand.

Treasury Regulations

The Internal Revenue Code generally provides that interest on “private activity bonds” is not excluded from gross income for federal income tax purposes. The private activity bond prohibition contains exceptions for bond-financed “exempt facilities,” including water and wastewater facilities. The applicable Treasury regulations provide that the private activity bond prohibition is applied based on the issuer’s reasonable expectations on the issue date of tax-exempt bonds and also applied subsequently if a “deliberate action” is taken by the issuer that causes such bonds to meet the private activity bond tests. Generally, the execution of a long term concession for a facility financed by tax-exempt bonds will be considered a deliberate action that causes the private activity bond tests to be met.

Under Section 1.141-12 of the Treasury Regulations, a post-issuance deliberate action that results in the associated bonds meeting the private activity bond test will cause the interest on the bonds to become taxable unless a permitted remedial action is taken by the issuer. In the context of bonds for water and wastewater treatment systems in which a P3 transaction is entered into, there are three possible remedial actions that can be taken:

(1) Defeasance and redemption of the bonds.
(2) Compliance with the “alternative use of facilities” rule through a deemed reissuance of the bonds.
(3) Compliance with the “alternative use of disposition proceeds” rule.

As a practical matter, the first remedial action, defeasance, is impractical in typical circumstances today because of the country’s low-interest-rate environment. To defease bonds bearing an interest rate of five or six percent by creating an escrow account to pay those bonds and funding it with Treasury securities yielding one percent or less would require a capital outlay substantially exceeding the principal balance of the outstanding debt. We estimate that defeasance could reduce as much as 15 percent of the value of typical transactions to the communities undertaking them.

The second possible remedial action, alternative use of facilities, is also impractical. Under that rule, a deliberate action will not result in loss of tax-exempt status if the bonds can be treated as newly

issued bonds and, as such, can satisfy all of the requirements for newly issued tax-exempt bonds for the facility financed. For example, since water facilities are exempt facilities, it is possible that the bonds deemed to be reissued would satisfy the tax rules at the time of reissuance. However, one of the regulatory requirements is that the issuer obtain an allocation of the state private activity bond volume cap in an amount equal to the amount of the outstanding bonds. For a P3 transaction that can take years to consummate, that requirement can be an insurmountable problem because of the difficulty in receiving assurance from state officials that sufficient volume cap will be made available at the time the P3 transaction is closed. Further, in certain states the applicable volume cap allocation legislation or process seems not to permit volume cap to be used for this type of deemed reissuance. Another roadblock for the deemed reissuance approach is the re-characterization of the interest on the bonds as a type of income subject to the alternative minimum tax. To deal with that consequence without forcing the bondholders to have a change in tax treatment, the IRS permits the issuer in these circumstances to make a payment equal to the present value of the product of .0014 and the amount of the bonds outstanding in each remaining year. That payment is a further hurdle to the transaction, with no benefit to the residents of the community served by the utility.

Request for Guidance

The third possible remedial action, alternative use of disposition proceeds, permits issuers to avoid the loss of the tax-exempt status of bonds upon a cash sale “or other disposition” of a facility financed by the bonds, provided the issuer uses the cash for other governmental purposes within 2 years, such as other infrastructure projects. The regulations, however, are unclear as to the application of that remedial action in some situations. In particular, the application of this rule is uncertain in the case of concession arrangements since it is unclear whether this type of arrangement is a “disposition” and, if so, how concession payments made over the term of the arrangement are dealt with under this remedial action. As described above, concession arrangements in which a private party obtains operational control of a facility for a substantial period of years but with a state or local government retaining ownership, have become the preferred form of P3s for water and waste water facilities today.

A simple clarification in the regulations that would have the effect of substantially unleashing P3s would be the following:

Revise the definition of “disposition proceeds” in the regulations to include amounts derived from a concession, provided the arrangement does not have the effect of transferring tax ownership of the property to the new user.
Revise the cash consideration requirement of the regulations for transactions other than sales to require the consideration to be exclusively cash, paid either at the time of the transaction or later pursuant to the terms of the concession.
Modify the two-year expenditure window of the regulations to require that the issuer reasonably expect to expend the cash disposition proceeds within three years of the execution of the arrangement or, if later, within one year of the receipt of any cash installment under the arrangement.

Clarify that permitted alternative uses of disposition proceeds include the payment of debt service on other obligations of the issuer or to make contributions to public pension funds, provided that the other applicable tax requirements are satisfied. These clarifications would facilitate sales of infrastructure facilities, and long term leases or concession arrangements that are treated as sales for tax purposes, while still resulting in the disposition proceeds being used for purposes that qualify for tax-exempt financing. As a result, these changes are consistent with the purpose of the existing regulations; we see no policy reason for the regulations to prohibit these uses of disposition proceeds. For example, distinguishing between the redemption of the bonds that financed the

facility being sold and the redemption of other tax-exempt bonds of the issuer of those bonds serves no policy imperative, as both are valid governmental purposes.

We believe the Treasury should provide guidance reflecting the above changes in the regulations as soon as possible. There is certainly nothing in the statute to preclude the Treasury from issuing such guidance, and such guidance would be fully consistent with the President's policy of promoting investment in U.S. infrastructure.

The regulations clearly were originally intended to provide state and local governments a reasonable path for preserving the tax-exempt status of bonds in cases of transfers of facilities financed by the bonds, particularly where those facilities could have qualified for tax-exempt private activity bond financing. The above guidance would provide precisely such a path with respect to transfers of facilities through the standard type of P3 arrangement used today — concessions.

We would be pleased to discuss this further with you.

Sincerely,

Michael Deane
Executive Director
National Association of Water
Companies
Washington, DC

cc:
Mr. Kent Hiteshew, Office of State and Local Finance
Ms. Vicky Tsilas, Office of Tax Legislative Counsel

FOOTNOTE

1 The American Society of Civil Engineers 2009 Report Card for America's Infrastructure

END OF FOOTNOTE

Womble Carlyle: Counties, Towns and Cities Still in the Cross Hairs.

On Wednesday the Senate rolled out a new PCS for HB 1224 – Economic Development Changes that added what lobbyists for local government groups were expecting to be additional authority over local taxes but was instead a limitation of those powers.

North Carolina operates an economic development funding program called JMAC operated by the Department of Commerce. The fund provides grants to certain approved companies who meet job creation thresholds. The grants have time limits and limits on funding amounts. The bill allows companies in Tier 2 counties (poor) to join Tier 1 counties (poorest) to be eligible. The bill also limits the number of JMAC grants to five whose total cost cannot exceed $79 million (up from $69 million). **My experience as a legislative staffer was that the JMAC program was amended only when it needed to fit with an economic development opportunity. Further specifications that indicate a grant recipient is in mind: if a large manufacturer is investing in its manufacturing process – transitioning from coal to natural gas – with additional pollution controls it may be eligible. The bill also grows JMAC by establishing that the Department of Commerce cannot enter into more than five

agreements/grants, with total aggregate cost not to exceed $79 million (was, $69 million).

Wednesday's new section which surprised local government groups was a provision allowing counties to increase local sales tax in increments of 1/4 %, by referendum to fund education OR local transportation projects, but not both at the same time. The total local sales tax in a jurisdiction must not exceed 2.5%, and the funds cannot be shared with municipalities. This provision proved to be very controversial and the bill was returned to committee for further consideration.

View HB 1224 here: http://www.ncleg.net/Sessions/2013/Bills/House/PDF/H1224v2.pdf

Last Updated: July 19 2014
Article by Laura DeVivo

Seventh Circuit Affirms Denial of Retirement Fund's Exempt Status.

The Seventh Circuit affirmed a district court decision that held that ABA Retirement Funds didn't qualify as a tax-exempt business league under section 501(c)(6), finding that it didn't work to improve the conditions of the legal profession generally and it engaged in business ordinarily conducted for profit.

ABA RETIREMENT FUNDS,
Plaintiff-Appellant,
v.
UNITED STATES OF AMERICA,
Defendant-Appellee.

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

No. 09 C 6993 — John J. Tharp, Jr., Judge.

ARGUED JUNE 5, 2014 — DECIDED JULY 21, 2014

Before WOOD, Chief Judge, and EASTERBROOK and KANNE, Circuit Judges.
WOOD, Chief Judge.

ABA Retirement Funds, to which we refer simply as ABA Retirement, appeals the district court's denial of its request for tax-exempt status for the years 2000 through 2002. Agreeing with the Internal Revenue Service, the district court found that ABA Retirement was not a tax-exempt "business league" under 26 U.S.C. § 501(c)(6) during the relevant period. We agree with that assessment and affirm.

I

Because the district court granted summary judgment for the United States, the account that follows represents the undisputed facts along with all reasonable inferences that favor ABA Retirement. See FED. R. CIV. P. 56(c). ABA Retirement is an Illinois not-for-profit corporation whose predecessor,

American Bar Retirement Association, was incorporated in 1963 at the direction of the American Bar Association as a non-profit corporation. The entity's name later changed to ABA Retirement Funds, but the change has no effect on the issues before us, and so we use only the current name. The prospectus for the new entity stated that it was organized "for the sole purpose of providing members of the [ABA] and their employees with a retirement plan designed to take advantage of the income tax benefits which apply to a qualified retirement plan." To that end, the prospectus continued, ABA Retirement was charged with "promoting and facilitating the operation of [tax-qualified retirement plans], and this is the only activity" in which ABA Retirement was expected to engage.

While ABA Retirement's stated purpose was to provide members of the ABA (and later organizations with at least one ABA-member participant) with retirement plans, ABA Retirement itself did not have members in the traditional sense. Its day-to-day operations were run by John Puetz and a staff of three; its only "members" were the people who made up the ABA's Board of Governors. These "members," of whom there were about 38 from 2000 to 2002, appointed the officers of ABA Retirement and the trustee of its retirement plans. In time, ABA Retirement created several master retirement plans for adoption by lawyers and law firms. We will refer to these plans in the aggregate as "the Plan" and the Plan in combination with ABA Retirement and its vendors' activities done in connection with it as "the Program."

Until 1992, the Program was offered pursuant to a group annuity contract issued by Equitable Life Insurance Company of America (Equitable). At that time, members of the ABA Retirement's Board of Directors were the trustees of the master trusts. They had direct responsibility for the selection, retention, and termination of the managers of the investment options offered by the Program. That changed in 1999 when ABA Retirement hired State Street Bank and Trust to replace Equitable and perform additional duties as sole Plan trustee, at which point the ABA Retirement directors ceased to be trustees in order to comply with federal securities law. Under the new arrangement, while ABA Retirement was no longer a trustee, it created and maintained the IRS-approved master tax-qualified retirement plans and took on the role of Plan fiduciary. Had ABA Retirement not undertaken the fiduciary role, the federal Employee Retirement Income Security Act (ERISA) would have required an employer who adopted the retirement plans for its employees either to assume the duties or hire a third party to do so. The Program as a whole competed with other retirement plans in the market.

ABA Retirement, as Plan fiduciary, had the authority to engage, monitor, and fire its trustee, State Street. It was responsible for the design and maintenance of Plan documents (including making sure that they were tax-qualified), oversight of vendors, contract negotiations, and the review and approval of State Street's annual marketing plan. The latter task included making recommendations to State Street about targets for growth of participants and assets. ABA Retirement also made the plans available to the public without charge from 2000 to 2002. The free documents, however, did not come with an adoption agreement, even though they were tailored to ABA Retirement's trust. State Street was responsible for marketing generally, but ABA Retirement promoted the Plan through mail solicitations to attorneys, Sections of the ABA, and other bar groups. It did not limit itself to advertising the plans; it actively worked both to publicize them and to see that they were sold. State Street handled record keeping, a variety of administrative services, and the direct marketing of the Plan to the legal profession (though ABA Retirement reviewed and approved the annual marketing plan). State Street had the authority to engage and fire investment advisors, but it was required to consult with ABA Retirement and give full consideration to ABA Retirement's recommendations. As noted, ABA Retirement had the power to fire State Street.

ABA Retirement had a financial incentive to increase plan assets, since the Plan paid ABA Retirement a program expense fee for its services in connection with the Program based on a

percentage of the total invested assets, excluding assets invested in self-directed brokerage accounts. Those who wished to pursue the self-directed route were required to invest a minimum of 5% of their total investment in accounts that would be subject to the program expense fee. ABA Retirement received the interest on the funds. The amount in the funds was not trivial; on its tax returns for 2000, 2001, and 2002, ABA Retirement reported a gross income of $1,861,258, $1,667,862, and $1,601,217, respectively. Its taxable income for those years was $672,098, $384,972, and $411,874; it held assets worth approximately $3.5 million. The tax returns show that ABA Retirement described itself as an employee benefit fund, and its product was retirement plans.

For a long time, it appears that ABA Retirement's revenues were not large enough to raise tax concerns among its managers. It treated itself as a taxable entity until 2004, when it sought tax-exempt status at the time it filed its Form 1024. In August 2005, the IRS notified ABA Retirement that ABA Retirement did not qualify for the exemption from federal income tax under section 501(c)(6) of the Code. ABA Retirement then filed administrative claims for refunds on the taxes it paid from 2000 through 2002 and, again, those were denied. ABA Retirement responded with this suit, arguing that it was a tax-exempt "business league" under I.R.C. § 501(c)(6), 26 U.S.C. § 501(c)(6), during the period from 2000 to 2002, and thus was entitled to a refund for federal income taxes paid. The government contended that ABA Retirement was not a "business league" and thus it owed the taxes. The district court agreed with the government and granted summary judgment in its favor. ABA Retirement appeals.

II

The question whether an association is a business league for purposes of 26 U.S.C. § 501(c)(6) is a mixed question of law and fact, but on summary judgment we must accept the facts in the light most favorable to the nonmoving party and ask whether the law nonetheless requires judgment for the movant. See Guide Int'l Corp. v. United States, 948 F.2d 360, 361 (7th Cir. 1991). Our review is de novo. See Hakim v. Accenture U.S. Pension Plan, 718 F.3d 675, 681 (7th Cir. 2013).
We begin with the language of the key statute, 26 U.S.C. § 501(c)(6), which grants a tax exemption to:

Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

The statute does not define "business league," and the term "has no well-defined meaning or common usage outside the perimeters of § 501(c)(6)." Nat'l Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. 472, 476 (1979). In fact, the Court noted that the precise term "business league" is one "so general . . . as to render an interpretive regulation appropriate." Id. (citing Helvering v. Reynolds Co., 306 U.S. 110, 114 (1939)).

The Treasury Department furnished just what the Court called for. See Treas. Reg. § 1.501(c)(6)-1 (1978), 26 C.F.R. § 1.501(c)(6)-1; see also Nat'l Muffler, 440 U.S. at 484 (Treasury regulation "merits serious deference"). Paraphrased, the regulation provides that an organization qualifies as a business league if and only if it is an association (1) "of persons having some common business interest;" (2) "the purpose of which is to promote such common interest;" (3) that is not organized for profit; (4) that does not "engage in a regular business of a kind ordinarily carried on for profit;" (5) whose activities are "directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons," and; (6) that is "of the same general class as a chamber of commerce or board of trade." See Treas. Reg. § 1.501(c)(6)-1, 26 C.F.R. § 1.501(c)(6)-1.

This is not a close case; save for the fact that it is a nonprofit corporation, ABA Retirement fails every necessary condition for business league status. Because the district court's opinion is thorough, here we focus on just two of the reasons why ABA Retirement is not a business league: (1) its activities are not directed to the improvement of business conditions for the legal field generally; and (2) it engages in a business ordinarily conducted for profit.

1. Improving business conditions of the legal profession

One of the prerequisites to business-league status is that the entity's activities must be "directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons." Treas. Reg. 1.501(c)(6)-1 (emphasis added). ABA Retirement fails to satisfy this requirement for at least two reasons: first, it characterized its business as the provision of individual benefits; and second, it has not shown anything that could reasonably be called improvement of business conditions for the legal profession generally.

On the tax returns it filed for the relevant years ABA Retirement stated that its business was the operation of an employee benefit fund and its product was retirement plans. This is a perfectly good business, but it is one that provides benefits to individual persons, not to an entire field of commerce. We have no doubt that, as § 1.501(c)(6)-1 recognizes, some organizations may improve business conditions in a line of business by performing services that benefit individual industry participants. Although state-created and thus not quite on point here, the Washington State Apple Advertising Commission illustrates the general idea. See Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333 (1977). Another example might be the Owner-Operator Independent Drivers Association. See Owner-Operator Indep. Driver Ass'n, Inc. v. Fed. Motor Carrier Safety Admin., 656 F.3d 580 (7th Cir. 2011). But those individual benefits must be incidental to the industry-wide benefits. The regulation requires improvement of business conditions "as distinguished from" the performance of particular services. That requires line-drawing. Organizations that provide benefits to an industry only by benefitting specific individuals within that industry fall on the other side of the "business league" line. ABA Retirement counters that lawyers secure in their retirement are happy, confident lawyers, and this is reflected in the general satisfaction quotient for the profession as a whole. That may be true: we do not doubt that retirement planning is good for the legal profession generally (as it is for everyone else), but ABA Retirement furnished that benefit almost exclusively by providing a particular service to particular persons, namely, retirement plans for those who signed up for its Program. The fact that it also distributed some materials without charge does not change the nature of the enterprise.

Assoc. Master Barbers & Beauticians of Am., Inc. v. Comm'r of Internal Revenue, 69 T.C. 53 (1977), is instructive. It stands for the proposition that regardless of whether an organization's activities further an exempt purpose, if those actions do not use non-exempt means, they will not receive tax-exempt status. The association in question was a non-profit entity that had been organized to unify master barbers. Id. at 55. The court did not question that the described goal would improve the conditions of the master barber industry. In trying to achieve this goal, the association provided its members with (among other things) various types of insurance, from which it received commissions. Id. at 59.

The tax court recognized that an organization "whose principal purpose and activity is such as to qualify for 'business league' exemption does not lose its exempt status by engaging in incidental activities which standing alone would be subject to taxation." It therefore proceeded to "examine the extent of petitioner's insurance activities to see if they constitute[d] only incidental, as opposed to substantial, activities." Id. at 67. It found that the association's insurance activities were directed towards providing benefits to individuals within the industry and those activities were substantial.

This was enough, it held, to require a finding that the association did not qualify for business league status. Here, we know that ABA Retirement's involvement with the Program was in no way "incidental" — it was the fiduciary, and its own prospectus states that it was incorporated "for the purpose of promoting and facilitating the operation of the Plan and this is the only activity in which it is expected that ABA Retirement will engage." ABA Retirement's day-to-day goal was to promote its own plan first and general retirement savings in the legal profession second; it therefore cannot receive tax-exempt status under § 501(c)(6).

2. Business ordinarily conducted for profit

Related to the finding that ABA Retirement's activities were aimed primarily at the provision of services to individual persons was the fact that it engaged in the business of providing retirement plans, a business ordinarily conducted for profit. ABA Retirement argues that the district court reached this conclusion by "conflating" ABA Retirement with the Program. It explains that while the Program itself may have been a business ordinarily conducted for profit, the Program was administered by State Street and ABA Retirement simply sponsored the Program as part of its mission to improve the condition of the legal industry.
ABA Retirement focuses on the "sponsoring" language because, pursuant to IRS regulations, a trade organization "having characteristics similar to those described in section 1.501(c)(6)-1 of the regulations" (i.e. characteristics similar to a business league) is permitted to sponsor retirement plans without losing its tax-exempt status. Rev. Proc. 89-9, 1989-1 C.B. 780, superseded by Rev. Proc. 2000-20, 2000-1 C.B. 553. Because the IRS approved ABA Retirement's retirement plans, and a condition of that approval that the organization have characteristics "similar to" a business league, ABA Retirement argues it is therefore a business league entitled to the exemption. Unfortunately, this is a bridge too far.

As a matter of logic, simply because x has "characteristics similar to" y does not necessarily make x a y. A cucumber has characteristics similar to a zucchini but it is not, in fact, a zucchini. And, while having characteristics similar to a zucchini may be enough for some purposes (for instance, to stand in as a zucchini in an impressionist still life), it will not be enough when an object possessing all the characteristics of a zucchini — in other words, a zucchini itself — is required (say, when making zucchini bread). In order to be a business league for purposes of 26 U.S.C. § 501(c)(6), ABA Retirement must satisfy every condition laid out in § 1.501(c)(6)-1; for purposes of Rev. Proc. 89-9 it needed only to have characteristics "similar to" those in the regulation.

Returning to the question at hand — whether ABA Retirement was engaged in business ordinarily done for profit during the relevant period — the answer is an unequivocal yes. ABA Retirement did not just sponsor the Program; it was the Program fiduciary. Assuming fiduciary duties on behalf of law firms that sign up for the Program is itself an act ordinarily done for profit. ABA Retirement has cited no case, nor can we find one, in which an entity was a plan fiduciary under ERISA and yet qualified as an exempt business league.

ABA Retirement finally relies on Am. Acad. of Family Physicians v. United States, 91 F.3d 1155 (8th Cir. 1996), where the Eighth Circuit found that the Academy's sponsorship of a group insurance program did not translate into taxable business activity by the Academy. See id. at 1159. Again, however, we see important differences between that case and ours. First, the question was not whether the Academy was a business league but instead whether the payments it received through its sponsorship of the insurance plans were taxable under 26 U.S.C. § 511 as "unrelated business taxable income." Our case involves the antecedent question whether ABA Retirement is a business league. As we explained above, ABA Retirement's activities were not primarily directed toward the improvement of the legal profession as distinguished from the performance of particular services for individual persons. Second, even if we put that aside, there are other crucial differences between

ABA Retirement and the Academy. In Family Physicians, the insurance program was administered "in its entirety by an unrelated, non-exempt corporation" over which the Academy "had no administrative or underwriting responsibilities" for the policies. 91 F.3d at 1159. The amounts paid to the Academy in relation to the insurance program "were neither brokerage fees nor other compensation for commercial services, but were the way the parties decided to acknowledge the Academy's eventual claim to the excess reserves while [the policy administrator] was still holding and using the reserves." Id. In contrast, nearly all of ABA Retirement's income came from a program expense fee State Street paid it for services in connection with the Program. The fee was also based on a percentage of the total invested assets. Unlike the Academy, ABA Retirement was the Plan fiduciary. Family Physicians does not compel a different result.

* * * * *

We conclude that ABA Retirement is not a business league under 26 U.S.C. § 501(c)(6). We therefore AFFIRM the judgment of the district court.

IRS Outlines Professional Responsibilities Under Circular 230.

The IRS has posted to its website information on who is subject to the Circular 230 practice standards and information on some of their responsibilities.

GUIDANCE TO PRACTITIONERS REGARDING PROFESSIONAL OBLIGATIONS
UNDER TREASURY CIRCULAR NO. 230

Who is Subject to Treasury Circular No. 2301

The provisions of Treasury Circular No. 230 apply to:

- Attorneys
- Certified Public Accountants
- Enrolled Agents
- Enrolled Actuaries
- Enrolled Retirement Plan Agents
- Appraisers
- Individuals representing others pursuant to limited practice regulations
- Individuals giving written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type OPR determines to have a potential for tax avoidance or evasion.

The Internal Revenue Service's Office of Professional Responsibility (OPR) may propose the censure, suspension, or disbarment of any practitioner, and the disqualification of any appraiser, from practice before the Internal Revenue Service if the individual is shown to be incompetent or disreputable, fails to comply with any regulation in Treasury Circular No. 230, or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. OPR may also propose a monetary penalty for an individual, and/or the employer of any individual subject to Treasury Circular No. 230, for violations of Circular 230 if (i) the violations occurred in connection with the individual's activities on behalf of the employer and (ii) the employer knew or reasonably should have known of the individual's conduct. Treasury Circular No. 230 § 10.3, § 10.7, § 10.8, § 10.50. 31 U.S.C. 330(b).

Selected Obligations Under Treasury Circular No. 230

The following is a summary description of certain obligations under Treasury Circular No. 230. This summary does not address all provisions of the Regulations. You should read the Circular/Regulations for a more complete understanding of the duties and obligations of someone practicing before the IRS.

Due Diligence. You must exercise due diligence in preparing and filing tax returns and other documents/submissions, and in determining the correctness of representations made by you to your client or to the IRS. You can rely on the work product of another person if you use reasonable care in engaging, supervising, training, and evaluating that person, taking into account the nature of the relationship between you and that person. You generally may rely in good faith and without verification on information furnished by your client, but you cannot ignore other information that has been furnished to you or which is actually known by you. You must make reasonable inquiries if any information furnished to you appears to be incorrect, incomplete or inconsistent with other facts or assumptions. Treasury Circular No. 230 § 10.22, § 10.34(d).

Competence. You must have the necessary knowledge, skill, thoroughness, and preparation necessary for the matter for which you have been engaged. You may be able to provide competent representation by researching and educating yourself on the issue or by consulting with another tax professional who has established competence in the field in question, but in doing so you must consider the requirements of Internal Revenue Code § 7216. Treasury Circular No. 230 § 10.35.

Conflicts of Interest. A conflict of interest exists if representing one of your clients will be directly adverse to another client. A conflict of interest also exists if there is a significant risk that representing a client will be materially limited by your responsibilities to another client, a former client or a third person, or by your personal interests. When a conflict of interest exists, you may not represent a client in an IRS matter unless (i) you reasonably believe that you can provide competent and diligent representation to all affected clients, (ii) your representation is not prohibited by law, and (iii) all affected clients give informed, written consent to your representation. You must retain these consents for 36 months and make them available to the IRS upon request. Treasury Circular No. 230 § 10.29.

Tax Return Positions. You cannot sign a tax return or refund claim or advise a client to take a position on a tax return or refund claim that you know or should know contains a position (i) for which there is no reasonable basis, (ii) which is an unreasonable position under Internal Revenue Code § 6694(a)(2), or (iii) which is a willful attempt to understate tax liability or a reckless or intentional disregard of rules or regulations. An unreasonable position is one which lacks substantial authority as defined in IRC § 6662 but has a reasonable basis, and is disclosed. For purposes of Circular 230, disclosure requires that you inform a client of any penalties that are reasonably likely to apply to the client with respect to a tax return position if you advised the client regarding the position or you prepared or signed the tax return and how to avoid the penalties through disclosure on the tax return (or, by not taking the position). Treasury Circular No. 230 § 10.34.

Written Tax Advice. In providing written advice concerning any Federal tax matter, you must (i) base your advice on reasonable assumptions, (ii) reasonably consider all relevant facts that you know or should know, and (iii) use reasonable efforts to identify and ascertain the relevant facts. You cannot rely upon representations, statements, findings, or agreements that are unreasonable or that you know to be incorrect, inconsistent, or incomplete. You must not take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit in evaluating a Federal tax matter. In providing your written advice, you may rely in good faith on the advice of another practitioner only if that advice is reasonable considering all facts and circumstances. You cannot rely

on the advice of a person whom you know or should know is not competent to provide the advice or who has an unresolved conflict of interest as defined in 10.29. Treasury Circular No. 230 10.37.

Errors and Omissions. If you know that a client has not complied with the U.S. revenue laws or has made an error in, or omission from, any return, affidavit, or other document which the client submitted or executed under U.S. revenue laws, you must promptly inform the client of that noncompliance, error, or omission and advise the client regarding the consequences under the Code and regulations of that noncompliance, error, or omission. Depending on the particular facts and circumstances, the consequences of an error or omission could include (among other things) additional tax liability, civil penalties, interest, criminal penalties, and an extension of the statute of limitations. Treasury Circular No. 230 § 10.21.

Furnishing Information to the IRS. If you receive a proper and lawful request for records or information from the IRS, you must promptly submit the requested information unless in good faith you reasonably believe that it is privileged. If the requested information is not in your or your client's possession, you must promptly inform the requesting IRS personnel of that fact. You must also provide any information you may have regarding who is in possession of the requested information, but you are not required (i) to make inquiries of anyone other than your client or (ii) to verify information provided by your client regarding the person(s) in possession of the requested information. You must not interfere with any lawful IRS attempt to obtain information unless in good faith you reasonably believe that the information is privileged. You cannot advise a client to submit any document to the IRS that is frivolous or that contains or omits information in a manner demonstrating an intentional disregard of a rule or regulation unless you also advise the client to submit a document that evidences a good faith challenge to the rule or regulation. Treasury Circular No. 230 § 10.20, § 10.34(b).

Handling Matters Promptly. You cannot unreasonably delay the prompt disposition of any matter before the Internal Revenue Service. This applies with respect to responding to your client as well as to IRS personnel. You cannot advise a client to submit any document to the IRS with the purpose of delaying or impeding the administration of the Federal tax laws. Treasury Circular No. 230 § 10.23, § 10.34(b).

Client Records. On request of a client, you must promptly return any client records necessary for the client to comply with his or her Federal tax obligations, even if there is a dispute over fees. You may keep copies of these records. If state law allows you to retain a client's records in the case of a fee dispute, you need only return the records that must be attached to the client's return but you must provide the client with reasonable access to review and copy any additional client records retained by you that are necessary for the client to comply with his or her Federal tax obligations. The term "client records" includes all written or electronic materials provided to you by the client or a third party. "Client records" also include any tax return or other document that you prepared and previously delivered to the client, if that return or document is necessary for the client to comply with his or her current Federal tax obligations. You are not required to provide a client with of your work product — i.e., any return, refund claim, or other document that you have prepared but not yet delivered to the client if (i) you are withholding the document pending the client's payment of fees related to the document and (ii) your contract with the client requires the payment of those fees prior to delivery. Treasury Circular No. 230 § 10.28.

Fee Arrangements. You cannot charge an unconscionable fee for services in any matter before the IRS. You also cannot charge a contingent fee for services in any IRS matter except for services in connection with:

- An IRS examination of or challenge to an original tax return;

- An IRS examination of or challenge to an amended tax return or refund claim, but only if the amended return or claim is filed (before/or) no later than 120 days after the taxpayer receives a written notice from the IRS of the examination of or written challenge to the original tax return;
- A claim for credit or refund filed relating solely to a determination of interest or penalties;
- Any judicial proceeding arising under the Internal Revenue Code Treasury Circular No. 230; or
- Whistleblower Claims Under IRC Sec 7623.

Treasury Circular No. 230 § 10.27, IRS Notice 2008-43.

Solicitation. With respect to any Internal Revenue Service matter, you may not use any form of public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement or claim. You also may not assist, or accept assistance from, any person or entity who obtains clients or otherwise practices in violation of the solicitation provisions. Treasury Circular No.230 § 10.30.

Negotiating Checks. You may not endorse, negotiate, electronically transfer, or direct the deposit of any government check relating to a Federal tax liability issued to a client. This prohibits any person subject to Treasury Circular No. 230 from directing or accepting payment from the government to the taxpayer into an account owned or controlled by that person. Treasury Circular No. 230 § 10.31.

Supervisory Responsibilities. If you have or share principal authority and responsibility for overseeing your firm's tax practice, you must take reasonable steps to ensure that your firm has adequate procedures in place to raise awareness and to promote compliance with Circular 230 by your firm's members, associates, and employees. Treasury Circular No. 230 § 10.36.

Best Practices. In addition to the rules with which persons must comply, Treasury Circular No. 230, § 10.33 includes aspirational best practices for those who provide include:

- Communicating clearly with the client regarding the terms of the engagement.
- Establishing facts, determining which facts are relevant, evaluating the reasonableness of any assumptions or representations, relating applicable law (including potentially applicable judicial doctrines) to the relevant facts, and arriving at conclusions supported by the law and the facts.
- Advising clients regarding the meaning of any conclusions reached by the person subject to Circular 230.
- Advising clients whether they may avoid accuracy-related penalties if the client acts in reliance on that person's advice.

Acting fairly and with integrity in practice before the Internal Revenue Service.

FOOTNOTE

1 All references to the publication called Treasury Circular No. 230 are to the June, 2014 version found at http://www.irs.gov/pub/irs-pdf/pcir230.pdf. The corresponding Regulations are available at 31 CFR Subtitle A, Part 10.

END OF FOOTNOTE

IRS Issues Interim Guidance on Using Electronic Signatures.

The IRS has issued a memorandum (AP-08-0714-0006) providing interim guidance on the

appropriate use of electronic signatures on Appeals letters and documents.

July 15, 2014

Expiration Date: July 18, 2016

Affected IRM: 8.6.4, Reaching Settlement and
Securing an Appeals Agreement Form

MEMORANDUM FOR:
Director, Field Operations West
Director, Field Operations East
Director, Specialty Operations
Acting Director, Campus Operations
Director, Account Processing & Support
Director, Appeals Quality Measurement System

FROM:
John V. Cardone
Director, Policy Quality & Case Support

SUBJECT:
Interim Guidance re: Electronic Signature Use on Appeals Letters
and Documents

This memorandum serves as interim guidance to Appeals employees regarding the appropriate use of electronic signatures until it is incorporated in IRM Part 8. This guidance is effective as of July 18, 2014.

Appeals is adopting the following electronic procedures that comply with the Government Paperwork Elimination Act (GPEA):

1. A person (i.e., the signer) must use an acceptable electronic form of signature;
2. The electronic form of signature must be executed or adopted by a person with the intent to sign the electronic record (e.g. to indicate a person's approval of the information contained in the electronic record);
3. The electronic form of signature must be attached to or associated with the electronic record being signed;
4. There must be a means to identify and authenticate a particular person as the signer; and
5. There must be a means to preserve the integrity of the signed record.

Note: See Use of Electronic Signatures in Federal Organization Transactions, dated January 25, 2013, prepared by General Services Administration (GSA).

As clarification regarding an acceptable and legally sufficient electronic handwritten signature, Appeals will use a method that:

A. Identifies and authenticates a particular person as the source of the electronic message;
B. Indicates such person's approval of the information contained in the electronic message; and
C. Displays the signer's signature pictorially either as a scanned image of the signer's written signature or as the signer's signature captured by use of a signature pad or written stylus device.

Copies of the signed documents must be included in the case file.

Appeals may use an electronic signature on the following documents:

Document	Description
Form 906	Closing Agreement on Final Determination Covering Specific Matters
Form 866	Agreement as to Final Determination of Tax Liability
Form 870-AD series	Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment
Form 890-AD	Estate Tax Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and of Acceptance of Overassessment
Form 2504-AD	Excise or Employment Tax-Offer of Agreement to Assessment and Collection of Additional Tax and Offer of Acceptance of Overassessment
Form 2751-AD	Trust Fund Recovery Penalty-Offer of Agreement to Assessment and Collection
Form 870-IS	Waiver of Collection Restrictions in Innocent Spouse Cases
Letter 3193	Notice of Determination
Letters 894 & 901	Notice of Deficiency

In addition to the documents identified above, electronic handwritten signatures may be used on closing letters to taxpayers and internal use documents. For example, Form 5402 (Appeals Transmittal and Case Memo) and Letter 913 (Closing Letter — Agreed Case) would be appropriate for electronic signature use.

At this time, however, the documents in the table below require an original signature:

Document	Description
Form 872 series	Consent to Extend the Time to Assess Tax
Form 656	Offer in Compromise

This guidance will be incorporated in IRM 8.6.4, Conference and Settlement Practices — Reaching Settlement and Securing an Appeals Agreement Form. Should the guidance pertain to other Appeals IRM subsections, authors may cite IRM 8.6.4 as a cross reference.

A link is available on the Appeals website, providing step-by-step instructions on the creation and use of electronic signatures.

If you have any questions, please contact Appeals Senior Program Analysts John Gonzalez and/or David Zito.

Distribution: www.IRS.gov

IRS Corrects Dates in Regs on Streamlined Exemption Process.

The IRS has corrected sunset dates in the text of temporary regulations (T.D. 9674) that provide guidance on a streamlined application process that eligible organizations may use to apply for recognition of tax-exempt status under section 501(c)(3).

Guidelines for the Streamlined Process of Applying
for Recognition of Section 501(c)(3) Status

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Treasury Decision 9674

RIN 1545-BM07

Correction
In rule document 2014-15623 on pages 37630-37632 of the issue of Wednesday, July 2, 2014 make the following corrections:

§ 1.501(a)-1T [Corrected]

1. On page 37631, in the third column, in § 1.501(a)-1T(f)(2), in the third line, “July 1, 2017” should read “June 30, 2017”.

§ 1.501(c)(3)-1T [Corrected]

2. On page 37632, in the first column, in § 1.501(c)(3)-1T(h)(2), in the third line, “July 1, 2017” should read “June 30, 2017”.

§ 1.508-1T [Corrected]

3. On page 37632, in the third column, in § 1.508-1T(c)(2), in the third and fourth lines, “July 3, 2017” should read “June 30, 2017”.

[FR Doc. C2-02014-15623 Filed 07/17/2014 at 8:45 am; Publication Date: 07/18/2014]

Comments Sought on Amortizable Bond Premium Regs.

The IRS has requested public comment on information collections under final regulations (T.D. 8746) on the income tax treatment of bond premium and bond insurance premium; comments are due by September 15, 2014.

Blame It on the ROO: Form 1023-EZ and Decline of EO Determinations.

Brad Bedingfield discusses the future role of the IRS Review of Operations Unit within the exempt organizations division.

With the development of streamlined procedures for processing applications for tax-exempt status, including the new Form 1023-EZ, the IRS EO division appears to be moving toward a self-certification system. The success of that strategy will depend largely on how well the IRS can strengthen its examination programs, including its Review of Operations Unit, also known as the "ROO."

* * * * *

Lois Lerner's now infamous comments at a May 10, 2013, conference regarding the handling of Tea Party applications for tax-exempt status may have marked the beginning of the end for the IRS exempt organizations determinations function. What had been a gradual shift of resources from review of initial applications to later examinations is quickly becoming a landslide. When the dust settles, many organizations seeking exempt status may enjoy something very close to a self-certification system. Whether that shift blows open the doors for bad actors to claim exempt status under false pretenses may depend largely on the success of a small and little-known program within the EO division, which may now morph (in some form) into one of its most important: the IRS Review of Operations Unit, also known as the "ROO."

What Is the ROO?

The ROO began in 2005, on the recommendation of the IRS Advisory Committee on Tax Exempt and Government Entities.1 At the heart of the ROO was a recognition that not every organization is entirely truthful in its initial application and that many organizations — even "good" ones — evolve significantly in their early years. EO determinations specialists have suspicions that an applicant isn't telling the whole story. They have a mechanism for asking for additional information: the so-called development letter.2 However, development letters are intended to solicit information necessary to make a determination, not to stress test an organization's representations or to catch organizations in a lie. A determinations specialist is generally reviewing an organization before it's really done anything. What if there is reason to suspect that an applicant may not really intend to operate for exempt purposes but there is no track record of activity to allow the specialist to prove it?

Since 2005 a determinations specialist has the option of approving an application subject to a ROO referral.3 The applicant receives its exemption letter, but behind the scenes its file is sent to a team of specialists, who, after a few years have passed, perform a "no-contact" review of the organization (as opposed to a compliance review or correspondence examination, which involve remote correspondence with the organization, or a field examination, which may involve an on-site review4). The organization has no way of knowing (without access to the IRS's internal file5) whether it is under ROO review. A ROO specialist will look at the first few years of annual returns (Form 990, 990-EZ, 990-PF, or 990-N) and at whatever information is publicly available regarding the organization, including information on its website. The specialist will then compare that information with the original application for recognition of exempt status. If there are inconsistencies or other causes for concern, the specialist may refer the case for further examination.

Why Expand It?

In the wake of the Tea Party scandal, the IRS hired "Lean Six Sigma" consultants to review the internal processes and workflow systems of the EO division.6 Those consultants identified various inefficiencies in the current determinations process, in part attributable to the fact that the IRS traditionally has tried to provide substantial review of purportedly EOs both on the front end — through the determinations process — and on the back end — through examinations.7 Whether an organization is exempt often depends on multiple facts and circumstances tests, which require significant time and resources to review adequately. At the same time, an effective examinations program arguably requires auditing a sufficient percentage of organizations to discourage others from playing the audit lottery. However, only a very small percentage of EOs get audited every year.8 By trying to catch bad actors on both the front end and the back end, dwindling IRS resources are doubly stretched, and more and more organizations slip through the cracks altogether.

This resource crunch is nothing new to the IRS, although it has been particularly acute in recent years. The EO division has long tried to find more efficient ways to catch bad actors while allowing good charities to get on with their programs. In recent years, it has experimented with special compliance projects, the development of risk analytics, and tiered determinations processing.9 In its determinations function, the IRS created teams of specialists to handle specific kinds of cases more efficiently, and it developed tracking and processing systems (such as the ill-fated "be on the lookout," or BOLO list) to direct cases to specialists. In the meantime, however, resources continued to dwindle, even as Congress added new duties, such as offshore account initiatives, the Affordable Care Act, and auto-revocation.

With dwindling resources on both the determinations side and the examinations side, the ROO, which sits somewhere between the two,10 is an attractive option. Inefficiencies on the determinations side are particularly problematic because the more time specialists spend pushing back on unqualified applicants, the more time other organizations have to wait in line for recognition of exempt status. Since 2010, when a massive influx of auto-revocation reinstatement cases flooded the system, many organizations now wait more than a year just to be assigned to a determinations specialist, and enough cases are taking multiple years to process that the IRS has had to issue guidance on what to do about organizations that are automatically revoked for failure to file annual returns for three years while awaiting review of their applications.11 Offloading that time-consuming initial review to the ROO would, in theory, allow the "good" organizations to get their exemption letters and get on with their charitable programs, while shifting the initial filtering process just a few years down the road, when the IRS can test organizations against actual activities, not just representations.

Will It Work?

The IRS is clearly betting that it will work. When it recently began allowing section 501(c)(4) applicants to attest that they would not engage in more than a designated amount of political activity, in lieu of full case development on that issue during the application process, the IRS signaled that reliance on attestations might be supplemented by a ROO referral.12 More recently, the IRS has been developing a more streamlined application process for section 501(c)(3) applicants, including a new Form 1023-EZ for some smaller organizations,13 and reliance on attestations rather than full development for many other applicants.14 IRS officials have stated that they intend to balance those streamlined application procedures with a more "robust compliance process on the back end."15

Form 1023-EZ appears to contemplate possible ROO referrals for some organizations. Part III, in particular, asks a series of questions (lines 4 through 11) regarding potential activities, including payment of compensation, international activity, lobbying activity, and specified financial transactions.16 According to the Instructions for Form 1023-EZ, the answers to those questions do

not affect eligibility to file the form.17 Organizations that answer yes to any of those questions are not asked for additional information, as they would be in a traditional Form 1023 application. What, then, is the purpose of the questions? It seems likely that at least one purpose is to generate data that may be used in deciding which organizations will receive a ROO or other examination referral.18

If the IRS does intend to rely heavily on the ROO, the agency will certainly need to expand it. As of September 2012, there were only 40 ROO specialists.19 Presumably, more will be needed to provide a meaningful backstop to the more than 60,000 applications the IRS receives each year. IRS officials have indicated that once the new streamlined application procedures are in place and the current backlog of applications has been addressed, determinations personnel will likely be reassigned to examinations (which includes the ROO).20

Also, the IRS will need to tighten its internal documentation and processes regarding ROO referrals and processing. In theory, at least some ROO referrals are randomly selected.21 However, it appears that many organizations may have historically been chosen for ROO referral based on a particular specialist's gut reaction to the organization's application.22 For this reason, the ROO has been criticized as prone to abuse — indeed, the House Ways and Means Committee recently called out the ROO (to which many Tea Party applications were referred) as the IRS's "surveillance program."23 Unless the IRS has sufficient resources to require a ROO referral for all organizations claiming tax-exempt status (or at least for all Form 1023-EZ filers), it will need to develop and publish objective criteria for determining what organizations get referred to the ROO, and it may need to combat the surveillance program characterization somewhat by at least informing organizations that they are or have been subject to the ROO.

However, even the most robust and transparent ROO program will not result in review of new EOs until some time after they have received exemption letters. Many governmental and other organizations, in granting tax preferences or otherwise in dealing with new EOs, rely to some extent on the fact that the IRS has performed some sort of meaningful initial review, and they have criticized the new streamlined processes as diluting the weight that an IRS exemption letter now may carry (at least in an organization's first few years).24 State officials and others are understandably concerned that shifting review to the ROO or other examination program will open the floodgates for purported EOs that might not have survived the traditional IRS application process.

It remains to be seen whether the IRS will find a way to filter out at least some of the unqualified applications upfront. Form 1023-EZ, unlike Form 1023, must be electronically filed. Electronic filing could in theory give the IRS an increased opportunity to educate applicants regarding the requirements for tax exemption as they complete the application, and perhaps the opportunity to weed out some applications through an interactive application process. The electronic Form 1023-EZ does not, however, appear to include such interaction between the Form and the Instructions. The IRS has estimated that organizations will take an average of 8.9 hours to complete the 2 1/2-page Form 1023-EZ.25 That estimate assumes that applicants will spend substantial time reviewing the Instructions in a good-faith attempt to understand the requirements for exempt status. That assumption may be naïve, however, and it does not account for the bad-faith attempt by organizations to take advantage of the lack of initial review.

Moreover, it is not yet clear what the consequences will be for an organization that incorrectly files a Form 1023-EZ.26 Some organizations may violate the filing criteria inadvertently. For example, the Form 1023-EZ Instructions preclude an organization with more than $50,000 of annual revenue in its early years from using the form. What if the organization is more successful in its early fundraising than anticipated? Will its exempt status be revoked? Will its initial exemption letter be

viewed as somehow contingent on continued compliance (at least during the first few years) with the Form 1023-EZ filing criteria? What about organizations that never intended to comply with the filing criteria? The threat of revocation, even retroactive revocation, will unlikely be a sufficient deterrent. Will the IRS actively pursue fraud or criminal penalties against enough bad-faith applicants to provide a meaningful chilling effect? The ultimate success of the streamlined application process and consolidation of resources on the examinations side will depend not just on beefing up the ROO or other examination programs but also on finding some way at least to limit the perception that bad actors are likely to get away with disingenuous Form 1023-EZ filings.

What Should We Expect?

At first blush, it appears that the universe of organizations that can file Form 1023-EZ is relatively small. An organization that anticipates more than $50,000 in annual revenue, or $250,000 in assets, in its early years doesn't qualify.27 Also excluded are supporting organizations, sponsors of donor-advised funds, schools, churches, and many others.28 When submitting a prior draft Form 1023-EZ to the Office of Management and Budget for its review, the IRS stated that it expected only about 17 percent of applicants will use the form.29 However, that draft provided significantly higher filing thresholds ($200,000 in annual revenue and $500,000 in assets). With the lower thresholds, the initial percentage may be lower.

However, the IRS may allow Form 1023-EZ to eventually be used by a much higher percentage of applicants. TE/GE Commissioner Sunita Lough has indicated that the filing criteria are not "cut in stone," and that perhaps as many as 70 percent of applicants may eventually use this form.30 Further, it appears that many Form 1023 applications will rely more on attestations than traditional case development at the determinations stage.31 Therefore, it seems likely that an ever-increasing percentage of organizations will receive exemption letters without significant upfront review.

What Should We Do?

If an organization clearly meets the Form 1023-EZ criteria and is willing to monitor with special care its annual returns, its website, and other public activity in its first five years, the lure of Form 1023-EZ is compelling. Instead of the current long wait times — even for many simple applications — organizations could get their exemption letters in "weeks rather than months" (or years).32 The ability to get an exemption letter and begin activities quickly can make all the difference to a young organization trying to jump-start its charitable programs.

However, an organization that (1) has any doubt about whether it will meet the Form 1023-EZ filing criteria in its early years; (2) must answer yes to any of the questions in Part III, lines 4 through 11; or (3) is concerned about the weight that state officials or others may give to an "EZ" determination letter may want to file a full Form 1023 application. It can be difficult to wait months or years for a determination. However, the IRS has committed to (eventually) processing all applications in six months or less, and because of the heavy backlog over the past several years, applicants have learned various methods (such as fiscal sponsors) to begin their charitable activities to some extent while waiting for a determination.

As of July 1, 2014, Form 1023-EZ is ready for electronic filing. It will be interesting to see how many organizations file the new form, and to what extent fear of the ROO can keep these new EOs in line.

FOOTNOTES

1 See Treasury Inspector General for Tax Administration, "Performance Measures and Improved Case Tracking Would Help the Exempt Organizations Function Better Allocate Resources" (Mar. 13,

2008) 2008 TNT 58-21: Treasury Reports.
2 See Internal Revenue Manual section 7.29.3.2.1.

3 See IRM section 7.20.1.5.2. The ROO also monitors organizations denied exemption to ensure that they are not holding themselves out as exempt. See IRM section 7.20.1.5.2(2).

4 See IRM section 4.75.27. See also IRS EO division, "FY 2012 Annual Report & FY 2013 Workplan," at 5 (Jan. 25, 2013) 2013 TNT 18-57: Other IRS Documents (fiscal 2012 report).

5 Specifically, Form 14266, which documents the reasons for the ROO referral.

6 Lean Six Sigma is a management re-engineering method used to optimize business performance.

7 See IRS EO division memorandum, "Streamlined Processing Guidelines for All Cases" (Feb. 28, 2014) 2014 TNT 46-64: Other IRS Documents.

8 See fiscal 2012 report, supra note 4, at 5.

9 Id.

10 The ROO is technically part of the IRS Exempt Organizations Compliance Area, a subdivision of EO Examinations. Id. at 2.

11 See IRS EO division memorandum, "Processing Guidelines for Certain Pending Applications of Exempt Organizations That Fail to File Annual Information Returns for Three Consecutive Years" (Mar. 14, 2014) 2014 TNT 59-31: Other IRS Documents.

12 See IRS EO division memorandum, "Interim Guidance on Optional Expedited Process for Certain Exemption Applications Under Section 501(c)(4)" (June 25, 2013) 2013 TNT 125-55: Other IRS Documents; IRS EO division memorandum, "Amendment to Interim Guidance on Optional Expedited Process for Certain Exemption Applications Under Section 501(c)(4)" (July 18, 2013) 2013 TNT 140-50: Other IRS Documents; and IRS EO division memorandum, "Expansion of Optional Expedited Process for Certain Exemption Applications Under Section 501(c)(4)" (Dec. 23, 2013).

13 See Form 1023-EZ; and Instructions for Form 1023-EZ (rev. June 2014) 2014 TNT 127-51: Forms Watch.

14 See "Streamlined Processing Guidelines," supra note 7.

15 See EO Tax Journal 2014-83; Diane Freda, "IRS to Roll Out Form 1023-EZ in Summer, Anticipates Little Risk of Noncompliance," Bloomberg BNA (Apr. 25, 2014) (reporting on an April 23 media call with IRS TE/GE Commissioner Sunita Lough); and John Koskinen, testimony on the fiscal 2015 IRS budget, at 11 (Apr. 7, 2014) 2014 TNT 67-31: IRS Testimony.

16 See Form 1023-EZ, supra note 13.

17 See Instructions for Form 1023-EZ, supra note 13.

18 Moreover, these questions may make it easier for the IRS to revoke the organization's exempt status, perhaps retroactively, if an organization's actual activities are inconsistent with these representations.

19 See fiscal 2012 report, supra note 4, at 12.

20 See supra note 15.

21 See fiscal 2012 report, supra note 4, at 12 (describing the ROO as consisting of "randomly selected follow-ups").

22 See IRM section 7.20.1.5(2)(B) ("A Review of Operations (ROO) follow-up referral is prepared when a determination specialist has concerns about the past, present, or future activities of the organization but does not have sufficient cause to deny exemption"); and IRM section 7.20.1.5.2 ("ROO follow-up referrals should be made for material issues when questionable activity is likely to occur, e.g., future operations may impact exempt status, generate UBI or other tax liabilities, or necessitate a change in private foundation classification").

23 See Ways and Means Committee letter to Attorney General Eric Holder, at 7 (Apr. 9, 2014) 2014 TNT 69-26: Congressional Tax Correspondence.

24 See, e.g., National Association of State Charity Officials, comments on proposed Form 1023-EZ (Apr. 30, 2014), available at http://www.nasconet.org/nasco-submits-comment-on-proposed-form-1023-ez/; and http://www.councilofnonprofits.org.

25 See Instructions for Form 1023-EZ, supra note 13, at 10.

26 See Rev. Proc. 2014-40, section 8.02.

27 See Instructions for Form 1023-EZ, supra note 13.

28 Id.

29 See draft Instructions for Form 1023-EZ (Feb. 10, 2014).

30 See EO Tax Journal 2014-83, supra note 15; and Fred Stokeld, "Streamlined Exemption Application Could Pose Compliance Problems," Tax Notes, Apr. 28, 2014, p. 439 2014 TNT 76-7: News Stories (reporting on April 23 telephone remarks by Lough).

31 See supra note 12.

32 Koskinen testimony, supra note 15, at 11.

END OF FOOTNOTES

By Brad Bedingfield

Brad Bedingfield is an attorney with Goulston & Storrs PC in Boston and a former tax law specialist in the IRS Exempt Organizations division.

The Affordable Care Act's Employer Shared Responsibility Provisions – What Government Employers Need to Know.

Free Webcast by the IRS office of Federal State and Local Governments

Date: July 24, 2014

Time: 12 p.m. Eastern Time

Learn about the following topics pertaining to the Affordable Care Act:

- Defining an Applicable Large Employer
- Determining whether or not the entity is an Applicable Large Employer
- When and how the employer shared responsibility applies
- Forms of transition relief

To register: Click here. You will use the same link to attend the event.

Please feel free to forward this message to anyone who you believe would be interested and would value this educational opportunity.

IRS: Revenue From Nonprofit Hospital's Lab Services Isn't Taxable.

In technical advice, the IRS concluded that a tax-exempt hospital's performance of laboratory testing for patients of private physicians located in a city, which is served by the hospital and designated as a "medically underserved population," is not an unrelated trade or business under section 513. The hospital is dedicated to improving the health status of the city's communities by enhancing preventive and primary care and by providing health education. The hospital, which is located in a rural area, describes itself as being committed to improving access to healthcare and to providing services to the underserved.

Rev. Rul. 85-110 provides that while generally a tax-exempt hospital's performance of laboratory testing services for nonpatients constitutes an unrelated trade or business, there may be unique circumstances when those services may further the hospital's exempt function. Those circumstances may exist if other laboratories are not available within a reasonable distance from the area served by the hospital or the laboratories are unable or inadequate to conduct tests needed by nonpatients.

The IRS determined in this case that while other laboratories are available and able to conduct tests for individuals who are not the hospital's patients, they are unable to do so adequately. The nearest full-service, commercial laboratory facility isn't within a reasonable distance of the city and its turnaround time for test results is much slower than the hospital's. The inability of other laboratories to adequately serve the patients of private physicians located in the city and its surrounding communities served by the hospital constitutes a unique circumstance under Rev. Rul. 85-110.

Accordingly, the IRS concluded that the hospital's performance of laboratory testing for the patients of private physicians located in the city and surrounding communities served by the hospital isn't an unrelated trade or business under section 513. The provision of laboratory services for those individuals is substantially related to, and contributes importantly to, the hospital's tax-exempt purpose of improving the health of the city and its surrounding communities. As a result, the hospital's revenue from that activity is not taxable under section 511.

Citations: TAM 201428030

Taxpayer's Name: * * *
Taxpayer's Address: * * *
Taxpayer's ID No.: * * *

Years involved: * * *
Conference held: * * *

UIL: 513.04-00
Release Date: 7/11/2014
Date: March 7, 2008

* * * Area Manager, EO Examinations

LEGEND:

A = * * *
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z-zz = * * *
xx = * * *
yy = * * *

ISSUE

Is A’s performance of laboratory testing for the patients of private physicians located in B and the surrounding communities served by A an unrelated trade or business within the meaning of Section 513 of the Internal Revenue Code?

FACTS

A is a nonprofit corporation formed on F in state C. Its Articles of incorporation state that it was formed to hold title to a hospital building and manage, maintain, and carry on said hospital.

The Internal Revenue Service recognized A as exempt from federal income taxation under [now]

section 501(c)(3) of the Code, and as a hospital described in section 170(b)(1)(A)(iii). A is located in the city of B, in state C.

According to A's Bylaws, the hospital is dedicated to improving the health status of the communities of B, G, H, I, J, and K by enhancing preventive and primary care, and by providing health education. A describes itself as being committed to improving access to care and to providing services to the underserved.

B is designated as a "medically underserved population" by the U.S. Department of Health and Human Services, Hearth Resources and Services Administration, Bureau of Health Professions, Shortage Designation Branch. The United States Census Bureau's Census 2000 data indicate that A is located in a rural area. Residents of B and surrounding communities are eligible to participate in the U.S. Department of Agriculture's Rural Housing Program.

A operates a full-service medical laboratory onsite within the hospital that strives to provide a high level of service to its community. A operates its laboratory 24 hours a day, seven days a week, 365 days a year. One of the laboratory's three pathologists, certified by the American College of Pathologists, is available to provide feedback to physicians 24 hours a day, seven days a week. Depending on the specific test ordered, the laboratory generally provides completed test results to the ordering physician within z-zz hours following receipt of a sample for testing, regardless of the time of day the test is ordered.

The majority of A's laboratory testing services are provided to A's patients. On average, approximately p% of tests performed by the A laboratory have historically involved testing for patients of private physicians (not patients of A) located in B and the surrounding communities of G, H, I, J, and K. A has historically reported income from these tests, for income tax purposes, as giving rise to unrelated business income (UBI). Approximately q% of all A's testing for patients of private physicians represents emergency testing, for which the A laboratory reports results within r hour(s) of receipt of the sample.

Private physicians who refer their patients to A for testing generally have admitting privileges at A. They typically draw the samples in their private offices. The samples are then picked up by an A employee for testing at the A laboratory. Depending on the location of the particular doctor's office or facility being served, the A courier may pick up samples for testing as many as s times per day.

A neither advertises its laboratory testing services nor employs salespeople or marketing professionals. Instead, physicians typically learn about A's laboratory services through A's new physician orientation process and through talking with other physicians.

There are no full-service, commercial or noncommercial laboratories in B or in any of B's surrounding communities. The nearest noncommercial laboratories are those of community Hospital N, which lies to the west of A and its surrounding communities, and community Hospital O, which lies to the east of A and its surrounding communities. The service areas of these other hospitals' laboratories do not overlap with A's laboratory service area.

The nearest full-service, commercial testing laboratory is D, located in E, in state C, approximately t miles from B. The round trip driving time between the D laboratory and B is generally u hours.

D operates drawing stations in both L and M (each approximately v miles from B), each of which is located between B and D's laboratory in E. The drawing stations perform no testing services on-site. Rather, these stations draw samples which are transported to the D facility in E for testing and analysis. The samples drawn at the stations are generally picked up by D near the end of the day. In

comparison, A picks up samples as frequently as s times per day.

D offers medical testing services to B-area physicians by providing a courier service which picks up samples from physicians' B-area offices and transports the samples to D's laboratory in E for testing. A indicated that D's courier generally picks up samples from physicians' offices located in B and its surrounding communities after the close of the physicians' normal business hours. The D courier then completes its route and delivers the samples to D's laboratory. Commonly ordered tests may be processed during the night, whereas less commonly ordered tests may be batched for processing later. Results of completed tests may be reported to the ordering physician w or more times per day depending upon D's arrangement with the specific physician.

The turnaround time for B-area physicians who send samples to D varies depending on whether the samples are drawn before or after D's daily pick up, and whether the laboratory tests are completed before or after D's scheduled delivery of test results. A B-area physician who draws a sample in his or her office in the morning for a commonly processed test would generally anticipate receiving laboratory test results from D the following morning (a turnaround time of up to x hours). In contrast, A's test result delivery in such a scenario is generally z-zz hours.

A states that D also offers emergency testing services. D typically performs each emergency test and provides the results of the test within y hours of receipt of the sample by D's courier. In comparison, A's emergency service generally provides a maximum turnaround of r hour(s).

D does not advertise in the B telephone book or actively market its laboratory work in the B area. Furthermore, the president of A's medical staff reported that neither he nor A have ever been solicited by D.

A states that most physicians in B and its surrounding communities use A's laboratory to test samples from their patients. A believes that the consensus of the private physicians in the B area is that A's laboratory services are adequate for their patients, whereas D's laboratory services are inadequate.

A represents that B-area doctors view the substantial difference in laboratory turnaround times between the A laboratory and the D as a critical distinction that may have important medical consequences for their patients, particularly for those who are elderly. A emphasizes the importance of timely information to doctors' medical decision making. Timing is critical, as several hours difference in receiving test results can make a significant difference in patient diagnosis and treatment. A states that that the recent trend toward reduced inpatient hospitalization and shorter inpatient stays has generally reduced the ability of physicians to physically observe patients and increased physicians' dependence upon outpatient, post-hospitalization laboratory testing. Consequently, physicians are required to make quicker medical decisions with respect to their patients. The need to order further tests, the need to modify medication levels, and the need to refer patients for emergency room care, inpatient check-in, or surgery are all vital medical decisions which frequently depend upon timely results of laboratory tests, according to A. For example, the results of a complete blood count test could indicate whether a patient is bleeding internally, suffering from coronary heart disease, or experiencing a heart attack, and could indicate the need for immediate medical intervention.

APPLICABLE LAW

Section 511 of the Code imposes a tax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax under section 501(c).
Section 512 of the Code provides that the term "unrelated business taxable income" means the gross

income derived by any organization from any unrelated trade or business (defined in section 513) regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business.

Section 513(a) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related," for purposes of section 513 of the Code, only if the causal relationship is a substantial one. For this relationship to exist, the production or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes. Whether the activities productive of gross income contribute importantly to such purposes depends in each case upon the facts and circumstances involved.

Rev. Rul. 85-110, 1985-1 C.B. 166, addresses whether the performance of diagnostic laboratory testing by a tax exempt hospital upon specimens from patients of private physicians (who are not patients of the hospital) constitutes unrelated trade or business within the meaning of section 513 of the Code. The hospital laboratory performed diagnostic laboratory testing upon specimens obtained by non-employee staff physicians at non-hospital facilities from members of the public who were not Hospital patients. The revenue ruling stated that commercial laboratories that performed testing identical to that performed by the hospital were available in the area and provided testing services on a timely basis. As such, the hospital laboratory's testing for the patients of private physicians who were not Hospital patients constituted a separate trade or business.

Rev. Rul. 85-110 provides that the provision of diagnostic laboratory testing to a private physician's patients (who are not Hospital patients) normally constitutes an unrelated trade or business for a tax-exempt hospital The revenue ruling also provides an exception to the general rule, stating in part.

. . . if other laboratories are not available within a reasonable distance from the area served by the Hospital Or are clearly unable or inadequate to conduct tests needed by Hospital Nonpatients, a hospital's testing services may further its exempt function of promoting community health. Whether such unique circumstances exist will be decided by the Internal Revenue Service on a case-by-case basis.

ANALYSIS

Rev. Rul. 85-110 provides that although the general rule is that the providing of laboratory testing services by a tax exempt hospital to nonpatients constitutes unrelated trade or business, unique circumstances may exist whereby such services may further the hospital's exempt function. Such "unique circumstances" may exist if other laboratories are (1) not available within a reasonable distance from the area served by the hospital, or (2) clearly unable or inadequate to conduct tests needed by Hospital Nonpatients. See Rev. Rul. 85-110. Here, although other laboratories are available and able to conduct tests needed by A's nonpatients, they are unable to do so adequately, for the reasons described below. Thus, unique circumstances exist whereby A's laboratory services to nonpatents in B and its surrounding communities further its tax exempt purpose.

The tax-exempt purpose of A is to improve the health status of B and its surrounding communities. A

is located in B, which is designated as a “medically underserved population” by the U.S. Department of Health and Human Services. A is located in a rural area, according to the U.S. Census Bureau.

The nearest full-service, commercial laboratory facility to the A laboratory is D, which is approximately t miles and a u-hour round trip from A’s laboratory. The general turnaround time for results from A’s laboratory, z-zz hours, is considerably faster than D’s turnaround time. A estimates the average differential in turnaround time to be between xx and yy hours.

A believes that the consensus of the private physicians in the B area is that A’s laboratory services are adequate for their patients, whereas D’s laboratory services are inadequate. A indicates that most physicians in B and the surrounding communities utilize A’s laboratory for speedier results, primarily because of the substantial difference in turnaround time between A’s laboratory and D. The difference in turnaround time can have important medical consequences for patients. A difference of several hours in receiving test results can make a significant difference in patient diagnosis and treatment, as test results may indicate the need for immediate medical intervention, including modifying medication levels, providing further testing or treatment, or conducting surgery. For instance, the results of a complete blood count test could indicate whether a patient is bleeding internally, suffering from coronary heart disease, or experiencing a heart attack, and could indicate the need for immediate medical intervention.

Therefore, although D’s laboratory is available for use by physicians and patients in B and its surrounding communities, D is not within a reasonable distance of those communities to adequately serve their health care needs, particularly the needs of patients for timely laboratory testing. See Rev. Rul. 85-110. Because A provides adequate laboratory services to B and its surrounding communities, A promotes the health of the community, and its laboratory services contribute importantly to the accomplishment of A’s tax exempt purpose of improving the health of its community. See section 1.513-1(d)(2) of the regulations.

Accordingly, the inability of other laboratories to adequately serve the patients of private physicians located in B and the surrounding communities served by A constitutes “unique circumstances” under Rev. Rul. 85-110. Thus, A’s provision of laboratory services to such patients furthers A’s tax exempt purpose of improving the health of B and its surrounding communities.

CONCLUSION

A’s performance of laboratory testing for the patients of private physicians located in B and the surrounding communities served by A is not an unrelated trade or business within the meaning of section 513 of the Code. The provision of laboratory services for such persons is substantially related to, and contributes importantly to. As tax exempt purpose of improving the health of B and its surrounding communities, consistent with section 1.513-1(d)(2) of the regulations and the “unique circumstances” test of Rev Rul. 85-110. Accordingly. A’s revenues from such activity is not taxable under section 511 of the Code.

IRS LTR: IRS Grants Extension of Expenditure Period for Bond Proceeds.

The IRS granted a school district an extension of the original expenditure period for available project proceeds of qualified school construction bonds because the district’s failure to spend the bond proceeds was due to reasonable cause and the district will spend the remaining proceeds for qualified purposes with due diligence.

Citations: LTR 201428001

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * * , ID No. * * *
Telephone Number: * * *

Index Number: 54F.00-00
Release Date: 7/11/2014
Date: April 07, 2014

Refer Reply To: CC:FIP:B05 – PLR-108519-14

LEGEND:
District = * * *
State = * * *
City = * * *
School = * * *
Bonds = * * *
Date 1 = * * *
Date 2 = * * *
Date 3 = * * *

Dear * * * :

This is in response to your request under § 54A(d)(2)(B)(iii) of the Internal Revenue Code for an extension of the expenditure period for the available project proceeds of qualified tax credit bonds.

FACTS AND REPRESENTATIONS

You make the following factual representations. District is a public school district and political subdivision of State.

District issued the Bonds on Date 1 and designated the Bonds as qualified school construction bonds within the meaning of § 54F(a)(3). All available project proceeds of the Bonds were to be spent on constructing, rehabilitating, and repairing School (the "Project"), and were expected to be spent before Date 2.

The original three-year expenditure period for the Bonds under § 54A(d)(2)(B)(i) will expire on Date 2 (the "Original Expenditure Period"). The Project entailed (1) construction of a new gymnasium and classroom wing for School, (b) completely rehabilitating School's original building, (3) demolishing an unneeded previous addition to School, and (4) acquiring real estate adjacent to School for use as parking space and an outdoor play area. School is an historic three-story public school facility which is approximately 140 years old and located in City. As of Date 1, District did expect that all of the available project proceeds of the Bonds would be spent on the Project by the expiration date of the Original Expenditure Period.

District is unable to expend all of the available project proceeds by the expiration date of the Original Expenditure Period because several unexpected events have caused unanticipated delays in the programming and design of the Project and in the acquisition, construction, rehabilitation, and repair of the Project. The programming and design phase of the Project was unexpectedly increased from 18 to 24 months because of Project alterations made by each of the governing authorities of the two City historic districts which School borders. These alterations were made over the course of

several meetings by the authorities and increased the time it took to design the Project. The programming and design phase of the Project was also unexpectedly lengthened because the magnitude of damage caused by a fire which had occurred prior to the Bonds being issued was greater than anticipated, and required District to develop more extensive rehabilitation and repair plans than it had originally thought necessary.

The acquisition, construction, rehabilitation, and repair phase of the Project was delayed by several unexpected events. First, City was late in issuing a building permit, which caused Project construction delays by pushing the construction of the building envelope and site development for School into a winter season with above average snowfall and uncharacteristically cold temperatures. Second, construction of a new addition to School required that the foundation of the addition and the foundation of School tie-in together. When the existing foundation of School was exposed it was discovered to have deteriorated more than expected and was unusable in some areas. Rehabilitation of this unanticipated condition caused additional Project construction delays. District expects to expend the remaining available project proceeds of the Bonds by Date 3.

District submitted this request for a ruling prior to Date 2.

LAW AND ANALYSIS

Section 54A(d)(1) provides that a qualified school construction bond is treated as a qualified tax credit bond for purposes of Section 54A.

Section 54A(d)(2)(B)(i) provides in part that to the extent that less than 100 percent of the available project proceeds of the issue are expended by the close of the expenditure period for 1 or more qualified purposes, the issuer shall redeem all of the nonqualified bonds within 90 days after the end of such period.

Section 54A(d)(2)(B)(ii) provides that for purposes of this subpart, the term “expenditure period” means, with respect to any issue, the 3-year period beginning on the date of issuance. Such term shall include any extension of such period under clause (iii).

Section 54A(d)(2)(B)(iii) provides that upon submission of a request prior to the expiration of the expenditure period (determined without regard to any extension under this clause), the Secretary may extend such period if the issuer establishes that the failure to expend the proceeds within the original expenditure period is due to reasonable cause and the expenditures for qualified purposes will continue to proceed with due diligence.

Section 54A(d)((2)(C)(iv) provides that for purposes of this paragraph, in the case of a qualified zone academy bond, a “qualified purpose” means a purpose specified in § 54E(a)(1).

Section 54A(e)(4) of the Code defines “available project proceeds” to mean (A) the excess of (i) the proceeds from the sale of an issue, over (ii) the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds), and (B) the proceeds from any investment of the excess described in subparagraph (A).

The Project was identified prior to the issuance of the Bonds and District reasonably expected to spend all of its allocable available project proceeds within the three-year period. The expected failure to spend all the available project proceeds of the Bonds by the expiration of the three-year period on Date 2 has been caused by events that were not reasonably expected at the time the Bonds were issued and were beyond the control of District. However, District to the extent possible considering the described unexpected external events that resulted in unforeseen delays, has and

will continue to exercise due diligence in spending the remaining available project proceeds on the Project. District expects to spend all available project proceeds of the Bonds not later than Date 3.

CONCLUSION

Under the facts and circumstances of this case, we conclude that District's expected failure to expend the available project proceeds of the Bonds by Date 2 is due to reasonable cause and that District's continued expenditure of the proceeds for qualified purposes will proceed with due diligence. Therefore, District is granted an extension of the Original Expenditure Period with respect to the Bonds until Date 3.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to District's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by District and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel
(Financial Institutions &
Products)

By:
Timothy L. Jones
Senior Counsel, Branch 5

IRS LTR: Support of Organization's Program Won't Affect Club's Exemption.

The IRS ruled that a social club's support of a social welfare organization established to conduct events for the club's members and the general public will not affect the club's exempt status, finding that the organization's gross receipts will not be attributed to the club and other payments will not be deemed gross receipts to the club.

Citations: LTR 201428009

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *

UIL: 501.07-00; 501.07-05
Release Date: 7/11/2014

Date: February 10, 2014

Employer Identification Number: * * *

LEGEND:

M = * * *
P = * * *
r = * * *
S = * * *

Dear * * *:

This responds to your letter dated June 24, 2011, in which you request rulings with respect to certain transactions between M and P, and their effect on M's status as an organization described in I.R.C. § 501(c)(7).

FACTS

M is organized as a not-for-profit corporation under state law. It is recognized as a social club described in § 501(c)(7). M has actively fostered interest in amateur r by organizing and conducting regional, national, and international r that were open or by invitation to both its members and nonmembers. These events were in addition to those organized solely for M's members.

P is organized as a not-for-profit corporation under state law. It is recognized as a social welfare organization described in § 501(c)(4). It was established to conduct the amateur open and by invitation r events previously conducted by M for members and nonmembers.

P has no members. Its activities are managed by a six-member board of directors. All of its directors and officers are presently members of M, though there is no requirement that they be so. Two directors are appointed by M, while the rest are presently neither trustees nor directors of M. P's bylaws provide that a majority of P's directors must at all times consist of persons who are not concurrently either a trustee or an officer of M, and that P's president must be a director who is not concurrently a trustee or officer of M.

P will conduct those open and by invitation r agreed with M. P will utilize volunteers and contractors to conduct its events; it does not expect to have employees of its own. In carrying out its responsibilities, P will utilize certain facilities, equipment, intellectual property and website facilities made available by M without cost. M will provide office space and record storage facilities to P without cost, and P will reimburse M for services provided by M's S Office and certain administrative employees (based on an allocable share of their compensation and benefits and their time devoted to P activities). P may either pay M for catering services and accommodations (based on member pricing rates) or obtain them from third parties.

More specifically, M and P have entered into an Administration Agreement, among the provision of which are the following —

S Office Personnel. During the Term [of the Agreement] M agrees to make available to P the services of its S Office personnel . . . for use in planning and conducting [r] Events & Programs, provided that P shall reimburse M for its allocable share of the compensation and benefits provided to such personnel based on the time that such employees devote to P activities.

Administrative Services. During the Term, M agrees to provide to P such administrative services

(including bookkeeping, clerical, secretarial, annual filings) relating to conducting Events & Programs and maintaining P's annual reporting requirements as P may request, and P agrees to reimburse M for its allocable share of the compensation and benefits provided to such personnel based on the time that such employees devote to P activities.

Insurance. During the Term, M agrees to include P as a named insured under its current personal injury and property damage insurance coverage so as to cover P's activities in conducting its Events & Programs. P agrees to reimburse M for P's allocable share of the premiums for such coverage as determined by the insurer(s), provided that M may in its discretion waive all or part of such reimbursement. P shall obtain, at its own cost, directors and officers liability insurance for P's directors and officers at the same level as that provided currently by M to its trustees and officers.

M and P maintain separate books and records on which their respective revenues and disbursements are recorded. They also maintain separate bank accounts into which their respective revenues are deposited and from which their respective expenses are paid. For accounting purposes, they will have separate audited financial statements, and they will file separate annual information returns on Form 990.
For accounting and Form 990 reporting purposes, M does not include P's allocable share of the compensation and benefits provided to S Office and administrative personnel or P's allocable share of insurance premiums in expenses when paid by M. Rather, such amounts are recorded as advances to P. Conversely, M does not include reimbursements by P in revenue, but, instead, records them as the payment of an advance.

RULINGS REQUESTED

M has requested the following rulings:

1. The gross receipts of P will not be attributed to M for purposes of determining M's compliance with the 15 percent limit on nonmember gross receipts under § 501(c)(7).

2. Payments made by P to M to reimburse M for shared services of S Office and certain administrative personnel, and for personal injury and property damage insurance coverage, will be regarded as reimbursements for advances made for the benefit of P and will not be deemed to be nonmember gross receipts to M.

3. M's exemption under § 501(c)(7) will not be adversely affected by its support of P's r program.

LAW

I.R.C. § 501(a) exempts from federal income taxation organizations described in § 501(c).

I.R.C. § 501(c)(7) describes clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Treas. Reg. § 1.501(c)(7)-1(a) provides that the exemption provided by § 501(a) for organizations described in § 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Treas. Reg. § 1.501(c)(7)-1(b) provides that a club which engages in business, such as making its social and recreational facilities available to the general public, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under § 501(a).

In Moline Properties v. Comm'r, 319 U.S. 436 (1943), the Supreme Court said that "[t]he doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of a business activity or is followed by the carrying on of business by the corporation, the corporate remains a separate taxable entity. . . . In general, in matters relating to the revenue, the corporate form may be disregarded where it is a sham or unreal. Id. at 438-39. In response to the argument that the corporation was a mere agent of its sole stockholder, the Court said that "the mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities, does not make the corporation the agent of its stockholders.

In National Carbide Corp. v. Comm'r, 336 U.S. 422, 437 (1949), the Supreme Court said that a finding of a "true agency" relationship turns on several factors. "Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belong to the principal are some of the relevant considerations in determining whether a true agency exists. If the corporation is a true agent, its relations with the principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purposes must be the carrying on of the normal duties of an agent."

In Krivo Indus. Supply Co. v. Nat'l Distillers & Chem. Corp., 483 F.2d 1098 (5th Cir. 1973) the court examined the "instrumentality doctrine," which allows the separate legal existence of a corporation to be disregarded when that corporation is a mere instrumentality of a dominant entity. Specifically, the court was called upon to determine whether a creditor corporation should be held liable for debts of its borrower, where the financial circumstances of the borrower put the creditor in a position to exert substantial influence over the operations of the borrower. Id. at 1101. The corporate form is not lightly disregarded; however, a subservient corporation's separate existence may be disregarded if the subservient corporation exists to further the purposes of the parent/dominant corporation and the subservient corporation has no separate, independent existence of its own. Id. at 1102. Direct and actual operative control of the subservient corporation is required to apply the instrumentality doctrine. The court will look past stock ownership to the specific facts to determine whether the dominant entity, in fact, possessed full control over the subservient corporation and whether, through its manipulation of the subservient corporation, a third party was harmed. Id. at 1104. The court held that the "absence of an independent corporate purpose is most apparent in those cases in which the dominant corporation, to further its own corporate purposes, either organized or acquired the subservient corporation." Id. at 1105. The court found that the creditor lacked the level of control over the borrower for the instrumentality doctrine to apply. Id. at 1114.

In United States v. Fort Worth Club of Fort Worth, Texas, 345 F.2d 52, (5th Cir. 1965), a § 501(c)(7) social club, through its wholly owned subsidiary, owned a 13 story building. The building was used in part by the club, and the remainder of the building was rented to commercial tenants. Each month, the subsidiary corporation turned over its income less expenses to the club. The club deposited these funds in its general bank account and drew on this account to pay expenses. The court held that the club was not organized and operated exclusively for social purposes, because, through a wholly owned subsidiary, the club was in the business of leasing office space to the public.

The court said that the social club was attempting to accomplish indirectly what it could not accomplish directly — to derive income from dealings with the general public.

Rev. Rul. 68-74, 1968-1 C.B. 267, concerns a social club that operates as a nonprofit corporation to promote yachting and other activities for the pleasure and recreation of its members. In addition to a clubhouse, the club owns yachting facilities, including a marina for the mooring and servicing of boats. The club formed a wholly owned stock corporation to which it leases its marina facilities for a rental that is based on the value of the facilities so leased. The subsidiary corporation operates the marina as a business for profit, and pays Federal income taxes on its earnings. Facilities in excess of membership usage are offered to the general public at the same rental as that paid by club members. The ruling states that the club, as sole owner of the subsidiary and the leased facilities, is entitled to receive all profits of the subsidiary and all rental payments for the facilities. To the extent that the subsidiary's profits and rental payments result from the business done with the general public, (1) nonmember income inures to the members of the club within the meaning of § 501(c)(7), and (2) the club is not supported solely by membership fees, dues, and assessments within the meaning of § 1.501(c)(7)-1. Accordingly, the ruling holds that the activities and operations of the wholly owned subsidiary are considered to be those of the club for purposes of determining whether the club is engaging in business with the general public for profit. The ruling cites United States v. Fort Worth Club for the proposition that social clubs claiming exemption under § 501(c)(7) may not do indirectly what they cannot do directly. A club may not insulate itself from the effects of business activities carried on with the general public for profit by forming a subsidiary corporation to carry out those activities.

In Rev. Rul. 84-138, 1984-2 C.B. 123, the taxpayer, a management investment company that elected to be taxed as a regulated investment company under subchapter M (§§ 851-855), established S, a wholly-owned subsidiary, to operate as a small business investment company under the Small Business Act of 1958. S also elected to be taxed as a regulated investment company under subchapter M. Because the taxpayer and S use the same facilities and some of the same personnel, it was agreed that taxpayer would pay all the expenses for general and administrative overhead, including personnel costs. S agreed to reimburse the taxpayer for its pro rata share of these expenses on an arms-length basis. The taxpayer was not engaged in the business of receiving compensation for services of the type that were reimbursed. The reimbursements were not included in gross income and no deduction was taken by the taxpayer for S's share of the expenses. The Service found that the amounts taxpayer received as reimbursement for paying S's general and administrative overhead expenses, including personnel costs, represented advancements made on behalf of S. Citing Rev. Rul. 80-348 (holding that amounts paid by a labor union to reimburse delegates from local chapters for expenses of traveling from home to attend a convention are not includible in gross income if the delegates have a right or expectation of reimbursement), the Service ruled that the amounts received in reimbursement for advances are not includible in gross income under § 61(a).

ANALYSIS

Issue 1: Whether the gross receipts of P would be attributed to M for purposes of determining M's tax-exempt status under § 501(c)(7).

Under the "separate-identity principle" annunciated in Moline Properties, Inc. v. Comm'r, the activities of a subsidiary will not be attributed to its parent unless (1) the subsidiary lacks a business purpose, or (2) the subsidiary is merely an arm or an agent of the parent. Aside from the fact that P is not a subsidiary of M, P was organized and is operated for the valid business purpose of conducting r events for M's members and for the general public, thus satisfying the first prong.

P also satisfies the second prong. Under the holding in National Carbide Corp. v. Comm'r, the finding of a true agency relationship turns on factors such as whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal. P is a separately incorporated entity. P operates under its own name and for its own account, not under the name or for the account of M. P's board of directors is not controlled by M, and M is not involved in the day-to-day management of P. P cannot bind M by its actions. P does not transmit the money it receives to M, except to reimburse M for certain administrative, insurance, and catering expenses. Although P will utilize some employees and assets of M under the Administrative Agreement, P will utilize volunteers and contractors to conduct the r events. And unlike the situation described in Krivo Indus. Supply Co., M does not have the direct and actual operative control of P that is required to apply the instrumentality doctrine. Therefore, under the separate-identity principle of Moline Properties v. Comm'r, the activities of P should not be attributed to M.

Nevertheless, United States v. Fort Worth Club of Fort Worth, Texas and Rev. Rul. 68-74 appear to hold that the activities and operations of a wholly-owned subsidiary could be considered those of its § 501(c)(7) parent for purposes of determining whether the parent is engaging in a business with the general public for profit for purposes of § 1.501(c)(7)-1(b), regardless of whether the subsidiary has a valid business purpose and is not a merely an arm, agent, or instrumentality of its parent. P, however, is not a wholly-owned subsidiary of M. Its bylaws provide that a majority of its directors must at all times consist of persons who are not concurrently either a trustee or an officer of M, and that P's President must be a director who is not concurrently a trustee or officer of M.

Consequently, we hold that the gross receipts of P would not be attributed to M for purposes of determining the percentage of M's gross receipts that M receives from sources outside its membership or that are derived from the use of M's facilities or services by the general public.

Issue 2: Whether the payments made by P to M under the Administration Agreement to reimburse M for shared services of M's S Office and certain administrative personnel, and for P's allocable share of the premiums for personal injury and property damage insurance coverage, would be deemed to be nonmember gross receipts to M.

"Gross receipts" for purposes of determining tax-exempt status of § 501(c)(7) organizations are the income from a club's usual activities, and include admissions, membership fees, dues, assessments, investment income, and normal recurring capital gains on investments. While M will receive amounts from P in reimbursement for the expense of providing P with the services of its S Office and certain administrative personnel, and for the cost of personal injury and property damage insurance coverage allocable to P's r Events & Programs, such amounts cannot be considered income from M's usual activities. M is not engaged in the business of rendering the services of its S Office and administrative personnel, or of providing personal injury and property damage insurance coverage, to others for profit. Under the reasoning of Rev. Rul. 84-138, amounts paid by M for these expenses represent advancements made on behalf of P, and amounts received in reimbursement for such advancements are not gross income. Reflecting this reasoning, M does not include these amounts in revenue for accounting or Form 990 reporting purposes. Consequently, since the amounts are not "income" and are not derived from M's usual activities, they do not constitute gross receipts for purposes of determining M's tax-exempt status under § 501(c)(7).

Issue 3: Whether M's exemption under § 501(c)(7) would be adversely affected by its support of P's r program.

M will support P's r program by allowing P to use a portion of its facilities, equipment, and

intellectual property without charge. As explained in Issue 2, above, M will also make available to P its S Office and administrative personnel in return for reimbursement.

When Congress amended § 501(c)(7) in 1976, it made clear that a social club should not lose its tax-exempt status if it receives no more than 35 percent of its gross receipts from sources outside its membership and, within that 35-percent amount, if no more than 15 percent of its gross receipts is derived from the use of its facilities or services by the general public. See S. Rep. No. 94-1318, at 4 (1976), reprinted in 1976 U.S.C.C.A.N. 6051, 6054.

You have asked us to assume that, for purposes of this ruling, such payments as M will receive from P (except those amounts received as reimbursement under the Administration Agreement), together with other nonmember payments, will make up no more than 15 percent of your total gross receipts. In Issue 1, above, we determined that the activities of P will not be attributed to M. Furthermore, in Issue 2, above, we determined that payments received from P under the Administration Agreement will not be considered gross receipts of M for purposes of determining M's exempt status under § 501(c)(7). Therefore, under these circumstances, we conclude that M's exemption under § 501(c)(7) will not be adversely affected by its support of P's r program.

CONCLUSION

In light of the foregoing, we rule as follows:

1. The gross receipts of P will not be attributed to M for purposes of determining M's tax-exempt status under § 501(c)(7).

2. The payments made by P to M under the Administration Agreement to reimburse M for shared services of M's S Office and certain administrative personnel, and for P's allocable share of the premiums for personal injury and property damage insurance coverage, will not be deemed to be gross receipts to M for purposes of determining M's tax-exempt status under § 501(c)(7).

3. M's exemption under § 501(c)(7) will not be adversely affected by its support of P's r program.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Steven B. Grodnitzky
Manager, Exempt Organizations
Technical Group 1
Enclosure
Notice 437

Congress Should End – Not Extend – the Ban on State and Local Taxation of Internet Access Subscriptions.

The Internet Tax Freedom Act (ITFA), enacted in 1998 and temporarily renewed in 2001, 2004, and 2007, imposed a moratorium on new state and local taxes on monthly Internet access fees while preserving ("grandfathering") existing Internet access taxes. The House Judiciary Committee recently approved a bill to eliminate the grandfather provision and permanently ban all state and local taxation of Internet access subscriptions. This represents the first time that Congress has seriously considered a permanent ban on taxing Internet service for all states, including those now using these taxes to help support public services. Rather than extend ITFA indefinitely, Congress should lift the ban and let states decide whether they and their local governments will impose their sales and telecommunications taxes on Internet access charges.

Center on Budget and Policy Priorities
By Michael Mazerov
July 10, 2014

Read the Full Report.

IRS Corrects Regs on Streamlined Exemption Process.

The IRS has corrected an error in final and temporary regulations (T.D. 9674) that provide guidance on a streamlined application process that eligible organizations may use to apply for recognition of tax-exempt status under section 501(c)(3).

Guidelines for the Streamlined Process of Applying for
Recognition of Section 501(c)(3) Status

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Treasury Decision 9674

RIN 1545-BM07

Correction

In rule document 2014-15623 on pages 37630-37632 of the issue of Wednesday, July 2, 2014 make

the following correction:

PART 1 — INCOME TAXES

On page 37631, in the third column, in the 26th line from the bottom, “§ 1.501(c)(3)” should read “§ 1.501(c)(3)-1T”.

[FR Doc. C1-2014-15623 Filed 7-9-14; 8:45 am]

BILLING CODE 1505-01-D

[FR Doc. C1-02014-15623 Filed 07/09/2014 at 8:45 am; Publication Date: 07/10/2014]

IRS Provides Procedures for Using Form 1023-EZ.

The IRS has issued guidance providing the procedures for applying for and issuing determination letters on tax-exempt status under section 501(c)(3) via Form 1023-EZ, “Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.”

An eligible organization may, but is not required to, seek recognition of tax-exempt status under section 501(c)(3) by submitting a Form 1023-EZ in accordance with Rev. Proc. 2014-40. The revenue procedure is generally available for specified U.S. organizations with assets of $250,000 or less and annual gross receipts of $50,000 or less. The current user fee for submitting an application under the revenue procedure is $400.

Rev. Proc. 2014-40 also provides the procedures that the IRS will use to process a Form 1023-EZ, including a provision that allows the IRS to request additional information from any organization before accepting a Form 1023-EZ for processing or making a determination of exempt status.

Rev. Proc. 2014-40 is effective July 1, 2014, and amplifies Rev. Proc. 2014-4, Rev. Proc. 2014-5, Rev. Proc. 2014-9, Rev. Proc. 2014-10, and Rev. Proc. 2014-11 and supplements Rev. Proc. 2014-8.

Final, Temporary Regs Published on Streamlined Exemption Process.

The IRS has published final and temporary regulations that provide guidance on a streamlined application process that eligible organizations may use to apply for recognition of tax-exempt status under section 501(c)(3). The text of the temporary regs also serves as the text of concurrently issued proposed regs.

The IRS is developing a streamlined form and procedures for some smaller organizations to make the process of meeting the section 508 notice requirements more efficient for those organizations. Thus, effective July 1, 2014, the final and temporary regs amend the applicable rules to allow eligible organizations to use a streamlined process to meet the section 508 requirements.

The regs give Treasury and the IRS the authority to issue guidance providing an exception to the requirement that an organization applying for tax-exempt status provide a detailed statement of its proposed activities. The regs also amend provisions on the IRS’s ability to revoke a determination because of a change in the law or regulations, or for other good cause, to refer to the IRS’s authority

to do so retroactively under section 7805(b). According to the preamble, no substantive change is intended by this amendment.

The regs amend a requirement that an organization claiming to be exempt from filing annual returns file with and as a part of its application a statement supporting its claim. According to the preamble, the change allows the IRS to issue guidance providing other methods of notifying the IRS that the organization is claiming an annual filing exemption. The regs provide that eligible organizations may use Form 1023-EZ, "Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code," to notify the IRS of their applications for tax-exempt status under section 501(c)(3). The IRS has concurrently issued guidance that provides the procedures for applying for recognition of exemption using Form 1023-EZ. The regs also make some technical changes that are described in the preamble.

Small Organizations Seeking Charitable Status Can Use Short Form.

Small organizations seeking tax-exempt status as charitable entities can now use a shorter, simpler application introduced by the IRS July 1, although some practitioners who raised questions when the IRS released the draft form in spring remain concerned.

Form 1023-EZ, "Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code," is about 2 1/2 pages long, compared to the standard Form 1023, which runs 26 pages. Unlike the standard form, the streamlined application does not require applicants to provide detailed statements of their planned activities.

"We believe that many small organizations will be able to complete this form without creating major compliance risks," IRS Commissioner John Koskinen said in a release. "Rather than using large amounts of IRS resources up front reviewing complex applications during a lengthy process, we believe the streamlined form will allow us to devote more compliance activity on the back end to ensure groups are actually doing the charitable work they apply to do."

But some practitioners expressed misgivings about the fact that filers will not have to provide details about their activities. "I still think the IRS ought to be asking for some information about their activities and their proposed budgets," said Charles M. Watkins of Webster, Chamberlain & Bean LLP, who expressed similar reservations when the draft was released. He said charities that want to register with the states for fundraising purposes may face questions about their activities from state charity regulators because that information will not be available on the Form 1023-EZ.

Arthur Rieman of The Law Firm for Non-Profits, who criticized the draft in comments earlier this year, said the release of the form was premature and possibly wrongheaded. "Clearly there is a need to streamline the exemption application review process," he said. "However, doing so in this manner has the potential to open the floodgates to people who will use the relaxed requirements for exemption to game and abuse the system to reap profit and private gain at the expense of the trusting public. Ultimately, the entire charitable sector may be tarnished."

The form's eligibility requirements ameliorate, but do not eliminate, the potential for abuse compared to the requirements promulgated in the draft, Rieman said. Because exemption for Form 1023-EZ applicants apparently will be all but automatic, anyone who attests to meeting the requirements — whether legitimately or not — can obtain section 501(c)(3) status, he said, adding that "once they obtain their determination letter, fraudsters will be able to use and abuse that status

with impunity for several years."

Rieman also said that although the IRS could revoke exemption if an organization misstates information on the form, neither the form nor its instructions inform applicants that inaccurate information can lead to revocation. "Apparently any revocations will follow the same procedure as applies to other 501(c)(3) organizations," he said. "This will give an abusive Form 1023-EZ applicant years to rip off the public before it is shut down."

The IRS also said most organizations with gross receipts of $50,000 or less and assets of $250,000 or less can use the new form. Those figures are less than those in the draft, in which the gross receipts threshold was $200,000 or less and the total assets figure was $500,000 or less.

Eve Rose Borenstein of Borenstein and McVeigh Law Office LLC said she was pleased with limiting the form "to the very smallest organizations." She said the new form is "akin to a self-registration process" that will provide the IRS with "a known pool of new, now-recognized 501(c)(3)s who can be provided targeted education. The originally proposed limits would have injected much more risk for abuse."

Benjamin Takis of Tax-Exempt Solutions PLLC said the IRS's decision to reduce the thresholds is a positive development. He wondered, though, whether the agency will be able to follow through with increased enforcement on the "back end," as it has promised.

"Unless the Service is able to hold organizations accountable for inaccurate financial projections or misrepresentation of their purpose or activities, the risk of fraud and noncompliance remains significant," Takis said.

In addition to organizations with receipts and assets above the thresholds, entities ineligible to use the form include those formed under the laws of foreign countries; successors to for-profit entities; churches or conventions or associations of churches; schools, colleges, or universities; hospitals or medical research organizations; supporting organizations described in section 509(a)(3); credit counseling organizations; and organizations that maintain or plan to maintain donor-advised funds. Organizations that are successors to or controlled by entities whose exempt status has been suspended because they have been identified with terrorism also may not use the short form.

Applicants must fill out an eligibility checklist before completing the form, which must be filed using pay.gov, with a $400 user fee due at filing. Revenue Procedure 2014-40, 2014-30 IRB 1 has more information about the new form, which also was accompanied by the publication of final and temporary regulations on the streamlined application process.

Fred Stokeld
Tax Analysts

IRS LTR: Organization Not Required to Submit New Exemption Application.

The IRS ruled that the conversion of a public nonprofit corporation into a nonprofit corporation under state law did not result in the creation of a new entity and, accordingly, the corporation is not required to submit a new application for tax-exempt status.

Citations: LTR 201426028

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *

UIL Number: 501.03-05
Release Date: 6/27/2014
Date: April 1, 2014

Employer Identification Number: * * *

LEGEND:

State = * * *

Dear * * *:

This is in response to your ruling request dated September 6, 2013, requesting a ruling that you are not required to submit a new Application foe Exemption under I.R.C. § 508(a).

FACTS

You have been recognized as an organization exempt under § 501(a) of the Code because you are described in § 501(c)(3) and are classified as a public charity within the meaning of §§ 509(a)(2). You were formed by act of the State Legislature. This act established your purpose, the processes of appointing and electing your directors and officers, and other specifics about your operations. Your purpose is to administer the Federal Family Education Loan Program. You review applications of students to determine eligibility for student loans, guarantee loans made to students, and perform various other administrative functions. Your enabling statute describes you as a "public nonprofit corporation . . . [with] all the powers and duties incident to a nonprofit corporation under the [State] Non-Profit Corporation Act."

You state that as a corporation created pursuant to an act of State Legislature you were not required to file articles of creation or incorporation with the state.

Your enabling statute was amended multiple times, but these amendments did not alter your purposes or corporate form. However, recently the State Legislature enacted legislation impacting your corporate identity. This legislation states that you are "converted . . . from a public nonprofit corporation to a nonprofit corporation." It directs you "to effectuate the conversion" by filing "a certificate of formation" or "certificate of conversion," as deemed appropriate by the State Secretary of State. Also, the legislation states that, even with this conversion, you, "continue[ ] in existence uninterrupted from the date of [your] creation." In addition, you state that your act of filing a Certificate of Conversion is a purely administrative act that does not impact your corporate structure or the continuous recognition of your nonprofit corporation status form your date of creation. Finally, under this legislation, your purpose and operations remain the same.

You abided by the requirements of this statute and filed documents determined to be appropriate by the State Secretary of State. You filed a certificate of conversion and attached to it a certificate of formation. Your certificate of conversion states that you are "a statutorily enabled [State] public nonprofit corporation" that is "converting to a nonprofit corporation formed under [State] Business Organizations Code." The certificate of conversion adds that you are "continuing [your] uninterrupted existence." The attached certificate of formation states that you were formed by the State Legislature pursuant to your original enabling statute.

RULING REQUEST

You requested the following ruling:
That a new entity was not created upon your filing a Certificate of Conversion with the Secretary of State of State and as such you are not required to submit a new Application for Exemption.

LAW

I.R.C. § 501(c)(3) exempts from taxation "Corporations, and any community chest, fund, or foundation" that fit certain criteria.
I.R.C. § 508(a) states that "New organizations must notify secretary that they are applying for recognition of section 501(c)(3) status."

Treas. Reg. 1.501(a)-1(a)(3) provides that an organization claiming exemption under I.R.C. § 501(a) and described in any paragraph of I.R.C. § 501(c) shall file the form of application prescribed by the Commissioner.

Treas. Reg. § 1.508-1(a) states that "New organizations must notify the Commissioner that they are applying for recognition of section 501(c)(3) status."

Treas. Reg. § 1.508-1(a)(1) provides that in general an organization organized after October 9, 1969, will not be treated as described in I.R.C. § 501(c)(3) unless such organization has given the Commissioner notice.

American New Covenant Church v. Commissioner, 74 T.C. 293, 301 (T.C. 1980) considered the question of whether a new organization was formed during the following course of actions. An unincorporated association filed an application for exemption. While its application was pending, the unincorporated association stated that it had changed its name and also it presented articles of incorporation bearing this new name. The Service determined that a new entity had been formed by the filing of these articles of incorporation. It concluded that 1) the newly formed corporation was distinctive from the unincorporated association that had previously filed an application for exemption and 2) the newly formed corporation needed to file its own application. The Tax Court agreed, ruling "that the two organizations [should] be treated as separate, independent legal entities." It stated, that the Service, "was entirely justified in insisting that [the newly formed corporation] submit a new application in order to determine whether it met the regulation requirements for tax-exempt status."

Rev. Rul. 67-390; 1967-2 C.B. 179, consider four situations in which organizations previously ruled as exempt underwent structural changes.

Case 1. An exempt trust was reorganized and adopted a corporate form to carry out the same purposes for which the trust had been established. Its operations were not changed.

Case 2. An exempt unincorporated association was incorporated and continued the operations which had qualified it for exemption.

Case 3. An exempt organization incorporated under state law was reincorporated by an Act of Congress to carry out the same purposes contained in the state charter.

Case 4. An exempt organization incorporated under the laws of one state was reincorporated under the laws of another state with no change in its purposes.

The ruling held that in all four situations, a new legal entity had been created and the new legal

entity was required to apply for exemption. The old organization's exemption would not suffice. Rev. Rul. 77-469, 1977-2 C.B. 196, held that an organization that filed its application for exemption less than 15 months after its incorporation under state law was exempt as of the date of its incorporation even though it had operated as an unincorporated association for three years prior to its incorporation. The ruling highlighted that the corporation was a new legal entity from the unincorporated one.

ANALYSIS

You were formed by an act of the State legislature as a public nonprofit corporation under State law. Thereafter, the State legislature declared that you would no longer be a public nonprofit corporation, but instead you would be a nonprofit corporation under State law. You then took the appropriate steps to convert yourself from a public nonprofit corporation to a nonprofit corporation. Under I.R.C. § 508(a) and Treas. Reg. § 1.508-1(a), provides that an organization claiming exemption under I.R.C. § 501(a) and described in any paragraph of I.R.C. § 501(c) shall file the form of application prescribed by the Commissioner

Rev. Rul. 67-390 considered four cases in which organizations that were recognized as exempt underwent structural changes, and the Revenue Ruling concluded that by these structural changes new organizations were formed. American New Covenant Church v. Commissioner, 74 T.C. 293, 301 (T.C. 1980) and Rev. Rul. 77-469 found that new organizations were created when unincorporated associations filed documents to incorporate themselves. Your situation of converting from public nonprofit corporation to a nonprofit corporation is distinctive from every one of these cases. Thus, your conversion does not amount to the creation of a new organization for purposes of I.R.C. § 508(a) and Treas. Reg. § 1.508-1(a).

RULINGS

Based on your facts and representations, we rule as follows:
A new entity was not created upon your filing of a Certificate of Conversion and you are not required to submit a new Application for recognition of exemption.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager
EO Technical
Enclosure
Notice 437

IRS LTR: State Instrumentality Granted Extension to Expend Bond Proceeds.

The IRS granted an extension of the original expenditure period for a state instrumentality to expend the available project proceeds of qualified school construction bonds because the expected failure is due to reasonable cause and the instrumentality's continued expenditure of the proceeds for qualified purposes will proceed with due diligence.

Citations: LTR 201426022

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *
Telephone Number: * * *

Index Number: 54F.00-00
Release Date: 6/27/2014
Date: April 2, 2014

Refer Reply To: CC:FIP:B05 – PLR-149991-13

LEGEND:

Authority = * * *
State = * * *
Bonds = * * *
Date 1 = * * *
Date 2 = * * *
Date 3 = * * *

Dear * * *:

This is in response to your request under § 54A(d)(2)(B)(iii) of the Internal Revenue Code for an extension of the expenditure period for the available project proceeds of qualified tax credit bonds.

FACTS AND REPRESENTATIONS

You make the following factual representations. Authority is a body corporate and politic constituting an instrumentality of State, empowered to issue bonds for any of its corporate purposes. The primary functions of Authority are to design and construct office buildings, quarters, courts, warehouses, shops, schools, health facilities, social welfare facilities, and related facilities for lease to State or any of its departments, agencies, instrumentalities, or municipalities.
Authority issued the Bonds on Date 1 and designated the Bonds as qualified school construction

bonds within the meaning of § 54F(a)(3). All available project proceeds of the Bonds were to be spent on a portion of the cost of constructing, renovating, and improving approximately 100 public school facilities and acquiring land together with equipment, furnishings, landscaping, and other site improvements (the "Project"), and were expected to be spent before Date 2.

The original three-year expenditure period for the Bonds under § 54A(d)(2)(B)(i) will expire on Date 2 (the "Original Expenditure Period"). However, several unexpected events have resulted in an unforeseen delay in the expenditure of the available project proceeds of the Bonds.

With respect to 12 of the approximately 100 public school facilities, the rehabilitation and construction work is expected to be completed by Date 2, but certain unexpected events have caused an unforeseen delay such that the available project proceeds allocated to those 12 schools is not expected to be spent by Date 2. These unexpected events involve either the contractor's poor performance delaying completion of the work, or resolving disputes over contract claims submitted by the contractor.

With respect to four of the approximately 100 public school facilities, due to unforeseen situations, rehabilitation and construction work will not be completed by Date 2. These unforeseen situations involve projects where either (1) a default notice has been issued to the contractor due to poor performance and negotiations are ongoing with the contractor's surety company for ratification of a project takeover agreement to complete the project, (2) the scope of the contracted work is being revised, or (3) the start of construction has been delayed because State has not yet granted the land use authorization.

With respect to five of the approximately 100 public school facilities originally identified as part of the Project, the proposed work has been cancelled and the schools removed from the Project. Three new public school facility projects (the "Added Projects") have been added to the Project. One of the Added Projects has been completed and fully disbursed. At the other two Added Projects, pre-construction activities have begun and construction is expected to start in the near future.

All of the available project proceeds of the Bonds will be spent on the Project by Date 3, or three years after the Original Expenditure Period expires. The Added Projects do not extend the delay in spending all of the available project proceeds of the Bonds. Even without the addition of the Added Projects, all of the available project proceeds of the Bonds would not be spent on the Project until Date 3.

Authority submitted this request for a ruling prior to Date 2.

LAW AND ANALYSIS

Section 54A(d)(1) provides that a qualified school construction bond is treated as a qualified tax credit bond for purposes of Section 54A.
Section 54A(d)(2)(B)(i) provides in part that to the extent that less than 100 percent of the available project proceeds of the issue are expended by the close of the expenditure period for 1 or more qualified purposes, the issuer shall redeem all of the nonqualified bonds within 90 days after the end of such period.

Section 54A(d)(2)(B)(ii) provides that for purposes of this subpart, the term "expenditure period" means, with respect to any issue, the 3-year period beginning on the date of issuance. Such term shall include any extension of such period under clause (iii).

Section 54A(d)(2)(B)(iii) provides that upon submission of a request prior to the expiration of the

expenditure period (determined without regard to any extension under this clause), the Secretary may extend such period if the issuer establishes that the failure to expend the proceeds within the original expenditure period is due to reasonable cause and the expenditures for qualified purposes will continue to proceed with due diligence.

Section 54A(d)((2)(C)(iv) provides that for purposes of this paragraph, in the case of a qualified zone academy bond, a "qualified purpose" means a purpose specified in § 54E(a)(1).

Section 54A(e)(4) of the Code defines "available project proceeds" to mean (A) the excess of (i) the proceeds from the sale of an issue, over (ii) the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds), and (B) the proceeds from any investment of the excess described in subparagraph (A).

The Project was identified prior to the issuance of the Bonds and Authority reasonably expected to spend all of its allocable available project proceeds within the three-year period. The expected failure to spend all the available project proceeds of the Bonds by the expiration of the three-year period on Date 2 has been caused by events that were not reasonably expected at the time the Bonds were issued and were beyond the control of Authority. However, Authority to the extent possible considering the described unexpected external events that resulted in unforeseen delays, has and will continue to exercise due diligence in spending the remaining available project proceeds on the Project. Authority expects to spend all available project proceeds not later than Date 3, or three years after the Original Expenditure Period expires.

CONCLUSION

Under the facts and circumstances of this case, we conclude that Authority's expected failure to expend the available project proceeds of the Bonds by Date 2 is due to reasonable cause and that Authority's continued expenditure of the proceeds for qualified purposes will proceed with due diligence. Therefore, Authority is granted an extension of the Original Expenditure Period with respect to the Bonds until Date 3.
Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to Authority's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by Authority and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel
(Financial Institutions & Products)

By: Timothy L. Jones
Senior Counsel, Branch 5

GFOA: House Judiciary Committee Approves State and Local Tax Preemption Legislation.

The House Judiciary approved the GFOA-opposed Permanent Internet Tax Freedom Act, H.R. 3086, which would permanently preempt state and local governments' authority to assess taxes on Internet access and pave the way for other industries to argue that they too deserve special protections from state and local taxation. Rep John Conyers (D-MI), the committee's ranking member, offered a GFOA-supported amendment to extend the moratorium for an additional four years, rather than making it permanent; he argued that a permanent extension is unwarranted because the Internet is no longer a nascent industry needing unlimited federal tax protection to grow and prosper. The amendment, while supported by many committee members, was not approved. In addition, if the bill becomes law, ten states that currently have the authority to tax Internet access under the Act's 1998 grandfather clause would lose that authority, as this original grandfather provision would expire as part of H.R. 3086. Seven of these ten states, including Hawaii, New Mexico, North Dakota, Ohio, South Dakota, Texas, and Wisconsin, currently tax Internet access. The loss of revenue for these states from the elimination of the grandfather provision is estimated at half a billion dollars a year.

Thursday, June 26, 2014

In the coming weeks, H.R. 3086 is expected to be considered by the full House. GFOA members should continue to urge their Congressional delegations to support a fair, short-term extension of the Internet tax moratorium, rather than a permanent moratorium, and to retain the long-standing grandfather provisions.

IRS Fed State & Local Governments - July 2014 Newsletter.

July 2014 edition of the FSLG Newsletter

Inside This Issue:

- Update on the Affordable Care Act
- Protective Claims
- Supreme Court Rules on Severance Pay
- Q&A on Tax Treatment of Difficulty of Care Pay
- Final Regulations on Designation of Person To Perform Acts of an Employer
- Directory of FSLG Specialists

Download the July edition.

Hogan Lovells: Fair Market Value and Uncertainty Regarding Highest and Best Use.

In this article, Montague argues that the Tax Court's valuation in Palmer Ranch Holdings did not reflect the property's true fair market value because it failed to account for uncertainty regarding

the property's highest and best use.

* * * * *

The central valuation issue in the recent Tax Court case Palmer Ranch Holdings Ltd. v. Commissioner1 was the question of the property's highest and best use. The partnership claimed a charitable contribution deduction of nearly $24 million for the donation of a conservation easement on 82.19 acres of undeveloped land in Sarasota County, Florida. In valuing the property, the partnership's appraiser relied on a land use analysis that concluded the highest and best use for the property was a 360-unit multifamily development. However, the property's zoning on the valuation date did not permit such a use.2 For that reason, the IRS insisted that the property's highest and best use was for low-density residential development as permitted by the property's then-current zoning, resulting in a substantially lower valuation.3 As in many conservation easement cases, the Tax Court was asked to decide the valuation dispute. Unfortunately, because the court considered the question of highest and best use separately from its analysis of the fair market value, it arrived at a value that exceeded the property's true fair market value.

Background on Valuing Conservation Easements

In general, when a taxpayer makes a charitable contribution of property other than money, the contribution amount is the fair market value of the property at the time of the contribution.4 The regulations under section 170 define fair market value as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts."5

The regulations provide specific guidance on valuing conservation easements: If a substantial record of sales of comparable easements exists, the fair market value of the donated easement should be based on the sales prices of those comparable easements; otherwise, it is acceptable to use what is known as the before-and-after method,6 which is often used for conservation easements because there is rarely a record of sales of comparable easements.7 As its name suggests, the before-an--after method considers "the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction."8 Using language closely modeled on the legislative history,9 the regulations provide:

If before and after valuation is used, the fair market value of the property before contribution of the conservation restriction must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use.10

In Hilborn v. Commissioner11 — one of the earliest and most frequently cited cases applying the before-and-after method — the Tax Court explained that the before value:

is arrived at by first determining the highest and best use of the property in its current condition unrestricted by the easement. At this stage the suitability of the property's current use under existing zoning and market conditions and realistic alternative uses are examined. Any suggested use higher than current use requires both "closeness in time" and "reasonable probability." Next, to the extent possible, the three commonly recognized methods of valuing property (capitalized net operating income, replacement cost, and comparable sales) are used, but are modified to take into account any peculiarities of the property which impact on the relative weight to be afforded each respective method.12

Hilborn seems to require that the court apply a two-step approach to valuation: First, it must determine the highest and best use of the property, and second, it must determine the fair market value of the property given the highest and best use determined in the first step. However, that two-step approach is inconsistent with the requirement that the property be valued at its fair market value. To understand that inconsistency, it is helpful to consider the application of the two-step approach in Palmer Ranch Holdings.

The Valuation in Palmer Ranch Holdings

When the conservation easement was donated on December 19, 2006, the 82.19 acres designated parcel B-10 was zoned RE-1, permitting residential development no denser than one house for every two acres.13 Nevertheless, the partnership's appraiser determined that the highest and best use of the land was for a multifamily development, which would have necessitated rezoning to moderate density residential, permitting development of up to 5 units per acre.14 The IRS pointed to several facts that it contended made rezoning unlikely.

First, and most significantly, only two years before the valuation date, the board of county commissioners (BOCC) denied an application to develop and rezone part of parcel B-10 and an adjacent parcel B-9. In 2003 the partnership agreed to sell 86.9 acres in parcels B-9 and B-10 to a developer contingent on the BOCC's approval of applications for development and rezoning the land to residential single family, which would have permitted development of 3.5 units per acre. In June 2004 the BOCC denied the development application by a 3-2 vote. Although the separate rezoning application was not voted on at that time, the BOCC presumably would not have approved it. In August 2004 the developer revised and resubmitted its applications, seeking to develop only parcel B-9 and to rezone it to residential multifamily, permitting up to six units per acre. In October 2004 the BOCC denied both the revised development plan and the rezoning application, again by a 3-2 vote. The ordinance issued by the BOCC in conjunction with its denial instructed the developer to resubmit its application including parcel B-10 that showed a plan "to keep Parcel B-10 intact as it related to the Eagle Preservation Area, the wetlands, and the wildlife corridor."15

Second, the IRS pointed to several environmental concerns that might have prevented rezoning. Those concerns included the BOCC's directive that future development plans keep parcel B-10 intact, as well as a comprehensive plan adopted by Sarasota County designating an eagle nest zone and a wildlife corridor, which included part of parcel B-10.16 The Eagle Preservation Area referred to in the 2004 ordinance included an eagle nest on parcel B-10 with a U.S. Fish and Wildlife Service-designated primary protection zone of 750 feet, and a secondary protection zone of 1,500 feet. In June 2006 the protection zone was reduced to 660 feet.17

Third, the IRS contended that multifamily development was not reasonably probable because Sarasota County regulations required residential developments of at least 100 units to have two fully functional access points, which parcel B-10 lacked. To achieve access, a developer would have had to obtain an easement on parcel B-9 and county approval to extend another road.18

Fourth and finally, the IRS pointed out that there had been vigorous neighborhood opposition to the 2004 rezoning attempt, which it contended would have resurfaced in response to any new rezoning application.19

The Tax Court considered each of the IRS's arguments. It rejected the first argument, weakly stating that the "rezoning history does not eliminate the reasonable probability on the valuation date of a successful zoning." As grounds for its conclusion, it reasoned that the previous rezoning attempt was of limited predictive value because it was two years before the valuation date and, although the BOCC had previously rejected a development plan that included parcel B-10, the only rezoning

application considered by the BOCC was for the adjacent parcel B-9. It also noted that the initial rezoning application had been rejected by a close vote.20 The court similarly rejected the second argument because the size of the Eagle Preservation Area had shrunk since 2004 and because some development had previously been allowed in the wildlife corridor, although it did not mention the density of that development.21 The court rejected the third and fourth arguments because even though there had previously been vigorous neighborhood opposition to the development, it was not certain that the opposition would resurface or that it would be successful in preventing rezoning.22 The court concluded that "there is a reasonable probability that parcel B-10 could have been successfully rezoned to allow for the development of multifamily dwellings. Therefore, the highest and best use of the property is development for multifamily dwellings."23

The Tax Court did not attempt to assign a percentage to the probability of rezoning, but it is safe to say that the percentage was not very high — perhaps even less than 50 percent. The phrase "reasonable probability" comes directly from Hilborn; it does not appear in the regulations or the legislative history. Although the Tax Court has not defined the term "reasonable probability," it is generally considered to be less than "more likely than not."24 In rejecting each of the IRS arguments for why rezoning would be improbable in Palmer Ranch Holdings, the court stated only that each argument did not preclude the reasonable probability of rezoning. Rezoning would not have been a sure bet. Yet because the court was applying the two-step approach articulated in Hilborn, once it decided that there was a reasonable probability of rezoning, it then concluded that the highest and best use of the property was for multifamily dwellings, and it went on to calculate the before value as if the property had been rezoned as of the valuation date.

Highest and Best Use as a Component of FMV

The problem with the two-step approach to valuation articulated in Hilborn25 and applied in Palmer Ranch Holdings is that it is not equivalent to fair market value. No willing buyer would have paid a price equal to the before value arrived at by the Tax Court. For purposes of valuation, the court's method treated what it probably considered to be a less than 50 percent chance that the property could have been rezoned as if it were a 100 percent certainty.26 Any buyer considering purchasing the property would have taken into account that there was a significant possibility that the rezoning application would have been rejected. After all, a development plan for a less-dense subdivision on the same parcel two years before had been denied, and a rezoning application for the adjacent parcel had also been denied. Those facts cast serious doubt on the probability that rezoning would have been granted, even if they do not preclude the possibility. Accordingly, any buyer with a reasonable knowledge of the relevant facts would have discounted the price to account for that uncertainty.27

Instead of considering the highest and best use of the property separately from its fair market value, the court should have considered it as a component of fair market value. In other words, the court should have considered the possibility that the property could have been used for multifamily development but discounted the value of that use to account for its uncertainty, just as a hypothetical buyer would have done. Doing so would have resulted in a fair market value between that arrived at by the partnership's appraiser, who assumed the property could be rezoned, and the IRS appraiser, who assumed that rezoning was impossible. That approach is the only one consistent with the regulations' requirement that the property be assigned its fair market value.

The two-step approach is also inconsistent with the approach to fair market value taken by other courts and by the Tax Court in some other cases. In discussing a property's highest and best use, along with Hilborn the Tax Court often cites Olson v. United States,28 a 1934 Supreme Court case. However, Olson is inconsistent with the two-step valuation approach endorsed in Hilborn. Olson was a condemnation proceeding in which the property owners insisted that the highest and most

profitable use for their land was the construction of a power plant. The Supreme Court stated that the fair market value of property:

does not depend upon the uses to which [the owner] has devoted his land but is to be arrived at upon just consideration of all the uses for which it is suitable. The highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future is to be considered, not necessarily as the measure of value, but to the full extent that the prospect of demand for such use affects the market value while the property is privately held.29

In other words, the highest and best use to which the property is adaptable and likely to be used in the near future should be considered as one factor affecting fair market value — that is, to the extent it would influence demand for the property. It is not determinative of fair market value as it is in Hilborn. As the Tax Court correctly stated in Boltar LLC v. Commissioner30: "The concept of 'highest and best use' is an element in the determination of fair market value, but it does not eliminate the requirement that a hypothetical willing buyer would purchase the subject property for the indicated value."

Although Hilborn is frequently cited in Tax Court cases considering the valuation of conservation easements, its two-step approach to valuation has not often been applied.31 Whether the court uses a two-step approach or considers highest and best use as a component of fair market value will make little difference in cases in which the proposed rezoning or other alternative use is a near certainty. As noted above, Palmer Ranch Holdings is not such a case.

In at least two cases with similar uncertainty about whether rezoning would be granted, the Tax Court has correctly used uncertainty as a factor in determining fair market value. For instance, in Mathis v. Commissioner,32 the Tax Court stated that although the prospects for zoning were uncertain, the IRS appraiser was wrong not to give any weight to such a possibility. Because the court concluded that both the IRS and the taxpayer miscalculated the chances that the property would be rezoned, it adjusted the property's fair market value accordingly. Similarly, in Hay v. Commissioner,33 the court concluded that on the valuation date, the highest and best use of the property was uncertain because of the challenge of obtaining the necessary zoning and other approvals, and it therefore adjusted the property's value to account for the uncertainty. The Tax Court should have followed a similar approach in Palmer Ranch Holdings.34

To arrive at the fair market value required by the regulations, the Tax Court should decline to follow the two-step approach of Hilborn and instead consider the highest and best use of the property as a component of its fair market value analysis.

FOOTNOTES

1 T.C. Memo. 2014-79 2014 TNT 88-14: Court Opinions.

2 Id. at *4-*7.

3 Id. at *22.

4 Reg. section 1.170A-1(c)(1).

5 Reg. section 1.170A-1(c)(2).

6 Reg. section 1.170A-14(h)(3)(i).

7 See, e.g., Hilborn v. Commissioner, 85 T.C. 677 (1985); Butler v. Commissioner, T.C. Memo. 2012-

72 2012 TNT 54-13: Court Opinions; Simmons v. Commissioner, T.C. Memo. 2009-208 2009 TNT 177-17: Court Opinions, aff'd, 646 F.3d 6 (D.C. Cir. 2011) 2011 TNT 120-13: Court Opinions.

8 Reg. section 1.170A-14(h)(3)(i).

9 S. Rep. No. 96-1007, at 14-15 (1980).

10 Reg. section 1.170A-14(h)(3)(ii).

11 Hilborn v. Commissioner, 85 T.C. 677.

12 Id. at 689. Although Hilborn continues to be one of the most frequently cited cases concerning the valuation of conservation easements, it predates the issuance of the regulations quoted in supra note 10.

13 Palmer Ranch Holdings, at *22.

14 Id. at *7.

15 Id. at *8-*10.

16 Id. at *28-*29.

17 Id. at *11-*12.

18 Id. at *34-*35.

19 Id. at *35-*36.

20 Id. at *27-*28.

21 Id. at *29-*31.

22 Id. at *34-*36.

23 Id. at *36.

24 See Kyles v. Whitley, 514 U.S. 419, 434 (1995).

25 Because there was general agreement in Hilborn on the highest and best use of the property, the two-step approach did not result in a markedly different valuation in that case.

26 Even if the court in Palmer Ranch Holdings considered the chance of rezoning to be more than 50 percent, as noted above, the reasonable probability standard from Hilborn does not require even that degree of certainty.

27 More than likely, the buyer would have included a contingency in the offer for obtaining the necessary rezoning and other approvals. But the regulations require that the property be assigned a fair market value as of the valuation date. On that date a hypothetical buyer purchasing the property would have been confronted with the uncertainty of rezoning.

28 292 U.S. 246 (1934).

29 Id. at 255 (citations omitted, emphasis added).

30 136 T.C. 326, 336 (2011) 2011 TNT 66-10: Court Opinions; see also the Tax Court's extensive discussion of the relationship between highest and best use and fair market value in Whitehouse Hotel Limited Partnership v. Commissioner, 139 T.C. 304, 330-337 (2012) 2012 TNT 206-8: Court Opinions.

31 One other case in which it has been applied with similar consequences is Stanley Works v. Commissioner, 87 T.C. 389 (1986). In that case, the taxpayer contended that the highest and best use of the property before the conservation easement was a hydroelectric power plant. The court rejected IRS arguments that the use was not reasonably probable given environmental concerns and public opposition and concluded that use was a "reasonable probability." Id. at 408. As in Palmer Ranch Holdings, despite the uncertainty regarding necessary approvals for use as a power plant, the court went on to value the property as if those approvals would have been granted. Id. at 411, 413. Again, no reasonably informed buyer would have purchased the property on the valuation date without discounting the price to account for the uncertainty.

32 T.C. Memo. 1989-254.

33 T.C. Memo. 1992-409.

34 Taxpayers who are in a position similar to the partnership in Palmer Ranch Holdings but who feel confident that their property will be rezoned should obtain that rezoning before donating a conservation easement. That the partnership failed to do so suggests that it thought rezoning was unlikely.

END OF FOOTNOTES

John Montague
John Montague is an associate at Hogan Lovells US LLP. The views expressed in this article are his own and do not necessarily reflect the views of Hogan Lovells or any of its clients.

IRS Memo Addresses Healthcare Credit for Small Tax-Exempt Employers.

The IRS Tax-Exempt and Government Entities Division has issued a memorandum (TEGE-04-06-4-0015) providing interim guidance to examining agents auditing small tax-exempt employers that may be eligible for the small business healthcare tax credit under section 45R.

The purpose of the interim guidance, which is effective immediately, is to ensure consistency in the application of section 45R, which provides a tax credit to eligible small employers — including tax-exempt organizations — that provide health insurance coverage to their employees. For tax-exempt employers, the credit under section 45R is a refundable credit based on premiums paid. The interim guidance provides that if a tax-exempt employer appears to be eligible for the tax credit, examining agents must inform the employer of its potential eligibility.

To ensure accuracy in verifying eligibility and computation of the credit, the interim guidance provides that agents must obtain technical consultation before proposing allowance, disallowance, or adjustment of the section 45R credit. And according to the guidance, required sequestration reductions include a reduction to the refundable portion of the section 45R credit for small tax-exempt employers. The sequestration reduction rate for the refund portion of this credit is 7.2 percent for refunds processed in the fiscal year ending September 30, 2014.

June 12, 2014

Affected IRM: 4.75.11, 4.75.13

Expiration Date: June 12, 2015

MEMORANDUM FOR
ALL EO EXAMINATIONS MANAGERS
AND
ALL EO EXAMINATIONS REVENUE AGENTS

FROM:
Mary A. Epps
Acting Director, EO Examinations

SUBJECT:
IRC 45R Credit for Small Tax-Exempt Employers

This memorandum provides interim guidance to examining agents when auditing small tax-exempt employers that may be eligible for the Small Business Health Care Tax Credit under section 45R of the Internal Revenue Code (IRC).

The purpose of this memorandum is to ensure consistency in the application of a recently enacted tax law affecting tax-exempt organizations.

IRC 45R was added by the Affordable Care Act (March 23, 2010), Public Law No. 111-148. The law provides a tax credit to eligible small employers, including tax-exempt organizations that provide health insurance coverage to their employees. Definitions and background information can be found in Proposed Regulations sections 1.45R-0 through 1.45R-5 (78 FR 52719; 2013-38 I.R.B 211); Notice 2014-06, Rev. Proc. 2013-35, Notice 2010-82, Notice 2010-44,and Rev. Rul. 2010-13.

For tax-exempt employers, the tax credit under IRC 45R is a refundable credit based on premiums paid. If a tax-exempt employer appears to be eligible for the tax credit, examining agents must inform the employer of its potential eligibility. If the employer wants to claim the tax credit it can file with the examiner Form 990-T, Exempt Organization Business Income Tax Return, and attach Form 8941, Credit for Small Employer Health Insurance Premiums. If Form 990-T has already been filed, the tax-exempt employer must file an amended Form 990-T with Form 8941 attached.

Examining agents can refer tax-exempt employers to the online Estimator in order to allow them to get an estimate of the tax credit. This tool, developed by the Taxpayer Advocate Service, is located online at: http://www.taxpayeradvocate.irs.gov/calculator/SBHCTC.htm#StartCalculator.

Caution: This calculation will only provide an estimate of the credit. Tax-exempt employers and examining agents may not rely on the correctness of this calculation. To determine the exact amount of the Small Business Healthcare Tax Credit, tax-exempt employers must complete the Form 8941 and attach it along with the other appropriate forms and file it together with Form 990-T.

In order to ensure accuracy in verifying eligibility and computation of the credit, agents will not propose allowance, disallowance or adjustment of the tax credit without first obtaining technical consultation. Examining agents must consult with Mandatory Review by submitting an e-mail to the mailbox at *TEGE EO Review Staff.

Include the following information in the e-mail:

- A preliminary number of full-time equivalent employees (FTE) during the tax year
- A preliminary estimate of the average annual wages
- For tax years beginning on or after 2014, whether the health insurance was offered through a Small Business Health Options Program (SHOP) Marketplace.

Mandatory Review will then provide further instructions to the agent on how to proceed and whom to contact. Examining agents will use principal issue code (PIC) 24E for any case where the issue of applicability of the tax credit is raised in an examination.

According to the requirements of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, certain automatic sequestration reductions to credits began March 1, 2013. These required sequestration reductions include a reduction to the refundable portion of the IRC 45R credit for small tax-exempt employers. The sequestration reduction rate for the refund portion of this credit is 7.2% for refunds processed in the fiscal year ending September 30, 2014. This sequestration reduction rate will be applied unless and until a law is enacted that cancels or otherwise impacts the sequester.

This temporary guidance is effective immediately.

The contents of this memorandum (or any permanent guidance developed) will be incorporated into IRMs 4.75.11 and 4.75.13.

Please submit your questions to Mandatory Review via *TEGE EO Review Staff.

DISTRIBUTION:
www.irs.gov

Citations: TEGE-04-0614-0015

Court Holds FOIA Suit Seeking Forms 990 May Proceed.

A U.S. district court refused to dismiss a Freedom of Information Act suit seeking the 2011 Forms 990 of nine tax-exempt organizations specifically in Modernized e-File format or any other machine-readable format, holding that section 6104 doesn't supersede FOIA or preclude the FOIA claim.

PUBLIC.RESOURCE.ORG,
Plaintiff,
v.
UNITED STATES INTERNAL REVENUE SERVICE,
Defendant.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

ORDER DENYING DEFENDANT'S MOTION TO DISMISS

Re: Dkt. No. 14

INTRODUCTION

This motion to dismiss presents the question of whether the Freedom of Information Act ("FOIA") is

superseded by section 6104 of the Internal Revenue Code, a previously enacted disclosure statute concerning Form 990 filings. Public.Resource.org ("PRO") seeks the tax return data of several nonprofit organizations in "machine-readable format." The United States Internal Revenue Service ("IRS") refuses because it contends that FOIA is superseded by section 6104 and its internal rules for releasing the requested data. Because of the breadth of FOIA's disclosure requirements, which has been repeatedly upheld by the courts, and the inapplicability of the cases on which the IRS relies, there is no basis to conclude that FOIA is superseded by section 6104. The IRS's motion is DENIED.

BACKGROUND

On March 11, 2013, PRO submitted a request for tax return data to the IRS pursuant to FOIA, 5 U.S.C. § 552. PRO requested the Form 990 filings of nine tax-exempt organizations from 2011, specifically in Modernized e-File (MeF) format or "any other machine-readable format." Complaint, Ex. F. The IRS uses the MeF format for all Forms 990 filed electronically.

The IRS responded to PRO on March 19, 2013, indicating that data are "excluded from disclosure in response to a written FOIA request" if such data are otherwise available through an established agency procedure. Compl., Ex. G at 1. The IRS directed PRO to Form 4506-A, which the IRS developed exclusively for requesting copies of tax-exempt organizations' annual Form 990 filings. Id. Form 4506-A allows the public to request digital copies of tax information on either CDs or DVDs, and in either "Alchemy" or "raw" format. Id. at 2-3. Discs with Alchemy-formatted data contain image files that are searchable in a database using Alchemy software. Discs with raw data contain image files in Tagged Image File ("TIF") format.

PRO contends that neither format satisfies its request for "machine-readable" data, and that Form 4506-A is therefore "inadequate" to satisfy PRO's FOIA request. Compl., Ex. H at 1. On April 12, 2013, PRO's counsel wrote to the IRS to request that it reconsider its position. In response, the IRS stated in a letter dated May 1, 2013, that it was unable to comply with PRO's FOIA request because Forms 990 in MeF format contain data that are protected from disclosure by section 6103(a) of the Internal Revenue Code, and because the existing process for releasing electronically filed Forms 990 is to convert MeF data into a Portable Document Format ("PDF") replica of the paper form, then redact the protected information. Compl., Ex. I.

PRO then filed this action on June 18, 2013, seeking declaratory and injunctive relief under both FOIA and the Administrative Procedure Act ("APA"), 5 U.S.C. § 703. Compl. ¶¶ 61-62, 67-68. I heard argument on the IRS's motion to dismiss on June 18, 2013.

LEGAL STANDARD

Under Federal Rule of Civil Procedure 12(b)(6), a district court must dismiss a complaint if it fails to state a claim upon which relief can be granted. To survive a Rule 12(b)(6) motion to dismiss, the plaintiff must allege "enough facts to state a claim to relief that is plausible on its face." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007). This "facial plausibility" standard requires the plaintiff to allege facts that add up to "more than a sheer possibility that a defendant has acted unlawfully." Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009). While courts do not require "heightened fact pleading of specifics," a plaintiff must allege facts sufficient to "raise a right to relief above the speculative level." Twombly, 550 U.S. at 555.

In deciding whether the plaintiff has stated a claim upon which relief can be granted, the court must assume that the plaintiff's allegations are true and must draw all reasonable inferences in the plaintiff's favor. See Usher v. City of Los Angeles, 828 F.2d 556, 561 (9th Cir. 1987). However, the

court is not required to accept as true "allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences." In re Gilead Scis. Sec. Litig., 536 F.3d 1049, 1055 (9th Cir. 2008).

DISCUSSION

The IRS seeks dismissal of both the FOIA and the APA causes of action for failure to state a claim. First, the IRS contends that section 6104 of the Internal Revenue Code, 26 U.S.C. § 6104, supersedes FOIA and precludes a FOIA claim. Def.'s Mot. to Dismiss at 7. Second, the IRS contends that the APA claim must be dismissed "by necessity" as the corollary of a favorable ruling on the FOIA claim. Id. at 8.

I. THE FREEDOM OF INFORMATION ACT

FOIA requires that a federal agency, upon receipt of a valid FOIA request, "provide the record in any form or format requested by the person if the record is readily reproducible by the agency in that form or format." 5 U.S.C. § 552(a)(3)(B). The scope of FOIA's disclosure requirements is broad, and courts have repeatedly declined to impose limits on FOIA that the statute itself does not expressly admit. Envtl. Prot. Agency v. Mink, 410 U.S. 73, 79-80 (1973), superseded by statute on other grounds; Dep't of Interior v. Klamath Water Users Protective Ass'n, 532 U.S. 1, 7 (2001); Maricopa Audubon Soc. v. U.S. Forest Serv., 108 F.3d 1082, 1085 (9th Cir. 1997). Although FOIA provides enumerated exemptions to disclosure, these exemptions "are 'explicitly made exclusive,' meaning that information not falling within any of the exemptions has to be disclosed." Yonemoto v. Dep't. of Veterans Affairs, 686 F.3d 681, 687 (9th Cir. 2012) (citations omitted) (quoting Mink, 410 U.S. at 79); see also 5 U.S.C. § 552(b).

FOIA's breadth reflects its "central purpose of exposing to public scrutiny official information that sheds light on an agency's performance of its statutory duties." U.S. Dep't of Justice v. Reporters Comm. for Freedom of the Press, 489 U.S. 749, 750 (1989). As this purpose cannot be served by a disclosure scheme relying solely on ad hoc agency consent, FOIA establishes a "comprehensive scheme," U.S. Dep't of Justice v. Tax Analysts, 492 U.S. 136, 153 (1989), that aims to "provide a 'workable formula' that 'balances and protects all interests.'" Mink, 410 U.S. at 80. This formula is backstopped by the courts, which provide individuals an opportunity to vindicate their "judicially enforceable public right to secure . . . information from possibly unwilling official hands." Id.; see also 5 U.S.C. § 552(a)(4)(B).

In its motion, the IRS does not dispute that it is an agency subject to FOIA, that the data in question qualify as "records" under the definition of the statute, or that the records were withheld. Rather, the IRS argues that FOIA has no application because the requested documents fall within section 6104, which provides the exclusive means by which Form 990 data are releasable. Def.'s Mot. to Dismiss at 1. For the reasons discussed below, I reject the IRS's argument.

A. The statutory scheme of the Internal Revenue Code.

The IRS contrasts FOIA's broad language mandating disclosure with the "comprehensive nondisclosure paradigm anchored by [s]ection 6103 of the Internal Revenue Code." Def.'s Mot. to Dismiss at 4. Under section 6103, all tax returns are presumptively confidential "except as authorized by [title 26]." 26 U.S.C. § 6103(a). Section 6104 provides one of several exceptions to this general nondisclosure rule, requiring, in relevant part, that Form 990 data "be made available to the public at such times and in such places as the Secretary may prescribe." 26 U.S.C. § 6104(b). However, section 6104(b) does not "authorize the Secretary to disclose the name or address of any contributor to any organization or trust" required to file a Form 990. Id. According to the IRS,

section 6103 and 6104 operate jointly as a "controlling statutory scheme" for the release of Form 990 data, with each imposing complementary "nondisclosure mandates" on the IRS. Def.'s Mot. to Dismiss at 4, 5. The IRS also notes that the Treasury has issued a regulation specifically governing disclosure under section 6104, which describes how the Form 990 data may be viewed or obtained. 26 C.F.R. § 301.6104(b)-1 to (d)-1.

B. Section 6104 is distinguishable from statutes held to supersede FOIA.

The IRS argues that the specific and detailed statutory scheme governing disclosure of Forms 990 supersedes the more general requirements of FOIA.1 Here the IRS relies on the "well settled rule of statutory construction" that "a specific statute will not be controlled by a general statute" unless there is clear legislative intent to the contrary. Def.'s Mot. to Dismiss at 7; Donaldson v. U.S., 653 F.2d 414, 418 (9th Cir. 1981). The IRS points to two lines of cases finding FOIA's general disclosure requirements superseded by more specific alternatives — the first dealing with section 6110 of the Internal Revenue Code, and the second dealing with the Presidential Recordings and Materials Preservation Act of 1974. Pub. L. 93-526, title I, §§ 101-106, 88 Stat. 1695-1698 (hereinafter "Materials Act").

The IRS reads both the canon and the cases too broadly. The textual touchstone for evaluating whether a statute might supersede FOIA is not the level of precision with which the statute defines covered records, but the comprehensiveness of its procedural scheme. See Julian v. U.S. Dep't of Justice, 806 F.2d 1411, 1420 (9th Cir. 1986), aff'd, 486 U.S. 1, 108 (1988) (finding that FOIA was not superseded by a statute whose scheme lacked the "specificity or particularity required to displace FOIA"). Both section 6110 and the Materials Act are distinguishable from section 6104 in this respect.

In Tax Analysts v. I.R.S., the District Court held that the detailed provisions of Section 6110, enacted after FOIA as part of the Tax Reform Act of 1976, indicated that Congress intended to supplant FOIA disclosure with respect to requests for the IRS's written determinations. Tax Analysts v. I.R.S., No. CIV.A. 96-2285, 2000 WL 689324 (D.D.C. Mar. 31, 2000), at *1. The Ninth Circuit similarly noted that section 6110 "replace[d] the procedures of FOIA . . . [with] a new set of procedures to be applicable to requests under section 6110." Long v. U.S. I.R.S., 742 F.2d 1173, 1178 (9th Cir. 1984). The Long court found that the wholesale displacement of FOIA procedures in section 6110 was indicative of Congress's desire to displace FOIA itself. Id.

The disclosure scheme provided by section 6104 is simply not of the same kind as that provided by section 6110, which sets forth detailed rules governing "[e]xemptions from disclosure" that plainly operate as a more limited replacement for the exemptions in FOIA itself. Compare 26 U.S.C. § 6110(c) (1982) with 5 U.S.C. § 552(b) (1982). Section 6110 lays out independent administrative remedies for disclosure disputes, 26 U.S.C. § 6110(f)(2)-(3) (1982), independent judicial remedies, § 6110(f)(4)-(5), and a schedule for disclosure and postponement of disclosure. § 6110(g)(1)-(4). It also establishes a specific forum for civil suits and an independent scheme for damages. Compare 26 U.S.C. § 6110(i) (1982) with 5 U.S.C. § 552(a)(4)(B)-(G) (1982). Most importantly, section 6110 expressly supersedes FOIA. 26 U.S.C. § 6110(l) (1982); see also Church of Scientology of Cal. v. I.R.S., 792 F.2d 146, 149 (D.C. Cir. 1986) ("Significantly, Congress did not leave us to speculate whether [section 6110] was comprehensive enough to constitute an implicit pro tanto repeal of FOIA; the last subsection specifies that the prescribed civil remedy in the Claims Court shall be the exclusive means of obtaining disclosure. . . .).

By contrast, section 6104 provides that Forms 990 should generally be made available for disclosure, with certain precise exceptions. This is manifestly different from a statute that purports to alter the procedural elements of FOIA and the means of judicial review. The content of section

6104 is more consistent with the IRS's depiction of the statute as a carefully delineated exception to the general nondisclosure rule from section 6103, Def.'s Mot. to Dismiss at 4, that the Ninth Circuit has already found insufficient to supersede FOIA. Long, 742 F.2d at 1178 ("[Congress's] failure to do likewise in amending section 6103 is highly persuasive of an intent not to preempt the procedural provisions of FOIA as to requests under section 6103."). Absent express language or a procedural scheme ostensibly displacing FOIA procedures, section 6104 — like section 6103 — cannot be held to supersede FOIA.

The Materials Act case, Ricchio v. Kline, 773 F.2d 1389, 1394-95 (D.C. Cir. 1985), is inapposite. The Materials Act created a procedure for collecting and making public certain "historical materials" related to "abuses of governmental power" during the Nixon Administration. Pub. L. 93-526, title I, §§ 101(b), 104(a), 88 Stat. 1695-1697 (1974). The statute required the General Services Administration to propose public access regulations consistent with seven enumerated factors, including affected individuals' right to an impartial trial, the protection of national security, and the private interest of President Nixon and his heirs in materials of trivial historical value. § 104(a), 88 Stat. 1696-1697. These regulations were then submitted to Congress and subject to potential disapproval. § 104(c), 88 Stat. 1697. The Act did not contain express language superseding FOIA.

In considering the statute, the D.C. Circuit in Ricchio found that "Congress provided a comprehensive, carefully tailored and detailed procedure designed to protect both the interest of the public . . . and of President Nixon." Ricchio, 773 F.2d at 1395. The court held that the Materials Act was intended to supplant FOIA as the exclusive method for obtaining specific documents of great public interest, namely "the Watergate Force's transcripts of the tape recordings of President Nixon's White House conversations." Id.; see also Julian, 806 F.2d at 1420. The court made clear that FOIA was superseded only with respect to this "specific, narrowly limited material," and not with respect to the vast remainder of presidential records to which the Materials Act disclosure scheme also applied. Ricchio, 773 F.2d at 1395; see Reporters Comm. for Freedom of the Press v. Sampson, 591 F.2d 944, 948 & n.12 (D.C. Cir. 1978) ("[W]e believe that the existence of an alternate method of access is completely compatible with Congress's intent to guarantee that materials from the Nixon presidency [be] available to the public.").

The IRS asserts that section 6104 compares favorably with the Materials Act in that both "specif[y] categories of records that [are] subject to [their] provisions . . . and specifically authorize[ ] the promulgation of procedural rules governing their disclosure to the public." Reply at 8. That much is true. However, a statute cannot be "comprehensive enough" to supersede FOIA simply by specifying categories of records exempt from disclosure, since this is a means of identifying statutory exemptions pursuant to FOIA. 5 U.S.C. § 552(b)(3)(A). If this sufficed, most statutory exemptions would supersede FOIA. Moreover, in the Materials Act, Congress authorized the creation of public disclosure regulations under specific constraints, in a unique context, and in a tightly controlled fashion. See §§ 102-104, 88 Stat. 1696-1698. The disclosure rules were to be submitted to Congress, tailored to the sensitive circumstances surrounding disclosure of the president's Watergate-related records and subject to judicial review on specified terms. § 105, 88 Stat. 1698. Even then, the D.C. Circuit held that FOIA was only superseded with respect to a small, closed subset of presidential records. Ricchio, 773 F.2d at 1395. Ricchio does not provide persuasive guidance for this case. See Julian, 806 F.2d at 1420 (distinguishing the Materials Act from the procedures governing disclosure of prisoners' presentence investigation reports, while also declining to adopt the reasoning in Ricchio).

C. Legislative history and intent indicate that FOIA applies to section 6104.

The IRS also argues that the relationship between section 6104 and FOIA is ambiguous as a result of FOIA's later date of enactment. Def.'s Mot. to Dismiss at 7 ("Because [s]ection 6104 predates the

FOIA, it is not required to include specific language as to its effect on the FOIA, and the Court must instead turn to traditional rules of statutory construction."). Again the IRS stresses that "a precisely drawn, detailed statute preempts more general statutory remedies," and the IRS argues that this resolves the ambiguity between the statutes in favor of section 6104. Mot. to Dismiss at 7 (quoting Brown v. General Services Administration, 425 U.S. 820, 834-35 (1976)).

The IRS's argument is again overbroad. Courts will defer to the more narrowly drawn statute only "where there is no clear legislative intent to the contrary." Donaldson, 653 F.2d at 418. Although the intent of section 6104 may be ambiguous in relation to FOIA, the reverse is not true. Courts have consistently understood FOIA as intended for broad application, with only limited exceptions. Church of Scientology of Cal., 792 F.2d at 149 ("FOIA is a structural statute, designed to apply across-the-board to many substantive programs; it explicitly accommodates other laws by excluding from its disclosure requirement documents 'specifically exempted from disclosure' by other statutes, 5 U.S.C. § 552(b)(3)."); see also N.L.R.B. v. Robbins Tire & Rubber Co., 437 U.S. 214, 220-21 (1978).

While I am leery of going down the path of legislative history too far, as the IRS invites me to do, I note my disagreement with its analysis. The IRS attempts to draw a distinction between pro-disclosure and nondisclosure statutes in FOIA's legislative history. Reply at 5-6. As it notes, FOIA arose in response to expansive agency interpretations of the discretion previously afforded under section 3 of the APA to deny access to public records. Id. at 5; S. REP. NO. 89-813 at 38-39 ("After it became apparent that section 3 of the Administration Procedure Act was being used as an excuse for secrecy, proposals for change began."). The IRS contends that this demonstrates Congress's intent to apply FOIA only to those documents previously subject to discretionary withholding under section 3 of the APA, and not to statutory schemes that provided disclosure by other means at the time of FOIA's original enactment. Reply at 6. As section 6104 predated FOIA and provided such other means, the IRS argues that section 6104 must supersede.

This argument is unpersuasive for several reasons. First, it mistakes legislative motivation for legislative intent, improperly reading the purpose of the statute as limited to the set of circumstances that gave rise to it. Such a narrow reading yields results incompatible with the language of FOIA, 5 U.S.C. § 552(b)(3), and the legislative record. S. REP. NO. 89-813 at 38 ("It is the purpose of the present bill to eliminate [portions of section 3 of the APA], to establish a general philosophy of full agency disclosure unless information is exempted under clearly delineated statutory language and to provide a court procedure by which citizens and the press may obtain information wrongfully withheld."). FOIA is broad precisely because Congress sought a comprehensive solution to what it viewed as a wide-ranging problem. Mink, 410 U.S. at 79-80. The pre-FOIA disclosure statutes will necessarily be narrower by comparison. FOIA's breadth cannot be both its purpose and its undoing. As the Supreme Court has held, "the clear legislative intent of the FOIA [is] to assure public access to all governmental records whose disclosure would not significantly harm specific governmental interests." Dep't of Air Force v. Rose, 425 U.S. 352, 365 (1976) (internal parentheses omitted) (quoting Soucie v. David, 448 F.2d 1067, 1080 (D.C. Cir. 1971)).

Second, where genuine disputes exist as to the legislative intent of FOIA, "the recognized principal purpose of the FOIA requires [courts] to choose that interpretation most favoring disclosure." Rose, 425 U.S. at 366; see generally Sinito v. U.S. Dep't of Justice, 176 F.3d 512, 514 (D.C. Cir. 1999) (discussing FOIA remedies and FOIA's potential function as a remedial statute). The IRS advances a theory by which any pre-existing disclosure statute could conceivably supplant FOIA, even where the pre-existing statute provides for significantly less disclosure than mandated by FOIA. Reply at 6. FOIA's pro-disclosure purpose would then be frustrated not by earlier nondisclosure statutes, but by earlier statutes with comparable pro-disclosure aims. Absent clear language to that effect, I cannot

accept that Congress intended FOIA's "'workable' rules" of disclosure to turn on such an opaque distinction. F.T.C. v. Grolier Inc., 462 U.S. 19, 27 (1983) (holding, in the context of FOIA's (b)(5) exemption, that "establishing a discrete category of exempt information[ ] implements the congressional intent to provide 'workable' rules").

Finally, the IRS contends that Congress, after enacting FOIA, "could have amended [s]ection 6104 to indicate that the FOIA would provide the scheme for the production of Forms 990, but it declined to do so." Def.'s Mot. to Dismiss at 7, 8. However, the IRS offers nothing to suggest that failing to introduce such an amendment was an affirmative act. Indeed, failure to amend is equally strong evidence of Congress's expectation that FOIA already governed.

D. The relationship between sections 6104 and 6103 confirms that FOIA governs.

The IRS frames section 6104 as operating within a statutory scheme "anchored by [s]ection 6103," in which adjacent subsections of section 6104 operate as pro-disclosure and nondisclosure mandates with respect to specific records. Def.'s Mot. to Dismiss at 4; 26 U.S.C. § 6104(a), (b). The IRS notes that without section 6104, release of Forms 990 would be completely barred by the nondisclosure provision for tax return information in section 6103(a). Def.'s Mot. to Dismiss at 8. The D.C. Circuit has generally accepted such a view of the statutes' relationship to one another. Tax Analysts v. I.R.S., 214 F.3d 179, 183 (D.C. Cir. 2000) ("I.R.C. § 6104 therefore may be characterized as an exception to the exception from the general disclosure rule offered by FOIA Exemption 3 and I.R.C. § 6103."); see also Lehrfeld v. Richardson, 132 F.3d 1463, 1467 (D.C. Cir. 1998).

However, it is unclear on what basis this depiction of section 6104 advances the IRS's position on FOIA preemption. Indeed, the Ninth Circuit has already considered and rejected the FOIA preemption argument with respect to section 6103. Long, 742 F.2d at 1177-78 ("Exemption 3 of FOIA was designed to give effect to just such explicit nondisclosure statutes as section 6103."); 5 U.S.C. § 552(b)(3). The D.C. Circuit has reached the same conclusion on multiple occasions. Tax Analysts v. I.R.S., 117 F.3d 607, 611 (D.C. Cir. 1997) ("That § 6103 is the sort of nondisclosure statute contemplated by FOIA exemption 3 is beyond dispute."); Maxwell v. Snow, 409 F.3d 354, 355 (D.C. Cir. 2005) ("Section 6103 thus 'does not supersede FOIA but rather gives rise to an exemption under Exemption 3' and FOIA procedures must still be followed in applying § 6103." (quoting Church of Scientology of Cal., 792 F.2d at 149-50)). If a tension exists between the pro-disclosure purposes of FOIA and the confidentiality interests of section 6103, FOIA itself provides the mechanism for reconciling the two. Therefore, in linking together sections 6103 and 6104 as "a comprehensive nondisclosure paradigm," the IRS articulates an argument not for preempting FOIA, but for a statutory exemption pursuant to FOIA. Def.'s Mot. to Dismiss at 4. Statutes providing such an exemption are subsumed within FOIA, and the burden then lies with the federal agency to demonstrate that the exemption applies to the discrete record request at issue. Kamman v. U.S. I.R.S., 56 F.3d 46, 48 (9th Cir. 1995); 5 U.S.C. § 552(a)(4)(B).

E. IRS regulations cannot be found to supersede FOIA absent statutory intent.

Finally, the IRS relies on the detailed access provisions contained in the regulation adopted to effect section 6104's mandates. Section 6104 delegates to the Secretary of the Treasury the authority to promulgate certain implementing regulations. 26 U.S.C. § 6104(b) ("The information required to be furnished [by section 6104] . . . shall be made available to the public at such times and in such places as the Secretary may prescribe."). The IRS contends that — at least as of November 2002 — Treasury adopted regulations that "expressly construe[ ] section 6104 as providing a comprehensive and exclusive disclosure scheme." Reply at 4-5; see 26 C.F.R. § 601.702(d)(3).

However, the IRS misstates the extent of the Secretary's power. The rulemaking power is only a

limited grant of authority "to adopt regulations to carry into effect the will of Congress as expressed by the statute." U.S. v. Larionoff, 431 U.S. 864, 873 n.12 (1977). If a dispute arises as to proper statutory interpretation, courts and federal agencies must defer to congressional intent. Lessner v. U.S. Dep't of Commerce, 827 F.2d 1333, 1335 (9th Cir. 1987). "If the intent of Congress is clear, that is the end of the matter." Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842 (1984).

As discussed, the congressional intent behind FOIA is clear, and nothing in the text, structure, purpose, or legislative history of either statute indicates that section 6104 should supersede FOIA. See Tax Analysts v. I.R.S., 350 F.3d 100, 103 (D.C. Cir. 2003) (holding that certain regulations implementing section 6110 were inconsistent with the statute's meaning, as determined by these "traditional tools of statutory interpretation" (quoting Pharm. Research & Mfrs. of Am. v. Thompson, 251 F.3d 219, 224 (D.C. Cir. 2001))). The IRS cannot achieve through rulemaking what it was not permitted to do by Congress.

II. ADMINISTRATIVE PROCEDURE ACT

As an alternative to its claims under FOIA, PRO seeks declaratory and injunctive relief under the APA, challenging as arbitrary and capricious the IRS's determination that Forms 990 in MeF format are not required to be released under FOIA. Compl. ¶¶ 61-62. The IRS argues that this claim should be dismissed for the same reason as the FOIA claim — that section 6104 preempts FOIA. Def.'s Mot. to Dismiss at 8. As I have determined that section 6104 does not preempt, and as the IRS raises no additional arguments, the IRS's motion fails with respect to the APA claim. While PRO will eventually have to elect its remedy, it need not do so now.

CONCLUSION

For the reasons set forth above, Defendant's motion to dismiss for failure to state a claim is DENIED.
IT IS SO ORDERED.

DATED: June 20, 2014.

William H. Orrick
United States District Judge
FOOTNOTE

1 Focusing on its argument that section 6104 preempts FOIA, the IRS does not argue that section 6104 creates a statutory exemption to FOIA under 5 U.S.C. § 552(b)(3). FOIA's (b)(3) exemption provides that material can be withheld from production under FOIA where a statute "requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue; or [ ] establishes particular criteria for withholding or refers to particular types of matters to be withheld." 5 U.S.C. § 552(b)(3)(A).

END OF FOOTNOTE

IRS LTR: Easement Sale Won't Jeopardize Club's Exemption.

The IRS ruled that a social and recreational club's sale of a conservation easement will not jeopardize its tax-exempt status and that the club's use of the sale proceeds to make capital

improvements will constitute other property purchased and used directly in the performance of the club's exempt function if purchased within a specified time.

Citations: LTR 201425016

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *

Uniform Issue List: 511.00-00, 512.00-00, 512.01-00, 512.09-03
Release Date: 6/20/2014
Date: March 28, 2014

Employer Identification Number: * * *

LEGEND:
Towns = * * *
Amount 1 = * * *
Year 1 = * * *
Amount 2 = * * *
Year 2 = * * *
Year 3 = * * *
Amount 3 = * * *
City = * * *
Date 1 = * * *
Amount 4 = * * *
Amount 5 = * * *

Dear * * *:

This is in response to your letter dated January 11, 2013, in which you requested certain rulings with respect to I.R.C. § 512(a)(3)(D).

BACKGROUND

You are recognized as an organization classified under § 501(c)(7). You are a social and recreational club located in Towns formed for the purpose of golf and other recreation. You have been operated continuously as a social club since you were recognized as exempt well over fifty years ago. You were formed for the primary purpose of owning and operating a private club for golf and other leisure activities for the recreation of your members. You own approximately one hundred and fifty plus acres ("Property"). All of your recreational facilities are located on the Property and you own no other real property. Your facilities include an 18-hole golf course, tennis courts and tennis shed, a swimming pool and pool house, staff house, and clubhouse.

You borrowed Amount 1 in debt in Year 1 and Amount 2 in Year 2 to make improvements to your Property. The debt was used exclusively to renovate the golf course, pool house, and clubhouse. You refinanced your debt in Year 3 for Amount 3 to pay off your original debts from Year 1 and Year 2.

On Date 1, you entered into an agreement with City for a conservation easement attaching to Amount 4 acres consisting primarily of your 18-hole golf course, surrounding wetlands, and shrubs. City seeks the easement since your land contains natural resources, such as watercourses, wetlands, and forests, which serve as a source of drinking water for residents of City. The easement is granted for the purpose of limiting development and disturbance of the easement property, preventing

pollution, and protecting any portion of the City's water supply system, including its reservoirs and tributaries. City will pay you Amount 5 for the easement.

As part of the easement you have agreed that you will not construct new paved roads; create new building envelopes with subsurface sewage treatment systems, paved surfaces, or wells; or store, bury, or dispose of hazardous materials designated by local, state, or federal regulations or dispose of cars, trash, sewage, or uncomposted animal waste. Furthermore, the easement restricts your ability to disturb the surface, subsurface, or trees on the easement land, though it does not remove those options entirely. The easement also provides for a building envelope for you where your current impervious surfaces are permitted along with certain expansions limited by the easement and subject to prior approval. Additionally, City will have the right to enter the land for inspections in order to monitor your use of the land. The easement will run with the land in perpetuity, thus restricting any future sale of the land. Finally, you have also agreed to terms for a Water Resource Protection Plan that dictates the manner you are permitted to care for your grounds to include the amount and type of fertilizer, herbicide, and pesticide as well as how often such efforts can occur. Your members, however, can, and will, continue to use the land for all of your traditional recreational activities such as golfing.

You intend to use the proceeds of the conservation easement agreement to make capital improvements to the Property. These improvements include renovating, expanding, and updating your existing club house; purchasing additional equipment and fixtures for the club house; renovating and expanding your staff house; updating and repairing your golf course; replacing equipment used to maintain golf course; renovating your golf cart barn; repaying and expanding your parking lot; building a new turf management maintenance facility; replacing pool, pool furniture, pump house, heating equipment and engaging in other pool repairs; repairing and updating pool house; refurbishing and expanding tennis courts and tennis house; updating irrigation system; and updating, expanding, and replacing ponds, water resources, and waste systems. All of the updated properties are used by your members in furtherance of your recreational purposes. In addition to expending money to make improvements to your facilities and land, you intend to pay off some of the refinanced debt from Year 3.

RULINGS REQUESTED

1. The sale of the easement will not jeopardize your exempt status under § 501(a) and § 501(c)(7).

2. The use of the proceeds of the sale of the easement to improve the golf course, purchase personal property and equipment and add on to, improve, or renovate your facilities, inclusive of those items listed on Exhibit "C," will constitute expenditures for property used directly in the performance of your exempt function for purposes of § 512(a)(3)D) and as such those proceeds will be exempt from tax.

3. The time period for reinvestment of the proceeds of sale of the easement specified in Section 512(a)(3)(D) begins one year before the date of closing of the sale not when the downpayment is deposited with the Escrow Agent or when the contract was signed.

LAW

I.R.C. § 501(c)(7) describes clubs that are organized for pleasure, recreation, and other nonprofit purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

I.R.C. § 512(a)(3)(A) defines unrelated business income, for an organization recognized under §

501(c)(7), as gross income (excluding any exempt function income) less the deductions allowed, both computed with the modifications provided in paragraphs (6), (10), (11), and (12) of § 512(b).

I.R.C. § 512(a)(3)(B) defines exempt function income for § 501(c)(7) organizations to mean gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing the goods, facilities, and services in furtherance of the purposes of the organization.

I.R.C. § 512(a)(3)(D) provides that if property used directly in the performance of the exempt function of an organization described in § 501(c)(7) is sold by such organization, and within a period beginning one year before the date of such sale, and ending three years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property.

I.R.C. § 1031 provides that no gain or loss shall be recognized on the sale or exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment. The date of the exchange is when the taxpayer transfers the property relinquished in the exchange.

Treas. Reg. § 1.501(c)(7)-1(b) provides that a club which engages in business, such as selling real estate, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes. However, an incidental sale of property will not deprive the club of its exemption.

Senate Report No. 91-552, 1st Session, 1969-3 C.B. 423, 470-71 explained the reasons for enacting § 512(a)(3)(D), noting:

"[T]he tax on investment income is not to apply to the gain on the sale of assets used by the organizations in the performance of their exempt functions to the extent the proceeds are reinvested in assets used for such purposes within the period beginning 1 year before the date of sale and ending three years after that date. The committee believes that it is appropriate not to apply the tax on investment income in this case because the organization is merely reinvesting the funds formerly used for the benefit of its members in other types of assets for the same purposes. They are not being withdrawn for gain by the members of the organization. For example, where a social club sells its clubhouse and uses the entire proceeds to build or purchase a larger clubhouse, the gain on the sale will not be taxed if the proceeds are reinvested in the new clubhouse within three years."

Rev. Rul. 69-232, 1969-1 C.B. 154 provides that even though a profit is realized, the sale of property will not cause a social club to lose its exemption provided the sale is incidental in that it does not represent a departure from the club's exempt purposes. All of the facts and circumstances of a sale must be considered in determining the club's primary purpose in making the sale, including: (1) the purpose of the club in purchasing the property; (2) the use the club makes of the property; (3) the reason for the sale; and (4) the method used in making the sale.
In Atlanta Athletic Club v. Commissioner, 980 F.2d 1409 (11th Cir. 1993), expenditures made for the construction of a tennis center and the renovation of a clubhouse were deemed to be purchases of other property for purposes of § 512(a)(3)(D). In analyzing whether the club's property was used directly in the performance of its exempt function prior to the sale, the court looked at the club's actual use of the property, regardless of continuity or regularity, rather than the club's intent for use.

In Tamarisk Country Club v. Commissioner, 84 T.C. 756 (1985 [CCH Dec. 42, 047]), the Tax Court

held that § 512(a)(3)(D) does not require the purchase of property that is of like kind or use to the property sold. Expenditures for golf carts, land improvements, and other items were qualifying purchases of other property for purposes of that section. However, the court found that the club's use of sale proceeds to repay debt owed and refund assessments to its members constituted a withdrawal for gain by the members of the club, who benefited from the decrease in the club's debt and return of the assessments, therefore subjecting the applicable proceeds to unrelated business income tax.

In Deer Park Country Club v. Commissioner, 70 T.C.M. (CCH) 1445, the sale of land that was never actually used for club purposes was not qualified for non-recognition under § 512(a)(3)(D), regardless of the fact that the organization originally purchased the land with the intent of using it for its exempt function.

ANALYSIS

Clubs that engage in the selling of real estate will not be considered to be operated for exempt purposes under § 501(c)(7). Section 1.501(c)(7)-1(b). However, if the selling of real estate is incidental to the club's exempt purpose it will not jeopardize the club's exemption. Id. Rev. Rul. 69-232, supra, provides that even if a sale results in a profit it will not result in a loss of exemption as long as it does not represent a departure from the club's exempt purpose. All the facts and circumstances are to be taken into account when determining whether a departure from the exempt purposes has occurred. Id. Items to consider include (1) the purpose of the club in purchasing the property; (2) the use the club makes of the property; (3) the reasons for the sale; and (4) the method used in making the sale. Id.
In this case, you have purchased the property with which the easement will run for the purpose of playing golf and other recreation, which are your exempt purposes. You have used this property since buying it and will continue to do so after the sale of the easement, for playing golf and other recreational activities. You are selling the easement in order to raise capital to invest in improvements to the grounds and equipment of your club. You are not selling the property as part of an ongoing plan to sell or develop real estate, and this sale is a one-time occurrence. The sale of this easement will not jeopardize your exemption under § 501(c)(7) of the Code.

You also requested a ruling that gain from the sale of a conservation easement will not be taxable income if reinvested in property furthering your exempt purpose. Section 512(a)(3) provides special rules defining taxable income for organizations described in § 501(c)(7). Specifically, gains from the sale of property, which has been used for the exempt purpose of certain organizations, will not be recognized, and therefore will not be taxed, to the extent that the sale price is reinvested in property used for the organization's exempt purpose, if that reinvestment occurs within one year prior to and three years following the sale of property. Section 512(a)(3)(D). This statute is further clarified by case law, which requires that the property being sold must have been "directly used" for the exempt purposes of the organization, see Atlanta Athletic Club, 980 F.2d 1409, not for some other benefit of the organization, see Deer Park Country Club, 70 T.C.M. (CCH) 1445, and must be reinvested into property up to the "organization's sales price" and not "withdrawn for the gain by the members of the organization." See Tamarisk Country Club, 84 T.C. 756.

The sale of the easement is considered by the Service to be a sale of property within the Internal Revenue Code. The easement will be attached to the land in perpetuity affecting all future transactions regarding the land. The easement removes your ability to construct new paved roads; create new building envelopes with subsurface sewage treatment systems, paved surfaces, or wells; or store, bury, or dispose of hazardous materials. It additionally hinders your ability to disturb or remove surface and subsurface areas as well as trees, though it does not remove those options entirely. The easement also gives access of your land to City in order to ensure such activities are

not taking place. Given the significant restrictions on you, and any purchaser of the land, and the rights provided to City, you have sold property.

The property you have sold must have been used directly for your exempt purpose. Section 512(a)(3)(D). You use the land over which the easement runs primarily for golf as the land contains your 18-hole golf course, including hazards and forest, which promotes your recreational and social comingling purposes, and other recreational facilities that are used by members to join together and engage in recreation. These activities are in direct furtherance of your exempt purpose. See e.g., Atlanta Athletic Club, 980 F.2d 1409. Thus, we conclude that the sale of the easement meets the first criteria because it is attached to land directly used for your exempt purposes. The fact that you continue to use the land under the easement for your exempt purposes does not alter the conclusion that you have sold property that you used for an exempt purpose.

You have stated that you intend to use a portion of the funds generated from the sale of the easement for capital investments in your facilities and equipment. These investments include improvements to your club house and staff house; improvements to your golf course, golf barn, and parking lot; improvements to your pool, pool house, and tennis courts; and updating, expanding, and replacing ponds, water resources, and irrigation and waste systems.

Purchasing personal property and updating real property constitutes the purchase of property for purposes of § 512(a)(3)(D). Congressional commentary on § 512(a)(3)(D) in the senate report uses the term assets where the statute uses the term property. S. Rep. No. 91-552, supra. Furthermore, the intent of the social club exemption is to allow individuals to pool their money for pleasure and not be taxed since they would not have been taxed had they spent that money on pleasure individually. Id. Given Congress' intent in providing special rules for unrelated business income for organizations exempt under § 501(c)(7) the purchase of equipment and capital improvements to land are considered reinvestments in property for your exempt purpose. The gain on the sale (less selling expenses) that is used on capital projects similar to those described herein that are used exclusively in furtherance of your exempt purpose within three years from the closing of the sale of the easement will not be recognized for tax purposes pursuant to § 512(a)(3)(D).

Finally, you requested a ruling that the date of sale of property for purposes of section 512(a)(3)(D) is the closing date of the sale, not when the downpayment is deposited with the escrow agent or when the contract was signed. Section 1031 describes that the date of sale or exchange of like kind property transactions is the date when the taxpayer relinquishes control of the old property. Here, for purposes of determining when the sale occurs in § 512(a)(3)(D), we rule that the date when you relinquish control of the property and title transfers under local law as the date when the sale occurs. Presuming the date of title transfer is the date of closing under local law, then we rule the date of sale under § 512(a)(3)(D) is the date of closing.

RULINGS

1. The sale of the easement will not jeopardize your exempt status under § 501(a) and § 501(c)(7).

2. The use of the proceeds of the sale of the easement to improve the golf course, purchase personal property and equipment and add on to, improve, or renovate your facilities, inclusive of those items listed on Exhibit "C," will constitute other property purchased and used directly in the performance of your exempt function for purposes of § 512(a)(3)(D) so long as the purchase occur within three years after the closing of the sale of the conservation easement. Additionally, capital improvements described above made in the year preceding closing will constitute other property purchased and used directly in the performance of your exempt function for purposes of § 512(a)(3)(D).

3. The date of sale of property for purposes of section 512(a)(3)(D) is the closing date of the sale.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager, EO Technical
Enclosure
Notice 437

IRS LTR: Tax-Exempt Orgs' LLC Is Exempt From Mortgage Pool Rules.

The IRS ruled that a nonprofit limited liability company formed by two tax-exempt organizations as part of a program to help individuals obtain affordable housing through direct financing is exempt from the taxable mortgage pool rules.

Citations: LTR 201425001

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: * * *, ID No. * * *
Telephone Number: * * *

7701.26-00, 115.03-00
Release Date: 6/20/2014
Date: December 18, 2013

Refer Reply To: CC:FIP:B06 – PLR-123088-13

LEGEND:

Corporation A = * * *
Corporation B = * * *
State = * * *
Area A = * * *
Area B = * * *
Program = * * *
Target Areas = * * *
Entity A = * * *
Program LLC = * * *
Corporation A LLC = * * *
Corporation B LLC = * * *
Date 1 = * * *
a = * * *
b = * * *
c = * * *
d = * * *
e = * * *
f = * * *

Dear * * *:

This responds to a letter dated May 15, 2013, and supplemental correspondence dated August 29, 2013, and November 4, 2013, submitted on behalf of Corporation A requesting a ruling under section 7701(i) of the Internal Revenue Code (1986) (the "Code") that expansion of Corporation A's joint non-profit home financing program with Corporation B to include the issuance of multiple maturity debt financing by an LLC will not result in treatment of the LLC as a taxable mortgage pool.

FACTS

Corporation A and Corporation B (collectively, the "Corporations") are organizations exempt from taxation under section 501(c)(3) of the Code. The Corporations assist low and moderate income individuals to obtain adequate and affordable housing within certain areas in State that have been identified as in moderate or high need for community stabilization. Corporation A and Corporation B provide assistance in Area A and Area B, respectively. The Corporations implement various programs intended to counteract housing deterioration in these communities. The Corporations operate in cooperation with, or on behalf of, various State and local governmental agencies, and neighborhood organizations.

As of Date 1, the Corporations jointly operate a home ownership program (the "Program") that provides financing directly to low and moderate income borrowers for the purchase of single-family owner-occupied homes (the "Loans"). To qualify for a Loan, a borrower must be ineligible for conforming market rate mortgage financing and must meet certain income requirements. At least a percent of the Loans must be provided to borrowers with incomes less than b percent of the area median income as determined by the U.S. Department of Housing and Urban Development ("HUD"). To date, less than c percent of borrowers had incomes above b percent of HUD area median income and more than d percent had incomes below a percent. Homes purchased through the Program are located in one of several Target Areas identified as in need of community stabilization.

The Loans are currently in the form of contracts for deeds, or land installment contracts, that are treated as mortgages for federal income tax purposes. The Program might be expanded in the future to include conventional mortgages. The maximum principal amount of a Loan is $e, and since inception of the Program, the average principal amount of a Loan has been $f. The Loans have

maturities of 10 years and bear fixed interest rates. One of the Program's goals is to assist the borrower in ultimately refinancing into a 30-year mortgage. The Program has implemented safeguards to mitigate a borrower's risk of default on a Loan, including extensive screening, financial counseling through a non-profit community-based counseling service, education, and other assistance in the event that the borrower experiences financial difficulty (including possible modification of a payment plan).

The Program is funded by charitable contributions and debt financing from the State housing finance agency, quasi-governmental and other housing non-profit entities, private sector donors, and investors. Credit enhancement for debt issued to fund the Program is often provided by several cities and counties in State, as well as nonprofit organization Entity A.

The Corporations wish to expand the Program to include the issuance of multiple maturity debt financing (the "Notes") secured by a pledge of the Loans. The Corporations have jointly established a special purpose limited liability company ("Program LLC") in order to issue the Notes. Program LLC is a nonprofit limited liability company organized under the law of State, the membership interests in which are owned by the Corporations through their wholly-owned disregarded entities, Corporation A LLC and Corporation B LLC. The Corporations represent that they may establish additional limited liability companies in the future. The Corporations represent that Program LLC will issue the Notes in multiple tranches with different maturity dates and interest rates in order to attract a broader base of investors with varied investment goals, which will expand the capacity of the Program to originate Loans. Under the related debt financing agreements, the Corporations may be required (or permitted) to repurchase a Loan in the event of a breach of certain representations, warranties or covenants in the related debt financing agreement if such breach materially affects the value of the Loan. In general, the lenders (or their agent) have the right to enforce the repurchase obligation against the Corporations (or related party). If a Loan is repurchased, it will have no impact on the ability of the borrower to remain in possession of her home. The Corporations have the right to exercise various remedies against the borrower if she is in default under a Loan.

Investors in the Notes are expected to include the State finance agency, quasi-governmental and other housing non-profit entities, and private sector investors. Credit enhancement for the Notes is expected to continue to be provided by several cities and counties in State, as well as nonprofit organization Entity A. The proceeds of the Notes will be used exclusively for the acquisition of homes eligible for inclusion in the Program, and the origination or purchase of Loans. The Corporations request a ruling that Program LLC's financing of pledged Loans with debt instruments having multiple maturities does not cause the LLC to be a taxable mortgage pool under section 7701(i) of the Code.

The Corporations represent that, with respect to any Notes issued by Program LLC that would cause Program LLC to be a taxable mortgage pool but for the requested ruling, Program LLC will hold, either directly or indirectly through an indenture trustee or other custodian who will hold the pledged Loans to satisfy the Notes, the remaining beneficial interest in all assets that support the Notes until they are retired.

LAW AND ANALYSIS

Section 7701(i)(1) provides that a taxable mortgage pool shall be treated as a separate corporation which may not be treated as an includible corporation with any other corporation for purposes of section 1501.

Section 7701(i)(2)(A) provides that in general, a taxable mortgage pool is any entity (other than a REMIC) if (i) substantially all of the assets of such entity consists of debt obligations (or interests

therein) and more than 50 percent of such debt obligations (or interests) consists of real estate mortgages (or interests therein), (ii) such entity is the obligor under debt obligations with 2 or more maturities, and (iii) under the terms of the debt obligations referred to in clause (ii) (or underlying arrangement), payments on such debt obligations bear a relationship to payments on the debt obligations (or interests) referred to in clause (i).

Section 7701(i)(2)(B) provides that any portion of an entity which meets the definition of subparagraph (A) shall be treated as a taxable mortgage pool ("TMP").

Section 301.7701(i)-4(a)(1) of the Procedure and Administration Regulations excludes certain governmental bond programs from the TMP rules. It provides that regardless of whether an entity satisfies any of the requirements of section 7701(i)(2)(A), an entity is not classified as a TMP if — (i) The entity is a State, territory, a possession of the United States, the District of Columbia, or any political subdivision thereof (within the meaning of § 1.103-1(b) of this chapter), or is empowered to issue obligations on behalf of one of the foregoing; (ii) The entity issues the debt obligations in the performance of a governmental purpose; and (iii) The entity holds the remaining interests in all assets that support those debt obligations until the debt obligations issued by the entity are retired.

The term "governmental purpose" means an essential governmental function within the meaning of section 115 and does not include mere packaging of debt obligations for resale in the secondary market. § 301.7701(i)-4(a)(2).

Section 301.7701(i)-4(a)(3) provides that if an entity is not described in paragraph (a)(1) of this section, but has a similar purpose, then the Commissioner may determine that the entity is not classified as a taxable mortgage pool.

Neither of the Corporations nor Program LLC are an entity described in section 301.7701(i)-4(a)(1)(i). Nevertheless Program LLC may qualify for an exemption from the TMP rules pursuant to section 301.7701(i)-4(a)(3), if it is found that the issuance of the Notes has a similar purpose as described in section 301.7701(i)-4(a)(1)(ii), that is, Program LLC's purpose in issuing Notes is to issue debt obligations in the performance of a governmental purpose and Program LLC meets the requirements of section 301.7701(i)-4(a)(1)(iii). In order to meet the requirement of "performance of a governmental purpose," Program LLC must satisfy the requirements under section 301.7701(i)-4(a)(2) that the issuance of the Notes (1) is in performance of an essential governmental function within the meaning of section 115 and (2) is not the mere packaging of debt obligations for resale in the secondary market.

In providing an exclusion from gross income, section 115 requires, among other things, that the income be derived in "the exercise of any essential governmental function."

Rev. Rul. 77-261, 1977-2 C.B. 45, holds, "Income from a fund, established under a written declaration of trust by a State, for the temporary investment of cash balances of the State and its political subdivisions . . . is excludable from gross income. . . ." The ruling reasons that the "investment of positive cash balances . . . in order to receive some yield on the funds until needed to meet expenses is a necessary incident of the power of the State or political subdivision to collect taxes and other revenues for use in meeting governmental expenses." In addressing the meaning of an "essential governmental function" for purposes of section 115, the ruling states, "Congress did not desire in any way to restrict a State's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the State government which, on a broad consideration of the question, may be the function of the sovereign to conduct."

CONCLUSION

Based on the information submitted and representations made, we conclude that Corporation A and Corporation B have satisfied the requirements under section 301.7701(i)-4(a)(1) for Program LLC to be exempt from the TMP rules under the facts and circumstances. Program LLC will hold, either directly or indirectly through an indenture trustee or other custodian, the remaining interests in Loans that support Notes issued by Program LLC until those Notes are retired. The activities of the Corporations and Program LLC provide funding to enable low and moderate income individuals to borrow the money they need to purchase housing in communities identified as in need of stabilization. Neither the Corporations nor Program LLC are in the business of purchasing and selling of debt obligations on the secondary market, rather Program LLC will function as the direct issuer of such bonds. Accordingly, Program LLC's issuance of Notes is in the performance of a governmental purpose for purposes of section 301.7701(i)-4(a)(2) because (1) its activities qualify as an "essential governmental function" under section 115, and (2) its issuance of Notes is not "the mere packaging of debt obligations for resale on the secondary market."

This ruling is limited to the exemption of Program LLC's issuance of Notes from the TMP rules under section 301.7701(i)-4. This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. No opinion is expressed with regard to whether Program LLC could meet the requirements of a REMIC under section 860D(a), whether Program LLC would otherwise be a TMP under section 7701(i), whether it is otherwise exempt under section 501(c)(3), or whether Program LLC's issuance of Notes satisfies either the accrual requirement or the private benefit requirement of section 115.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the provisions of a Power of Attorney on file, we are sending a copy of this ruling letter to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely

Mary Brewer
Assistant to the Branch Chief
Office of Chief Counsel, Branch 6
(Financial Institutions & Products)

EO Update: e-News for Charities & Nonprofits - June 20, 2014

1. ACT submits UBIT recommendations

The advisory committee suggests ways to improve reporting of unrelated business income. Read recommendations.

2. IRS adopts "Taxpayer Bill of Rights"

The IRS recently announced the adoption of a Taxpayer Bill of Rights that will become a cornerstone document to provide the nation's taxpayers with a better understanding of their rights. Read news release.

3. Register for the June 26 webcast: Unrelated Business Income (UBI) and Exempt Organizations

2 p.m. ET – Register for this presentation.

Learn about:

- How to be organized for an exempt purpose
- Unrelated Business Income activities
- Exceptions and exclusions
- Special UBIT rules for certain organizations
- UBIT and the Form 990-T

4. IRS recorded phone forum presentations posted

Review recently posted phone forum recorded presentations on the IRS Stay Exempt Resource Library page:

Good Governance makes sense for exempt organizations
Stay Exempt: A guide for charitable organizations with changing leadership presentation

5. New FBAR Form 114 due June 30

U.S. persons, including tax-exempt organizations, with a financial interest in, or signature authority over, a foreign financial account (or accounts) with aggregate value of more than $10,000 at any time during the calendar year must file Form 114, Report of Foreign Bank and Financial Accounts (FBAR). FBARs for the 2013 year are due June 30.

IRS Exempt Bonds Director Emphasizes Clarity and Transparency.

The new head of tax-exempt bonds (TEB) at the IRS said June 19 she is trying to ensure clarity and transparency in all of the agency's public documents on exempt financing.

During an IRS webcast, Rebecca Harrigal, director (TEB), IRS Tax-Exempt and Government Entities Division, who assumed her role in October, said she wants to be sure that the exempt bond community understands what the IRS is trying to accomplish and that the agency explains its actions as transparently as possible. For example, TEB is making significant revisions to its voluntary closing agreement program (VCAP) manual to make it clearer and has developed standardized closing agreements that will be posted online, she said.

TEB is also making efforts to measure customer satisfaction, particularly following examinations, Harrigal said, adding that the IRS hopes to have a satisfaction survey in place early in 2015. She also said her office continues to evaluate and update its programs, such as taking steps this year to ensure the arbitrage rebate penalty is applied in a flexible manner. TEB has also put its compliance check program on hold while it evaluates the program to determine when it will be used in the future, she said.

Harrigal said she is looking at other IRS offices, such as the Large Business and International Division, to see whether they have practices in place that TEB could adopt. TEB is also targeting older inventory, particularly old VCAP and examination cases, to see if those could be moved more quickly, she said.

TEB continues to focus on post-issuance compliance, according to Harrigal. She said the IRS needs to be flexible in this area to allow best practices to develop and that IRS compliance tests "should not be on any particular format for the post-issuance compliance; rather, it should be on the effectiveness of that post-issuance compliance."

Harrigal said TEB hopes to conduct two more webcasts this summer, one on arbitrage and the other on qualified section 501(c)(3) bonds.

Fred Stokeld

FASB Won't Require Tax Status Disclosure From Nonprofit Entities.

The Financial Accounting Standards Board on June 18 tentatively decided that its nonprofit financial reporting project will not produce requirements for nonprofit organizations to disclose their tax-exempt status in the financial statement footnotes.

At a meeting in Norwalk, Connecticut, Richard Cole, a FASB project manager, said that members of the board's Not-for-Profit Advisory Committee had suggested that nonprofit entities should be required to disclose their tax status under section 501(c)(3) because that status may affect an individual's ability to record a tax deduction for a donation or gift granted to the nonprofit.

Cole said that while the staff agreed that information about a nonprofit's tax status could be useful for some financial statement users, they didn't believe that a footnote disclosure should be required because that information can be easily obtained from other sources.

FASB member Thomas Linsmeier supported the staff recommendation but he added that his vote against requiring a footnote disclosure was not based on the existing tax status information found in Form 990, "Return of Exempt Organization." "I'm not sure that it's our role to be necessarily overly emphasizing the tax deductibility of items within reported financial statements, other than indicating what the tax is," he added.

Based on the staff's recommendation, the board will not pursue more disclosure from nonprofit organizations on governing board policies or the risks of operating in international jurisdictions.

FASB will seek the added support of its Not-for-Profit Advisory Committee before finalizing its tentative decision not to pursue those additional footnote disclosure requirements.

FASB agreed that the staff efforts should proceed regarding potential improvements to the accounting and disclosure requirements for the underwater endowment funds held by a nonprofit entity.

The board clarified a recent tentative decision on the presentation and disclosure of investment expenses by voting to remove the proposed requirement to disclose the investment expenses that have been netted against the investment return of mutual and hedge funds.

Cloud Computing

FASB accepted a staff recommendation to issue a proposed accounting standards update to amend the Accounting Standards Codification (ASC) by including implementation guidance to better indicate the accounting for customers' fees paid in cloud computing arrangements.

To assist the customer's determination on whether a cloud computing arrangement should be accounted for as a license or a service contract from the service provider, the board tentatively decided that it will add the revenue recognition guidance from ASC 985, "Software," to the internal-use software guidance under ASC 350, "Intangibles — Goodwill and Other."

FASB decided that the proposed update will be effective for public entities in the annual and interim periods beginning after December 15, 2015. All other entities can begin applying the guidance for the annual periods beginning after December 15, 2015, and for the interim periods beginning after that initial annual report. The board would permit entities to elect a retrospective or prospective transition method when applying the guidance.

The staff said that the exposure draft of the proposed accounting standard update will likely be released by late July or early August. The board agreed to provide a 90-day public comment period for the exposure draft.

Treasury recently announced that it may expand existing regulations or draft new regs to help determine the appropriate sourcing for cloud computing transactions.

Thomas Jaworski

Hospital Group Seeks Changes to Tax-Exempt Bond Rules.

The American Hospital Association has urged Treasury to modify the tax-exempt bond rules, noting that the current rules pose a barrier to hospital and medical foundations' use of specific types of arrangements that are encouraged by the Affordable Care Act, such as accountable care organizations, bundled payments, and other shared savings programs.

June 12, 2014

Vicky Tsilas
Associate Tax Legislative Counsel
Office of the Tax Legislative Counsel
Department of the Treasury
1500 Pennsylvania Avenue, NW Room 3044
Washington DC 20220

Johanna Som de Cerff
Senior Technician Reviewer
Office of Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Dear Ms. Tsilas and Ms, Som de Cerff:

Thank you for taking the time on May 20th to discuss with me, Mike Rock and representatives from several of the American Hospital Association's hospital members the importance of updating tax-exempt bond rules to accommodate the intent, requirements and incentives of the Affordable Care Act (ACA) for high-quality, cost-effective health services.

As we discussed, current rules as embodied in Rev. Proc. 97-13 present a barrier to hospital and medical foundation use of particular arrangements that are encouraged by the ACA, such as accountable care organizations, bundled payments and other shared savings programs. Furthermore, hospitals face significant penalties tinder readmission reduction and value-based purchasing programs. Rev. Proc. 97-13 prevents the types of arrangements that can effectively align incentives among physicians, hospitals, medical foundations and other health care service providers to meet the goals of the ACA.

During our call, you asked for (1) suggestions on the types of quality measures hospitals or medical foundations use in management contracts to incentivize physicians that should be considered acceptable under the "private business use" standards; and (2) suggested language to allow retroactivity of the new rules after any new guidance is issued (or old agreements that are materially modified or extended after that date).

Quality Measures

A number of third-party organizations develop and evaluate quality measures for the purpose of evaluating and reporting on the performance of health care providers.

Public measure developers include the Center for Medicare and Medicaid Services (CMS), and the Agency for Healthcare Research and Quality (AHRQ). CMS currently uses measures to financially reward providers who are able to deliver better-quality care to beneficiaries at a lower cost. CMS defines quality measures as, "tools that help (us) measure or quantify healthcare processes, outcomes, patient perceptions, and organizational structure and/or systems that are associated with the ability to provide high-quality health care and/or that relate to one or more quality goals for health care. These goals include: effective, safe, efficient, patient-centered, equitable, and timely care."

Non-profit, private developers of quality measures include the Joint Commission, which evaluates and accredits more than 20,000 healthcare organizations and programs in the United States, and the National Quality Forum (NQF), a multi-stakeholder organization that endorses consensus standards for performance measurement. The measures they develop are predominantly used by payers in public reporting and provider incentive programs. The NQF, for instance, uses four criteria to assess a measure for endorsement:

(1) Important to measure and report to keep our focus on priority areas, where the evidence is highest that measurement can have a positive impact on healthcare quality.
(2) Scientifically acceptable, so that the measure when implemented will produce consistent (reliable) and credible (valid) results about the quality of care.
(3) Useable and relevant to ensure that intended users — consumers, purchasers, providers, and policy makers — can understand the results of the measure and are likely to find them useful for quality improvement and decision-making.
(4) Feasible to collect with data that can be readily available for measurement and retrievable without undue burden.

It is also important to recognize that pursing quality measures may also have the additional benefit of reducing costs by eliminating unnecessary or duplicative tests, promoting the efficient use of

supplies, facilitating coordination with other providers, or reducing length of stay. Management contracts between hospitals or medical foundations and physicians or other providers should not give rise to private use if they base incentive compensation on quality measures including those that have the added benefit of producing gains in the efficiency and effectiveness of care. Further, such compensation should be permitted to be structured on a sliding basis without limit on its frequency. Finally, hospitals or medical foundations should have flexibility in the terms of the management contract in order to ensure the quality measures can be accomplished.

Effective Date

We believe that any new rules should generally apply for new agreements entered into after the new guidance is issued (or old agreements that are materially modified or extended, except under a renewal option, after that date). We also suggest a 90-day delay between the date of publication and the effective date so that healthcare providers with outstanding or proposed tax-exempt bonds have time to digest the rules and won't have to apply them to agreements that have already been negotiated but not yet signed. We also believe flexibility should be provided by allowing healthcare providers with outstanding tax-exempt bonds the option to apply the new rules retroactively to older agreements. The following is our suggested language:

"_. Effective Date

This [revenue procedure] is effective for any agreement entered into, materially modified, or extended (other than pursuant to a renewal option) on or after [DATE THAT IS 90 DAYS AFTER DATE OF PUBLICATION]. In addition, healthcare providers with outstanding tax-exempt bond may apply this revenue procedure to any agreement entered into prior to [DATE THAT IS 90 DAYS AFTER DATE OF PUBLICATION]."

Conclusion

The need to improve the quality and cost-effectiveness of health care delivery requires hospitals and medical foundations to integrate among themselves and with other providers by sharing financial risk through incentives, encouraging the streamlining of management services. Regulatory barriers such as the private use rules related to tax-exempt bond financing constrain the pace of innovation and increase the cost of care. Your efforts to update those rules are vital to the success of the payment and quality reforms of the ACA. Our recommendations aim to ensure that quality incentives would not give rise to private use, and that any new guidance allows healthcare providers with outstanding tax-exempt bonds the option to apply the new rules retroactively to older agreements.

Sincerely,

Melinda Reid Hatton
Senior Vice President and General
Counsel
American Hospital Association
Washington, DC

Cc:
Daniel Foster
Health Counsel, Office of Representative Jim McDermott

IRS LTR: Healthcare Organization's Exemption Not Jeopardized by Agreement.

The IRS ruled that an agreement between the parent of a nonprofit healthcare system and a nonprofit hospital plan corporation under which the parent and its affiliates will receive funds for hospital construction projects will not jeopardize the parent's tax-exempt status or its supporting organization classification.

Citations: LTR 201424025

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *

Uniform Issue list: 501.03-00, 509.03-00, 511.00-00
Release Date: 6/13/2014
Date: March 18, 2014

Employer Identification Number:* * *

LEGEND:

Plan = * * *
Hospital = * * *
x = * * *
Year 1 = * * *
Year 2 = * * *
Year 3 = * * *

Dear * * *:

This responds to your letter of February 24, 2009, in which you request rulings on the application of the federal tax laws to the transactions described below.

You are exempt from federal income taxation under § 501(a) of the Internal Revenue Code as an organization described in § 501 (c)(3). For foundation classification purposes, you are a supporting organization within the meaning of § 509(a)(3). Your mission is to promote health by acting as the parent of a nonprofit health care system and by raising funds and otherwise supporting the health care system.

You are the sole member of various health care corporations that are exempt from federal income taxation under § 501(a) as an organization described in § 501(c)(3) (the "Affiliates"), including two acute care hospitals, a specialty hospital that operates a Medicare-certified psychiatric hospital that provides outpatient services, a corporation that provides outpatient and inpatient physician services through employed physicians, a fundraising foundation, and a corporation that operates a radiation therapy center. None of these Affiliates is a private foundation within the meaning of § 509 of the Code.

Plan is a nonprofit hospital plan corporation that provides fully insured products and administers employer-funded health care plans to residents in the region of the state in which you operate. Plan represents the largest nongovernmental payer for patient services provided by your Affiliates.

Your Affiliates maintain a self-funded health insurance plan for their employees and covered dependents. Each Affiliate contributes funds to the self-funded health insurance plan on a monthly basis to cover health care claims and related fees and expenses, including third party administrator (TPA) services.

Plan provides the TPA services for this self-funded health insurance plan. Plan began providing these TPA services pursuant to a 5-year agreement with you effective in July of Year 2. You selected Plan to be TPA after putting out a bid for these services and determining that Plan offered the best overall proposal in terms of pricing, capabilities and services among the bidders.

You have undertaken an approximately $62.5x capital improvement project (the "Project") that will involve critically needed health care facilities and equipment improvements, expansions, and updates for the Affiliates. At one Affiliate hospital, the Project will result in a newly remodeled hospital campus with * * * square feet of new hospital space (including new space for emergency services, imaging services, and surgical services), a new acute-care bed patient tower enabling the transition of all multi-patient rooms to single occupancy, and a new hospital entrance. At another Affiliate hospital, the Project will result in the expansion of medical oncology services, the expansion and renovation of the radiation therapy area (including the installation of state-of-the-art stereotactic technology), and other upgrades throughout the facility. At a third Affiliate hospital, the Project will include the remodeling of inpatient rooms and a new addition to the main entrance to the long-term care center to provide a family visitation center. You state that the Project is needed to improve health care for patients, enhance delivery and service capabilities, enhance patient safety, increase patient privacy, increase staff effectiveness, health, and safety through a better workplace, and improve building operating efficiencies.

In Year 1, Plan and the state Insurance Department entered into an agreement requiring Plan to make a specified annual financial commitment to providing health insurance through state approved programs for persons of low income and other community benefit activities approved by the Insurance Department. This agreement resulted in Plan seeking ways to reinvest its surplus funds in community health projects. In that context, Plan offered you financial assistance for the Project. This financial assistance was provided pursuant to an agreement (the "Agreement") between you and Plan (the "Parties").

Under the Agreement, which was effective in January of Year 3 ("Effective Date"), Plan agreed to make available to you and your Affiliates a total amount of $6x. (the "Funding"). Pursuant to the Agreement, Plan paid your Affiliate, Hospital, the total amount of the Funding over a one year period to cover the costs and expenses associated with construction of Hospital's new acute-care bed patient tower and remodeling of Hospital's campus with * * * square feet of new hospital space including new space for emergency services, imaging services, and surgical services. The Funding was also used in the development/construction of a new Energy Service Center and a new hospital entrance. The Funding was contributed to, and booked by, Hospital, not you.

Under the Agreement, the Funding is conditioned on you and your Affiliates meeting the following seven obligations. First, during the first three years of the Agreement's five-year term (the "Term"), you and your Affiliates that has employees with health coverage agreed to continue to use Plan as the exclusive TPA for their self-funded health insurance plan, provided the terms and conditions offered by Plan were commercially reasonable. The Agreement allows you to hire an independent actuary mutually agreeable to the Parties to analyze and validate the reasonableness of the rates offered by Plan. If the independent actuary determines that Plan's rates are not reasonable, Plan is required to either adjust its rates in accordance with the evaluation of the independent actuary, or elect not to accept the rates of the independent actuary and permit you and your Affiliates not to use Plan as their administrative services provider without you being in default under the Agreement.

Although the Agreement required you and your Affiliates to use Plan as your TPA for the first three years of the Term, you and your Affiliates were already obligated to use Plan to perform this function for the first half of this three-year period under the five-year agreement that had been effective since July of Year 2. When the five-year term of the agreement effective July of Year 2 expired, you negotiated a one-year and then a three-year extension of the contract on an arm's length basis. These negotiations and renewal processes were conducted without regard to, and independent of, the Agreement, which had been consummated and completed by the time the negotiations took place. You state that the extensions provided for fair and reasonable administrative fees that remained within the reasonable range of administrative fees by reference to the bids you had previously received for these administrative services. More generally, you represent that all the fees paid to Plan for administrative and related services have been, and continue to be, commercially reasonable, developed through arm's length negotiations, for fair market value, and comparable to (or below) what similarly-situated entities would be paid for equivalent services.

Second, you agreed to enter into mutually-agreed extensions to the current terms, or to establish mutually-agreed new terms, of certain provider agreements between Plan and your Affiliates (the "System Provider Agreements"). Under the Agreement, the specified System Provider Agreements will have their current terms extended or have agreed new terms for a period at least equal to the Agreement's Term and continuing through the natural expiration of any relevant provider agreement that has a natural expiration longer than Term. You represent that the mutually-agreed-upon new terms of the System Provider Agreements with Plan were commercially reasonable, developed by the Parties through arm's length negotiations, and provide for fair and reasonable reimbursements for your Affiliates' provision of healthcare services.

Third, you agreed to establish a committee of your Board of Directors (the "Liaison Committee") to meet with a committee established by Plan's Board of Directors up to four times a year during Term. The purpose of such meetings is for the Liaison Committee to provide the Plan's committee with information on the use of the Funding and information on current and future plans and programs that affect Plan members. The meetings are for discussion purposes only and do not involve in any way a delegation of authority by you to Plan.

Fourth, you agreed to provide a "Change of Control Notice" to Plan in the event you receive an offer for a Change of Control Transaction1 for yourself or certain enumerated Affiliates during the Term and granted Plan the right to either (i) notify you of its approval of your entering into the Change of Control Transaction on the condition that the party that offered the transaction assume all of your obligations under the Agreement, or (ii) notify you of its disapproval of your entering into the Transaction. Proceeding with the Change of Control Transaction after notice of Plan's disapproval would constitute a default under the Agreement.

Fifth, you agreed to adopt and provide to Plan certain performance metrics, including financial and clinical milestones. The performance metrics, which are to be developed by you in your complete discretion, were required to be provided to Plan on or before Effective Date and are reviewed and updated by your Board of Directors at least annually during the Term. In the event that you fail to materially meet your annual performance metrics during the Term, the Agreement provides that you will develop and share with Plan action plans that allow you to achieve the performance metrics. In the event that you fail to meet performance metrics for two consecutive years during the Term, Plan may require you to hire an independent consultant to recommend ways for you to achieve minimum performance metrics. Your refusal to either hire an independent consultant after being directed to do so by Plan, or to timely prepare and submit performance metrics and updates to Plan, would be a default under the Agreement. You state that you developed and adopted these performance metrics, and reported them to Plan, primarily to demonstrate that the Funding provided under the

Agreement was being used to further your § 501(c)(3) charitable purposes, specifically addressing your goals of providing high quality healthcare services and improving clinical performance, all in a financially viable manner.

Sixth, you agreed to cooperate with a new medical college described under § 501(c)(3) to develop and implement mutually-agreed-upon student rotations, residency, and/or teaching programs at you and your Affiliates. You have no obligation under the agreement to provide any financial assistance to the medical college. You state that you view the medical college as an integral partner in carrying out your tax-exempt healthcare mission, principally with respect to alleviating the increasingly severe shortage of physicians in some of the areas you serve. You believe that having physician instructors and the medical college's students on site will have an overall positive impact on the medical staff of your hospitals as well as on the care they provide. You also believe that, by introducing medical students to clinical practice in your service area, this cooperation will continue to provide you with an enhanced ability to recruit and retain well trained and highly-qualified physicians and allow you to carry out your § 501(c)(3) healthcare mission.

Seventh, within twelve months of Effective Date, you and Plan agreed to identify and initiate specific mutually-agreed-upon projects, including regional information technology projects and clinical quality improvement projects. You state that your only obligation under the Agreement was to seek mutually-agreed-upon opportunities in good faith and that there was no affirmative obligation for you to agree to or fund any specific project. You engaged in discussions and planning with Plan to develop a health information exchange (which you say would have been important to improving your delivery of healthcare). but you and Plan never implemented that exchange because a similar health information exchange became operational first. You did not identify or initiate any other projects within 12 months of the Effective Date and have not identified or initiated any other projects since. You state that the failure to identify and initiate a mutually-agreed-upon project was a not a default under the Agreement because any obligation to pursue a project was contingent on mutual agreement being reached. You state. further. that you would not have agreed to initiate any project that was not in furtherance of or substantially related to your exempt purposes.

A failure to fulfill any of these seven obligations during the Term would result in a default. meaning that you would need to repay an amount up to the amount of Funding received (without interest). As an alternative to repayment, Plan may seek alternative remedies. including a decree compelling specific performance under the Agreement or orders restraining and enjoining any act that would constitute a breach under the Agreement.

RULINGS REQUESTED

The following rulings have been requested:

1. By entering into the Agreement and fulfilling your obligations thereunder. you will not jeopardize your status as an organization described in § 501(c)(3)
2. By entering into the Agreement and fulfilling your obligations thereunder, you will not jeopardize your classification as a supporting organization described in § 509(a)(3).
3. The Funding you received under the Agreement will not constitute unrelated business taxable income within the meaning of §§ 511-514.

LAW

I.R.C. § 501(a) exempts from federal income taxation organizations described in § 501(c), among others.

I.R.C. § 501(c)(3) describes corporations, trusts, and associations organized and operated exclusively for charitable and other enumerated exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

I.R.C. § 507(d)(2)(A) provides that the term "substantial contributor" means any person who contributed or bequeathed an aggregate amount of more than $5.000 to the organization. if such amount is more than 2 percent of the total contributions and bequests received by the organization before the close of the taxable year of the organization in which the contribution or bequest is received by the organization from such person.

I.R.C. § 509 defines the term "private foundation" as a domestic or foreign organization described in § 501(c)(3) other than an organization described in § 509(a)(1), (2), (3), or (4).

I.R.C. § 509(a)(3) describes an organization which

A. Is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in § 509(a)(1) or (2);
B. Is (i) operated, supervised or controlled in connection with one or more organizations described in § 509(a)(1) or (2); (ii) supervised or controlled in connection with one or more such organizations; or (iii) operated in connection with one or more such organizations, and
C. Is not controlled directly or indirectly by one or more disqualified persons (as defined in § 4946) other than foundation managers and other than one or more organizations described in § 509(a)(1) or (2).

I.R.C. § 511 imposes a tax for each taxable year on the unrelated business taxable income of organizations described in § 501(c).
I.R.C. § 512(a) defines "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions which are directly related to the carrying on of such trade or business, both computed with the modifications provided in § 512(b).

I.R.C. § 513(a) defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable or other purpose or function constituting the basis for its exemption under § 501.

I.R.C. § 4946(a)(1)(A) provides that "disqualified person" includes a person who is a substantial contributor to the organization, as defined in § 507(d)(2).

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 501 (c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in § 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second) of Trusts, §§ 368, 372; IV Scott on Trusts, §§ 368, 372 (3rd ed. 1967); and Revenue Ruling 69-545, 1969-2 C. B. 117.

Treas. Reg. § 1.502-1(b) provides that if a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization.

Treas. Reg. § 1.509(a)-4(j)(1) provides that an organization will be considered "controlled," for purposes of § 509(a)(3)(C), if disqualified persons, by aggregating their votes or positions or authority, may require such organization to perform any act which Significantly affects its operations or may prevent such organization from performing such act.

Treas. Reg. § 1.513-1(a) provides that, unless one of the specific exceptions of § 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by § 511 is includible in the computation of unrelated business taxable income if: (1) It is income from trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Treas. Reg. § 1.513-1(b) provides that, for purposes of § 513, the term trade or business has the same meaning it has in § 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Treas. Reg. § 1.513-1(d)(2) provides that a trade or business is related to exempt purposes, in the relevant sense, only where the conduct of the business activity has a causal relationship to the achievement of exempt purposes (other than through the production of income), and it is substantially related, for purposes of § 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Rev. Rul. 78-41, 1978-1 C.B. 148, concerns a trust created by a § 501(c)(3) tax-exempt hospital for the sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital, and from which the hospital directs the bank-trustee to make payments to claimants. By serving as a repository for funds paid in by the hospital, and by making payments at the direction of the hospital to persons with malpractice claims against the hospital, the trust is operating as an integral part of the hospital. Of equal importance is the fact that the trust is performing a function that the hospital could do directly. Accordingly, the organization is operated exclusively for charitable purposes and, thus, is exempt from federal income tax under § 501(c)(3).

ANALYSIS

Issue 1: Whether by entering into the Agreement and fulfilling your obligations thereunder, you jeopardize your status as an organization described in § 501(c)(3).
You have been recognized as an organization described in § 501(c)(3) because, by serving as the corporate parent of your § 501(c)(3) Affiliates, you perform an essential service for your Affiliates and, therefore, your activities are an integral part of the exempt charitable activities of your Affiliates within the meaning of § 1.502-1(b). Rev. Rul. 78-41. By entering into the Agreement and fulfilling the obligations thereunder, your activities will continue to support your Affiliates and be an integral part of their healthcare activities in furtherance of charitable purposes. Your Affiliate, Hospital, used the Funding received under the Agreement to improve the quality of patient care, expand hospital facilities, and advance medical training, education, and research programs.

As for the obligations under the Agreement, you represent that the extensions of your administrative services contact and System Provider Agreements with Plan were negotiated at arm's length and resulted in reasonable, fair market value compensation. The Agreement specifically stipulates that your use of Plan as the TPA for your Affiliates' self-funded health insurance plan would be on "commercially reasonable" terms and gives you the right to hire an independent actuary to analyze and validate the reasonableness of rates offered by Plan. In the event an actuary were engaged under this provision, either Plan must accept the actuary's rates or you are relieved of the obligation to hire Plan as an administrative services organization without being in default under the Agreement. The Agreement also requires that the extensions of the System Provider Agreements be "mutually agreed" upon by you and Plan, and you represent that the System Provider Agreement terms you negotiated at arm's length and agreed upon ensure your Affiliates fair and reasonable reimbursements for their provision of health care services to patients insured by Plan. Thus, any private benefit to Plan as a result of your agreeing to extend your administrative services contract and the System Provider Agreements is insubstantial and incidental to the essential services you provide in fulfillment of the exempt purposes of your Affiliates.

The Agreement's requirements that you establish a Liaison Committee to provide Plan with information on the use of the Funding and to adopt and report on financial and clinical milestones (that were developed solely at your discretion) appear to be reasonable precautions to ensure that the Funding would be used to further § 501(c)(3) purposes by promoting the health of the community, as do the Agreement's provisions regarding Change of Control Transactions during the Term.

The student rotations, residency, and/or teaching programs you agreed to develop and implement in cooperation with the medical college were to be "mutually agreed upon" and require no financial commitment from you. Moreover, these activities are consistent with your purpose of providing services in fulfillment of the exempt purposes of your Affiliates because they positively impact patient care and help to train and recruit qualified physicians.

Finally, your agreement to identify and initiate a mutually-agreed-upon project within the first 12 months after Effective Date did not require you to identify and initiate any project that you did not agree to and you have represented that you would not agree to any project that did not further your exempt purposes.

Thus, by entering into the Agreement and fulfilling your obligations thereunder, you will not jeopardize your status as an organization described in § 501(c)(3).

Issue 2: Whether by entering into the Agreement and fulfilling your obligations thereunder. you jeopardize your classification as a supporting organization described in § 509(a)(3).

For purposes of private foundation classification, you are classified as a supporting organization

described in § 509(a)(3) because you are organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of your Affiliates, which are classified as organizations described in § 509(a)(1).

You will not cease to be organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of your Affiliates as a result of entering into the. Agreement and fulfilling the obligations thereunder. The Agreement also will not affect whether you are operated, supervised or controlled by or in connection with your Affiliates.

To be described in § 509(a)(3), you also must not be controlled directly or indirectly by one or more disqualified persons. You state that all of the Funding was designated for and paid to and for the use of Hospital and that it was Hospital, not you, that booked the Funding on its balance sheet for accounting purposes. You state that, because Plan did not contribute any funds to you under the Agreement, Plan did not become a substantial contributor to you and thus is not a disqualified person.

However, even if Plan were considered a "substantial contributor" and thus a disqualified person with respect to you, the Agreement did not result in you or your Affiliates being controlled directly or indirectly by Plan within the meaning of § 509(a)(3)(C). Taken together, your obligations under the Agreement do not give Plan the ability to require you or your Affiliates to perform any act which significantly affects your or your Affiliates' operations or to prevent you or your Affiliates from performing such act. While the provisions related to Change of Control Transactions could affect your operations, they do not give Plan the power to prevent you from entering into such transactions. Rather, even if Plan objects to a Change in Control Transaction, you can proceed with the transaction as long as you repay certain amounts of the Funding that Plan paid to you.

Consequently, by entering into the Agreement and fulfilling your obligations thereunder, you will not jeopardize your classification as a supporting organization described in § 509(a)(3).

Issue 3: Whether the Funding you received under the Agreement constitutes unrelated business taxable income within the meaning of §§ 511-514.

You state that the Funding was contributed to and booked by Hospital, not you. Thus, you did not receive any income which could be unrelated business taxable income with respect to you. However, even if the Funding had been contributed to you, your obligations under the Agreement either do not constitute a trade or business within the meaning of § 1.513-1(b) or are substantially related to your exempt purposes within the meaning of § 1.513-1(d)(2). To the extent a portion of the Funding constitutes a payment to extend your contract with Plan to provide TPA services for your Affiliates' self-funded health insurance plan for the first three years of the Term, such payment would only serve as a reduction to the price you pay in exchange for Plan's services; it would not constitute your performance of services (or sale of goods) in exchange for income.

The obligation to enter into mutually-agreed-upon extensions of the System Provider Agreements relates to your negotiation of the compensation your Affiliates receive in exchange for their provision of the health care services constituting the basis of their exemption under § 501(c)(3) and, hence, is substantially related to your exempt purposes. Your agreement to cooperate with a medical college to develop and implement mutually agreed-upon student rotations, residency, or teaching programs is also substantially related to your exempt purpose.

The obligations to inform Plan, via the Liaison Committee, on the use of the Funding and to adopt and report on certain clinical and financial performance metrics appear to be reasonable precautions to ensure that the Funding would be used to further § 501(c)(3) purposes by promoting

the health of the community, as do the Agreement's provisions regarding Change of Control Transactions during the Term.

Finally, the obligation to identify and initiate a project was contingent on your reaching a mutual agreement with Plan on a project, and you represent you would not have agreed to any project that was not substantially related to your exempt purpose.

Thus, the Funding you received under the Agreement will not constitute unrelated business taxable income within the meaning of §§ 511-514.

RULINGS

Based on the information submitted, we rule as follows:

1. By entering into the Agreement and fulfilling your obligations thereunder, you will not jeopardize your status as an organization described in § 501(c)(3).
2. By entering into the Agreement and fulfilling your obligations thereunder, you will not jeopardize your classification as a supporting organization described in § 509(a)(3).
3. The Funding you received under the Agreement will not constitute unrelated business taxable income within the meaning of §§ 511-514.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.
This ruling is directed only to the organization that requested it. I.R.C. § 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolved questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager, EO Technical
Enclosure
Notice 437

FOOTNOTE

1 The Agreement defines a "Change of Control Transaction" as any sale or other disposition of all or substantially all of the assets, or any merger, consolidation, or other similar transaction that results in any individual or entity other than you or your Board having the authority to appoint or elect a

majority of the board of directors or similar managing body of yours or any of your Affiliates. However, a Change of Control Transaction does not include any transaction with a tax-exempt, locally controlled provider (as defined in the Agreement) that is not in the insurance business.

END OF FOOTNOTE

'On Behalf of' Issuers May Issue Tribal Economic Development Bonds

In generic legal advice, the IRS concluded that an Indian tribal government that receives an allocation of volume cap to issue tribal economic development bonds may designate an “on behalf of issuer” to issue the bonds.
An Indian tribal government is treated as a state for purposes of section 103. Section 7871(f)(2) provides in part that, for a tribal economic development bond, the bond shall be treated as if it were issued by a state, and the Indian tribal government issuing the bond and any instrumentality of the tribal government shall be treated as a state for purposes of section 141. Section 7871(f)(3)(A) defines a tribal economic development bond as any bond issued by an Indian tribal government, the interest on which would be exempt from tax under section 103 if issued by a state or local government.

A tribal government that receives an allocation of volume cap to issue tribal economic development bonds may designate an “on behalf of issuer,” within the rules applicable to bonds issued under section 103, that is formed under the laws of that tribal government to issue those bonds. The proceeds of any bonds issued in this manner will be treated as if they were proceeds of bonds issued by the Indian tribal government that received the allocation.

UILC: 103.02-02, 7871.00-00
Release Date: 6/13/2014
Date: June 9, 2014

CC:FIP:05:SWHanemann – POSTN-143922-13

to:
Director, Tax-Exempt Bonds

from:
Associate Chief Counsel
(Financial Institutions & Products)

subject:
On-Behalf-Of Issuers of Tribal Economic Development Bonds

This advice may not be used or cited as precedent.

ISSUE

Can an Indian tribal government that receives an allocation of volume cap to issue tribal economic development bonds designate an “on behalf of issuer” to issue those bonds?

LAW AND ANALYSIS

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any State or local bond. Section 103(b) provides in part that § 103(a) shall not apply to any private activity bond which is not a qualified bond. Section 103(c)(1) defines the term "State or local bond" as an obligation of a State or political subdivision thereof. Section 103(c)(2) defines the term State to include the District of Columbia and any possession of the United States. Section 1.103-1(b) of the Income Tax Regulations provides in part that obligations issued by or on behalf of any State or local governmental unit by constituted authorities empowered to issue such obligations are the obligations of such a unit.
Section 7871(a)(4) provides that, subject to § 7871(c), an Indian tribal government shall be treated as a State for purposes of § 103. Section 7871(c)(1) provides that § 103(a) shall apply to any obligation issued by an Indian tribal government (or subdivision thereof) only if such obligation is part of an issue substantially all of the proceeds of which are to be used in the exercise of any essential governmental function. Section 7871(c)(2) generally provides that, with very limited exception, § 103(a) shall not apply to any private activity bond (as defined in section 141(a)) issued by an Indian tribal government (or subdivision thereof).

Section 7871(f)(2) provides in part that, in the case of a tribal economic development bond, notwithstanding § 7871(c), such bond shall be treated for purposes of the Code in the same manner as if such bond were issued by a State, and the Indian tribal government issuing such bond and any instrumentality of such Indian tribal government shall be treated as a State for purposes of section 141. Section 7871(f)(3)(A) defines a "tribal economic development bond" in relevant part as any bond issued by an Indian tribal government, the interest on which would be exempt from tax under section 103 if issued by a State or local government.

An Indian tribal government that receives an allocation of volume cap to issue tribal economic development bonds may designate an "on behalf of issuer", within the rules applicable to bonds issued under § 103, that is formed under the laws of that tribal government to issue those bonds. The proceeds of any bonds issued by such an "on behalf of" issuer will be treated as if they were proceeds of bonds issued by the Indian tribal government that received the allocation. See Notice 2009-51, 2009-28 I.R.B. 128.

Please call (202) 317-6980 if you have any further questions.

Helen M. Hubbard
Associate Chief Counsel
(Financial Institutions and
Products)

Citations: AM 2014-005

IRS LTR: Advance Refunding Bonds Won't Become Transferred Proceeds.

The IRS ruled that none of the unspent proceeds or allocable investments of the advance refunding bonds of a utility system owner will become transferred proceeds or investments of the proposed tax-exempt current refunding bonds.

Citations: LTR 201424002

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: * * *, ID No. * * *
Telephone Number: * * *

Index Number: 148.00-00
Release Date: 6/13/2014
Date: February 25, 2014

Refer Reply To: CC:FIP:BRANCH 5 – PLR-116921-13

LEGEND:

Issuer = * * *
Advance Refunding Bonds = * * *
Proposed Tax-Exempt Current Refunding Bonds = * * *
Date 1 = * * *
a = * * *
b = * * *
c = * * *

Dear * * *:

This is in response to your request for a ruling that none of the proceeds of the Advance Refunding Bonds in the defeasance escrow described below will become transferred proceeds, under § 1.148-9(b) of the Income Tax Regulations, of the proposed tax-exempt bonds, the proceeds of which are to be used to currently refund a specified portion of the Advance Refunding Bonds.

FACTS AND REPRESENTATIONS

Issuer makes the following factual representations. Issuer owns, operates, and maintains a combined water and sewer utility system (the Utility System). Issuer financed the construction and improvement of the Utility System with a number of issues of bonds As part of an effort to obtain relief from certain requirements relating to the use of the Utility System revenues, Issuer issued the Advance Refunding Bonds, on Date 1, to defease a issues of revenue bonds (the Prior Issues). Certain of the Advance Refunding Bonds were issued as non-callable bonds. The proceeds of the Advance Refunding Bonds and the proceeds of a bona fide debt service fund allocable to the outstanding Prior Issues were deposited in a defeasance escrow fund (the Escrow) and used to purchase investments to repay the Prior Issues.
Issuer has fully redeemed b of the a Prior Issues (the Discharged Prior Issues) using a portion of the Escrow. Issuer expects to use the unspent proceeds of the Advance Refunding Bonds in the Escrow (the Unspent Proceeds) to pay the debt service on the outstanding bonds of the remaining c Prior Issues (the Outstanding Prior Issues).

Prior to the issuance of the proposed bonds (described below), Issuer proposes to use the multipurpose allocation rules of § 1.148-9(h) to allocate the bonds, proceeds, and investments of the Advance Refunding Bonds into a separate issues, the purpose of each of which is to refund one of the Prior Issues. Issuer represents it will allocate the bonds of the Advance Refunding Bonds ratably to those separate issues and allocate the sales proceeds based on the present value of the refunded debt service on the Prior Issues in accordance with §§ 1.148-9(h)(4)(i) and (ii). It will allocate the investments in the Escrow purchased with proceeds of the Advance Refunding Bonds, based on the maturities and amounts of the investments, to the separate issues in accordance with the debt service payments of the Prior Issues that the respective investments are expected to pay.

Issuer intends to issue bonds to refund the callable portion of the Advance Refunding Bonds. Issuer proposes to issue the Proposed Tax-Exempt Current Refunding Bonds to currently refund the callable Advance Refunding Bonds it will have allocated to the separate issues the purposes of which are to refund the respective Discharged Prior Issues and issue taxable bonds (the Proposed Taxable Bonds) to refund the callable Advance Refunding Bonds it will have allocated to the separate issues the purposes of which are to refund the respective Outstanding Prior Issues.

LAW AND ANALYSIS

Section 148(a) of the Internal Revenue Code (Code) provides that, for purposes of § 103, the term "arbitrage bond" means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly to acquire higher yielding investments, or to replace funds which were used directly or indirectly to acquire higher yielding investments. For purposes of § 148(a), a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described above.

Section 1.148-0(b) provides that §§ 1.148-1 through 1.148-11 apply generally for purposes of the arbitrage restrictions on State and local bonds under § 148.

Section 1.148-9(b) provides that when proceeds of the refunding issue discharge any of the outstanding principal amount of the prior issue, proceeds of the prior issue become transferred proceeds of the refunding issue and cease to be proceeds of the prior issue. The amount of proceeds of the prior issue that becomes transferred proceeds of the refunding issue is an amount equal to the proceeds of the prior issue on the date of that discharge multiplied by a fraction the numerator of which is the principal amount of the prior issue discharged with proceeds of the refunding issue on the date of that discharge and the denominator of which is the total outstanding principal amount of the prior issue on the date immediately before the date of the discharge. Principal amount means, in reference to a plain par bond, its stated principal amount, and in reference to any other bond, its present value.

Section 1.148-9(c)(1)(ii) provides that, when proceeds of a prior issue become transferred proceeds of a refunding issue, investments (and the related payments and receipts) of proceeds of the prior issue that are held in a refunding escrow for another issue are allocated to the transferred proceeds under the ratable allocation method described in § 1.148-9(c)(1)(iii). Section 1.148-9(c)(1)(iii) provides that, under the ratable allocation method, a ratable portion of each nonpurpose and purpose investment of proceeds of the prior issue is allocated to transferred proceeds of the refunding issue.

Section 1.148-9(h)(1) provides that the portion of the bonds of a multipurpose issue reasonably allocated to any separate purpose under § 1.148-9(h) is treated as a separate issue for all purposes of § 148, except for certain arbitrage purposes listed therein. Such exceptions include determining the yield on a multipurpose issue and the yield on investments for purposes of the arbitrage yield restrictions of § 148 and the arbitrage rebate requirements of § 148(f).

Section 1.148-1(b) defines a multipurpose issue as an issue the proceeds of which are used for two or more separate purposes determined in accordance with § 1.148-9(h). Section 1.148-9(h)(3)(i) provides, in part, that separate purposes of a multipurpose issue include refunding a separate prior issue, financing a separate purpose investment, financing a construction issue (as defined in § 1.148-7(f)) and any clearly discrete governmental purpose reasonably expected to be financed by the issue.

Section 1.148-9(h)(2)(i) provides that § 1.148-9(h) applies to allocations of multipurpose issues,

including allocations involving the refunding purposes of the issue. Except as otherwise provided in § 1.148-9(h), proceeds, investments, and bonds of a multipurpose issue may be allocated among the various separate purposes of the issue using any reasonable, consistently applied allocation method. An allocation is not reasonable if it achieves more favorable results under sections 148 or 149(d) than could be achieved with actual separate issues. Allocations under § 1.148-9(h) may be made at any time, but once made may not be changed.

Section 1.148-9(h)(4)(i) provides that after reasonable adjustment of the issue price to account for common costs, the portion of the bonds of a multipurpose issue allocated to a separate purpose must have an issue price that bears the same ratio to the aggregate issue price of the multipurpose issue as the portion of the sale proceeds of the multipurpose issue used for that separate purpose bears to the aggregate sale proceeds of the multipurpose issue. For a refunding issue used to refund two or more prior issues, the portion of the sales proceeds allocated to the refunding of a separate prior issue is based on the present value of the refunded debt service on that prior issue, using the yield on investments in the refunding escrow allocable to the entire refunding issue as the discount rate.

Section 1.148-9(h)(4)(ii) provides that the use of the relative amount of sales proceeds used for each separate purpose to ratably allocate each bond or a ratable number of substantially identical whole bonds is a reasonable method for allocating bonds of a multipurpose issue.

Section 1.148-9(h)(4)(v) provides, in part, that for each portion of a multipurpose issue that is used to refund a separate prior issue, a method of allocating bonds of that issue is reasonable under § 1.148-9(h) if, in addition to the requirements of §§ 1.148-9(h)(1) and (2), the portion of the bonds allocated to the refunding of that prior issue results from a pro rata allocation under § 1.148-9(h)(4)(ii).

Section 1.148-9(i)(1) provides that, for purposes of § 1.148-9(h)(3)(i), the separate purposes of a prior issue include the refunded and unrefunded portions of the prior issue. Thus, the refunded and unrefunded portions are treated as separate issues under § 1.148-9(h)(1). Those separate issues must satisfy the requirements of §§ 1.148-9(h) and (i). The refunded portion of the bonds of a prior issue is based on the fraction the numerator of which is the principal amount of the prior issue to be paid with the proceeds of the refunding issue and the denominator of which is the outstanding principal amount of the bonds of the prior issue, each determined as of the issue date of the refunding issue.

Section 1.148-9(i)(2) provides that, as of the issue date of a partial refunding issue under § 1.148-9(i), unspent proceeds of the prior issue are allocated ratably between the refunded and unrefunded portions of the prior issue and the investments allocable to those unspent proceeds are allocated in the manner required for the allocation of investments to transferred proceeds under § 1.148-9(c)(1)(ii).

Section 1.148-9(i)(3) provides that if the refunded and unrefunded portions of a prior issue are treated as separate issues under § 1.148-9(i), then, except to the extent that the context clearly requires otherwise (e.g., references to the aggregate prior issue in the mixed escrow rule in § 1.148-9(c)(2)), all references in § 1.148-9 to prior issue refer only the refunded portion of that prior issue.

When proceeds of a refunding issue discharge any of the outstanding principal of a prior issue, unspent proceeds of the prior issue become transferred proceeds of the refunding issue and investments allocated to unspent proceeds of the prior issue are allocated to those transferred proceeds. For none of the Unspent Proceeds (and allocable investments) in the Escrow to become transferred proceeds (and investments) of the Proposed Tax-Exempt Current Refunding Bonds, the Unspent Proceeds (and investments) must have been allocated to an issue other than one to be

refunded by the Proposed Tax-Exempt Current Refunding Bonds. To achieve this result, Issuer proposes to apply the multipurpose issue allocation rules to separate the Advance Refunding Bonds into separate issues. This requires, first, that the Advance Refunding Bonds be a multipurpose issue, that is, an issue the proceeds of which are used for two or more separate purposes under 1.148-9(h). Under § 1.148-9(h)(3)(i), separate purposes of a multipurpose issue include refunding of a separate prior issue. The Advance Refunding Bonds refunded a separate prior issues, i.e., the Prior Issues. Accordingly, the Advance Refunding Bonds issue is a multipurpose issue.

Second, the Issuer must allocate the bonds, proceeds, and investments of the Advance Refunding Bonds among the separate purposes using a reasonable, consistently applied method. Issuer represents that it will allocate the bonds and sale proceeds of the Advance Refunding Bonds among the separate purposes of refunding the respective Prior Issues in accordance with §§ 1.148-9(h)(4)(i) and (ii). As stated in these provisions and § 1.148-9(h)(4)(v) applicable to refunding bonds, these allocations are reasonable. Further, Issuer will apply these methods consistently to all the bonds and sale proceeds. Because the present value of the debt service on the Discharged Prior Issues is zero as of the date of the multipurpose allocation, no Unspent Proceeds will be allocated to the b separate issues of the Advance Refunding Bonds the purposes of which are to refund the respective Discharged Prior Issues.

Issuer will allocate the investments of the Advance Refunding Bonds among the separate purposes according to the debt service payments of the Prior Issues that the respective investments are expected to pay. Issuer expects to use all of the investments remaining in the Escrow to pay debt service on the c Outstanding Prior Issues, and thus Issuer will allocate all of the investments among the c separate issues the purposes of which are to refund the respective Outstanding Prior Issues. All investments allocable to the debt service of the b Discharged Prior Issues have been liquidated and the proceeds spent to fully repay the Discharged Prior Issues. This allocation of investments does not achieve more favorable results under § 148 or § 149(d) than could be achieved with actual separate issues to refund the respective Prior Issues. Thus, we conclude that Issuer's method of allocating the investments to the separate purposes is a reasonable, consistently applied method.

Because Issuer's methods of allocating the bonds, proceeds, and investments of the Advance Refunding Bonds among the separate purposes of that issue are reasonable, consistently applied methods, the bonds allocated to the refunding of each of the Prior Issues may be treated as separate issues under § 1.148-9(h). As a result, all of the Unspent Proceeds and allocable investments in the Escrow will be allocated among the separate issues of the Advance Refunding Bonds the respective purposes of which are to refund one of the Outstanding Prior Issues, and no Unspent Proceeds or investments will be allocated among the separate issues of the Advance Refunding Bonds the respective purposes of which are to refund one of the Discharged Prior Issues.

Finally, the Proposed Tax-Exempt Current Refunding Bonds and the Proposed Taxable Bonds will not refund the non-callable bonds of the Advance Refunding Bonds. In allocating all of the Advance Refunding Bonds ratably among the a separate purposes, Issuer will allocate the non-callable bonds ratably among those purposes. Thus, each of the a separate issues will include non-callable bonds that will not be refunded.

Pursuant to § 1.148-9(i), the refunded and unrefunded portions of a prior issue are separate purposes of the prior issue and treated as separate issues. Further, unspent proceeds of the prior issue and allocable investments held in a refunding escrow are to be allocated ratably between the refunded and unrefunded portions. Accordingly, each of the separate issues within the Advance Refunding Bonds will be further divided into its refunded and unrefunded portions. Thus, the Unspent Proceeds and allocable investments to be allocated to each of the separate issues the purpose of which is to refund one of the Outstanding Prior Issues will be further allocated ratably

between the refunded and unrefunded portions of each of those separate issues of the Advance Refunding Bonds. Because no Unspent Proceeds or investments will be allocated to the separate issues of the Advance Refunding Bonds the respective purposes of which are to refund one of the Discharged Prior Issues, no Unspent Proceeds or investments will be allocated to the refunded or unrefunded portions of those separate issues.

Accordingly, when proceeds of the Proposed Tax-Exempt Current Refunding Bonds refund portions of those separate issues of the Advance Refunding Bonds, no Unspent Proceeds or investments of the Advance Refunding Bonds will become transferred proceeds of the Proposed Tax-Exempt Current Refunding Bonds.

CONCLUSION

Accordingly, we conclude that, under the facts and circumstances described above, none of the Unspent Proceeds or allocable investments of the Advance Refunding Bonds will become transferred proceeds or investments of the Proposed Tax-Exempt Current Refunding Bonds under § 1.148-9(b).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any return to which it is relevant.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Associate Chief Counsel
(Financial Institutions & Products)

By: Johanna Som de Cerff
Senior Technician Reviewer
Branch 5

IRS Eliminates Circular 230 Covered Opinion Rules in Final Regs.

The Internal Revenue Service (IRS) has issued final “Circular 230” regulations governing the standards for written advice by practitioners. The final regulations eliminate some of the requirements regarding tax opinions classified as “covered opinions” by modifying the standards governing written advice. The IRS received comments that overwhelmingly recommended that these provisions be eliminated.

The new regulations replace the old Covered Opinion rules in Circular 230 requiring attorneys to include disclaimers on emails and letters that advice given couldn't be relied upon to avoid penalties. Under Section 10.37, practitioners are required to base all written advice on "reasonable factual and legal assumptions, exercise reasonable reliance, and consider all relevant facts that the practitioner knows or reasonably should know." Also under Section 10.37 is the addition of a definition for certain things that do not constitute written advice. The rules now state that "government submissions on matters of general policy are not considered written tax advice on a Federal tax matter…."

The final regulations were released on Monday, and took effect on Thursday, June 12, 2014, and can be seen here.

The Tax Exemption Under Section 501(c)(4).

This brief discusses the justification for income tax exemption for organizations qualifying under section 501(c)(4). It explores why these organizations are deemed unworthy of the charitable contribution deduction but nevertheless entitled to be exempt on their entire income. It notes that income tax exemption generally only benefits entities that accumulate funds, suggesting accumulation is desirable. It further points out that the subsidy from income tax exemption for long-term accumulation can exceed the benefit of the charitable deduction. The brief concludes that income tax exemption under section 501(c)(4) cannot be justified either on the grounds that it is relatively unimportant or by analogy to the treatment of mutual organizations, whose exemption has been circumscribed.

Dan Halperin

Read complete document: PDF

FASB Hears Mixed Feedback on Nonprofit Expense Reporting.

The Financial Accounting Standards Board on June 10 heard feedback on proposed nonprofit reporting requirements that some members of the nonprofit sector thought were burdensome while others believed them to be aligned with the existing transparency required from those organizations.

During a teleconference meeting with FASB's Not-for-Profit Advisory Committee (NAC), Jeffrey Mechanick, an assistant director at FASB, said that if the board completes deliberations on the nonprofit reporting project the week of June 16, the staff can begin to prepare an exposure draft of the proposed requirements that could be issued in October.

According to Mechanick, the exposure draft will likely be subject to a public comment period of at least four months to provide stakeholders adequate time to weigh in on the proposed rule changes. The rulemaking proposal also will illustrate how various types of nonprofit organizations should present the newly required financial disclosures, he said.

On May 14 FASB tentatively decided that a nonprofit organization should disclose the costs of investment activities it performs itself as well as those conducted on its behalf by a third party to generate investment income. According to the board, the required disclosure would include all

expenses that are direct and contracted to the nonprofit organization. (Prior coverage 2014 TNT 94-9: News Stories.)

Mechanick said the American Institute of Certified Public Accountants Not-for-Profit Expert Panel had suggested that FASB consider those disclosure requirements for investment expenses.

NAC member Clara Miller of the F.B. Heron Foundation supported the proposed disclosure requirements for nonprofit organizations, saying that those entities have a public duty of care that involves being transparent about the cost of their operations. Because investment activities are becoming a core business for many nonprofit institutions, the related expenses should be disclosed like every other business expense, she added.

Most nonprofit institutions should have the required management capacity and funding to provide the disclosure on investment expense, said Miller, adding that the presentation of investment expense is required for tax compliance.

NAC member Norman C. Mosrie of Dixon Hughes Goodman expressed concern that the proposed disclosure requirements would be burdensome for larger nonprofit institutions that maintain hundreds of different types of investments and mutual funds.

Mosrie also questioned how useful the reported expense information would be to a potential donor or lender to a nonprofit organization, adding that those parties would likely be more concerned with the information about the total investment return.

NAC member Stephen Golding of the University of Pennsylvania was concerned about the timeline for the proposed nonprofit requirements for financial reporting that could be issued in the second half of the year. He suggested that the board instead gather more feedback on the possible changes associated with investment expense disclosure and cash flow presentation before a formal proposal is issued.

“I do feel like in a way we are the guinea pigs here” with some of the proposed changes, in advance of similar potential rule changes for the for-profit sector, Golding said.

FASB member Lawrence Smith said that proposed presentation and disclosure requirements represent important communications to users of nonprofit financial statements.

Smith said it is important that FASB move toward an exposure draft of those proposed requirements in order to receive a broad range of stakeholder views that can be considered during re-deliberations. He added that a less formal document may not receive the same attention from the board’s constituency.

Thomas Jaworski

IRS Outlines Guidance on Internal Use Software Research. Activities.

In e-mailed advice, the IRS addressed the current legal standard for the internal use software exception under section 41, outlining the applicable internal use software guidance and recent case law.

Citations: ECC 201423023

UILC: 41.00-00
Release Date: 6/6/2014
ID: CCA_2014052909222361

From: * * *
Sent: Thursday, May 29, 2014 9:22:23 AM
To: * * *
Cc: * * *
Bcc:
Subject: RE: CCA Request — IUS Legal Standard

Hello * * *

This is in response to your request regarding the current legal standard for the internal use software exception under section 41. Presently, the only published internal use software guidance is in the ANPRM, issued on December 31, 2003. The ANPRM provides, in relevant part, that for taxable years beginning after December 31, 1985, and until further guidance is published in the Federal Register, taxpayers may continue to rely upon all provisions of the 2001 proposed regulations, or all provisions of TD 8930 with respect to their internal use software research activities. For example, the ANPRM requires taxpayers relying upon the internal use software rules of TD 8930 to also apply the "discovery" test as set forth in TD 8930. Concurrent with the publication of the ANPRM, the Treasury Department and the IRS finalized the 2001 proposed regulations in the Federal Register as TD 9104 on December 31, 2003. TD 9104 retained the "discovery" test in the same manner as the 2001 proposed regulations but removed the internal use software provisions and marked § 1.41-4(c)(6) as "Reserved." TD 9104 applied to taxable years ending on or after December 31, 2003; however, TD 9104 stated that the IRS would not challenge return positions that are consistent with its rules for taxable years ending before December 31, 2003.

Since publication of the ANPRM, its enforceability was questioned by the court in FedEx Corporation v. United States of America, 108 AFTR 2d 2011-5669 (W.D.Tenn Mar 28, 2011), denying reconsideration of 103 AFTR 2d 2009-2722, 2009-1 USTC ¶ 50,435 (W.D.Tenn 2009). The court questioned the authority to require taxpayers to comply with the ANPRM that may partly conflict with TD 9104 and allowed the taxpayer to apply the internal use software rules of TD 8930 while applying the general eligibility rules under TD 9104. Please note, however, that the taxable years at issue in FedEx were prior to the issuance of the ANPRM.

TD 9104 clearly states that the IRS would not challenge return positions that are consistent with its rules for prior years; therefore, it is inappropriate for the IRS to challenge taxpayers who apply the general eligibility provisions of TD 9104. Since the ANPRM is the only internal use software guidance available, taxpayers may continue to follow the ANPRM in its entirety. However, we should not challenge taxpayers that choose instead to follow only the internal use software provisions of § 1.41-4(c)(6) in either TD 8930 or the 2001 proposed regulations, and follow TD 9104 for the general eligibility rules for qualified research.

I hope this answers your question. Please let me know if you want to discuss further.

Thank you

* * *

H.R. 4757 Would Expand Bond Exceptions for Farmers.

H.R. 4757, introduced by Rep. Tom Latham, R-Iowa, would expand exceptions to private activity bond rules for first-time farmers.

113TH CONGRESS
2D SESSION

H.R. 4757

To amend the Internal Revenue Code of 1986 to expand certain exceptions to the private activity bond rules for first-time farmers, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MAY 29, 2014

Mr. LATHAM introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to expand certain exceptions to the private activity bond rules for first-time farmers, and for other purposes.
Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. EXPANSION OF CERTAIN EXCEPTIONS TO THE PRIVATE ACTIVITY BOND RULES FOR FIRST-TIME FARMERS.

(a) INCREASE IN DOLLAR LIMITATION. —

(1) IN GENERAL. — Section 147(c)(2)(A) of the 8 Internal Revenue Code of 1986 is amended by striking “$450,000” and inserting “$509,600”.

(2) REPEAL OF SEPARATE LOWER DOLLAR LIMITATION ON USED FARM EQUIPMENT. — Section 147(c)(2) of such Code is amended by striking subparagraph (F) and by redesignating subparagraphs (G) and (H) as subparagraphs (F) and (G), respectively.

(3) QUALIFIED SMALL ISSUE BOND LIMITATION CONFORMED TO INCREASED DOLLAR LIMITATION. — Section 144(a)(11)(A) of such Code is amended by striking “$250,000” and inserting “$509,600”.

(4) INFLATION ADJUSTMENT. —

(A) IN GENERAL. — Section 147(c)(2)(G) of such Code, as redesignated by paragraph (2), is amended —

(i) by striking “after 2008, the dollar amount in subparagraph (A) shall be increased” and inserting “after 2014, the dollar amounts in subparagraph (A) and section 144(a)(11)(A) shall each be increased”, and

(ii) by striking “2007” in clause (ii) and inserting “2013”.

(B) CROSS REFERENCE. — Section 144(a)(11) of such Code is amended by adding at the end the following new subparagraph:

“(D) INFLATION ADJUSTMENT. — For inflation adjustment of dollar amount contained in subparagraph (A), see section 147(c)(2)(G).”.

(b) SUBSTANTIAL FARMLAND DETERMINED ON BASIS OF AVERAGE RATHER THAN MEDIAN FARM SIZE. — Section 147(c)(2)(E) of such Code is amended by striking “median” and inserting “average”.

(c) EFFECTIVE DATE. — The amendments made by this section shall apply to bonds issued after the date of the enactment of this Act.

IRS Rules on Tax Treatment of Cooperative's Proposed Settlement.

The IRS ruled that an electric cooperative’s tax-exempt status will not be jeopardized by a proposed settlement with former members to redeem their capital credits, that the discounted portion of redeemed capital credits will not be included in income, and that the redemption of capital credits will constitute patronage dividends or sourced income.

Citations: LTR 201423027

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *

UIL 501.12-03
Release Date: 6/6/2014
Date: March 13, 2014

Employer Identification Number: * * *

LEGEND:

State = * * *
Date = * * *
X = * * *
Year = * * *

Dear * * *:

We have considered your ruling request regarding the tax consequences relating to the proposed transactions described below.

FACTS

You are an electric cooperative, formed as a cooperative, nonprofit, membership corporation under the laws of State on Date. You are organized under your bylaws to operate on a cooperative, nonprofit basis for the mutual benefit of your members. You are exempt from federal income tax

under § 501(c)(12) of the Internal Revenue Code ("Code"). In the past you have satisfied, and you expect to continue to satisfy, the member income requirements for exemption under § 501(c)(12).

You have approximately X current members. Your members are entitled to vote on all matters presented at meetings of the members, and all questions put to vote to the members are generally decided by majority vote. Your governing board is composed of nine trustees, all of whom are elected by the members at your annual meetings. Members elect the trustees on a one member, one vote basis. In addition, a trustee may be removed and replaced by a majority vote of the members upon a member initiated petition signed by the lesser of 10% or 400 members.

Pursuant to your bylaws, you are obligated to account to all of your members on a patronage basis for all amounts received and receivable from electric energy in excess of operating costs and expenses properly chargeable against the furnishing of such services. You are required to credit to a capital account all such amounts in excess of operating costs and expenses for each member. You are obligated to maintain books and records reflecting the amount of capital credited to each patron's account on an annual basis and to notify members of the capital credited to their accounts within a reasonable time after the close of the fiscal year.

Your bylaws provide that, in the event of your dissolution or liquidation, all of your outstanding indebtedness will be paid first, and then outstanding capital credits of current and former members will be retired, without priority, on a pro rata basis. The remaining property and assets — representing your "net savings" account — will then be distributed among the members and the former members in proportion to the patronage each bears to the total patronage of all members during the seven years next preceding the date of filing of the certificate of dissolution.

Your bylaws also provide that, at any time prior to dissolution or liquidation, capital credited to the members' accounts may be retired in full or in part if the Board determines that your financial condition would not be impaired thereby. In the event of a capital credit retirement occurring earlier than the time scheduled by the Board, the amount of the capital credit may be discounted to present value in accordance with applicable accounting standards and as the Board may determine to establish the amount to be received by the distribute in respect to such early retirement.

The Board has adopted a policy for the regular assignment and retirement/payment of capital credits ("Policy"). The Policy provides that, upon payment of discounted capital credits, the difference between the discounted value paid and the stated value of the member's or patron's capital account will be credited to an equity account in the name of the member or patron to be held as retired capital. Thus your members retain a continuing property right in the net savings for the difference between the stated value of the patronage allocation and any discounted value that has been paid.

In Year you were sued by a group of former members ("Former Members") who allege that you should immediately retire capital credits of a member once the member ceases taking power from you and thus ceases to be your customer. You have negotiated a settlement proposal with the Former Members ("Settlement Proposal"), which provides that, after off-setting their bad debt, you will then discount to present value all capital credits of the Former Members and pay out such capital credits over a defined period.

The parties have agreed that the rate of return of a competing electric utility within your service area should be used as the capital credit discount/present value rate. The capital credits allocated to the Former Members will be discounted on a ten-year basis, and then immediately retired as a condition of the settlement. Pursuant to the Settlement Proposal, the Former Members will receive their pro rata share of the discounted capital credit amount, less attorneys' fees, administrative costs, and payment of compensation to the class representatives.

The discounted portion of the Former Members' redeemed capital credits — the difference between the discounted amount and the original amount in the capital credit account — will be retained on your books as permanent equity and available for distribution to the members and former members upon dissolution and liquidation as part of your net savings account. It will not be reallocated to the capital credit accounts of current members.

You request the following rulings:

1. The proposed transaction consisting of your (a) entering into a settlement agreement consistent with the terms of the Settlement Proposal, (b) redeeming capital credits of the Former Members at a discount rate pursuant to the terms thereof, and (c) transferring the discounted portion to your permanent equity will not adversely affect your tax-exempt status under § 501(c)(12).

2. The discounted portion of the Former Members' redeemed capital credits will not be included in your income for purposes of the 85 percent member income test under § 501(c)(12).

3. The redemption of the capital credits of the Former Members pursuant to the Settlement Proposal will constitute patronage dividends or patronage sourced income.

LAW

Section 501(c)(12) of the Code provides for the exemption from federal income tax of benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations, but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses. Rev. Rul. 72-36, 1972-1 C.B. 151, describes certain basic characteristics an organization must have in order to be a cooperative organization described in § 501(c)(12)(A). These characteristics include the following: A cooperative must keep adequate records of each member's rights and interest in the assets of the organization. A cooperative must not retain more funds than it needs to meet current losses and expenses. The rights and interests of members in the organization's savings must be determined in proportion to their business with the organization. A member's rights and interests may not be forfeited upon the withdrawal or termination of membership. Upon dissolution, gains from the liquidation of assets should be distributed to all current and former members in proportion to the value or quantity of business that each did with the cooperative over the years.

This ruling also addresses a situation involving forfeiture of a former member's rights and interests where the bylaws provide for such action upon withdrawal from the cooperative or termination. It states that even if forfeiture is permitted by the bylaws, the organization has not operated on a cooperative basis and should not be recognized as tax-exempt.

In Puget Sound Plywood, Inc. v. Commissioner, 44 T.C. 305 (1965), acq. 1966-1 C.B. 3, the court stated that an organization must meet certain common law requirements in order to be a cooperative. These common law requirements include: democratic control of the organization by members, the organization operates at cost for the benefit of members, and the contributors of capital to the organization do not control or receive most of the pecuniary benefits of the organization's operations (i.e. subordination of capital).

DISCUSSION

Section 501(c)(12) of the Code provides for the federal tax exemption of cooperative telephone companies or like organizations, including mutual or cooperative electric companies, and other cooperative organizations not relevant here. While the term "cooperative" is not defined in I.R.C. §

501(c)(12) or the regulations thereunder, a cooperative has been traditionally and historically defined as a voluntary, membership business organization that is organized in response to the economic needs of and to perform services for its members, and not to realize monetary gains as a separate legal entity. A cooperative is organized and operated for the benefit of and is democratically controlled by its members. See Puget Sound Plywood Inc., v. Commissioner, 44 T.C. 305 (1965), acq. 1966-1 C.B. 3. Hence, to qualify for exemption under I.R.C. § 501(c)(12), an organization must be a cooperative and organized and operated as such. Puget Sound Plywood v. Commissioner describes the principles that are fundamental to the organization and operation of cooperatives. They are: (1) democratic control by the members, (2) operation at cost, and (3) subordination of capital. These principles apply to organizations described in I.R.C. § 501(c)(12).

Democratic control requires that the cooperative be governed by members and on a one-member, one-vote basis. Each member has a single vote regardless of the amount of business he or she does with the organization. The issue of democratic control is a question of fact.

Operation at cost requires that the cooperative's net earnings or savings derived from furnishing services in excess of costs and expenses be returned to its members in proportion to the amount of business conducted with them. This principle ensures that a cooperative's net savings from members are returned to members in proportion to the amount of business each transacts with the cooperative. A cooperative satisfies this requirement by making annual allocations of patronage to members.

Subordination of capital has two requirements. First, control of the cooperative and ownership of the pecuniary benefits arising from the cooperative's business remains in the hands of the members rather than with non-patron equity investors. Second, the returns on equity investments must be limited. Hence, the net savings that accrue to the cooperative from the business activities it transacts with its members will largely inure to the benefit of those members rather than to its equity investors. The rationale for these limitations is to ensure that the cooperative remains faithful to its purpose — providing services at the lowest possible prices (or highest possible prices for a marketing cooperative) to its members and not to realize profits for capital. If it were otherwise, the emphasis then would likely be on protection of returns of equity capital rather than services to members, and this would destroy the basic purpose of cooperatives. See Puget Sound Plywood Inc., v. Commissioner, 44 T.C. 305 (1965), acq. 1966-1 C.B. 3.

Rev. Rul. 72-36, supra, describes additional fundamental requirements for operation of cooperatives described in I.R.C. § 501(c)(12). It requires that a member's rights and interest in the assets of a cooperative cannot be forfeited upon termination of membership. It also requires that upon dissolution, a cooperative must distribute any gains from the sales of its assets to those who were members during the period that the assets were owned.

A. Redemption of Capital Credits at Discount

A fundamental tenet of cooperative operation is that the earnings of a cooperative are allocated and ultimately distributed to its members based on the amount of business (patronage) done with those members. The amount a cooperative member pays for the cooperative's services less the cost of providing such services is allocated to the member. Thus, the presumption is that the cooperative's services are provided at cost to the members. But it is impractical for such a cooperative to return immediately all the amounts or earnings to its members because the cooperative needs to have reserves in order to operate, meet unexpected expenses, or to expand. These amounts or earnings are held by the cooperative for a certain period of time as prescribed by cooperative bylaws and are allocated as capital credits to accounts kept for each member. These capital credits are returned to the members or former members when the cooperative redeems them (i.e., sends a check for the

amount of the capital credits) at the end of the prescribed time.

The primary issue raised by the transaction described in the Settlement Proposal is whether it violates any of the cooperative requirements described Puget Sound Plywood, Inc., v. Commissioner, 44 T.C. 305 (1965), acq. 1966-1 C.B. 3, and Rev. Rul. 72-36. The cooperative principle of democratic control by members is satisfied because the redemption of capital credits at discount will not affect member voting rights or governing rights. We also note that the transaction described in the Settlement Proposal is consistent with the fiduciary duties of the cooperative (and its board of directors and management) to former members, and their ability to enforce their rights in the courts. See Lamesa Cooperative Gin v. Commissioner, 78 T.C. 894 (1982). The cooperative principle of operating at cost is satisfied because the members' right to receive the excess over the cost of electricity service (i.e. capital credits) is also not adversely affected.

The cooperative principle of subordination of capital is satisfied because the transaction described in the Settlement Proposal does not adversely affect the members' control and ownership of the cooperative assets. The cooperative requirement that there is no forfeiture of former members' rights to assets of the cooperative is not violated. Specifically, the terms of the Settlement Proposal permit the Former Members to receive the present value of their capital credit accounts at a date before dissolution and liquidation of the company. The discount rate is in accordance with the prevailing market rate. Further, by discounting to present value, the Former Members are not treated more favorably than current members.

B. Transfer of Discount Portion of Capital Credits to Net Savings

Pursuant to the Policy, the difference between the discounted value paid to Former Members and the value stated in the member's account will be credited to an equity account within your net savings account in the name of that member. In accordance with your Bylaws, the retired capital in the net savings account will be distributed to Former Members upon dissolution prior to distributing any remaining amounts in the net savings account.

Based on the facts presented, we do not believe that your establishment of this second capital account for each member would create taxable income to you as a cooperative. Analogizing to a corporate transaction, under § 1032, a corporation will not recognize gain or loss on the receipt of money or property in exchange for stock. Therefore, when a stockholder contributes money in exchange for stock in the corporation, the corporation does not have taxable income. Applied to a cooperative, so long as the member contributed money to the cooperative in the capacity of a member, the cooperative would not have income.

It appears that, according to your Policy, you are simply transferring money already received from members from one equity account to another equity account. As a result, it appears that nothing has changed and you will not receive any income pursuant to the transaction. The transfer of the discounted portion from the Former Members' capital credit accounts to an equity account within the net savings account where their continuing equity interest will be recorded is simply an organizational tool.

C. Redemption of Capital Credits Constitute Patronage Dividends or Patronage Sourced Income

Regarding whether the redemption of capital credits are excluded from income as patronage dividends or patronage sourced income, in Pomeroy Cooperative Grain Co. v. United States, 31 T.C. 674, 685-686 (1958), the U.S. Tax Court held that an allocation must represent true patronage dividends to be given an exclusion from gross income. According to the court, three prerequisites must be satisfied to exclude patronage dividends from gross income:

(1) The allocations must have been made under a pre-existing legal obligation, one which existed when the patrons transacted their business with the cooperative.

(2) The allocations must have been made out of profits or income realized from transactions with the particular patrons (members) for whose benefit the allocations were made, and not out of profits or income realized from transactions with other persons or organizations.

(3) The allocations must have been made equitably, so that profits realized from selling merchandise or services to patrons, and profits from marketing products purchased from patrons, were allocated ratably to the particular persons whose patronage created each particular type of profit.

You maintain that the redemption of the Former Members' capital credit accounts qualify as patronage dividends, excluded from gross income, because they will be made under a pre-existing legal obligation, on the basis of patronage, and from profits derived from the patrons' business dealings with you. Based on your representations, it appears that the requirements set forth by the U.S. Tax Court in Pomeroy Cooperative Grain Co. v. United States, 31 T.C. 674, 685-686 (1958) have been satisfied, and we have found no contrary authority.

RULING

Accordingly, based on the foregoing facts and circumstances, we rule as follows:

1. The transaction described in the Settlement Proposal, consisting of your (a) entering into a settlement agreement, the terms of which are not yet finalized, but will be consistent with the Settlement Proposal, (b) redeeming capital credits of the Former Members at a discount/present day value rate pursuant to the terms thereof, and (c) transferring the discounted portion to your permanent equity will not adversely affect your tax-exempt status under Section 501(c)(12) of the Code.

2. The discounted portion of the Former Members' redeemed capital credits will not be included in your income for purposes of the 85 percent member income test under Section 501(c)(12) of the Code.

3. The redemption of the capital credits of the Former members pursuant to the Settlement Proposal will constitute patronage dividends or patronage sourced income.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Mary J. Salins
Manager, Exempt Organizations
Technical Group 4
Enclosure
Notice 437

IRS LTR: Tax-Exempt Status Not Affected by Loan Servicing Activity.

The IRS ruled that an organization's activity of servicing direct student loans originated by the Education Department under the Healthcare and Education Reconciliation Act of 2010 won't affect the organization's tax-exempt status and that revenue generated from the activity won't constitute unrelated business taxable income under sections 512 and 513.

Citations: LTR 201423028

Contact Person: * * *
Identification Number: * * *
Contact Number: * * *
FAX Number: * * *

UIL: 501.03-00, 512.00-00, 513.00-00
Release Date: 6/6/2014
Date: March 12, 2014

Employer Identification Number: * * *

LEGEND:
State = * * *
Commission = * * *
Year = * * *

Dear * * *:

This is in response to your letter dated December 3, 2010, requesting a ruling relating to changes in your federal student loan activities as a result of the 2010 Healthcare and Education Reconciliation Act of 2010 (HCERA).

FACTS

You are a nonprofit organization incorporated under the laws of State and recognized as exempt from federal income tax as an organization described in § 501(c)(3) of the Internal Revenue Code (Code) and as a publicly supported organization under §§ 170(b)(1)(A)(vi) and 509(a)(1). You were formed at the request of the then-governor of State to facilitate and promote post-secondary education in State by financing the purchase, sale, and general marketing of student loans guaranteed by the U.S. government under the Higher Education Act of 1965 (HEA).

In a designation letter, the governor of State specifically requested that you:

. . . assist [State] by making arrangements necessary for providing a statewide student loan acquisition program through a not-for-profit corporation [under the HEA] . . . [You] should be established and operated exclusively for the purpose of acquiring student loan notes incurred under the [HEA] . . . The program to be established should be as comprehensive as feasible within the limitations of the applicable provisions of federal and state law.

According to your original Articles of Incorporation (AOI), you were organized exclusively for the purpose of acquiring student loan notes incurred under the HEA and to devote any excess income to purchase additional student loan notes or to pay income to State.

On your Form 1023, Application for Recognition for Exemption, you stated that you would engage in the purchase of qualified loans from banks and other participating financial institutions. You stated that your primary activity was to purchase and service student loans guaranteed by the U.S. government made under the Federal Family Education Loan Program (FFELP), which was part of the HEA. The governor of State designated you, under the HEA, as the sole entity for State to provide funds and acquire student loan notes from lenders representing loans to State students attending schools anywhere and loans to students from other states attending State schools.

According to your AOI, your 11-member board of directors is comprised of the following members:

2 directors from State banking institutions

1 director from State savings and loan institutions

1 director from State credit unions

1 director from State regents' institutions

1 director from State private colleges and universities

1 director from State "Merged Area Schools"

4 directors from the general public

Each of your board members is, and has always been, appointed by the governor of State. Each of them serves on your board "by reason of being appointed by public officials, and some of the above persons serve as members of the governing body by reason of being public officials." Your AOI also provide that upon dissolution all of your property, after the payment of debts and expenses, will vest in and become the property of State.

Historically, you have raised revenues to purchase student loans from the sale of bonds. As your revenue base increased, you began engaging in new activities aimed at benefitting students: you established a borrower benefits program (e.g., reducing interest rates for timely payments); a private loan program to supplement the financial needs of students; an interest forgiveness program for student loans issued to U.S. military members; and a student loan forgiveness program for individuals engaged in specialized professions (e.g., nursing) in State. You also established an independent § 501(c)(3) organization to assist students in completing financial aid forms issued by the U.S. Department of Education (DOE).

In Year, under legislation enacted by the State legislature, your purposes were expanded allowing you to originate and service private loans to students who are State residents or students attending

an educational institution in State. You engaged in this activity in partnership with Commission, the designated guarantor of federally guaranteed students loans originated under FFELP for the DOE.

In 2010, the U.S. Congress passed the HCERA, under which the federal government discontinued guaranteeing student loans originated under the FFELP. Instead, effective July 1, 2010, federal student loans are now made directly by the U.S. government to borrowers. According to the floor discussion accompanying the legislation, the "provisions of this legislation will convert all new Federal student loans to the Direct Loan Program . . . saving $61 billion over the next 10 years. These changes will also upgrade the customer service borrowers receive when repaying their loans. " 156 Cong. Rec. S1923, S1984 (daily ed. Mar. 24, 2010) (Sen. Harkin).

HCERA also amended 20 U.S.C. § 1078f by adding subsection (4) which provides that the Secretary of Education may award contracts for servicing federal direct student loans to "eligible non-profit service providers."1 One of the ways to satisfy the criteria for eligible non-profit service providers is exemption under section 501(c)(3), along with other requirements. Id. The floor discussion accompanying the legislation noted: "[T]his legislation recognizes that non-for-profit servicers play a unique and valuable role in helping students in their States succeed in postsecondary education and that students should continue to benefit from the assistance provided by not-for-profit servicers." 156 Cong. Rec. S1923, S1984 (daily ed. Mar. 24, 2010) (Sen. Harkin).

Prior to HCERA, 20 U.S.C. § 1078f provided that contracts may be awarded to "only entities which the Secretary determines are qualified to provide such services and supplies and will comply with the procedures applicable to the award of such contracts." The section also contained a preference for certain state agencies since the Secretary is directed (when considering entering into agreements with entities who already have agreements under 20 U.S.C. § 1078(b) and (c)) to "give special consideration to State agencies with a history of high quality performance to perform services for institutions of higher education within their State." See 20 U.S.C. § 1078f(a)(2).

With the enactment of the HCERA, you will now service student loans owned by the federal government, rather than loans you acquire in the secondary market or originate on your own. You will also begin servicing the federal direct loans of students residing throughout the United States, rather than just State residents or non-resident students attending school in State. Initially, the minimum number of loans required by law to be allocated by the DOE to qualified non-profit corporations is 100,000. By the end of your 2014 fiscal year, you project that you will be servicing one million loans for the DOE. Your goal is to ultimately service two million or more loans for the DOE.

To effectuate your new duties, you amended your AOI to allow you to enter into contracts relating to the origination, servicing, and collection of student loans and to establish and operate data systems for the maintenance of records for the direct student loan program.

Over time, your revenue attributable to direct loan servicing will represent an increasing percentage of your total revenue. Your use of all revenue, including those generated from servicing federal direct loans, will remain substantially unchanged after the adoption of HCERA.

RULINGS REQUESTED

You have requested the following rulings:

1) Performing loan services on direct student loans originated by the DOE under the HCERA will not adversely affect your exempt status under § 501(c)(3).
2) Revenue generated from performing these loan services will not constitute unrelated business

taxable income under §§ 512 and 513.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for religious, charitable, or educational purposes.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations described in § 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions and modifications.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the functions constituting the basis for its exemption.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (regulations) provides that to be exempt as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for exempt purposes only if it engages primarily in activities that accomplish one or more of the exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(2) of the regulations provides a definition of the term "charitable" as it is used in § 501(c)(3). The term "charitable" is used in its generally accepted legal sense and includes both the advancement of education and the lessening of the burdens of the government. Further, the term "educational" as used in § 501(c)(3), relates both to the instruction or training of the individual for the purpose of improving or developing his or her capabilities and instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes, and it is "substantially related" only if the causal relationship is a substantial one. For the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Rev. Rul. 85-2, 1985-1 C.B. 178, set forth the following criteria for determining whether an organization's activities lessen the burdens of government: first, whether the governmental unit considers the organization's activities to be its burden; and second, whether these activities actually lessen the burden of the governmental unit. An activity is a burden of the government if there is an objective manifestation by the governmental unit that it considers the activities of the organization to be its burden. The interrelationship between the governmental unit and the organization may provide evidence that the governmental unit considers the activity to be its burden. Whether the organization is actually lessening the burdens of government is determined by considering all of the

relevant facts and circumstances. Rev. Rul. 85-2 held an organization that provides legal advice and training to volunteers who serve as guardian ad litems in juvenile court lessens the burdens of government and is exempt under section 501(c)(3). The juvenile court required the appointment of guardians ad litem. The organization's training of lay volunteers was an integral part of the government's program of providing guardians ad litem. The organization actually was lessening the government's burden because the government could not continue its present program unless it trained lay volunteers itself or appointed attorneys to act as guardians.

Rev. Rul. 85-1, 1985-1 C.B. 177, held an organization that assisted a county's law enforcement agencies in more effectively policing illegal narcotics traffic lessened the burdens of government and was exempt under section 501(c)(3). The municipality demonstrated that these activities were a part of its burden because the organization funded activities the municipality treats as an integral part of its program to prevent the trafficking of illegal narcotics. The organization actually lessened that burden by enabling the municipality to augment its law enforcement activities in the area of illegal drug traffic without the appropriation of additional governmental funds.

Indiana Crop Improvement Association, Inc. v. Commissioner, 76 T.C. 394, acq., 1981-2 C.B. 1, held an association whose primary activity was the certification of crop seed under State and Federal law was exempt under section 501(c)(3). The association was delegated these functions in accordance with State law. The court concluded the association lessens the burdens of government, finding it "direct assists the U.S. Department of Agriculture in enforcing the standards and procedures established in the regulations under the Federal Seed Act within the State, and provides a public service to Indiana which the State legislature clearly considers to be necessary and appropriate." 76 T.C. at 398-399.

Professional Standards Review Organizations of Queens County v. Commissioner, 74 T.C. 240 (1980), held a professional standards review organization authorized by the Department of Health, Education, and Welfare lessened the burdens of government under section 501(c)(3). Congress authorized the establishment of independent review organizations to advance the important congressional policy of ensuring the effective, efficient, and economical delivery of health care services to Medicare and Medicaid beneficiaries. 74 T.C. at 245. Congress believed the formation of review organizations was "necessary for the Government to make its Medicare and Medicaid programs cost-effective." 74 T.C. at 249. Congress determined it was "preferable and appropriate that organizations of professionals undertake review of members of their profession rather than for Government to assume that role," for which it was "ill equipped." 74 T.C. at 249. The court concluded the organization lessened the burdens of the federal government. 74 T.C. at 251. See Virginia Professional Standards Review Foundation v. Blumenthal, 466 F. Supp. 1164 (D.D.C. 1979), appeal dismissed., Civ. No. 79-1501 (D.C. Cir. 8/13/1979) (Professional standards review organization was exempt under section 501(c)(3) where its principal purposes were to ensure effective and economical delivery of health care services to patients and reduce unnecessary spending on health care programs).

ANALYSIS

Pursuant to HCERA, the U.S. Government discontinued guaranteeing student loans originated under the FFELP. Under the new law, the U.S. Government now makes student loans directly to borrowers, establishing the provision of student loans as the government's burden. See PSRO of Queens County (Implementing Medicare and Medicaid programs was a governmental burden); Indiana Crop (Implementing Federal Seed Act standards and procedures was a governmental burden); Rev. Rul. 85-2 (guardian ad litem program was governmental burden); Rev. Rul. 85-1 (policing illegal narcotics traffic was governmental burden).

HCERA provided that the Secretary of Education may award contracts for servicing the federal direct student loans to eligible non-profit service providers. The statute specifically provided that exemption under section 501(c)(3) is one of the ways to be eligible as a non-profit service provider, along with other requirements. Congress enacted HCERA with the expectation the direct loan program would produce substantial savings for the U.S. Government. It specifically provided for section 501(c)(3) organizations to service the new federal direct student loans, aware of the unique and valuable role of non-profit service providers to the program and the beneficial assistance they provided to students. See Professional Standards Review Organizations of Queens County, 74 T.C. at 249 (Review organizations were necessary to make Federal programs cost-effective, and the Government was ill-equipped to assume their role); Indiana Crop Improvement Association, 76 T.C. at 398-399 (organization directly assisted the Federal government enforcing regulatory standards and procedures); Rev. Rul. 85-1 (organization's activities were an integral part of governmental program); Rev. Rul. 85-2 (organization's activities were an integral part of governmental program). Therefore, based on all the facts and circumstances, your activities of servicing direct student loans the Department of Education originates under the HCERA further the exempt purpose of lessening the burdens of government.

Ruling #1:

Your activity of servicing student loans the Department of Education originates under the HCERA primarily furthers an exempt purpose under § 501(c)(3).

Ruling #2:

Your activity of servicing direct student loans for the DOE is substantially related to the performance of the functions that constitute the basis of your exemption. Thus, the revenue you generate from this activity will not constitute unrelated business taxable income under §§ 512 and 513.

RULINGS

Based on the foregoing, we rule as follows:

1. Servicing direct student loans originated by the DOE under the HCERA furthers your exempt purposes under § 501(c)(3), and it will not adversely affect your exempt status under § 501(c)(3).

2. The revenue generated from servicing direct student loans originated by the DOE under the HCERA will not constitute unrelated business taxable income under §§ 512 and 513.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.
This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone

number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael Seto
Manager, Exempt Organizations
Technical
Enclosure:
Notice 437

FOOTNOTE

1 The definition for an "eligible not-for-profit servicer" includes an entity "(A) that is not owned or controlled in whole or in part by — (i) a for-profit entity; or (ii) a nonprofit entity having its principal place of business in another State; and (B) that — (i) as of July 1, 2009 — (I) meets the definition of an eligible not-for-profit holder under section 1085(p) of this title . . . and (II) was performing, or had entered into a contract with a third party servicer . . . who was performing, student loan servicing functions for loans made under part B of this subchapter; (ii) notwithstanding clause (i), as of July 1, 2009 — (I) is the sole beneficial owner of a loan for which the special allowance rate is calculated under section 1087-1(b)(2)(I)(vi)(II) of this title because the loan is held by an eligible lender trustee that is an eligible not-for-profit holder as defined under section 1085(p)(1)(D) of this title; and (II) was performing, or had entered into a contract with a third party servicer (as such term is defined in section 1088(c) of this title) who was performing, student loan servicing functions for loans made under part B of this title. . . ." 20 U.S.C. § 1087f(a)(4). An eligible not-for-profit holder is defined as "an eligible lender under subsection (d) . . . that is — (A) a State, or a political subdivision, authority, agency, or other instrumentality thereof, including such entities that are eligible to issue bonds described in section 1.103-1 of Title 26, Code of Federal Regulations, or section 144(b) of Title 26; (B) an entity described in section 150(d)(2) of such title that has not made the election described in section 150(d)(3) of such title; (C) an entity described in section 501(c)(3) of such title; or (D) acting as a trustee on behalf of a State, political subdivision, authority, agency, instrumentality, or other entity described in subparagraph (A), (B), or (C), regardless of whether such State, political subdivision, authority, agency, instrumentality, or other entity is an eligible lender under subsection (d)." 20 U.S.C. § 1085(p).

END OF FOOTNOTE

IRS LTR: Change to Board Composition Wouldn't Affect Exempt Status.

The IRS ruled that an organization associated with healthcare facilities operated by a public university wouldn't lose its section 501(c)(3) exemption or its public charity status as a result of proposed changes that would make the organization's board of directors identical to the university's board.

Citations: LTR 201423026

Contact Person: * * *
Identification Number: * * *

Telephone Number: * * *

UIL Number: 501.03-05
Release Date: 6/6/2014
Date: March 12, 2014

Employer Identification Number: * * *

LEGEND:

Date = * * *
Public University = * * *
State = * * *

Dear * * *:

We have considered your ruling request dated February 7, 2014, submitted by your authorized representative, requesting rulings about maintaining your recognition of exemption from federal income taxation and public charity status.

FACTS

You are a nonprofit organization incorporated under the laws of State. On Date, you received recognition of exemption under § 501(c)(3) and were classified as a public charity under §§ 170(b)(1)(A)(iii) and 509(a)(1). You are associated with Public University, a public body created by an act of the State legislature. Public University operates three health care facilities. Your exempt purpose is offering medical care, research and education at these health care facilities. Specifically, you provide patient care, engage in investigative studies, and teach students.
Currently, your board has nineteen members. Nine of those directors are ex-officio members and hold concurrent positions with Public University. The remaining ten directors are members of the general public. All directors serve three-year terms. You are proposing to change the composition of your board of directors. Following your proposed change, the members of your board of directors will be identical to those of the board of Public University. Public University's board has seventeen members. It has two ex-officio members — State's Governor and State's Superintendent of Education. The remaining fifteen members are by appointed by the State's Governor with the consent of the State Senate. Three appointed members represent the county in which Public University is located. Three represent State at large. Nine represent the nine State Senate districts surrounding the area in which Public University is located.

You will effectuate this change to your board composition by amending your articles of incorporation and bylaws. Also, the members of Public University's board of directors will resolve to accept their new positions as your directors. None of your new directors will receive compensation from you or any organization related to you. Further, none of your new directors will be related to each other through business or family relationships.

You represent that you are making this change to coordinate your and Public University's delivery of medical services and to simplify your and Public University's system of financial reporting. You have represented, and submitted documentation showing, that this change will not alter your purpose, mission, or operations. It will affect your board composition only.

RULINGS REQUESTED

1) That the proposed amendments to your articles of incorporation and by-laws (and their

implementation) will not result in revocation of or otherwise adversely affect your exemption under § 501(c)(3).
2) That the proposed amendments to your articles of incorporation and by-laws (and their implementation) will not adversely affect your status as an organization described in §§ 509(a)(1) and 170(b)(1)(a)(iii).

LAW

I.R.C. § 170(b)(1)(A)(iii) describes an organization the principal purpose or functions of which are the providing of medical or hospital care or medical education or medical research.

I.R.C. § 501(c)(3) provides that organizations may be exempted from tax if they are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and "no part of the net earnings of which inures to the benefit of any private shareholder or individual." I.R.C. § 509(a) provides that an organization exempt under I.R.C. § 501(c)(3) is a private foundation unless the organization is excepted under I.R.C. §§ 509(a)(1), (2), (3), or (4).

I.R.C. § 509(a)(1) provides that an organization described in I.R.C. § 501(c)(3) is other than a private foundation if it is described in I.R.C. § 170(b)(1)(A) (other than in clauses (vii) and (viii)).

Treas. Reg. § 1.170A-9(d)(1) provides that an organization is described in § 170(b)(1)(A)(iii) if —

(i) It is a hospital; and
(ii) Its principal purpose or function is the providing of medical or hospital care or medical education or medical research.

Rev. Rul. 69-545, 1969-2 C. B. 117 compares two hospitals. The first hospital is controlled by a board of trustees composed of independent civic leaders. The hospital maintains an open medical staff, with privileges available to all qualified physicians; it operates a full-time emergency room open to all regardless of ability to pay; and it otherwise admits all patients able to pay (either themselves, or through third party payers such as private health insurance or government programs such as Medicare). In contrast, the second hospital is controlled by physicians who have a substantial economic interest in the hospital. This hospital restricts the number of physicians admitted to the medical staff, enters into favorable rental agreements with the individuals who control the hospital, and limits emergency room and hospital admission substantially to the patients of the physicians who control the hospital. Rev. Rul. 69-545 notes that in considering whether a nonprofit hospital is operated to serve a private interest, the Service will weigh all the relevant facts and circumstances in each case, including the use and control of the hospital. The revenue ruling concludes that the first hospital continues to qualify as an organization described in § 501(c)(3) and the second hospital does not because it is operated for the private benefit of the physicians who control the hospital. Rev. Rul. 83-157, 1983-2 C.B. 94 states that the following factors indicative that an organization promotes health for the benefit of the community: a board of directors drawn from the community, an open medical staff policy, treatment of persons paying their bills with the aid of public programs like Medicare and Medicaid, and the application of any surplus to improving facilities, equipment, patient care, and medical training, education, and research, indicate that the hospital is operating exclusively to benefit the community.

ANALYSIS

Ruling 1: That the proposed amendments to your articles of incorporation and by-laws (and their implementation) will not result in revocation of or otherwise adversely affect your exemption under §

501(c)(3).

On Date, you received recognition as an organization exempt under § 501(c)(3). You are an organization that provides health care. Your previous recognition of exemption means that the Service determined that you provide health care in a charitable manner and for the benefit of the community. One factor that indicates that an organization provides care in a charitable manner is the composition of its board. See Rev. Rul. 69-545, 1969-2 C. B. 117; Rev. Rul. 83-157, 1983-2 C.B. 94. Currently, nine of your board members are public officials and the remaining ten members are from the general public. The inclusion of several community members on your board indicates that you provide health care for the benefit of the community.

You are proposing to change your board composition such that it will be identical to the board of Public University. Following this change, your board will be made up of State's Governor, State's Superintendent of Education, and fifteen individuals are by appointed by the Governor with the consent of the State Senate. These appointed individuals will represent State at large and specified areas within State. Your proposed board will be a community board. Your board members will be public officials and people appointed by public officials to represent certain geographic areas. They will have no family or business relationships to each other. They will serve without receiving compensation. Accordingly, these individuals will represent community rather than private interests. By contrast the board of the hospital found to be non-exempt in Rev. Rul. 69-545 was composed of physicians having economic interest in the organization. Your proposed board is a broad based community board and denotes that you operate for a charitable purpose.

Your proposal will not change the community nature of your board. Further, you represent that the proposed board plan will not affect your mission and operations. Accordingly, your proposal will not adversely affect your exemption under § 501(c)(3).

Ruling 2: That the proposed amendments to your articles of incorporation and by-laws (and their implementation) will not adversely affect your status as an organization described in §§ 509(a)(1) and 170(b)(1)(a)(iii).

On Date, you received recognition as a public charity under §§ 170(b)(1)(a)(iii) and § 509(a)(1). Thus, the Service determined that you are a hospital with a principal purpose of proving medical care, education or research. See Treas. Reg. § 1.170A-9(d)(1). You represented that your proposed change will affect only your board composition, and not your mission and operations. Accordingly, your proposal will not change your recognition under §§ 170(b)(1)(a)(iii) and § 509(a)(1).

RULINGS

1) The proposed amendments to your articles of incorporation and by-laws (and their implementation) will not result in revocation of or otherwise adversely affect your exemption under § 501(c)(3).
2) The proposed amendments to your articles of incorporation and by-laws (and their implementation) will not adversely affect your status as an organization described in §§ 509(a)(1) and 170(b)(1)(a)(iii).

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.
This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code

provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2
Enclosure
Notice 437

Illinois – Cloud Computing Receipts Characterized as Services for Sales Factor Apportionment Purposes.

The Illinois Department of Revenue ruled that agreements for information technology hosting and cloud computing are properly characterized as service contracts for Illinois sales factor apportionment purposes. [Illinois Private Letter Ruling IT 14-0003 PLR (4/24/2014)]

Download PDF.

Jun 03, 2014

Shearman & Sterling: Litigation Heats Up in Section 1603 Cash Grant Program for Renewable Energy Projects

Following the 2008 financial crisis, Congress enacted Section 1603 of the American Recovery and Reinvestment Act of 2009, which established a cash grant program for applicants with eligible energy properties. Energy industry participants relied upon the government to calculate the awards in a manner consistent with the calculation of tax credits under Internal Revenue Code section 48, but the government has, in some cases, awarded smaller grants after changing its formula for such calculations. Some energy participants, feeling shortchanged by the government's methodology, are now suing.

The Origins of the Section 1603 Program

Congress enacted Section 1603 of the American Recovery and Reinvestment Act of 2009 ("the

Section 1603 Program") during the economic recession.1 The 1603 Program reimburses eligible applicants for part of the cost of installing specified energy property used in a trade or business or for the production of income after the energy property is placed in service. An applicant who accepts a Section 1603 grant elects not to claim the energy tax credits under Internal Revenue Code section 48 or the renewable energy production tax credit under Internal Revenue Code section 45 for otherwise qualifying facilities placed into service on or after January 1, 2009.2

The Section 1603 Program created an investment incentive in the tax equity market in response to the reduced demand for investment tax credits that began during the recession. The program had several stated purposes, including preserving and creating jobs, promoting economic recovery, spurring technological advances, and investing in infrastructure and environmental protection. Originally set to expire at the end of 2010, the program was extended through the end of 2011.

Under the Section 1603 Program, the Treasury Department awarded more than 9,000 grants, totaling $18.5 billion.3 Wind energy projects accounted for $12.6 billion of grants awarded, and solar power projects accounted for $4.4 billion.4 Geothermal heat pump, biomass, hydropower, landfill gas, and fuel cell energy properties constituted the other ten percent of grant awards.5

Program Participants and Government Dispute Grant Awards

Controversy has now arisen over certain of the grant awards, and during the past two years several participants in the Section 1603 program have filed suit against the United States alleging violation of the statutory and regulatory obligations of Section 1603. Generally, the plaintiffs in these cases claim that the government paid less than the program mandated because the government changed its basis calculation for the projects, thereby undermining the economic expectations of the participants. Although Treasury is allowing unsatisfied participants to pay back grant awards received under the Section 1603 Program and claim tax credits instead, some participants have chosen to litigate the issue instead.

Legal Basis for Suit

Section 1603(a) generally provides that the Secretary of the Treasury shall provide a grant for reimbursement to each person who applies for such grant and has placed in service specified energy property, subject to certain other conditions. Under section 1603(b), the amount of the grant is the applicable percentage of the basis of the property, which is either thirty or ten percent depending upon the type of property. Treasury promulgated cost basis rules to determine the basis for investment property that are different from the basic rules that apply under Internal Revenue Code section 48.

Blue Heron Properties v. US

On July 24, 2013, Blue Heron Properties, LLC ("BHP"), a company with multiple energy projects, brought suit against the United States in the Federal Court of Claims complaining that the government made grant payments substantially less than the amounts to which BHP was entitled under Section 1603.6 According to the complaint, BHP submitted an application for a grant payment in connection with its project First Brandon Oaks System.7 BHP claimed the full purchase price as a cost basis, and Treasury awarded the full amount requested, $10.50 a watt.8 After BHP purchased three additional solar panel systems at prices between $9.52 and $10.50 a watt, BHP applied for grant payments under Section 1603 for those projects.9 The complaint alleges that BHP met all the program conditions and was therefore entitled to thirty percent of its basis in each project.10 Instead, Treasury only awarded one of the three projects the full grant amount and accepted only $5.56 and $5.43 a watt for the two reduced grant awards.11 The complaint alleges that this is a

violation of Section 1603.12

RP1 Fuel Cell LLC v. US

In RP1 Fuel Cell LLC v. US, another grant application that had placed in service two fuel cell power plants in California brought suit against the United States for reduced grant awards.13 The plaintiffs began construction of their fuel cells in 2011 and placed them into service in 2012, within the timeframes specified in Section 1603(a).14 According to the complaint, Treasury, without explanation, awarded a grant payment reduced by $1.6 billion after removing all costs relating to gas conditioning equipment associated with the project.15

Other 1603 Litigation

The litigants in four other Section 1603 cases allege similar harms and focus on the government's calculation of cost basis. In Vasco Winds, LLC v. US, the grant applicant filed a complaint after the government used a reduced cost basis to calculate the grant aware for its wind farm in California.16 As a result the grant applicant received approximately $6 million less than requested. After being denied a full grant award for their energy facilities, the plaintiffs in Sequoia Pacific Solar I, LLC, v. US17 and Mustang Hills, LLC v. US18 filed a complaint alleging, among other things, that Treasury improperly changed the rules of the Section 1603 Program, reduced grant payments by improperly changing the basis calculation, and undermined the economic assumptions of industry participants. Most recently, the plaintiff in Fire Island Wind LLC v. United States, alleged that the government improperly denied reimbursement to the plaintiff for construction costs associated with the construction of a Doppler Navigation System ("DNS"), in Anchorage Alaska.19 Construction of the DNS was required by the Federal Aviation Administration to obtain approval for the construction of a 17.6 megawatt wind turbine project on Fire Island.

All these cases are still in the early stages of litigation, and it is likely that more plaintiffs will come forward. Grant applications have six years after a grant is paid to file suit.

Report by the Treasury Inspector General for Tax Administration

Presently, the government is not appearing to back down from its tough stance on the Section 1603 Program grants either. On January 31, the Treasury Inspector General for Tax Administration ("TIGTA") released a report finding significant compliance problems among participants in the energy grants in lieu of tax credits program in its first review of returns claiming Section 1603 grants.20 After examining the returns of 83 taxpayers seeking Section 1603 grants, the IRS's Small Business/Self-Employed Division found that changes were necessary to 51 of the returns.21 Large Business and International reviewed 16 returns and found significant issues resulting in changes for eight.22

The review's initial focus was on taxpayers' 2009 tax returns but has been expanded to include 2010 and 2011 tax returns now, too.23 The stage is set for more litigation.

Footnotes

1 Pub. L. No. 111-5, 123 Stat. 115 (2009).

2 See id.; see also Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 111th Congress at 109-110. JCS-2-11 No. 6 (I.R.S.), 2011 WL 940372.

3 Review of Section 1603 Grants in Lieu of Energy Investment Tax Credit, Memorandum for Deputy Commissioner for Services and Enforcement from R. David Holmgren, ref. no. 2014-IE-R006, Dec.

17, 2013, p. 1.

4 Id. at 2.

5 Id. at 2.

6 Compl. filed in Blue Heron Properties, LLC v. United States, No. 1:13-cv-00505 (Fed. Ct. Jul. 24, 2013).

7 Id. at 5-6.

8 Id. at 6.

9 Id. at 6-7.

10 Id. at 7-8.

11 Id. at 7-9.

12 Id. at 9.

13 Comp. No. 1:13-cv-00552 (Fed. Cl. Aug. 6, 2013).

14 Id. at 19.

15 Id. at 13, 19.

16 Compl. No. 1:13-cv-00697 (Fed. Cl. Sept. 18, 2013).

17 Compl. No. 1:13-cv-00139-ECH (Fed. Cl. Feb. 2, 2013).

18 Compl. No. 1:14-cv-00047-TCW (Fed. Cl. Jan. 22, 2014).

19Compl. No. 1:14-cv-403T (Fed. Cl. May 12, 2014).

20 Eric Kroh, "IRS Compliance Review finds Problems with Energy Grants Program." Tax Analysts, Feb. 3, 2014.

21 Id.

22 Id.

23 Id.

Last Updated: June 2 2014
Article by Douglas R. McFadyen
Shearman & Sterling 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.

S. 2345 Would Exempt Water, Sewage Facility Bonds From Cap.

S. 2345, the Sustainable Water Infrastructure Investment Act of 2013, introduced by Senate Finance Committee member Robert Menendez, D-N.J., would exempt bonds for water and sewage facilities from the volume cap on private activity bonds.

113TH CONGRESS
2D SESSION

S. 2345

To amend the Internal Revenue Code of 1986 to provide that the volume cap for private activity bonds shall not apply to bonds for facilities for the furnishing of water and sewage facilities.

IN THE SENATE OF THE UNITED STATES

MAY 15, 2014

Mr. MENENDEZ (for himself and Mr. CRAPO) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to provide that the volume cap for private activity bonds shall not apply to bonds for facilities for the furnishing of water and sewage facilities.
Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Sustainable Water Infrastructure Investment Act of 2013”.

SEC. 2. FINDINGS AND PURPOSE.

(a) FINDINGS. — Congress finds the following:

(1) Our Nation’s water and wastewater systems are among the best in the world, providing safe drinking water and sanitation to our citizens.

(2) In addition to protecting the health of our citizens, community water systems are essential to our local economies, enabling industries to achieve growth and productivity that make America strong and prosperous.

(3) Regulated under title XIV of the Public Health Service Act (42 U.S.C. 300f et seq.; commonly known as the “Safe Drinking Water Act”) and the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.), community drinking water systems and wastewater collection and treatment facilities are critical elements in the Nation’s infrastructure.

(4) Water and wastewater infrastructure is comprised of a mixture of old and new technology. In many local communities across the Nation, the old infrastructure has deteriorated to critical conditions and is very costly to replace. Recent government studies have estimated costs of $500,000,000,000 to $800,000,000,000 over the next 20 years for maintaining and improving the

existing inventory, building new infrastructure, and meeting new water quality standards.

(5) The historical approach of funding infrastructure is insufficient to meet the investment needs of the future.

(6) The Federal partnership with State and local communities has played a pivotal role in improving the Nation's water quality and drinking water supplies. Federal assistance under this partnership has been the linchpin of these improvements.

(7) In light of constrained Federal budgets, the availability of exempt-facility financing represents an important financing tool to help close the gap between funds currently being invested and water infrastructure needs, preserving the Federal partnership.

(8) Providing alternative financing solutions, such as tax-exempt securities, encourages investment in water and wastewater infrastructure that in turn creates local jobs and protects the health of our citizens.

(9) Federally mandated State volume cap restrictions in conjunction with other priorities have limited the use of tax-exempt securities on water and wastewater infrastructure investment.

(10) Removal of State volume caps for water and wastewater infrastructure will accelerate and increase overall investment in the Nation's critical water infrastructure; facilitate increased use of innovative infrastructure delivery methods supporting sustainable water systems through public-private partnerships that optimize design, financing, construction, and long-term management, maintenance and viability; and provide for more effective risk management of complex water infrastructure projects by municipal utility and private sector partners.

(b) PURPOSE. — The purpose of this Act is to provide alternative financing for long-term infrastructure capital investment programs, and to restore the Nation's safe drinking water and wastewater infrastructure capability and protect the health of our citizens.

SEC. 3. EXEMPT-FACILITY BONDS FOR SEWAGE AND WATER SUPPLY FACILITIES.

(a) BONDS FOR WATER AND SEWAGE FACILITIES EXEMPT FROM VOLUME CAP ON PRIVATE ACTIVITY BONDS. — Paragraph (3) of section 146(g) of the Internal Revenue Code of 1986 is amended by inserting "(4), (5)," after "(2),".

(b) CONFORMING CHANGE. — Paragraphs (2) and (3)(B) of section 146(k) of the Internal Revenue Code of 1986 are both amended by striking "(4), (5), (6)," and inserting "(6)".

(c) EFFECTIVE DATE. — The amendments made by this section shall apply to obligations issued after the date of the enactment of this Act.

IRS LTR: VEBA's Exemption Not Jeopardized.

The IRS ruled that a voluntary employees' beneficiary association's tax-exempt status will not be jeopardized when it provides benefits to active and retired staff of a labor union's affiliates who are not members of the union or its affiliates.

Citations: LTR 201422025

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *

UIL: 501.09-00, 501.09-04
Release Date: 5/30/2014
Date: March 6, 2014

Employer Identification Number: * * *

LEGEND:

Association = * * *
x = * * *

Dear * * *:

We have considered your ruling request dated June 26, 2012, as amended on January 2, 2014, concerning your proposal to provide welfare benefits to certain actively employed and retired non-member staff of the state and local affiliates of Association.

FACTS

You are a voluntary employees' beneficiary association (VEBA) exempt under § 501(c)(9) of Internal Revenue Code. The Association established and controls you. You provide certain life, accidental death and dismemberment, and other insurance benefits to the Association's members.

The Association, your sponsor, is a national labor union recognized as exempt under § 501(c)(5). The Association operates through a network of affiliated state and local associations. The Association charters these affiliates and requires that they meet certain standards in order to retain their affiliation with Association. The Association requires members of its state and local affiliates to join the Association, unless they are otherwise ineligible. Because of this structure, nearly all members of the Association's state and local affiliates (99%) are also members of the Association.

You propose to amend your plan to allow participation by certain actively employed and retired staff of the Association's state and local affiliates ("proposed participants"). The proposed participants are not members of, and are not eligible for membership in, the Association or its state and local affiliates. You estimate the number of proposed participates to be x. You certify that, on at least one day of each quarter of your taxable year, 90 percent of your total membership consists of members of the Association and its affiliates.

RULINGS REQUESTED

You have requested the following rulings:

1. The participation of non-member actively employed and retired staff of the Association's state and local affiliates will not jeopardize your exempt status under § 501(a) as an organization described in § 501(c)(9).
LAW

I.R.C. § 501(c)(9) exempts VEBAs from federal income if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual tax. A VEBA provides for the payment of life, sick, accident, or other benefits to the

members of such association or their dependents or designated beneficiaries.
Treas. Reg. § 1.501(c)(9)-1 provides that, for an organization to be described in § 501(c)(9), it must be an employees' association; membership in the association must be voluntary; the organization must provide for the payment of life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries, and substantially all of its operations are in furtherance of providing such benefits; and no part of the net earnings of the organization can inure, other than by payment of the permitted benefits to the benefit of any private shareholder or individual.

Treas. Reg. § 1.509(c)(9)-2(a)(1) provides that the membership of a VEBA must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Typically, those eligible for membership in a VEBA are defined by reference to a common employer (or affiliated employers), to coverage under one or more collective bargaining agreements (with respect to benefits provided by reason of such agreement(s)), to membership in a labor union, or to membership in one or more locals of a national or international labor union. For example, membership in VEBA might be open to all employees of a particular employer, or to employees in specified job classifications working for certain employers at specified locations and who are entitled to benefits by reason of one or more collective bargaining agreements. In addition, employees of one or more employers engaged in the same line of business in the same geographic locale will be considered to share an employment-related bond for purposes of an organization through which their employers provide benefits. Employees of a labor union also will be considered to share an employment-related common bond with members of the union, and employees of a VEBA will be considered to share an employment-related common bond with members of the VEBA. Whether a group of individuals is defined by reference to a permissible standard or standards is a question to be determined with regard to all the facts and circumstances, taking into account the guidelines set forth in this paragraph. Exemption will not be denied merely because the membership of an association includes some individuals who are not employees (within the meaning of § 1.501(c)(9)-2(b)), provided that such individuals share an employment-related bond with the employee-members. Such individuals may include, for example, the proprietor of a business whose employees are members of the association. For purposes of the preceding two sentences, an association will be considered to be composed of employees if 90 percent of the total membership of the association on one day of each quarter of the association's taxable year consists of employees (within the meaning of § 1.509(c)(9)-2(b)).

Treas. Reg. § 1.509(c)(9)-2(b) provides that whether an individual is an employee is determined by reference to the legal and bona fide relationship of employer and employee. The term employee includes the following:

(1) An individual who is considered an employee:

(i) For employment tax purposes under subtitle C of the Internal Revenue Code and the regulations thereunder, or
(ii) For purposes of a collective bargaining agreement,

whether or not the individual could qualify as an employee under applicable common law rules. This would include any person who is considered an employee for purposes of the Labor Management Relations Act of 1947, 61 Stat. 136, as amended, 29 U.S.C. 141 (1979).

(2) An individual who became entitled to membership in the association by reason of being or having been an employee. Thus, an individual who would otherwise qualify under this paragraph will continue to qualify as an employee even though such individual is on leave of absence, works temporarily for another employer or as an independent contractor, or has been terminated by reason

of retirement, disability or layoff. For example, an individual who in the normal course of employment is employed intermittently by more than one employer in an industry characterized by short-term employment by several different employers will not, by reason of temporary unemployment, cease to be an employee within the meaning of this paragraph.

(3) The surviving spouse and dependents of an employee (if, for purposes of the 90-percent test of § 1.501(c)(9)-2(a)(1) they are considered to be members of the association).

In Water Quality Asso. Employees' Benefit Corp. v. United States, 795 F.2d 1303 (7th Cir. 1986), the court invalidated a regulation under § 501(c)(9) that required all employees to be of the "same geographic locale." Nonetheless, the court confirmed "[t]hat the quintessential element of a section 501(c)(9) tax-exempt VEBA is the commonality of interests among its employee members."

ANALYSIS

Your information establishes that you are a VEBA recognized under § 501(c)(9) providing certain welfare benefits to the members of the Association. You propose to amend your governing instrument to provide benefits to certain active and retired staff of the Association's state and local affiliates who are not members of the Association or its state and local affiliates ("proposed participants").

The membership of a VEBA must consist of individuals: (1) who became entitled to participate by reason of their being employees; and (2) whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Treas. Reg. § 1.509(c)(9)-2(a)(1). The proposed participants are all active or retired employees of the Association's state and local affiliates. Treas. Reg. § 1.501(c)(9)-2(b). Thus, the issue is whether the proposed participants share an employment-related common bond with the members of the Association and its state and local affiliates. Even though the proposed participants are not members of the Association, they share an employment-related common bond with members of the Association and with members of the state and local affiliates of the Association.

The purpose of requiring an employment-related common bond is to evidence "a commonality of interests among [the VEBA's] employee members." Water Quality Assoc. Employees' Benefit Corp. v. United States, 795 F.2d 1303 (7th Cir. 1986). The regulations list several categories of individuals that "will be considered" to share an employment related common bond:

Employees of one or more employers engaged in the same line of business in the same geographic locale;
Employees of a labor union with the members of that labor union;
Employees of a VEBA with the members of that VEBA.

Treas. Reg. § 1.501(c)(3)-2(a)(1). The same commonality of interests that exists between the employees of the labor union or VEBA and its respective members exists between the proposed participants and the members of the Association's state and local affiliates. Accordingly, the proposed participants share an employment-related common bond with the members of the state and local affiliates who are also the members of the Association.

CONCLUSION

Based on the foregoing, we rule as follows:

1. The participation of non-member actively employed and retired staff of the Association's state and local affiliates will not jeopardize your exempt status under § 501(a) as an organization described in

§ 501(c)(9).

This ruling is based on the representation that at least 90% of your total membership consists of members the Association and its state and local affiliates on one day of each quarter of your taxable year. See Treas. Reg. § 1.501(c)(9)-2(a)(1).

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Theodore Lieber
Manager, Exempt Organizations
Technical Group 3
Enclosure
Notice 437

IRS Further Extends Application of Streamlined E/O Process.

The IRS Tax-Exempt and Government Entities Division has issued a memorandum (TEGE-07-05-4-0014) further extending a streamlined application process to cases processed by the IRS's exempt organizations rulings and agreements employees, including exempt organizations technical and guidance employees.
The IRS developed the streamlined application process using Lean Six Sigma Organization concepts described in a prior memo (TEGE-07-0214-02) that applied to cases processed by the IRS's exempt organizations determinations and quality assurance units.

MEMORANDUM FOR EXEMPT ORGANIZATIONS TECHNICAL UNIT
AND EXEMPT ORGANIZATIONS GUIDANCE UNIT

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

WASHINGTON, D.C. 20224

May 23, 2014

Control No: TEGE-07-0514-0014
Affected IRM: IRM 7.29.3
Expiration Date: May 23, 2015

FROM:

Stephen A. Martin /s/ Stephen A. Martin
Acting Director, Rulings and Agreements, Exempt Organizations

SUBJECT:

Streamlined Processing Guidelines for Cases Extended to All EO R&A Employees

To assist in the processing and review of applications, the streamlined process developed using the LSSO concepts and discussed in TEGE-07-0214-02 (February 28 memo) is now extended to all of Exempt Organizations Rulings and Agreements, including Exempt Organizations Technical (EOT) and Exempt Organizations Guidance (EOG). This modification is made in the interest of fair and efficient tax administration.

Specialists in EOT and EOG will receive training on the streamlined concepts developed during the LSSO process (see attachment to February 28 memo). The training includes assessing risk and using paragraphs in notices developed by the LSSO team (see attachment to February 28 memo). To further assist in the implementation of the LSSO pilot, EOT and EOG employees will follow and implement the following procedures effective upon issuance of this memo:

1. Specialists will use Letter 1312 (with any necessary return address modifications) when corresponding with organizations.
2. Specialists will use the paragraphs as described in the attachment (to February 28 memo) and where appropriate for Letter 1312.
3. The inventory will be allocated among specialists based on the number selected to work the cases.
4. The specialists will work the cases to completion using the LSSO concepts.

The contents of the memorandum will be incorporated into IRM 7.29.3.
Please contact the Senior Manager, Rulings and Agreements, Technical with any questions regarding the application of this memorandum.

cc:
www.irs.gov

Citations: TEGE-07-0514-0014

Success-Based Fee Safe Harbor Not Limited to Investment Bankers.

Taxpayers can include success-based fees paid to professionals other than just investment bankers when making a safe harbor election for allocating such fees paid in business acquisitions or reorganizations, an IRS official said May 29.

The safe harbor is available as long as the payment adheres to the definition of a success-based fee in Rev. Proc. 2011-29, 2011-18 IRB 746 , and meets the other requirements, Scott Dinwiddie, special counsel, IRS Office of Associate Chief Counsel (Income Tax and Accounting), said at a Federal Bar Association insurance tax seminar in Washington.

Rev. Proc. 2011-29 offers taxpayers a simplified method for allocating success-based fees paid in transactions described under reg. section 1.263(a)-5(e)(3) that contain both activities that facilitate a covered transaction and those that do not. In lieu of maintaining the supporting documentation required by the regulation, taxpayers electing the safe harbor can treat 70 percent of the success-based fee as an amount that does not facilitate the transaction. The remaining portion of the fee must be capitalized as an amount that does facilitate the transaction.

Practitioners attending a panel on capitalization at the seminar said that though companies have historically paid success-based fees to investment bankers, they have seen a recent increase in such fees paid to attorneys.

In a July 2012 legal memorandum (ILM 201234027), the IRS concluded that nonrefundable milestone payments are not success-based fees and do not qualify for the safe harbor. However, in two later directives (LB&I-04-0413-002 ; LB&I-04-0114-001), the IRS Large Business & International Division told examiners not to challenge a taxpayer's treatment of eligible milestone payments for investment banking services made or incurred in a covered transaction under reg. section 1.263(a)-5(e)(3) regarding a success-based fee if the requirements are met. Jennifer Kennedy of PricewaterhouseCoopers LLP said the LB&I directives do not appear to afford the same treatment to milestone payments made to attorneys.

Dinwiddie said the directives' limitation to only investment banking payments may create some tension for practitioners. However, he said, LB&I's exam function has the authority to determine that it doesn't want to pursue those fees for reasons of administrative convenience as long as the taxpayer is otherwise in compliance. The directives are likely of limited scope because they reflect the issues field agents are actually dealing with and "where the dollars are," Dinwiddie said.

In several recent letter rulings, such as LTR 201405010 and LTR 201338009, the IRS granted a taxpayer an extension of time to file the mandatory statement regarding the election to use the safe harbor method of allocating success-based fees. Dinwiddie said that in those cases the taxpayers simply forgot to attach the election statement but that they deducted 70 percent in accordance with the safe harbor. He said that while the IRS would consider similar relief for a taxpayer that had neither attached the statement nor taken the deduction on its tax return, it would be a much harder case for the taxpayer to make.

by Jaime Arora

District Court Holding 'Eviscerates' Work Product Protection.

A district court holding that the work product doctrine does not protect a tax memo prepared by an accounting firm from disclosure to the IRS "eviscerates" the doctrine, a practitioner told Tax Analysts May 29.

Rachel Leigh Partain of Caplin & Drysdale said the analysis by the U.S. District Court for the Southern District of New York in its May 28 holding in Schaeffler v. U.S., No. 1:13-cv-04864 (S.D.N.Y. 2014) was hard to comprehend.

“Frankly, I don’t understand how work product exists after this opinion,” Partain said. “I don’t know what would satisfy this court that a tax memo is work product.”

In Schaeffler, the court denied the petitioner’s motion to quash an IRS administrative summons on the grounds that it called for privileged materials. As part of a complex debt refinancing and corporate restructuring done to address solvency issues, the Schaeffler Group, a German manufacturer, hired EY to provide it with tax advice on the U.S. tax implications of the transaction. EY prepared tax memoranda and in accordance with an agreement it shared its analyses with a consortium of banks that had financed the original transaction that was being refinanced and restructured.

In the agreement, both parties expressed a desire to share privileged, protected, and confidential documents and analyses without waiving those privileges. As part of the refinancing, the banking consortium also agreed to subordinate its claims to Schaeffler Group owner Georg F.W. Schaeffler’s personal tax liabilities and provide an additional line of credit to pay the liabilities. Also, the parties agreed that the consortium would have the opportunity to advise on any contesting or settlement of a tax dispute, which the taxpayer expected was possible at the earliest planning stages of the refinancing and restructuring.

Regarding the work product doctrine, the court held that although the protection was not waived after disclosure with the consortium because of the parties’ similar interests as well as the contractual obligation to keep the information confidential, the privilege still did not apply. The court reasoned that the EY tax memo would have been created in an essentially similar form had litigation not been expected. The fact that the memo weighed the chances of success in court for some tax positions did not indicate that the document would have been created differently, the court held.

Partain took exception to the court’s rationale.

“This court treats a tax memo as a document that would have been prepared for other reasons,” Partain said. “The court said the taxpayer would have received a 321-page memo regardless of whether it anticipated being audited or not. Not only that, the memo would have looked exactly the same.” Partain added that it is uncommon for taxpayers to receive a tax memo of such a length and form unless they expect litigation.

The court cited Circular 230’s stipulation that tax practitioners not allow the possibility that a tax return will remain unaudited to affect the advice they give.

Judge Gabriel W. Gorenstein said in his opinion, “When tax practitioners give advice to clients, they must ignore the actual possibility of an audit — and, by extension, litigation — in opining on the tax implications of a transaction. Thus, when providing legal advice on the tax treatment of the restructuring and refinancing transactions, the Ernst & Young advisors had a responsibility to consider in full the relevant legal issues regardless of whether they anticipated an audit and ensuing litigation with the IRS.”

Partain said that the court’s interpretation of Circular 230 is incorrect. Circular 230 stands for the proposition that an adviser cannot “take the audit lottery into account” when providing tax advice to a client, she said.

Under Circular 230, an adviser has to assume the taxpayer will be audited, Partain said. “The fact that this taxpayer obtained a Circular 230-compliant memo rather than a non-compliant memo demonstrates that the memo was prepared because of the anticipation of audit and litigation,” she

said.

Does Not Comport With Adlman

Partain said that because the court's holding does not comport with the liberal standard of work product protection enunciated in United States v. Adlman, 134 F.3d 1194, 1196 (2d Cir. 1998) , she would not be surprised if the decision was overturned on appeal. Adlman holds that a document used for other purposes can still receive work product protection if it is prepared in such form because of the prospect of litigation, Partain said.

Robin L. Greenhouse of McDermott Will & Emery LLP said that although the court used the language of Adlman in setting forth the legal standard, it appeared to be applying the Fifth Circuit's narrower "primarily-to-assist-in-litigation" standard when determining if a document should be afforded protection. That standard, however, was rejected by the Second Circuit in Adlman.

The Schaeffler court "is looking for some sort of memo that addresses litigation strategy," Greenhouse said. "For example, it would say, 'If we go to litigation, we will move for summary judgment, or we are going to do this discovery.'"

When the Schaeffler court is applying the portion of Adlman that says if a document would have been prepared in essentially the same way then it is not work product, what Adlman is really referring to is business documents, Greenhouse said. Such documents might include a step plan, but not a tax memo that addresses the likelihood of success on the merits, she said.

Although the court's opinion could be seen as being limited by the facts and circumstances, if it was to be applied more broadly it could mean that the work product doctrine and the attorney-client privilege were mutually exclusive, which is clearly wrong and contrary to the Adlman case, Greenhouse said.

Attorney-Client Privilege Waived

Regarding the attorney-client privilege, the court held that although the privilege is not waived when disclosures are made to parties who are engaged in a common legal enterprise, which is known as the common interest rule, that rule does not apply to a relationship that is mainly an economic one, as was the case in Schaeffler, and therefore that privilege likewise does not apply.

The consortium's "enormous stake" in the tax consequences of Schaeffler's refinancing and restructuring did not equate to a common interest and therefore the disclosure of documents to the consortium waived the privilege, the court said.

"It is not enough that the Bank Consortium had a desire for Schaeffler to succeed in a dispute with the IRS. What is lacking is any common legal stake in Schaeffler's putative litigation with the IRS. If the Bank Consortium could have been named as a co-defendant in the anticipated dispute with the IRS, the result would undoubtedly be different," Gorenstein said.

The court likewise gave no credence in terms of its application to the attorney-client privilege to the agreement the consortium and the Schaeffler Group made before the litigation that sought to preserve privilege while sharing tax memoranda.

Partain said that although the case likely does not move the needle on common legal interest rule, given that not many favorable common legal interest decisions exist, every decision helps to further refine the parameters of the waiver exception.

The Schaeffler decision comes on the heels of AD Investment 2000 Fund LLC v. Commissioner, 142 T.C. No. 13 (2014) . In that decision, the Tax Court held that taxpayers forfeit the protection of attorney-client privilege on tax opinion letters from a law firm if they seek to avoid accuracy-related penalties by asserting affirmative defenses of good faith and state of mind.

by Andrew Velarde

IRS' TEB Office: Village Center CDD Ruling Should Be Retroactive.

The Internal Revenue Service's tax-exempt bond office is arguing there should be retroactive application of the chief counsel office's technical advice memorandum that concluded the Village Center Community Development District in Florida is not qualified to issue tax-exempt bonds.

The ruling, if it stands and is retroactive, "would render taxable the interest on some $426 million of bonds" issued from 1993 to 2004, the Village Center CDD has told TEB.

The TAM, issued in May 2013, found that the CDD is not a political subdivision for purposes of issuing tax-exempt bonds because its board is, and always will be, controlled by the developer rather than publicly-elected officials.

The CDD opposes the conclusion, but said that even if the TAM is upheld, it should be applied prospectively. The CDD claims TEB mischaracterized the basis upon which it is seeking prospective application.

The IRS chief counsel's office has to decide whether it will grant the district's request for relief from the TAM being applied retroactively. Ordinarily, TAMs are applied retroactively, but the IRS has discretionary authority to prescribe they only be applied in the future.

If the chief counsel's office denies the district's request, a years-long audit of the CDD's bonds will continue. If the IRS concludes the audit and determines the bonds are taxable, the district can appeal the ruling to the agency's Office of Appeals. If the appeals office also finds the bonds to be taxable, the CDD will want to pursue litigation in court, said Richard Chirls, a partner at Orrick, Herrington & Sutcliffe in New York. Chirls is working with Perry Israel, a lawyer with his own practice in Sacramento, Calif., on the Village Center case. Israel represents the Village Center CDD and Chirls represents a related CDD.

The Village Center CDD's request for relief is not only significant for it, but is also important for other districts and the broader municipal finance community, Chirls said. If the chief counsel's office decides that the TAM only will be applied prospectively, the market would have comfort that future guidance from the Treasury Department on the definition of a political subdivision would be forward looking, he said.

The IRS and Treasury has put the definition of a political subdivision on its priority guidance plan.

Last summer, the CDD asked the IRS to reconsider the TAM, but the IRS denied this request. Additionally, in August 2013, the district requested relief under Internal Revenue Code section 7805(b) that the TAM not be applied retroactively, and it provided supplements to this request in October and November.

TEB said last month that it disagreed that the TAM should be applied prospectively. TEB said the

CDD has to show why its situation is so unique that it deserves to be granted relief from being applied retroactively, but it has not met its burden of proving that there are rare or unusual circumstances. Instead, TEB believes the district was arguing that the TAM was wrong, essentially re-raising the request to reconsider the TAM that was already denied.

In a reply to TEB sent to that office and the chief counsel's office on May 20, the CDD said that TEB incorrectly characterized its basis for requesting relief.

For the purpose of the request for relief only, the CDD will accept that the TAM was correct. However, the district said it relied on existing IRS practice and published positions at the time it issued its bonds, and the TAM applies a new theory. Moreover, applying this theory retroactively would be a rare and unusual circumstance that "would work inequitable results," the CDD said.

The TAM concludes that the CDD is not a political subdivision because it's not a division of the state. But when authorities have discussed whether an entity is a division of a state, they haven't required it to be answerable to a general public electorate. Instead, they have discussed other factors such as the public purpose of the entity and the treatment of it as a "public body corporate" by state law, which the district satisfies, the CDD said.

The CDD noted that a National Association of Bond Lawyers review of more than 250 private-letter rulings found that only one even suggests that control by an electorate was relevant to determining whether an issuer is a political subdivision. However, in that ruling, accountability to an electorate was not identified as a necessary factor.

The CDD acknowledges that it is not enough to show it relied on previous IRS rulings to get relief, and that it also must show that applying the TAM retroactively would be inequitable. But that is the case in this circumstance, the CDD said.

The district noted that the IRS had previously audited some of its bonds and upheld their tax-exemption. Also, audits of other "landowner-controlled" districts have closed with no change to the bonds' tax-exempt status. "To apply a new interpretation of the requirement of control that requires that the entity be answerable to a general electorate would, in light of the past practice, work an inequitable result upon not only the [CDD], but also its nearly 100,000 residents and the hundreds, if not thousands, of holders of its bonds," the district said.

BY NAOMI JAGODA
MAY 23, 2014 4:12pm ET

Register for the Form 990-N and 990-EZ Filing Tips Webcast.

Thursday, May 29 – 2 p.m. Eastern Time

Topics include:

- Tips to help you save time preparing the forms
- Steps to avoid penalties
- Discussion of automatic revocation
- New reinstatement procedures under Rev. Proc. 2014-11
- Online resources that will help your organization

To receive CE credit (and a certificate of completion) you must view the presentation for a minimum of 50 minutes.

Register for this presentation.

IRS Releases Draft Form 990-EZ for 2014.

The IRS has released draft Form 990-EZ, "Short Form, Return of Organization Exempt From Income Tax."

IRS Announces TE/GE Advisory Committee Meeting, New Members.

The IRS has announced (IR-2014-65) that its Advisory Committee on Tax-Exempt and Government Entities plans to hold a public meeting June 11 to present its recommendations to agency leaders on employee retirement plans; tax-exempt organizations; tax-exempt bonds; and federal, state, local, and Indian tribal governments. Ten newly appointed members of the panel will also be introduced at the meeting.

May 21, 2014

WASHINGTON — The Internal Revenue Service's Advisory Committee on Tax Exempt and Government Entities (ACT) will hold a public meeting on June 11, when the panel will submit its annual reports and recommendations to senior IRS executives.Ten newly appointed members of the panel (listed below) will also be introduced at the public meeting. They will begin two-year terms and join 10 returning members.

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. ACT members are appointed by the Secretary of the Treasury and generally serve two-year terms. They advise the IRS on operational policy and procedural improvements.

At the public meeting, five ACT project teams will present the following five reports that include recommendations on:

- **Employee Plans:** Analysis and Recommendations Regarding the Pre-Approved and Determination Letter Programs.
- **Exempt Organizations:** Analysis and Recommendations Regarding Unrelated Business Income Tax Compliance of Colleges and Universities.
- **Federal, State and Local Governments:** The Affordable Care Act and Government Employees.
- **Indian Tribal Governments:** IRS Tribal Consultation: A Compliance Audit and Recommendations for Improvement.
- **Tax Exempt Bonds:** Today's Reality: The Increased Reliance on the "Facts and Circumstances" Test in Analyzing Management Contracts for Private Business Use.

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 9:30 a.m. EDT on June 11, 2014, at the IRS headquarters at 1111 Constitution Ave. NW, Washington, D.C. The 2014 ACT reports 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 Cynthia PhillipsGrady to confirm their attendance. She can be reached at 202-317-8782 (not a toll-free call). Attendees must have photo identification and are encouraged to arrive at least 30 minutes before the session begins.

The 10 new members of the ACT are listed below and grouped by their relevant project team:

Employee Plans

Christopher W. Shankle, Shreveport, La.

Shankle is a Retirement Services Specialist at Capital One in Shreveport. He works on a broad array of employee benefits issues, including retirement plan administration, testing and disclosure. For the last five years, he has led an American Institute of Certified Public Accountants (AICPA) technical resource panel on employee benefit plans monitoring legislative and regulatory activity. Shankle has been involved in numerous outreach initiatives on employee benefits issues. He has a bachelor's degree in accounting from the University of Mississippi and is a licensed CPA in Mississippi and Louisiana.

Matthew I. Whitehorn, Philadelphia

Whitehorn is a partner and chair of the employee benefits group at Dilworth Paxton in Philadelphia. He has more than 25 years of experience working with qualified and non-qualified plans including 457 plans, deferred compensation plans and 403(b) plans. Whitehorn chairs the Philadelphia Bar Association's employee benefits committee. Whitehorn has a B.A. in History from Johns Hopkins University, a J.D. from Villanova University and an LL.M. in Taxation from Temple University School of Law.

Exempt Organizations

Amy C. Madsen, Baltimore

Madsen is the director of standards at the Excellence Institute, a program of the Maryland Association of Nonprofit Organizations. She is involved in education and has experience with small/medium-size exempt organizations. Madsen received her Bachelor of Arts degree at Virginia Polytechnic Institute and State University, and her Masters of Arts in Policy Studies at Johns Hopkins University.

Andrew Watt, Arlington, Va.

Watt is the president and CEO of the Association of Fundraising Professionals, based in Arlington. AFP is a 30,000-member association of individuals who generate philanthropic support for nonprofit organizations. From 1993 to 2005 Watt was employed by a similar organization in Britain. He has international experience, fundraising expertise and experience with small/medium nonprofits. He received his B.A. at the University of Edinburgh.

Government Entities: Federal, State and Local Governments

David P. Augustine, San Francisco

Augustine is currently serving as Tax Collector under the Office of Treasurer and Tax Collector for the city/county of San Francisco. Augustine oversees 125 employees encompassing four operating sections: Business Tax, Property Tax, Legal and the Bureau of Delinquent Revenue. He has more than 10 years of professional experience, including legal experience in the municipal finance/bond arena, and is an active member of the Government Finance Officers Association. He has also received several awards for his work in developing new business practices. Augustine received his J.D. from Stanford University Law School in 2002 and a certificate from the Harvard University Kennedy School of Government — Executive Education.

Dean J. Conder, Denver

Conder is the Deputy State Social Security Administrator for the State of Colorado and has more than 13 years of experience working with state and local governments on FICA tax compliance matters and related training. He is a member of the National Conference of State Social Security Administrators and serves as its training and succession planning chairperson. He co-authored an article on "Common Errors in State and Local Government FICA and Public Retirement System Compliance," which was published in the Government Finance Review (GFOA) in August 2009. He has also served as a state level board member for the state's Section 457 retirement plan. Conder previously served on the IRS Taxpayer Advocacy Panel. He is a past president of the National Association of State Social Security Administrators. Conder holds a M.S. degree from the University of Denver College of Law.

Vandee V. DeVore, Jefferson City, Mo.

DeVore is the Deputy State Social Security Administrator for the State of Missouri and has more than 25 years of government experience, including experience as an accountant, auditor, payroll manager and Assistant Director, Division of Accounting. As the Assistant Director, Division of Accounting, DeVore oversaw and managed statewide payroll, including tax withholding, reporting and reconciliations, Social Security Administration and statewide employee benefit budget preparation. As the Deputy State Social Security Administrator, DeVore acts for the state with respect to its responsibilities for maintaining and administering the provisions of the state's Section 218 agreement/modifications and the proper application of Social Security and Medicare coverage. She is an active member of the National Conference of State Social Security Administrators and is currently an officer. DeVore is also an adjunct instructor of governmental and non-profit accounting at Columbia College in Missouri. She has a B.A. degree in accounting from William Woods College in Missouri and a M.B.A. from Columbia College.

Government Entities: Indian Tribal Governments

Stefani A. Dalrymple, Fairbanks, Alaska

Dalrymple is a CPA and owner of Yukon Accounting & Consulting in Fairbanks. For the past 10 years, she has worked primarily with the Native Alaskan villages and organizations in rural Alaska to ensure compliance with federal and state tax and accounting requirements. Stefani has also served directly as a tribal government employee in the capacities of both Fiscal Officer and Payroll Manager. Dalrymple earned her Bachelor of Science degree in Accounting at the University of Alaska Fairbanks.

Tino Batt, Fort Hall, Idaho

Batt is a member of the Fort Hall Business Council, the governing body of the Shoshone-Bannock Tribes of Idaho. He has served in the appointed position of Tribal Treasurer since 2009. In this position, Batt is involved in monitoring the financial management and accounting practices of all tribal entities operating within the tribal government structure. Batt also serves on the Board of Directors for the Native American Bank and has served since 2005 as a volunteer with the Volunteer Income Tax Assistance (VITA) program. In addition, he represents the Shoshone-Bannock Tribes at the Tribal Interior Budget Council (TIBC), which provides a forum and process for tribes and federal officials to work together in developing annual budget requests for Indian programs in the Department of Interior. Batt has a Bachelor of Science degree in human resource/corporate training and development from Idaho State University.

Government Entities: Tax Exempt Bonds

Floyd Newton III, Atlanta

Newton is a partner at King & Spalding in Atlanta in the public finance practice. He has more than 30 years of broad experience with tax-exempt bonds. Newton is an active member of the ABA Tax Section 103 Committee and the National Association of Bond Lawyers. He was President of NABL in 1998-1999 and served on NABL's Board of Directors from 1994-2000. Newton received a Bachelor's degree, magna cum laude, from Princeton University, and received a Juris Doctorate, magna cum laude, from the University of Georgia Law School.

ACT Members Continuing on the Committee in 2014

Employee Plans

- Alison Cohen, Transamerica Retirement Solutions, Atlanta
- Donna M. Mueller, Iowa Public Employees Retirement System, Des Moines, Iowa
- David A. Mustone, Hunton & Williams LLP, McLean, Va.
- Stuart A. Sirkin, The Segal Company, Washington, D.C.

Exempt Organizations

- Virginia Gross, Polsinelli PC, Kansas City, Mo.
- David Moja, Capin Crouse LLP, Orlando, Fla.
- Gary J. Young, Northeastern University, Boston

Indian Tribal Governments

- Diane M. Gange, Jamestown S'Klallam Tribe, Sequim, Wash.

Tax Exempt Bonds

- Katherine A. Newell, New Jersey Educational Facilities Authority, Princeton, N.J.
- Lorraine Tyson, Pugh, Jones & Johnson, P.C., Chicago

Wyden's Build America Bonds Reboot Relies on Cities: Muni Credit.

On paper, Senator Ron Wyden's idea to resurrect the Build America Bonds program would go a long

way toward fixing the nation's crumbling highways and bridges.

The federally subsidized municipal bonds created in the 2009 U.S. economic stimulus proved popular with Wall Street investors and went on to finance almost $190 billion of public-works projects. Now, as Wyden tries to jump-start debate on long-term highway funding, he's struggling to gain traction.

Even with benchmark municipal yields at 11-month lows, localities are selling fewer bonds as they mend their finances after the recession sapped revenue. The federal government let the Build America Bonds program expire at the end of 2010 and later scaled back the 35 percent subsidy to issuers as part of broader spending cuts.

"Many governments were burned pretty badly," Steve Benjamin, mayor of Columbia, South Carolina, said in an interview. "The confidence is just not there."

A reboot of Build America Bonds would take a large enough federal subsidy to entice states to run up debt after the recession, said Scott Pattison executive director of the National Association of State Budget Officers.

Fresh Memories

"The memory is still pretty fresh," Pattison said in a telephone interview. "The sweetener would have to be pretty significant."

Wyden, an Oregon Democrat who runs the Senate Finance Committee, has been pitching ideas to finance a six-year measure boosting infrastructure spending and replenish the U.S. Highway Trust Fund. That pool may not be able to meet its financial obligations as early as July. He said last week that while he hasn't decided on an approach, it may include boosting the 18.4 cents-per-gallon gasoline tax and restoring Build America Bonds.

"There are two pieces in the transportation funding equation," Wyden said in an interview. "One is funding, which is the downstream approaches like the gas tax. Then on top of that, I want to focus on finance because Build America Bonds was so successful."

By most measures, the program was just that. Municipalities sold $188 billion of the taxable bonds to finance investment in infrastructure such as water, road and transit projects, data compiled by Bloomberg show.

Investors Gain

The securities became the fastest-growing part of the $3.7 trillion municipal market and drew international buyers. The debt has earned 9.6 percent this year through May 20, beating the 6.3 percent gain for the entire local-bond market, Bank of America Merrill Lynch data show.

Municipalities have sold about $95 billion of long-term, fixed-rate debt this year, down from $132 billion in the same period of 2013, Bloomberg data show.

Wyden would also have to win over debt-reduction Republicans in Congress who had complained that the original 35 percent subsidy on municipalities' interest payments was too expensive.

Build America Bonds may cost the Treasury about $3.8 billion in the current budget year, according

to the White House Office of Management and Budget.

President Barack Obama has proposed a four-year, $302 billion highway bill that would raise $150 billion through taxes on overseas earnings and by closing loopholes that would normally let companies defer those obligations.

Republican Compromise

The Senate Environment and Public Works Committee last week approved a six-year highway measure that calls for the same amount of money annually as the current two-year, $105 billion bill expiring in September, plus inflation. The panel left it up to Wyden and his Finance Committee to figure out how to pay for it.

Some senior Republicans on Wyden's panel said his idea of restarting Build America Bonds deserves consideration if it helps prod debate on the highway measure. That includes Senator Orrin Hatch of Utah, the committee's top Republican, and Senator Charles Grassley, an Iowa Republican.

"I've never been a big fan of Build America Bonds, because it's just another way of spending and getting us deeper into debt," Hatch said in an interview. "But then again, it may be one of the ways we'll have to do it under the current difficulties we're in. There's no question we're going to have to try and find money for highways."

Three Wins

Some proposals already are on the table. In April, Senator Edward Markey, a Massachusetts Democrat, introduced a bill resurrecting Build America Bonds and making the program permanent. It would set the subsidy for states and localities at 31 percent in 2014, gradually lowering it to 28 percent in 2017 and later years.

It's a companion measure to a bill introduced last year by Representative Richard Neal, also a Massachusetts Democrat.

Markey said his proposal is a "win-win-win for cities, states and the entire country." His home state issued almost $5 billion in bonds when Build America was operating, with most of the funds used to repair or rebuild hundreds of bridges across the state.

In 2013 and again this year, Obama proposed similar securities providing direct interest-payment subsidies targeted at infrastructure, only to see them make little headway in Congress.

Meanwhile, not a single House Republican has signed onto Neal's bill. House Ways and Means Committee Chairman Dave Camp, a Michigan Republican, has made clear in the past he's not a fan of Build America Bonds. In 2010, he called it a "heavily subsidized spending program providing direct payments to state and local governments that issue bonds."

Municipal Skeptics

"It doesn't solve the funding problem," said Joshua Schank, president of the Eno Center for Transportation, a nonpartisan policy research group based in Washington. "If anything, this will cost money."

Wyden said that testimony this month before his committee bolsters his effort. Jayan Dhru, senior managing director for corporate and infrastructure ratings at Standard & Poor's, told the Senate

Finance Committee on May 6 that as much as $200 billion a year in additional infrastructure funding could be obtained through private investors.

He told the committee that investors are “well-positioned to fill the void” with approaches like public-private partnerships.

State and local officials may hesitate after the across-the-board federal spending cuts, known as sequestration, that began last year, said Susan Collet, a lobbyist for the Bond Dealers of America in Washington.

“They’re worried about proposals that could be subject to the federal government readily clawing back part of the subsidy,” said Collet, whose group represents securities firms. “Investors and issuers are going to be more skeptical than last time these proposals were introduced.”

By Laura Litvan and William Selway May 22, 2014

To contact the reporters on this story: Laura Litvan in Washington at llitvan@bloomberg.net; William Selway in Washington at wselway@bloomberg.net

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Novogradac News Brief: Renewable Energy Tax Credits.

Published By Novogradac & Company LLP

On March 11, 28 senators sent a letter to Senate Majority Leader Harry Reid, D-Nev., and Finance Committee Chairman Ron Wyden D-Ore., stating their support for the consideration of the Renewable Energy Parity Act of 2014 (S. 2003). The Senators wrote to express their support for modifying the eligibility standard under the Section 48 investment tax credit (ITC) in a tax extenders package. The bill would extend the ITC for solar projects under construction. Currently, a project must be placed in service by Dec. 31, 2016 to qualify. The letter is available at www.energytaxcredits.com

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On March 17, the Massachusetts Department of Energy Resources (DOER) released the draft Assurance of Qualification Guideline for review and comment. The DOER is specifically looking for feedback on the process for obtaining extended reservation periods under Section 5.B. of the guideline. Comments are due by March 28. The guideline outlines the process by which the DOER will grant assurances of qualification to projects under the Solar Renewable Energy Credit (SREC-II) Solar Carve-Out program. The SREC-II shifts development away from large, standalone ground-mounts and toward three specific market sectors: residential or carport projects or any project up to 25 kilowatts; rooftop or ground-mounted projects greater than 25 kilowatts with at least two-thirds of annual output used on-site; and landfill or brownfield projects, or projects up to 650 kilowatts with less than two-thirds of annual output used on-site. Projects that do not fall into one of these categories will be in the managed growth market sector. The program’s goal is to install 1.6 gigawatts of solar photovoltaic projects by 2020. The program is expected to become effective early

in the second quarter, once formal review proceedings are completed. The draft guideline is available at www.mass.gov/eea.

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On March 21, Sens. Mark Udall, D-Colo., and Chuck Grassley, R-Iowa, along with 24 other senators, sent a letter to the Senate Finance Committee urging extension of the ITC and production tax credit (PTC) for wind energy in the tax-extender legislation. The PTC expired at the end of 2013. The letter states that wind energy provides power to more than 15 million homes across the and that the industry has spurred $105 billion in investment in the U.S. economy. They close the letter by stating that the legislation should be taken into consideration immediately. The letter is available at www.energytaxcredits.com.

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On March 31, the American Council on Renewable Energy (ACORE) released the report, "Outlook for Renewable Energy in America: 2014." The report was co-authored by the U.S. Renewable Energy Trade Associations, and evaluates the energy market and forecasts each renewable energy technology sector from the perspectives of U.S. renewable energy trade associations. The articles in the report detail specific market drivers for the biofuel, biomass, geothermal, hydropower, solar, waste and wind energy sectors. The report is available at www.energytaxcredits.com.

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On March 19, SunEdison announced the completed construction of the Cascade solar power plant. The 24 megawatt (MW) direct current solar power plant located in the California Desert, is working with San Diego Gas & Electric to supply the company renewable electricity through a 20-year power purchase agreement (PPA). The PPA was given under the California Renewable Auction Mechanism. SunEdison, a solar technology manufacturer and provider of solar energy services, worked with Wells Fargo, which provided tax equity financing for the 150-acre solar power plant. SunEdison Renewable Operation Center, which provides asset management, monitoring, field dispatch and reporting services, will manage the plant.

***

New Generation Power Texas LLC announced on Feb. 13 that it has begun construction on the first phase of the Texas Wind Farm. In order to qualify for the PTC, which expired at the end of 2013, the renewable energy company works on pre-construction development, early investments and permitting. The 400 MW wind farm is located in Haskell County outside of Dallas, Texas, on 22,000 acres of land. Construction will be completed in two phases, with total costs estimated to be between $650 and $700 million. The wind farm is expected to produce more than 1,800 million megawatt hours (MWh) of energy annually. Rosendin Electric Inc., an engineering, power and communications provider, will be the primary contractor. Construction of both phases is expected to be complete by the end of 2015.

***

On April 2, the Treasury Inspector General for Tax Administration (TIGTA) released the report, "Recovery Act: Processes for Ensuring Compliance with Qualifying Advanced Energy Project Credit Requirements Can Be Strengthened." TIGTA conducted the audit to assess the effectiveness of the Internal Revenue Services' (IRS') efforts to ensure manufacturer compliance with advanced energy credit requirements. The report, published on Feb. 6, found that the IRS ensured manufacturers

complied with agreement and certification requirements. However, the report stated that the IRS does not have a process to identify individual taxpayers who incorrectly claim the tax credit. TIGTA found that more than 1,000 individual taxpayers who claimed more than $3 million in Advanced Energy Credits for Tax Year 2011 but did not appear to have a relationship with a manufacturer that was awarded the credit. TIGTA provided recommendations for the IRS to develop processes to ensure that changes in projects are fully evaluated and to ensure that individuals are properly claiming the credit. The report is available at www.energytaxcredits.com.

EO Update: e-News for Charities & Nonprofits - May 16, 2014

Register for the IRC 501(c)(6) Organizations Phone Forum.

Thursday, May 22 – 11 a.m. Eastern Time
Topics include:
• To file or not to file an application for recognition of exemption
• Form 1024: Applying for exemption
• Annual filing requirements for exempt organizations
• Permitted 501(c)(6) purposes and activities
To receive CE credit (and a certificate of completion) you must view the presentation for a minimum of 50 minutes.
Register for this presentation.

IRS LTR: IRS Extends Expenditure Period for Bond Proceeds.

The IRS has agreed to extend the period for expending the proceeds of bonds to finance a school construction project after concluding the borrower's expected failure to meet the original expenditure date was due to reasonable cause.

Citations: LTR 201420016

Third Party Communication: None

Date of Communication: Not Applicable
Person To Contact: * * *
Telephone Number: * * *

Index Number: 54F.00-00
Release Date: 5/16/2014

Date: February 3, 2014

Refer Reply To: CC:FIP:B05 – PLR-147648-13

LEGEND:

Authority = * * *
Borrower = * * *
State = * * *
Bonds = * * *
School Site = * * *
New Facility = * * *
Town = * * *
Date 1 = * * *
Date 2 = * * *
Date 3 = * * *
Date 4 = * * *
Date 5 = * * *
Date 6 = * * *

Dear * * *:

This is in response to your request under § 54A(d)(2)(B)(iii) of the Internal Revenue Code for an extension of the expenditure period for the available project proceeds of qualified tax credit bonds.

FACTS AND REPRESENTATIONS

You make the following factual representations. Authority is a political subdivision of State, organized in part to assist in financing programs or loans to non-profit corporations and political subdivisions in State, including educational organizations described in § 501(c)(3) such as Borrower.Authority issued the Bonds on Date 1 and designated the Bonds as qualified school construction bonds within the meaning of § 54F(a)(3). All available project proceeds of the Bonds were to be spent on acquiring the School Site and construction of the New Facility (the "Project"), and were expected to be spent before Date 2.

The original three-year expenditure period for the Bonds under § 54A(d)(2)(B)(i) expired on Date 2 (the "Original Expenditure Period"). Borrower started its search for a suitable site for the New Facility approximately two years prior to the issuance of the Bonds, and had been making plans during that two-year period for financing and constructing the New Facility. Borrower identified a site which it intended to acquire approximately one month after the Bonds were issued. However, progress toward completion of both phases of the Project within the original schedule was delayed significantly by unanticipated events which arose before issuance of the Bonds. These events included a prolonged search for an appropriate site for the New Facility after a court-ordered change in location from the initial site. A school at the initial site was not expected to achieve federal desegregation goals in the area.

Immediately upon the court's determination, Borrower began searching for another site for the New Facility. On Date 3, approximately eight months after the Bonds were issued, Borrower entered into an agreement to purchase a substitute site. However, after Borrower completed plans for development of the substitute site, Town's engineers determined that Town could not furnish sewer services to the substitute site due to the high cost of sewage treatment facilities. After again

conducting a search for an appropriate site, Borrower settled on and acquired the School Site. Construction work began on Date 4 to extend water and sewer lines to the School Site. Borrower expects to complete construction of the New Facility by Date 5, or approximately six months after the Original Expenditure Period expired. Borrower expects to spend all available project proceeds not later than Date 6, or two years after the Original Expenditure Period expired.

Authority submitted this request for a ruling prior to Date 2.

LAW AND ANALYSIS

Section 54A(d)(1) provides that a qualified school construction bond is treated as a qualified tax credit bond for purposes of Section 54A.Section 54A(d)(2)(B)(i) provides in part that to the extent that less than 100 percent of the available project proceeds of the issue are expended by the close of the expenditure period for 1 or more qualified purposes, the issuer shall redeem all of the nonqualified bonds within 90 days after the end of such period.

Section 54A(d)(2)(B)(ii) provides that for purposes of this subpart, the term "expenditure period" means, with respect to any issue, the 3-year period beginning on the date of issuance. Such term shall include any extension of such period under clause (iii).

Section 54A(d)(2)(B)(iii) provides that upon submission of a request prior to the expiration of the expenditure period (determined without regard to any extension under this clause), the Secretary may extend such period if the issuer establishes that the failure to expend the proceeds within the original expenditure period is due to reasonable cause and the expenditures for qualified purposes will continue to proceed with due diligence.

Section 54A(d)((2)(C)(iv) provides that for purposes of this paragraph, in the case of a qualified zone academy bond, a "qualified purpose" means a purpose specified in § 54E(a)(1).

Section 54A(e)(4) of the Code defines "available project proceeds" to mean (A) the excess of (i) the proceeds from the sale of an issue, over (ii) the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds), and (B) the proceeds from any investment of the excess described in subparagraph (A).

The Project was identified prior to the issuance of the Bonds and Borrower reasonably expected to spend all of its allocable available project proceeds within the three-year period. The expected failure to spend all the available project proceeds of the Bonds by the expiration of the three-year period on Date 2 has been caused by events that were not reasonably expected at the time the Bonds were issued and were beyond the control of Borrower. However, Borrower to the extent possible considering the described unexpected external events that resulted in unforeseen delays, has and will continue to exercise due diligence in spending the remaining available project proceeds on the Project. Borrower expects to spend all available project proceeds not later than Date 6, or two years after the Original Expenditure Period expired.

CONCLUSION

Under the facts and circumstances of this case, we conclude that Borrower's expected failure to expend the available project proceeds of the Bonds by Date 2 is due to reasonable cause and that Borrower's continued expenditure of the proceeds for qualified purposes will proceed with due diligence. Therefore, Authority is granted an extension of the Original Expenditure Period with respect to the Bonds until Date 6.Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this

letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to Authority's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by Authority and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

- Sincerely,
- Associate Chief Counsel
- (Financial Institutions & Products)
- By: Timothy L. Jones
- Senior Counsel, Branch 5

IRS LTR: Arrangements Won't Hurt Group's Tax-Exempt Status.

The IRS ruled that modified arrangements in which several senior executive employees of a tax-exempt organization would become employees of a corporation and then would be "seconded" back to the organization would not adversely affect the organization's tax-exempt status.

Contact Person: * * *
Identification Number: * * *
Telephone Number: * * *
UIL: 501.00-00, 501.03-00, 501.33-00
Release Date: 5/9/2014
Date: February 14, 2014
Employer Identification Number: * * *

LEGEND:

Corporation = * * *
Year = * * *

Dear * * *:

This is in response to your letter dated January 26, 2012, in which you requested a ruling that if you implement a proposed modification to an existing secondment arrangement, you will continue to be recognized as a tax-exempt organization described in § 501(c)(3) of the Internal Revenue Code of 1986, as amended (Code). This letter supersedes our letter dated December 20, 2013, which is hereby withdrawn.

FACTS

You have been recognized as an organization exempt under § 501(c)(3) of the Code and classified as an organization other than a private foundation because you normally receive a substantial part of your support from contributions from the general public, within the meaning of §§ 509(a)(1) and 170(b)(1)(A)(vi). Your charitable purposes are to receive and administer funds for religious, charitable, scientific, and educational purposes. You also are a sponsoring organization for donor advised funds within the meaning of § 4966(d)(1) that makes grants from your investment income and assets. You are an independent organization associated with Corporation.You propose to make changes to the workforce arrangement that you currently have with Corporation. Under the proposal, three of your senior executive employees would become employees of Corporation and then would be seconded back to you. Currently, all of your staff except for these three employees are employed by Corporationand seconded to you on a full-time basis. Your existing Administrative Services Agreement with Corporation would be amended to cover payroll services and employee benefits for the three additional employees. The Administrative Services Agreement provides that you will pay Corporation annually an administrative fee not to exceed five basis points times the average daily balance of all donor-advised fund accounts maintained by you, which shall be due and payable quarterly. Corporation maintains the right to waive or reduce this fee at any time. Amounts payable are to be reviewed annually to ensure that all amounts payable are priced at or below fair market value. However, you state that Corporation has waived this fee for you and provided these services and infrastructure free of charge since Year.

You will continue to be independent of Corporation. The changes to your Administrative Services Agreement will have no effect on your Board of Directors. Your Board of Directors consists of one employee of Corporation and five independent directors. Your Board of Directors meets three times a year to address your strategy and progress, to approve recommendations from committees, and to review and approve grants made, among other things. The three employees who will be added to the Administrative Service Agreement attend all Board meetings as your top officials and inform the Board of your day-to-day operations. The approval and appointment of these three employees will continue to be made by the Board on an annual basis. You maintain full control of whether or not any seconded employee remains your employee. You maintain the responsibility of interviewing, negotiating compensation and benefits, and approving the hiring of any employee that will be seconded to you. And, you also maintain control over future negotiations and decisions regarding compensation and benefits for any seconded employees.

You state that after the three senior executive employees are seconded back to you, you will continue to be organized and operated for the charitable purpose of promoting philanthropy and will not confer on any party any impermissible private benefit or private inurement. You also represent that corporate law dictates that a duty of loyalty is owed to you, rather than to Corporation, once the employees are seconded to you.

In addition to the independent control and management performed by your Board of Directors, you also offer many options for donor advised funds to make investments in addition to those offered by Corporation. You offer a variety of investment pools featuring top performing mutual funds. Half of these funds are offered through other investment firms. Additionally, donors to larger accounts are permitted to have the funds in such accounts be managed by independent investment advisors who are not associated with Corporation.

RULING REQUESTED

- You will continue to be recognized as a tax-exempt organization described in § 501(c)(3) if you implement the proposed modification to the existing Administrative Services Agreement.

LAW

I.R.C. § 501(c)(3) provides that organizations may be exempted from tax if they are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes and "no part of the net earnings of which inures to the benefit of any private shareholder or individual."Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that in order to be exempt under § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the exempt purposes specified in that section.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirement of this subsection, the burden of proof is on the organization to show that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Revenue Ruling 70-186, 1970-1 C.B. 128, discusses an organization formed to preserve and enhance a lake as a public recreational facility by treating the water. The lake is large, bordering on several municipalities. The public uses it extensively for recreation. Along its shores are public beaches, launching ramps, and other public facilities. The organization is financed by contributions from lake front property owners, members of the adjacent community, and municipalities bordering the lake. The revenue ruling concludes that the benefits from the organization's activities flow principally to the general public through well-maintained and improved public recreational facilities. Any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

Revenue Ruling 73-407, 1973-2 C.B. 383, states that a contribution by a private foundation to a public charity that was conditioned upon the agreement of the public charity to change its name to that of a substantial contributor to the private foundation and not to change it again for 100 years was not an act of self-dealing because the resulting benefit to the substantial contributor was incidental and tenuous, and not economic in nature.

Revenue Ruling 98-15, 1998-1 C.B. 718, provides two scenarios where exempt hospitals enter joint ventures with for-profit hospitals. In the first scenario, the exempt hospital maintains control of the board and the day-to-day operations of the LLC that owns the hospital. The governing documents of the LLC require it to operate any hospital it owns in a manner that furthers charitable purposes by promoting health for a broad cross section of its community. In the event of a conflict between operation in accordance with the community benefit standard and any duty to maximize profits, the members of the governing board are to satisfy the community benefit standard without regard to the consequences for maximizing profitability. In addition, all returns of capital and distributions of earnings made to owners of the LLC are to be proportional to their ownership interests in the LLC. The terms of the governing documents are legal, binding, and enforceable under applicable state law.

In the second scenario of Revenue Ruling 98-15, control and management of the hospital is transferred to an LLC, the board of directors of which consists of three members appointed by the exempt organization and three appointed by the for-profit. Major operating decisions (budgets, distributions of earnings, etc.) have to be approved by a majority of the board.

In both scenarios, the exempt hospitals receive income interests in proportion to the assets contributed to the joint ventures. Only in the first scenario was the hospital activity considered to continue as an exempt activity and not to be operated for the private benefit of the for-profit hospital.

In Church by Mail v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), aff'g 48 T.C.M. (CCH) 471 (1984), the Tax Court found it unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officers. The 9th Circuit Court of Appeals, in affirming the Tax Court's decision, stated: "The critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."

Broadway Theatre League of Lynchburg, Virginia v. U.S., 293 F. Supp. 346, 355 (D.C. VA. 1968), states that "An organization can incur ordinary and necessary expenditures in its regular activities without losing its exempt status.St. Germain Foundation v. Commission, 26 TC 648 (1956); A. A. Allen Revivals, Inc., PH TC Memo 1963-281. A contract entered into by a foundation, for its benefit, even if the contract is responsible for the creation of the foundation, is not necessarily as a matter of law executed to avoid taxation. Commissioner of Internal Revenue v. Orton, 173 F.2d 483 (6th Cir. 1949)."

In est of Hawaii v. Commissioner, 71 T.C. 1067, 1081-82 (1979), the Tax Court held that compensation need not be unreasonable or exceed fair market value to constitute private benefit, stating "[n]or can we agree with petitioner that the critical inquiry is whether the payments made to International were reasonable or excessive. Regardless of whether the payments made by petitioner to International were excessive, International and EST, Inc., benefited substantially from the operation of petitioner."

In P.L.L. Scholarship v. Commissioner, 82 T.C. 196 (1984), the Tax Court found that an organization that operated charitable bingo on the premises of a bar allowed the bar to increase its sales of food and drinks by its operations in the bar, thereby benefiting the bar in more than an insubstantial way. The organization and bar were controlled by some of the same persons. The Court held that the operations of the organization and bar were so interrelated as to be "functionally inseparable," the effect of which was that any economic benefit the bar received was not incidental.

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36; 56 T.C.M. (CCH) 1140 (1989), an organization, the activity of which was to conduct continuing medical education tours abroad and which exclusively used one for-profit travel agency to arrange its travel tours, was found not to be operated exclusively for purposes described in § 501(c)(3). The same individuals controlled both the organization and the for-profit travel agency, and the organization did not solicit bids from any other travel agency. Both entities shared the same office. The Tax Court found that the organization was not operated exclusively for one or more exempt purposes because of its provision of benefits to the travel agency.

ANALYSIS

To continue to qualify as an exempt organization described in § 501(c)(3), you must be organized and operated for one or more exempt purposes. Section 1.501(c)(3)-1(a)(1). An organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet this requirement, the burden of proof is on the organization to show that it is not organized or operated for the benefit of private interests, such as designated individuals, its creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. Section 1.501(c)(3)-1(d)(1)(ii).You propose to make changes to your workforce arrangement with Corporation. Under the proposal, three of your current employees will become employees of Corporation. Under the Administrative Services Agreement between you and Corporation, those same three employees would be seconded back to you. In addition, your Administrative Services Agreement would be amended to cover the payroll services

and employee benefits for those three employees.

In certain cases, an organization contracting its services away may be found to no longer perform an exempt function because it has contracted out all of its activities and control. This is not the case with you, however, as your Board of Directors continues to be independent of Corporation. Additionally, an organization is permitted to contract out some services for a fee to a for-profit corporation without jeopardizing its tax exemption. See Broadway Theatre, 293 F. Supp. at 355. Your Board of Directors will still meet quarterly to evaluate and approve your grants for charitable purposes, despite the contract for administrative and employment services. Additionally, your funds will be used to pay for the seconded employees, and they will remain responsive to you. You will determine the employees' compensation and whether or not they will remain employed by Corporation for your purposes. Furthermore, you represent that corporate law cases have determined that such seconded employees owe a duty of loyalty to you, rather than to Corporation. Given your exercise of control over the seconded employees and your operations through your independent Board of Directors, you have not contracted away your exempt activities.

Additionally, in order to be operated for an exempt purpose, you must be operated for a public, rather than private, benefit. Section 1.501(c)(3)-1(d)(1)(ii). When assessing whether an organization is formed for a private benefit, "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially" from the operation of the exempt organization. Church by Mail, 765 F.2d at 1392. One way in which a for-profit organization might benefit substantially from the operation of an exempt organization is by being the exclusive client of that for-profit. This is especially true in cases where both the for-profit and the non-profit are controlled by the same persons. In Church by Mail, 765 F.2d 1387, the for-profit organization ran a printing business for the church's publications, which was the non-profit's sole purpose. The printing company had been started by the founders of the church and operated exclusively to provide printing for that church. The for-profit printing company would not have existed if not for the existence of the church. Also, in est of Hawaii, 71 T.C. 1067, the non-profit school exclusively taught the lessons of a for-profit company run by employees of another, related for-profit company. The non-profit purchased, taught, and promoted exclusively the material of the for-profit company. There, the purpose of the non-profit was determined to be the distribution and collection of income for the for-profit company. Here, however, business from you constitutes less than one percent of the business of Corporation, and you are not controlled by Corporation. The separation of control, combined with the fact that your operations do not serve to "substantially benefit" Corporation, suggests that you are not operated for the private benefit of Corporation.

Additionally, an organization might be operated for private benefit if it exclusively uses a related for-profit to provide its services without seeking out the best possible service provider, International Postgraduate, 56 T.C.M. (CCH) 1140, or if its operations are conducted in a manner that any external business is sent exclusively to that for-profit.P.L.L. Scholarship, 82 T.C. 196. This is especially true when the non-profit and for-profit organizations are controlled by the same persons. Again, you and Corporation are not controlled by the same persons. Additionally, you do not exclusively use the investment products of Corporation; rather, you provide donors with the opportunity to invest in outside funds. Furthermore, you allow large donors to select outside fund advisors. The access to outside investment products and advisors also means that the operation of your program does not merely act as a means to provide business opportunities to Corporation through a captive audience, such as the one in P.L.L. Scholarship, 82 T.C. 196.

While you do contract exclusively with Corporation for your Administrative Service Agreement, the agreement provides for the use of the employees at cost, as if you were employing them directly,

and Corporation has waived any fees for the administrative services since Year. Therefore, there has been no financial gain to Corporation in the Administrative Services Agreement. Any private benefit that may be gained by Corporation in providing you with seconded employees, including your highest ranking executives, is incidental. See Rev. Rul. 70-186, supra(indicating that specific benefits to a defined group may be incidental to the performance of an exempt organization and, thus, are not incompatible with tax exemption). Rev. Rul. 98-15, supra, describes two scenarios where tax exempt organizations enter joint ventures with for-profit corporations. In the first scenario, the tax exempt organization maintains control over the joint venture and is able to ensure that its operations further the charitable purpose of the tax-exempt organization. The for-profit organization that enters the joint venture receives a proportionate amount of any income generated by the joint venture, but this sharing of revenue is considered to be incidental to the furtherance of the exempt organization's purpose, furthered by the joint venture. Here, your activities create income for Corporation through the investment activities of your donor-advised funds, but this income represents less than one percent of Corporation's overall income, and you maintain control over your funds and activities through an independent board, as described above. Your continued control over your activities allows you to further your own exempt purpose and not the private benefit of Corporation. You are not operated for the private benefit of Corporation, and the inclusion of your highest ranking employees in your Administrative Services Agreement is not incompatible with your tax exemption under § 501(a).

RULING

- Implementation of the proposed modification to the existing secondment arrangement between you and

Corporation

- will not adversely affect your status as a tax-exempt organization described in § 501(c)(3).

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose.* A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.This ruling is directed only to the organization that requested it. Section 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

- Sincerely,
- Ronald Shoemaker
- Manager, Exempt Organizations

- Technical Group 2

Enclosure
Notice 437

Citations: LTR 201419015

ABA Meeting: IRS Standardizing Exempt Bond Closing Agreements.

The IRS is taking steps to standardize and simplify its voluntary compliance program in the area of tax-exempt bonds, an agency official said May 9.

Rebecca Harrigal, director (tax-exempt bonds), IRS Tax-Exempt and Government Entities Division, said her office is creating two standard closing agreements: one for field operations and one for the compliance and program management office. Most closing agreements will fit within those categories, she said. Harrigal spoke at the Tax-Exempt Financing session of the American Bar Association Section of Taxation meeting in Washington.

The agency hopes the simplification will help it apply its limited resources where they are most needed, Harrigal said. Any problems or concerns that bond counsel have had with closing agreements should be brought to the attention of the IRS now because those issues may be addressed through the establishment of the standard closing agreements, she said.

The IRS also is significantly rewriting its voluntary closing agreement program manual, Harrigal said, adding that the Service will try to standardize as much as it can. There is a new closing agreement team that will look at all nonstandard closing agreements and will get involved "when closing agreement terms get changed from the standard language that we're working on," she said. "They will be looking for consistency and enforceability in those," she added.

MAY 12, 2014

by Fred Stokeld

ABA Meeting: IRS Official Addresses Concerns About EO Form.

An IRS official May 9 addressed concerns that have been raised about the recently released draft of a simplified application for tax-exempt status, saying there could be changes as to who is and is not eligible to use the new form.

Speaking at the Exempt Organizations session of the American Bar Association Section of Taxation meeting in Washington, Sunita Lough, commissioner, IRS Tax-Exempt and Government Entities Division, discussed the draft Form 1023-EZ, "Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code," which the IRS introduced last month and which organizations can use if they have annual gross receipts of $200,000 or less and meet other eligibility requirements.

Practitioners have asked why some categories of EOs — hospitals, colleges and universities, and organizations with donor-advised funds, to name a few — would be ineligible to use the short form. Lough said the draft and its eligibility requirements are not set in stone and that some categories of organizations not eligible to use the simplified application could become eligible later and vice versa. She said the IRS will need to review its eligibility checklist to determine whether to make changes.

Other commentators have noted that unlike the longer Form 1023, the draft Form 1023-EZ does not require a narrative statement of an applicant's exempt purpose, leading some to wonder how the IRS will determine whether an organization will pursue charitable activities. But Lough said a narrative statement is not necessarily dispositive of how an organization will operate and that the IRS believes looking at what a small organization does after receiving its determination letter will show whether it is furthering exempt functions.

In response to worries that the Form 1023-EZ will not be an adequate learning tool because of its simplicity, Lough said the IRS has tried to make the instructions educational, adding that information will also be available on the EO portion of the IRS website.

The IRS will do some predetermination checks on a sample of Forms 1023-EZ by asking filers about items they have checked on the form, according to Lough. The contacts will give the IRS feedback on areas of the form and instructions that may need improvement, she said.

Lough said she expects the Form 1023-EZ to be ready for electronic filing by midsummer.

MAY 12, 2014

by Fred Stokeld

Exemption Applicants Can Appeal Determinations, Koskinen Says.

The Service has changed its process for reviewing organizations' appeals of unfavorable determinations for tax-exempt status, IRS Commissioner John Koskinen said May 7 at a hearing of the House Ways and Means Oversight Subcommittee.

Previously, some conservative groups' appeals were directed to a trio of IRS executives rather than to the independent appeals function established for that purpose by the Internal Revenue Service Restructuring and Reform Act of 1998. The changes should safeguard exemption applicants' right of appeal, whether they originally went through the exempt organizations office in Cincinnati or through IRS headquarters in Washington, Koskinen said.

Koskinen was responding to a question by subcommittee Chair Charles W. Boustany Jr., R-La., who noted that some groups alleged that the IRS had denied their rights to appeal the determinations.

Boustany also inquired about what he called the apparent subversion by former IRS official Lois Lerner of internal agency controls to prevent taxpayer targeting. Koskinen said, "I think the process that I hope will reassure Americans is that, not only do we have a structure in place, [but] we're trying to build a structure that will accept and be welcoming to people who say there's a problem that needs to be looked into," whether the source is Congress, IRS oversight bodies, taxpayers, or IRS employees.

Asked by Boustany about alleged abuse of audit selection criteria by IRS examiners against conservative groups and donors, Koskinen told the committee that the IRS is negotiating with the National Treasury Employees Union, which represents most IRS workers, over performance awards given to employees disciplined for being delinquent on their taxes. The commissioner said he hoped that a ban on such awards would be included in the union's contracts and in IRS regulations and policies, although he did not specify a time frame.

"Legislation is kind of a blunt instrument," Koskinen told Rep. Sam Johnson, R-Texas, who is promoting his No Bonuses for Tax Delinquent IRS Employees Act of 2014 (H.R. 4531), which seeks an absolute ban on such awards. "You will be satisfied, I hope, with our union negotiations, that policies we have are appropriate," Koskinen said.

The NTEU's contract with the IRS expires October 1, although the two sides can agree to an extension.

The commissioner also weighed in on the debate over reviving private collection of debts owed to the IRS, as included in the Senate Finance Committee's tax extenders bill (the Expiring Provisions Improvement, Reform, and Efficiency (EXPIRE) Act of 2014 (S. 2260)). Previous experiences with the strategy revealed it to be unexpectedly expensive and inefficient, Koskinen said. Private debt collection was also limited because it did not include enforcement authority, he noted.

Koskinen said a recent phone scam, in which fraudsters representing themselves as IRS employees called taxpayers and threatened them with jail unless they paid supposed tax debts, raises questions about the public reception to private collections. "If you're surprised to be hearing from us on the phone, you're probably not hearing from us," he said, noting that the IRS does not initiate contact by phone.

The commissioner also made a pitch for Congress to enact several administration proposals, including accelerating due dates for information returns to facilitate faster and better matching with tax returns to prevent refund fraud, and authorizing the IRS to regulate return preparers.

Granting the IRS correctible error authority also would allow the Service to make more corrections to taxpayers' returns using independently verifiable information, without initiating an audit as is required now, Koskinen noted.

Subcommittee ranking minority member John Lewis, D-Ga., expressed concerns about the IRS's budget.

"Your workload is getting heavier," Lewis said. "The issues you face are becoming more and more complex. But your appropriation keeps getting smaller." Noting the Service's ongoing battles against tax-related identity theft and its grappling with needs of low-income and elderly taxpayers, compared with the Service's continued funding crunch, Lewis asked, "Are you being set up for failure, for disaster?"

Koskinen replied, "No, we have a very can-do agency." But he added, "I am very concerned. I've never dealt with an organization, even a major one in bankruptcy, that is so consistently understaffed across the board."

The IRS Oversight Board in a May 7 report said the Service's shrinking and uncertain budget and "unfunded legislative mandates" are harming both enforcement and taxpayers' ability to comply with tax laws.

MAY 8, 2014

by William Hoffman

Guidance Requested on Deductibility of Water Right Contributions.

Thomas Hicks of Trout Unlimited has asked the IRS to include on its 2014-2015 priority guidance list (Notice 2014-18) guidance that clarifies the deductibility of a charitable contribution of an entire interest of an appropriative water right to an organization described in section 170(c) and an undivided portion of the taxpayer's entire interest in an appropriative water right under section 170(f)(3)(B)(ii).

April 30, 2014

Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2012-25)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: IRS Notice 2014-18 Public Comment on Recommendations for *2014-2015 Priority Guidance Plan List*

Trout Unlimited submits these recommendations for the *2014-2015 Priority Guidance Plan*. There remains a continued and overwhelming need for the IRS to clarify an ambiguity in the federal tax deductibility of charitable contributions of entire and certain partial interest of appropriative water rights.Published administrative guidance is sought to clarify Internal Revenue Code (I.R.C.) § 170 and the deductibility of a charitable contribution of:

- 1. an entire interest of an appropriative water right to an organization described in I.R.C. § 170(c); and

2. an undivided portion of the taxpayer's entire interest in an appropriative water right under I.R.C. § 170(f)(3)(B)(ii).

This 2014 recommendation is based upon an initial April 2012 recommendation and an October 2012 Revenue Ruling Request. In this interim, there has been increased public interest in the outcome of this Request. Attached is related correspondence between U.S. Senator Max Baucus and the IRS Commissioner. In addition, there are other letters in support from Washington State Department of Ecology, Oregon Water Resources Department, Montana Department of Fish, Wildlife & Parks, and others.Timely resolution of these federal tax ambiguities is important for taxpayers in appropriative water right states. It is particularly important now, in times of climate change and drought, to obtain clarity regarding these questions.

Please call 415.309.2098 if you have any questions or we can be of any further assistance.

- Sincerely,
- Thomas Hicks
- Of Counsel, TU Western Water

- Project
- Trout Unlimited
- Laura Ziemer
- Senior Counsel and Water Policy
- Advisor
- TU Western Water Project
- Trout Unlimited

cc:
Karin Gross
Internal Revenue Service
Office of Chief Counsel
CC:ITA:01 — Room 4043
1111 Constitution Ave. NW
Washington, DC 20224
E-mail: Karin.Gross@irscounsel.treas.gov

Ruth Madrigal
Attorney Advisor
Office of Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Ave. NW
Washington, DC 20220
E-mail: Ruth.Madrigal@treasury.gov

Guidance Requested on Treatment of Charitable Contributions Costs.

Marc Gerson of Miller & Chevalier has asked the IRS to include on its 2014-2015 priority guidance list (Notice 2014-18) guidance clarifying the treatment under current law of current year acquisition costs for charitable contributions of inventory and other property under section 170(e)(3).

April 30, 2014
Courier's Desk Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2014-18)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Recommendation for the 2014-2015 Priority Guidance Plan Pursuant to Notice 2014-18

To Whom It May Concern:

Pursuant to Notice 2014-18, 2014-15 I.R.B. 1 (the "Notice"), Miller & Chevalier Chartered respectfully requests that guidance in the form of a notice clarifying the treatment under current

law of current year acquisition costs with respect to charitable contributions of inventory and other property under Section 170(e)(3) of the Internal Revenue Code[1] (as contemplated by Notice 2008-90, 2008-43 I.R.B. 1000) be included on the 2014-2015 Priority Guidance Plan under the jurisdiction of the Office of Associate Chief Counsel (Income Tax & Accounting).

I. Requested Guidance Pursuant to Section 170(e)(3)

Guidance in the form of a notice is requested clarifying the treatment under current law of current year acquisition costs with respect to charitable contributions of inventory and other property under Section 170(e)(3) for the benefit of the ill, the needy, or infants.[2] Specifically, such guidance should provide that such current year acquisition costs are treated as cost of goods sold (and, therefore, not classified and deducted as a charitable contribution) under current law. Such guidance will provide certainty that, consistent with the existing regulatory charitable contribution regime, donors of inventory and other property for the benefit of the ill, the needy, or infants will under all circumstances (i) be allowed to recover their basis in donated inventory or other property, and (ii) be able to compute the enhanced charitable contribution deduction available under Section 170(e)(3). For your consideration, (i) enclosed as Exhibit A is a draft notice providing the requested clarifying guidance, and (ii) enclosed as Exhibit B is an example demonstrating the application of such guidance.

It should be noted that the application of Section 170(e)(3) to current year acquisition costs is particularly important in the context of charitable contributions of food to satisfy the increased demand on food banks and other hunger relief agencies as a result of the current economic situation.[3] In order to ensure that such contributions continue to satisfy such increased demand, it is respectfully requested that guidance with respect to the treatment of such current year acquisition costs be included on the 2014-2015 Priority Guidance Plan and then be issued in the form of a notice drafted by the Office of Associate Chief Counsel (Income Tax & Accounting) as soon as practically possible thereafter.[4]

II. Discussion

Section 170(e)(1) provides the general rule that donors are permitted a deduction for charitable contributions of ordinary income and capital gain property equal to the lower of the donor's basis or the fair market value of the property at the time of donation. Treas. Reg. § 1.170A-1(c)(4) provides that under this general rule (i) current year acquisition costs (i.e., purchases) with respect to contributed property should be treated as cost of goods sold (and, therefore, not classified and deducted as a charitable contribution), and (ii) prior year acquisition costs with respect to contributed property that are included in opening inventory in the year of contribution should be "removed" from inventory and classified and deducted as a charitable contribution (the so-called "removal rule").[5] This longstanding regulation ensures that donors will recover current year acquisition costs through cost of goods sold without regard to the limitations imposed on charitable contributions under Section 170, primarily the taxable income limitation of Section 170(b)(2).

Section 170(e)(3) is a special incentive designed to provide an enhanced charitable deduction (the so-called "bump") with respect to donations of inventory and other property for the benefit of the ill, the needy or infants equal to the lower of (i) twice the cost basis of the contributed property, or (ii) the cost basis plus one-half of the appreciation in excess of basis. Treas. Reg. § 1.170A-4A(c)(3) provides that "[n]otwithstanding the rules of § 1.170A-1(c)(4), the donor of the property which is inventory contributed under this section must make a corresponding adjustment to cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the contributed item or the amount of basis. . . ."

Clarification is necessary with respect to the treatment of current year acquisition costs with respect to charitable contributions of inventory and other property under Section 170(e)(3). Specifically, there is uncertainty regarding the scope and application of Treas. Reg. § 1.170A-4A(c)(3) and, in particular, whether current year acquisition costs with respect to charitable contributions under Section 170(e)(3) are (i) treated as cost of goods sold under the general rule of Section 170(e)(1) and Treas. Reg. § 1.170A-1(c)(4), or (ii) subject to the removal rule and classified and deducted as charitable contributions under Treas. Reg. § 1.170A-4A(c)(3).[6] We respectfully request that clarifying guidance in the form of a notice be issued that such costs are treated as cost of goods sold under current law and regulations, as such treatment is consistent with the intent of the existing regulatory charitable contribution regime as described above.

The regulatory development of Treas. Reg. § 1.170A-4A(c)(3) clearly supports the treatment of current year acquisition costs as cost of goods sold. Treas. Reg. § 1.170A-4A(c)(3) originally required the donor to apply the removal rule by reducing its cost of goods sold by the basis of the donated property.[7] The Treasury Department and the Internal Revenue Service (the "IRS"), however, recognized that this rule created a problem with respect to "underwater" inventory having a fair market value less than its basis:

- Where the basis of the contributed inventory property qualifying under section 170(e)(3) exceeds the property's fair market value, the underlying purpose of the section to encourage contributions of this type of property for the purposes specified in section 170(e)(3) may be frustrated. This is because the entire basis of the contributed property is removed from the cost of goods sold while the charitable contribution is limited to the property's fair market value. It would be more advantageous for the taxpayer to destroy or sell the property than to contribute it for the care of the ill, the needy, or infants. A taxpayer would then be entitled to deduct its entire basis in the property as a loss deduction under section 165 or as part of the cost of goods sold as compared to a charitable contribution amount limited to the property's fair market value.

[8]

Treas. Reg. § 1.170A-4A(c)(3) was subsequently amended by T.D. 7962 "[i]n order to remove this disincentive."[9] It is important to note, however, that although not explicit in the text of T.D. 7962 or the regulation itself, it is clear that the amended regulation was directed at limiting the removal rule with respect to prior year acquisition costs[10] and was not intended to override the established treatment of current year acquisition costs as cost of goods sold under the general rule of Section 170(e)(1) and Treas. Reg. § 1.170A-1(c)(4).Treas. Reg. § 1.170A-4A(c)(3) by its terms applies to "property *which is inventory.*" Designation of property as "inventory" is limited to prior year acquisition costs under the existing regulatory charitable contribution regime as evidenced by Treas. Reg. § 1.170A-1(c)(4), which distinguishes between (i) "[a]ny costs and expenses pertaining to the contributed property which were incurred in taxable years preceding the year of contribution and are properly*reflected in the opening inventory* for the year of contribution" (i.e., prior year acquisition costs subject to the removal rule), and (ii) "[a]ny costs and expenses pertaining to the contributed property which are incurred in the year of contribution" (i.e., current year acquisition costs treated as cost of goods sold). Current year acquisition costs by definition are not "inventory" (i.e., they remain as part of cost of goods sold in the current year and, therefore, are never reflected in inventory) and, therefore, should not be subject to the application of Treas. Reg. § 1.170A-4A(c)(3) which as noted above is limited to "property *which is inventory.*"[11]

It should be noted that it is our understanding that some parties have interpreted the introductory language of the regulation (i.e., "[n]otwithstanding the rules of § 1.170A-1(c)(4)") to disregard the established treatment of current year acquisition costs as cost of goods sold, when such language

should for the reasons described above be limited to an interpretation of the application of the removal rule to prior year acquisition costs. As detailed above, the context of the amendment to Treas. Reg. § 1.170A-4A(c)(3) was clearly limited to the treatment of prior year acquisition costs and there is nothing to suggest that the established treatment of current year acquisition costs as cost of goods sold under Treas. Reg. § 1.170A-1(c)(4) was intended to be modified. This is further supported by the fact that Treas. Reg. § 1.170A-4A(c)(3) was amended without being subject to the normal notice and comment procedures and effective date limitations of the Administrative Procedure Act (the "APA") as the Treasury Department and the IRS determined that the amendment "merely liberalize[d] the provisions of § 1.170A-4A(c)(3)."[12]Therefore, it was "found unnecessary to issue it with notice and public procedure under [the APA] or subject to the effective date limitation of [the APA]."[13] It is respectfully submitted that the amendment to Treas. Reg. § 1.170A-4A(c)(3) was not intended as a restriction on the established treatment of current year acquisition costs as cost of goods sold under Treas. Reg. § 1.170A-1(c)(4), since if it was intended as such a restriction the Treasury Department and the IRS presumably would not have viewed the amendment as a "liberalization" and, therefore, would have been compelled to follow the required APA procedures.

Despite the fact that the context of the amendment to Treas. Reg. § 1.170A-4A(c)(3) suggests that the removal rule provided by that regulation be limited to prior year acquisition costs, the fact that there is not an explicit reference to such prior year acquisition costs has created uncertainty as to the treatment of current year acquisition costs. In response to taxpayer concerns regarding this uncertainty,[14] the Office of Associate Chief Counsel (Income Tax & Accounting) issued Notice 2008-90, which allowed taxpayers to treat current year acquisition costs as cost of goods sold in certain circumstances.[15] The notice itself, however, announced a larger study of the treatment of charitable contributions under Section 170(e)(3) and contemplated the issuance of future guidance.[16] Consistent with the underlying intent of this study, it is respectfully submitted that such future guidance be included on the 2014-2015 Priority Guidance Plan and ultimately be issued by the Office of Associate Chief Counsel (Income Tax & Accounting) to provide comprehensive clarification that current year acquisition costs are treated as cost of goods sold under current law in all circumstances.

III. Appropriateness of Inclusion of Requested Guidance on the 2014-2015 Priority Guidance Plan

Pursuant to the Notice, the Treasury Department and the IRS consider the following in reviewing recommendations and selecting projects for inclusion on the 2014-2015 Priority Guidance Plan: (i) whether the recommended guidance resolves significant issues relevant to many taxpayers; (ii) whether the recommended guidance promotes sound tax administration; (iii) whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance; (iv) whether the recommended guidance involves regulations that are outmoded, ineffective, insufficient, or excessively burdensome and that should be modified, streamlined, expanded, or repealed; (v) whether the IRS can administer the recommended guidance on a uniform basis; and (vi) whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the IRS.

It is respectfully submitted that the recommended guidance satisfies each of these criteria. With respect to the first criteria, the recommended guidance resolves significant issues relevant to many taxpayers. Specifically, the treatment of current year acquisition costs under Section 170(e)(3) impacts the wide number of donors and recipients of charitable contributions of inventory and other property for the benefit of the ill, the needy, or infants. This is particularly true with respect to donors of food (including grocery stores, food manufacturers and others), as well as food banks and other hunger relief agencies that are the recipients of such donations.[17] Uncertainty regarding the treatment of current year acquisition costs has caused such donors to consider suspending or

eliminating long-standing charitable donation programs. In this regard, such uncertainty has caused such donors to consider destroying or otherwise disposing of inventory and other property (and claiming a loss deduction) rather than donating it in order to ensure that they recover the basis of such property without being subject to the taxable income limitation of Section 170(b)(2).[18]

With respect to the fourth criteria, the recommended guidance involves regulations that are ineffective because, as discussed above, such guidance would address the uncertainty regarding the scope and application of Treas. Reg. § 1.170A-4A(c)(3)[19] and, in particular, whether current year acquisition costs with respect to charitable contributions under Section 170(e)(3) are (i) treated as costs of goods sold under the general rule of Section 170(e)(1) and Treas. Reg. § 1.170A-1(c)(4), or (ii) subject to the removal rule and classified and deducted as charitable contributions under Treas. Reg. § 1.170A-4A(c)(3).

With respect to the remaining criteria, the recommended guidance would (i) promote sound tax administration, (ii) be drafted in a manner that will enable taxpayers to easily understand and apply it, (iii) be administered by the IRS on a uniform basis, and (iv) reduce controversy and lessens the burden on taxpayers or the IRS. As evidenced by the draft notice enclosed as Exhibit A and the example demonstrating the application of that draft notice enclosed as Exhibit B, the recommended guidance allows for the simple classification of acquisition costs and the straightforward calculation of the Section 170(e)(3) enhanced deduction. Such classification and calculation is (i) easily applied by taxpayers and easily administered and reviewed by the IRS,[20] and (ii) would result in relatively little if any additional recordkeeping or compliance burden for taxpayers.

* * * * * *

Thank you in advance for your consideration of this request. We appreciate the opportunity to submit this request and would welcome the opportunity to meet with the Treasury Department and the IRS to discuss it in greater detail or to answer any questions that you may have.

- Respectfully submitted,
- Marc J. Gerson
- Miller & Chevalier Chartered
- Washington, DC

Enclosures

cc:
Alexa M. Claybon
M. Ruth M. Madrigal
Treasury Department Office of Tax Policy

Andrew J. Keyso, Jr.
Associate Chief Counsel (Income Tax & Accounting)

Roy A. Hirschhorn
Chief, Branch 6
Associate Chief Counsel (Income Tax & Accounting)

Steven I. Hurok
Citrin Cooperman

* * * * ***Exhibit A**
Draft Notice

Part III — Administrative, Procedural, and MiscellaneousCharitable Contributions of Inventory And Other Property Under § 170(e)(3)

Notice 2014-[XX]

SECTION 1. OVERVIEW

This notice provides guidance clarifying the treatment under current law of current year acquisition costs with respect to charitable contributions of inventory and other property that constitute qualified contributions as defined in Section 170(e)(3) of the Internal Revenue Code.

SECTION 2. GUIDANCE UNDER SECTION 170(e)(3)

For a particular qualified contribution of inventory and other property under § 170(e)(3) that otherwise satisfies the requirements of § 170 and the relevant regulations, any costs and expenses pertaining to the contributed property which are incurred in the year of contribution and would, under the method of accounting used, be properly reflected in the cost of goods sold for such year ("current year acquisition costs") are to be treated as part of the cost of goods sold for such year.

SECTION 3. RELIANCE ON NOTICE

Taxpayers may rely on this notice unless and until further guidance is issued.

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is [insert] of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice contact [insert] at [insert] (not a toll free call).

Exhibit B
Example

Corporation X has taxable income of $2,000 for 2014. Corporation X makes a charitable contribution of food to a local food bank in 2014. The contribution is a "qualified contribution" under Section 170(e)(3)(A). The food was purchased during 2014 and had a basis of $100 and a fair market value of $150 on the date of contribution. The amount and classification of the resulting deductions for 2014 are as follows: Portion of deduction classified and allowed as cost of goods sold ("COGS")

Cost basis	$100
Portion of deduction classified as charitable contribution	
Fair market value of contributed property	$150
Reduction for 50% of profit ($150 - $100)	($25)
Net	$125
Twice cost basis of contributed property	$200
Lower of net (computed above) or twice cost basis	$125
Portion of deduction classified and allowed as COGS	($100)
Net Section 170(e)(3) "bump"	$25

Application of Section 170(b) taxable income limitation	
Total 2014 charitable contribution	$25
Taxable income limitation (10% of $2,000)	$200
Charitable contribution deduction in 2014	$25
Total cost recovery in 2014	
Portion of deduction classified and allowed as COGS	$100
Charitable contribution deduction in 2014	$25

FOOTNOTES

[1] All section references are to the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder, unless otherwise specified.[2] Because such guidance would clarify the treatment of current year acquisition costs under current law, such guidance should be applicable retroactively.

[3] Increased demand on food banks and other hunger relief agencies, and the increased efforts of donors of food to satisfy such demand, has been widely reported. *See, e.g.*, Nixon, "Food Banks Anticipate Impact of Cuts to Food Stamps, New York Times (Jan, 22, 2014); Bello, "Food Stamp Cuts Create High Demand For Food Bank Supplies," USA Today (Nov. 4, 2013). *See also* Feeding America, 2013 Annual Report (noting that the Feeding America nationwide network of member food banks provided 3.2 billion meals to 37 million people in the United States in a single year).

[4] As discussed in greater detail herein, the requested guidance with respect to the treatment of current year acquisition costs may be issued in a manner that is consistent with the existing regulatory charitable contribution regime (i.e., such that no modification of the existing regulations would be required). Therefore, it is respectfully requested that guidance be issued in the form of a notice such that it may be issued in an expedited fashion. To the extent that the Treasury Department and the Internal Revenue Service are considering the issuance of broader guidance under Section 170(e)(3) that would in fact require a modification to the existing regulations, it is respectfully requested that the requested guidance with respect to the treatment of current year acquisition costs be issued in the form of a notice in advance of such regulations for the compelling socioeconomic circumstances discussed above.

[5] Treas. Reg. § 1.170A-1(c)(4) ("Any costs and expenses pertaining to the contributed property which were incurred in taxable years preceding the year of contribution and are properly reflected in the opening inventory for the year of contribution must be removed from inventory and are not a part of the cost of goods sold for purposes of determining gross income for the year of contribution. Any costs and expenses pertaining to the contributed property which are incurred in the year of contribution and would, under the method of accounting used, be properly reflected in the cost of goods sold for such year are to be treated as part of the cost of goods sold for such year.").

[6] *See* American Institute of Certified Public Accountants, Compendium of Legislative Proposals — Simplification and Technical Proposals, at 74-76 (Feb. 19, 2014) (the "AICPA Legislative Proposals"). Although the AICPA Legislative Proposals suggest that such uncertainty may be resolved through legislation amending Section 170(e)(3), it is respectfully submitted that because the classification of current year acquisition costs is addressed through the existing regulatory charitable contribution regime as described above, such uncertainty may be clarified through the guidance requested in this submission.

[7] Former Treas. Reg. § 1.170A-4A(c)(3), T.D. 7807, 1983-2 C.B. 41, 45 ("The donor of property which

is inventory contributed under this section must make a corresponding adjustment to cost of goods sold by decreasing the cost of goods sold by the amount of basis. . . .").

[8] T.D. 7962, 1984-2 C.B. 57.

[9] *Id*.

[10] The Treasury Department and the IRS could, of course, amend the regulation with respect to the treatment of prior year acquisition costs. Such an amendment, however, is beyond the scope of the requested guidance contained herein.

[11] Furthermore, as noted above, Treas. Reg. § 1.170A-4A(c)(3) was amended to address situations involving "underwater" inventory that has decreased in value. T.D. 7962, 1984-2 C.B. 57. Such "underwater" inventory situations are most prevalent with respect to prior year acquisition costs as opposed to current year acquisition costs given the greater opportunity for valuation disparities to occur with respect to prior year acquisition costs. *See also* Treas. Reg. § 1.170A-4A(c)(4) Ex. 1 (500% increase in fair market value of donated property suggests property was included in beginning of year inventory as prior year acquisition costs).

[12] 1984-2 C.B. 57.

[13] *Id*.

[14] *See* "Attorneys Alert Treasury to Unintended Consequences of Existing Charitable Contribution Regs," 2008 TNT 94-19 (May 2, 2008) (the "2008 Treasury Submission").

[15] Notice 2008-90 at Section 2. *See also* "Firm Makes Recommendation for Treatment of Charitable Contributions of Inventory Property," 2009 TNT 17-21 (Jan. 22, 2009) (the "2009 Treasury Submission").

[16] Notice 2008-90 at Sections 1, 4.

[17] *See* Footnote 3 and accompanying text

[18] *See* 2008 Treasury Submission. As a result of this uncertainty, the Treasury Department and the IRS issued Notice 2008-90, which allows taxpayers in certain circumstances to recover their tax basis in donated inventory and other property as cost of goods sold. *See* 2009 Treasury Submission.

[19] As noted above, such uncertainty is caused, in particular, by the introductory language of that regulation (i.e., "[n]otwithstanding the rules of § 1.170A-1(c)(4)").

[20] Furthermore, the promulgation of the recommended guidance would not prevent the IRS from challenging other issues with respect to the Section 170(e)(3) enhanced deduction. *See* CCA 201012061 (Nov. 10, 2009) (Notice 2008-90 does not prevent IRS from challenging other issues under Section 170(e)(3)). In addition, the IRS's ability to administer the recommended guidance would be enhanced if, consistent with the 2009 Treasury Submission, such guidance was limited to Section 170(e)(3) contributions of inventory and other property and not expanded to apply to Section 170(e)(4) contributions of scientific property used for research and Section 170(e)(5) contributions of computer technology and equipment for educational purposes, despite the cross reference in those sections to Section 170(e)(3). See 2009 Treasury Submission.

END OF FOOTNOTES

Draft of Simplified EO Application Presents Problems, Group Says.

Draft Form 1023-EZ, “Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code,” would decrease the quality of information the IRS needs to make informed decisions, according to Tim Delaney of the National Council of Nonprofits.

April 30, 2014

Office of Information and Regulatory Affairs
Office of Management and Budget
Attention: Desk Officer for Treasury
New Executive Office Building, Room 10235
Washington, DC 20503

Treasury PRA Clearance Officer
1750 Pennsylvania Avenue NW, Suite 8140
Washington, DC 20220

- RE: TREASURY DEPARTMENT’S PROPOSAL TO RADICALLY ALTER THE PROCESS FOR OBTAINING TAX-EXEMPT STATUS VIA AN ALTERNATIVE FORM 1023-EZ APPLICATION FOR RECOGNITION OF EXEMPTION UNDER SECTION 501(c)(3) OF THE INTERNAL REVENUE CODE

Dear Office of Management and Budget Officials:The National Council of Nonprofits submits the following comments in response to the Treasury Department’s Notice of Submission for OMB Review published in the Federal Register (79 FR 18124) on March 26, 2014. That Notice invited “comments regarding the burden estimate, or any other aspect of the information collection” associated with the Internal Revenue Service (IRS) proposal to radically alter the process for obtaining tax-exempt status by “introducing an ‘EZ’ version of the Form 1023 as an alternative in applying for recognition of exemption from federal income tax under section 501(c)(3).”

As explained below, we are concerned that the proposed new Form 1023-EZ and related streamlined approval process for tax-exemption will:

- 1. Decrease, rather than improve, the quality of information the IRS needs to make informed decisions;

2. Reduce public trust; and

3. Inappropriately shift the IRS’ obligations onto others — foisting burdens on the public, existing charitable nonprofits, the funding community, and state charity regulators.
OMB should not approve the proposed Form 1023-EZ; instead, OMB should — consistent with the Paperwork Reduction Act — put the public’s interest in “accountability, transparency, and openness in Government and society” before the interest of simply reducing a backlog at the IRS, significant though it may be. See 44 U.S.C. § 3501.We agree with the IRS that the long-established Form 1023 and application process need review and streamlining. However, we are concerned that the proposed new EZ Form and related express-lane approval process go too far and too fast, representing radical departures from proven protocols. In response to the Treasury Notice seeking

"suggestions for reducing the burden," the IRS should meet first with other key stakeholders — including the public, existing charitable nonprofits, the funding community, and state charity regulators, such as occurred when the IRS redesigned the Form 990. Therefore, we are sending a copy of these Comments to the Commissioner of Tax Exempt and Government Entities and the Director of the IRS Exempt Organizations Division to alert them to our serious concerns and request that they withdraw the proposed new form and gather more input before radically changing the way applications for tax-exemption are evaluated by the IRS.

The Interests of the National Council of Nonprofits

The National Council of Nonprofits is a 501(c)(3) charitable nonprofit that serves as a trusted resource and advocate for America's charitable nonprofits. Through our network of State Associations and 25,000-plus members — the nation's largest network of charitable nonprofits — we serve as a central coordinator and mobilizer to help nonprofits achieve greater collective impact in local communities across the country. We identify emerging trends, share proven practices, and promote solutions that benefit charitable nonprofits and the communities they serve. Our core mission is "to advance the vital role, capacity, and voice of charitable nonprofit organizations through our state and national networks."An IRS decision to grant status as a charitable nonprofit is a momentous one creating cascading results, so it should not be done lightly. Through operation of longstanding interdependent federal and state laws, many things happen once the IRS issues a determination letter recognizing an organization as being exempt from federal income tax under section 501(c)(3). For instance, in many states it activates exemptions from state income taxes and local property taxes. Also, it triggers eligibility for charitable nonprofits to receive donations that are deductible at the federal and usually state levels. In exchange for these and other benefits of being recognized as tax-exempt, charitable nonprofits and private foundations forfeit certain rights. For example, they are not allowed to support or oppose political candidates. Plus, they give up privacy rights afforded to others — they file federal tax information returns annually that are open to public inspection. And the list of inter-related federal, state, local, and private causes and effects/costs and benefits goes on.

The IRS' proposed new Form 1023-EZ and related process for obtaining express-lane authority to solicit charitable deductions are radical departures from proven protocols that could have a profound impact on the foregoing inter-related balancing that involves the nonprofit community. To underscore the significance of what the proposed changes could mean, consider the following observations we have received from nonprofit leaders across the country in the last several days since learning about the Paperwork Reduction Act review (emphasis added):

- *I counsel new nonprofits weekly, and though I appreciate the IRS's attempt at efficiency, I think **this could be disastrous**. I think that we need to look at the overall confidence this move could erode with the American public over time (based on potentially "legitimate" nonprofits seeking funding for causes that have not been thoroughly vetted). This wouldn't happen immediately, but it **could be a bad legacy to leave for the next generation** of leadership, one that would be difficult to course correct once people became use to the ease of the process.*
- *The current process is slow but it requires effort and energy and pushes away those that are not prepared. At a minimum allows some thoughtfulness and energy in describing who you are and how you will operate. **To remove the requirement simply pushes the clean up to 3 years from now as the system falls apart and there is a backlash of onerous exams and audits.***
- *We **don't need a proliferation of tax exempt organizations**. Already, cultivating and recruiting functional boards is a challenge. Funding is a challenge.*
- *Having gone through the application process with a museum I helped start, we were put through the ringer by the IRS which to some extent **forced us to think through our plans** (mission,*

vision, intent, how we would operate, etc.) ultimately, I believe, making us stronger.

- *While I recognize the process in and of itself is not necessarily user friendly, it has supported a perception of the awesome responsibility to become tax exempt and serving the community. In making the process more streamlined it may only lessen the perception of* ***the "awesome" responsibility to the community that a group has*** *after being granted the tax status.*
- *While the idea of simplifying the application process for smaller organizations is laudable,* ***the proposed Form 1023 EZ goes way too far****. Although a charity is supposed to review the requirements in advance and attest to having the requisite purposes and documents, this proposal removes the crucial step of having someone independent (in this case, the IRS) to verify the existence of these documents or ensure that the required provisions are actually in place.* ***Although the IRS estimates that it will take 14 hours to fill out the new Form 1023 EZ, I could easily see many applicants spending as little as an hour or so — not because they deliberately intend to skirt the law, but because they simply don't know or understand what they are required to certify****. Sure, they may (or may not) have the documents, but do they even say the right things? We've encountered similar situations through our legal assistance program for startup organizations, simply because people often "don't know what they don't know" without a legal review or a competent IRS agent. Clearly,****without these safeguards in place, the door could be opened for improper approval of thousands of applications each year.***
- *Generally, Form 1023 is not very accessible, too long, and quite cumbersome. The form should be simplified,* ***but this EZ form does this too much****. There some useful exercises that are part of the 1023 filing process that are useful in setting up a sustainable organization (bylaws, business/revenue plan, conflict of interest policies, the programs narrative). The full 1023 is overwhelming and is discouraging to some, but* ***also a deterrent to those with only half-baked plans and ideas****. I understand that the IRS wants to clear the backlog, but this may not be the best solution as it is in its current draft format. If the 1023 EZ was improved in some ways, it might be a good option.*
- ***This change could wreak added havoc for regulators****, since the rigorous review of EO applications will not have been done beforehand, opening the door for all kinds of problems in terms of non-compliance (again, intentional or otherwise) and enforcement issues for both state and federal regulators. In terms of wise utilization of IRS resources,* ***this may actually cost more in the long run****, and* ***could seriously undermine public trust in the sector if problems end up increasing as a result.***

Before such a potentially significant change is implemented, it merits far greater public input than just a limited Paperwork Reduction Act review. The IRS should seek the views of not only existing charitable nonprofits (many of which, in hindsight, recognize the value of slowing down to complete the Form 1023), donors and foundations (many of whom — because they already question whether there are too many nonprofits — may want to be heard on the subject of possible proliferation), researchers (who may express concern that a valuable source of information — all parts of the Form 1023 application, plus accompanying documentation — will no longer be available to them), and state charity regulators (whom we understand will be filling separate comments to detail their concerns and reiterate their position in 2012 when they "uniformly oppose[d] a Form 1023-EZ"[1]).

Background

During the last several years, the IRS has accumulated a backlog of pending applications for tax-exempt status.[2]According to an internal IRS memorandum dated February 28, 2014, IRS managers have been analyzing how to streamline its processes. That memorandum suggests that the only goals considered in connection with the proposed streamlined process were to reduce (a) the IRS backlog of filings and (b) the informational burden for the applicants. Both are laudable goals. However,

focusing on those two exclusively ignored multiple other perspectives and significantly sidestepped the IRS' obligation to base a determination about tax-exempt status on solid information rather than a mere certification. This excerpt from the memo suggests the IRS focused on its own internal management issues rather than any consideration of the possible external consequences that its proposed radical changes might create:

The assessment concluded that the current process has high inventory, limited resources, inaccurate forms, outdated IRMs, continuously changing procedures, multiple touch points, multiple work streams, and non-standard processes. In addition, inadequate technical tax law training has not equipped the workforce to effectively/ efficiently complete the work.

The memorandum also reveals that the IRS has been working on this issue internally since at least June 2013. However, neither the memo nor a review of the IRS website shows any indication that the IRS invited the public or affected stakeholders to provide their informed perspectives, until Treasury filed its narrow Paperwork Reduction Act Notice in the Federal Register on March 31, 2014. That is most unfortunate, because the proposed Form 1023-EZ is a radical departure from the more meaningful review that multiple stakeholders have relied on the IRS to conduct with profound care.The Notice published in the Federal Register on March 31, 2014 asking for comments on the new form by April 30, 2014 may suffer from a fatal procedural flaw. The Notice referenced a draft Form 1023-EZ that was two pages in length, dated February 19, 2014 (labeled "Version A, Cycle 4"). Yet almost a month later, the IRS disclosed a possible substitute two-and-a-half page draft Form 1023-EZ, dated April 23 (labeled "Version A, Cycle 12"). It appears that Treasury gave OMB and thereby the public one version of the Form 1023-EZ, but the IRS has revised the form during the comment period without resubmitting it for approval. The two forms, while carrying the same title and similar in many respects, contain material differences. The subsequent version expressly allows use by organizations seeking two alternatives for reinstatement after automatic revocation, while the first version does not provide them. If the Paperwork Reduction Act process is to be meaningful, then the document being submitted for public comment and OMB approval should not be a moving target. At a bare minimum, OMB, rather than approve the Form 1023-EZ that the Treasury submitted for public comment on March 26, should require Treasury to resubmit.

I. The Proposed EZ Form and Express-Lane Approval Process Will Decrease, Rather Than Improve, the Quality of Information the IRS Needs to Make Informed Decisions

To ensure that organizations are properly qualified and prepared to earn tax exempt status and thus eligible to receive deductible contributions, the IRS has required organizations seeking tax-exempt status under section 501(c)(3) to apply for that benefit. For decades, the IRS has used Form 1023 for groups seeking exemption under section 501(c)(3) (public charities and private foundations). The Form 1023 requires organizations to think through the fiduciary and governance responsibilities of the board of directors as well as identify what the organization will achieve, and how it will be funded.Typically, during a regular review of exemption applications, IRS employees ask questions and require submissions that ensure that start-up groups have at least a passing understanding of such concepts as not furthering non-exempt purposes and private inurement. Unless that sort of verification process is ensured in the streamlined process, there is a risk that recognition for tax-exemptions will be handed to applicants that fail to meet statutory requirements or do not have a threshold understanding of what tax-exempt status requires of their activities and operations. The streamlined procedures only require that a filing organization "certify" compliance (as opposed to the IRS verifying compliance). As enumerated below, in our opinion the 1023-EZ streamlined approval process does not give the IRS enough quality information to determine eligibility for federal tax-exemption. Moreover, there are a few vague questions in the proposed form that may prove problematic for applicants.

The proposed Form 1023-EZ (looking at the official February 19, Version A, Cycle 4):

- 1. Has no requirement that the applicant demonstrate it has adopted bylaws.

2. Part II, Lines 5, 6, and 7: Unless the instructions are very detailed, easily understandable, and specific, many applicants will need guidance in order to understand the organizational test and to complete the certifications accurately on a truly informed basis.

3. Part III, Line 2: Rather than asking the applicant to describe what its purposes are (which requires the IRS to have trained examiners to discern whether the description meets the operational test), the Form 1023-EZ invites applicants to "check all that apply" and offers eight categories that may prove confusing to applicants since their perceptions of their own organizations may not fit into those pre-selected legal categories.

4. Part III, lines 4-11: These questions require a "yes" or "no" answer. Many of these questions ask about activities that could go over the line into impermissible conduct by a 501(c)(3) organization, but may also be permissible, depending on the circumstances. If the IRS intends to use the responses to these "yes" or "no" questions to deny tax-exempt status, without probing further into the expected activities of the applicant on, that would be inappropriate and harmful to those attempting to establish legitimate tax-exempt public charities but who misunderstand the concepts or have language differences. Consequently, including these questions on the form requires an investigation of the responses, which therefore must be reflected in the protocol /procedures for the examining IRS agent.

5. Part IV, under the heading: "Part IV is designed to classify you as an organization that is either a private foundation or a public charity. *Public charity status is a more favorable tax status than private foundation status*."(Emphasis added.) It seems curious for the IRS, as the regulating entity responsible for evaluating eligibility for tax-exemption, to be advising the filing organization as to the more advantageous tax status.

6. Part IV, Line 1: These three sub-questions require a level of understanding of the federal Tax Code and public support test that we submit most of the applicant using the 1023-EZ will not have. Consequently, these questions are likely to lead to errors by the applicants which will only lead to increased burdens, both on the IRS (unless it has a smooth efficient process planned to educate filing organizations) and the applicants down the road that may inaccurately complete the form, only to have their applications rejected.

7. Unlike in Part V of the existing Form 1023, the proposed Form 1023-EZ does not ask sufficient questions about the family relationships of board members or the business relationships between the applicant and its board members for the IRS to determine whether there is a risk of private inurement or private benefit.

8. The current Form 1023 application process asks the applicant to submit its organizing documents, which then become part of the public record. With the streamlined process, organizing documents will not be required if the applicant uses the certification option. This reduces the amount of data available to researchers and the public about the charitable nonprofit community (and creates a disconnect with the Form 990, which asks filing organizations to submit updates/amendments to their organizing documents).

9. Pointedly, there is no question on the proposed Form 1023-EZ asking whether the filing organization has a conflict of interest policy, which is a fundamental governance document for any tax-exempt organization and should be part of the scrutiny given by the IRS at this critical juncture in evaluating eligibility for tax-exemption. The existing full Form 1023 does.

10. There should be more guidance in the instructions about the annual filing requirement — including the thresholds for which version of the Form 990 should be filed.

We support efficiency and reducing burdens to applicants, but not at the expense of accountability. In filing these comments we find ourselves in an ironic position. In most instances, the National Council of Nonprofits would applaud efforts to simplify and streamline government forms and processes. *See, e.g.,* our statement commending OMB for its work streamlining the government grant process and our Streamlining Reports, such as *Partnering for Impact: Government-Nonprofit Contracting Task Forces Produce Results for Taxpayers*. *Yet* here, in looking at the full picture over the long-term, we are concerned that the advantages of a rapid-fire approval process will not outweigh (a) the risks and ramifications of recognizing groups as tax-exempt that may not be prepared to meet ongoing exempt organization requirements, or (b) the risk of not recognizing eligible groups that make errors completing the Form 1023-EZ due to lack of guidance by the IRS in a streamlined process.

II. Concerns That the Proposed New Form and Related Express-Lane Approval Process Will Reduce Public Trust

We *expressly* and *emphatically* reject any notion that smaller organizations are more likely to evade the law or commit errors, purposefully or otherwise. Smaller does not equate to incompetent or fraudulent. Yet if the IRS significantly lowers the bar for recognition for applicants claiming to be smaller, then it stands to reason that bad actors will seek to exploit this weakness in the overall application system and opt to use the EZ express-lane approval process to avoid the transparency mandate that is integral to the current Form 1023 application process. When *fraudulent* disguises itself in this situation, everyone suffers. Thus, we are concerned that the proposed radical diminishment of information available to the IRS to make informed determinations about Section 501(c)(3) status will erode public trust in charitable nonprofits.For individual charitable nonprofits, earning the public's trust starts with the application for tax-exemption.[3] Federal law has long required each charitable nonprofit to make its organization's application for tax-exemption, *including all supporting documents* and related correspondence, freely available for public inspection. Reducing the Form 1023-EZ to a simple check-off form renders the mandate of transparency to public scrutiny a rather empty and meaningless exercise.

The IRS has an obligation to ensure that organizations are properly qualified as tax exempt and thus eligible to receive deductible contributions. Completing the Form 1023 requires organizations to think through and identify their anticipated sources of revenue and planned activities, as well as demonstrate that the filing organization is organized in accordance with the Internal Revenue Code's requirements for public charity or private foundation status. Typically the process of completing the application is time-consuming, often due to back-and-forth communications between the IRS and the filing organization, all of which are subject to public disclosure. In fact, those communications provide a window of transparency for the public into the process by which applicants are evaluated and recognized by the IRS as tax-exempt. In contrast, with the streamlined process of merely asking filing organizations to certify to the existence of various provisions in their organizing documents, the transparency that the public has come to expect (the ability to view organizing documents and understand why tax-exemption was either recognized or denied) will be eliminated.

III. The IRS Is Inappropriately Shifting Its Duties onto Others — Foisting Burdens on the Public, Existing Charitable Nonprofits, and State Charity Regulators

The IRS recognizes that it is stepping back from its front-end enforcement work in favor of having a "robust compliance process at the back end."[4] Yet, as noted above, a complex interdependent system relies on the IRS to perform its vital front-end duties. Furthermore, as the IRS continues to be underfunded and understaffed to conduct current compliance tasks, it should not rely on expanding back end enforcement as a remedy for lowering the initial barrier to entry. By abandoning aspects of its initial screening role, the IRS is passing its responsibilities onto others, creating new burdens for them. That is fundamentally unfair, especially when the IRS has not conducted a full risk assessment with other partners in the complex system that rely on the IRS to do its duty.Increases Potential

Burdens to Taxpayers

By abdicating important aspects of its front-end review of tax-exempt eligibility, the IRS is shifting burdens to others, including the public, which will potentially be faced with more expensive back end enforcement actions for groups that received fast-track tax-exemption, but are not following the procedures expected of tax-exempt organizations. The IRS has indicated that it does not have enough auditors to do needed back end enforcement work, so this effort to create an expedited process to solve an immediate backlog problem may only exacerbate problems at the back end, creating more costs for taxpayers to clean things up when things go awry.

Increases Burdens for Existing Nonprofits

As mentioned earlier, each charitable nonprofit relies on the public's trust in order to continue to attract resources to advance its mission. The proposed easy-application/easy-approval process portends damaging the public trust that legitimate charitable nonprofits earned and need to operate in local communities across America. When negative stories get published about nonprofits (even non-charitable nonprofits, such as social welfare organizations), it hurts all nonprofits, making it more difficult to recruit board members, volunteers, and obtain donations to advance charitable missions.

Increases Burdens to State Governments

By abdicating its front-end review of tax-exempt eligibility, the IRS is also shifting part of its enforcement duties and costs to state charity officials, who now rely on the IRS' known-to-be-tough scrutiny in the tax-exempt determinations process. The abdication of the IRS' scrutiny could lead to problems in the field, adding to the potential distrust of charitable nonprofits and the IRS' determination process.

IV. The Proposed EZ Form and Approval Overlook the Value of the Full Form 1023

As the IRS ACT report, "Exempt Organizations: Form 1023 — Updating It for the Future," observed:

- The primary reason we do not recommend the development of a Form 1023-EZ is because Form 1023 serves an important educational purpose for applying organizations. Through its questions, the form forces the applying organization to think somewhat deeply about its activities, finances, and management. The form also signals to the organization that it is entering into a (probably unfamiliar) comprehensive regulatory regime, and working through the questions on the form provides the organization with a great deal of information about compliance with this regime. We agree with the many practitioners we spoke with who believe that the educational benefits of Form 1023 are especially important for small organizations. And we do not believe that a significantly shorter Form 1023 could provide a comparable level of these benefits.

Our concern is that rather than help smaller groups start out on the right foot, the fast-track approval process will loosen the threshold requirements that currently ensure a thoughtful process that makes a newly-forming exempt organization aware of its initial and ongoing obligations. Without a significant effort by the IRS to educate newly formed groups about the obligations of tax-exemption, filing out the proposed Form 1023 EZ will be just as confusing, and perhaps more confusing because of the lack of explanation, than the existing Form 1023. Since by definition the streamlined process will result in the IRS spending less time reviewing the applications, we are equally concerned about applicants using the proposed Form 1023 EZ only to have their applications denied — when in other circumstances a more thorough review would have resulted in recognition of tax-exempt status.

* * *

As a network that assists individuals who are in the process of creating charitable nonprofits, we agree that the existing Form 1023 and associated approval process need to be improved. But we reject a perspective that puts more weight on a short-term myopic perspective of what's easiest for the IRS today, rather than on a process that over the long-term serves and supports everyone — applicants, charitable nonprofits, funders, state charity regulators, and the public.

V. Recommendations

The National Council of Nonprofits calls on the OMB to not approve the Form 1023 EZ. We also urge the Treasury Department and IRS to:

- 1. Withdraw the proposed Form 1023-EZ and streamlined determinations process;

2. Continue the reform effort because the old Form 1023 and application review process need updating, but do so only with guidance from the public, the charitable nonprofit community and its stakeholders, so the appropriate balance can be struck between increasing efficiency, minimizing the burden on the filing organization and the IRS, and enhancing public trust.

- Respectfully submitted,
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FOOTNOTES

[1] See IRS Advisory Committee on Tax Exempt and Government Entities (IRS ACT), "Exempt Organizations: Form 1023 — Updating It for the Future," in Report of Recommendations (June 6, 2012) at 32 of Exempt Organizations report (page 104 of PDF) (emphasis added).[2] We recognize that some of the backlog may be due to reduced funding, forcing the IRS workforce to be reduced by about 10 percent since 2010. See Prepared Remarks of Commissioner of Internal Revenue Service John Koskinen before the National Press Club, April 2, 2014. That backlog may have grown when more than 250 IRS employees were diverted to comply with information requests by six investigations dealing with the Exempt Organizations Division that oversees the applications for both 501(c)(3) charitable nonprofits and the 501(c)(4) social welfare organizations that has generated so much negative publicity in the last year.

[3] The National Council of Nonprofits' Public Policy Agenda notes, among other things: "The nonprofit

community recognizes that mission-driven nonprofits can be successful only by earning and maintaining public trust through appropriate transparency, which can be guided by reasonable regulation that recognizes the unique role of these organizations in communities."

[4] "A new streamlined process for the Form 1023-EZ . . . will also allow the IRS to concentrate more on compliance for Section 501(c)(3) organizations at the back end." See Diane Freda, " IRS to Roll Out Form 1023-EZ in Summer, Anticipates Little Risk of Noncompliance," Bloomberg BNA (April 25, 2014) (media call with Sunita Lough, IRS

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