Internal Revenue Service

Number: **200441025**
Release Date: 10/8/04
Index Number: 141.01-01

Department of the Treasury
Washington, DC 20224

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Refer Reply To:
CC:TEGE:EOEG:TEB:PLR-169176-03
Date:
June 14, 2004

Legend

City =

State =

Bonds =

Developer =

Corporation 1 =

Corporation 2 =

Partnership =

Date 1 =

Date 2 =

Year 1 =

a =

b =

c =

d =

e =

f =

g =

h =

i =

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l =

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o =

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Dear :

This is in response to your request for the following rulings:

1) That the proposed allocation of proceeds of the Bonds to the Parking Unit (defined below) is reasonable.
2) That certain contractual arrangements for the use of the Project (defined below) will not cause the Bonds to meet the private business tests under section 141(b) of the Internal Revenue Code.[1]

[1] Unless otherwise stated, all section references are to the Internal Revenue Code of 1986.

FACTS AND REPRESENTATIONS:

The Proposed Bonds

The City is a political subdivision of State. On Date 1, the City Council adopted an initial resolution approving the issuance of the Bonds.

The Bonds will be general obligation bonds of the City and will not be secured by a specific project. The Bonds are expected to be issued as fixed rate bonds in the principal amount of a and will be used to finance certain costs related to the construction of a parking and retail structure located in the City (the Project).

The Project

The Project will consist of a multi-level parking ramp, a retail structure adjacent to the ground floor of the parking ramp, a roof deck constructed to accommodate development on top of the parking ramp, and related infrastructure improvements. The total costs of the Project, including land acquisition and construction, are estimated to be b.

The City has made a declaration of condominium under State law creating separate properties within the Project: the Parking Unit and the Retail Units. The Parking Unit consists of c parking spaces on levels of the parking ramp (the "Parking Ramp") and the roof of the parking ramp (the "Roof Deck"). The Retail Units will accommodate a mix of retail and office and are expected to be transferred to the Developer pursuant to the Development Agreement (described below).

The Parking Unit is expected to be used by the City for public parking and related purposes. In addition, under the declaration of condominium, each Retail Unit owner will have the nonexclusive right to use all of the vehicular parking and traffic areas, the elevators, stairways and other pedestrian areas in the Parking Unit in the same manner as members of the general public and subject to the City's imposition of fees and other rules.

The City expects that the Roof Deck will be used to support a condominium project that will be owned or operated by a nongovernmental person. The cost of the Roof Deck, including the additional costs of constructing the Parking Ramp because of the location of the Roof Deck, is expected to be d. None of the Bond proceeds will be used for these costs. The City proposes to allocate the proceeds of the Bonds to the costs of constructing the Parking Ramp that are not associated with the Roof Deck. These costs of the Parking Ramp are estimated to be e. All costs related to the construction of the Roof Deck, include costs for the structural components of the Parking Ramp that are required solely because of the location of the Roof Deck, will be paid from the City's revenues or the proceeds of taxable bonds (the "City's Equity"). City's Equity will also be used to finance a portion of the costs of the Parking Ramp.

Thus, f percent of the Parking Ramp will be financed with the proceeds of the Bonds. The proceeds of the Bonds and the City's Equity will be proportionately allocated to all costs of the Parking Ramp.

The Development Agreement

The Retail Units will consist of separate, commercial space located at ground level on two sides of the Parking Ramp. The City's Equity will be used to complete the first stage of constructing the Retail Units. No Bond proceeds will be used to construct the Retail Units. The Developer will pay the additional costs necessary for completing construction of the Retail Units.

Under the Development Agreement between the City and the Developer, two fees will be paid to the City: the Annual Development Fee and the Initial Development Fee. The Initial Development Fee, in the amount of g, is to be paid by the Developer to the City at the time title to the Retail Units is transferred to the Developer.

The Annual Development Fee paid by the Developer has a term of h years commencing in Year 1. For the first 5 years of the Agreement, the minimum annual amount of the fee is i. Thereafter, the annual fee will be j.

Pursuant to the Development Agreement, the Developer has the option, exercisable until Date 2, to reserve and pay for up to k parking spaces. The option terms and fee for the parking spaces will be substantially the same as those contained in the Supplemental Lease (discussed below). The City also agrees to reserve no less than l parking spaces on levels two and three of the Parking Ramp for use by the general public. The City represents that the spaces that will be reserved for the general public will be available for use on the same basis by persons not engaged in a trade or business.

The Parking Agreements

In addition to the Development Agreement, the City has entered into the following arrangements with respect to the Project:

1) A parking lot lease agreement between the City and Corporation 1 (the Primary Lease);

2) A parking lot lease agreement between the City and Partnership (the Supplemental Lease); and

3) A parking lot lease agreement between the City and Corporation 2 (the Master Lease) (The Master Lease; the Primary Lease; and the Supplemental Lease are referred to collectively as the "Parking Agreements").

The Primary Lease provides for the lease of m parking spaces in the Parking Ramp to Corporation 1 during the term of the contract. The rent for the first 10 years of the Primary Lease is n per month per parking space. Thereafter, the rates will be adjusted every five years to the fair market rent at the beginning of the five year period.

The terms of the Supplemental Lease are substantially the same as the Primary Lease, including the rate per space, except it provides for the lease of l parking spaces to the Partnership and provides the Partnership with the option to lease an additional o spaces on the same terms.

The Master Lease provides Corporation 2 the right to lease up to p spaces in the Parking Ramp. However, the Master Lease is subordinate to both the Primary Lease and the Supplemental Lease. Thus, Corporation 2 has no right to lease parking spaces that are being leased under either the Primary Lease or the Supplemental Lease. Rental payments under the Master Lease are set at the same rates as the Primary Lease and the Supplemental Lease.

Payments received under all the Parking Agreements are gross rent amounts and are not reduced by the ordinary and necessary expenses attributable to the operation and maintenance of the Parking Ramp. The City represents that the expected ordinary and necessary expenses attributable to the operation and maintenance of the Parking Ramp related to the use of the p spaces under the Parking Agreements is q and the present value of those payments is r.

LAW:

Generally, section 103(a) provides that gross income does not include interest on any State or local bond. Section 103(b)(1) provides that this exclusion does not apply to any private activity bond unless it is a qualified bond under section 141.

Section 141(a) provides that a bond is a private activity bond if the bond satisfies the private business use test and the private security or payment test of section 141(b) or the private loan financing test of section 141(c).

Under section 141(b)(1), 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. Private business use is defined in section 141(b)(6) 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 is treated as a trade or business.

Section 141(b)(2) provides, in general, that an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of the issue is (under the terms of the issue or any underlying arrangement) directly or indirectly (A) secured by any interest in property used or to be

used for a private business use, or payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 1.141-2(d)(1) provides that an issue is an issue of private activity bonds if the issuer reasonably expects, as of the issue date, that the issue will meet either the private business tests or the private loan financing test. Section 1.141-2(d)(1) further provides that an issue is also an issue of private activity bonds if the issuer takes a deliberate action, subsequent to the issue date, that causes the conditions of the private business tests or the private loan financing test to be met.

Section 1.141-3 provides rules relating to the definition of private business use. Section 1.141-3(a)(1) provides, in part, that the use of financed property is treated as the direct use of proceeds. Under section 1.141-3(a)(2), in determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct uses of proceeds.

Under section 1.141-3(b)(1), both actual and beneficial use by a nongovernmental person may be treated as private business use. Section 1.141-3(b)(1) further provides that, 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 of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

Under section 1.141-3(b)(7)(i), any other arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to ownership, leases, management contracts, output contracts, or research agreements results in private business use. For example, an arrangement that conveys priority rights to the use or capacity of a facility generally results in private business use.

Section 1.141-3(g) provides the rules for measurement of private business use. Section 1.141-3(g)(1) provides that in general, the private business use of proceeds is allocated to property under section 1.141-6. Section 1.141-6(a) provides that allocations generally may be made using any reasonable, consistently applied method, and that allocations under section 141 and section 148 must be consistent with each other.

Section 1.141-3(g)(1) also provides that the amount of private business use of property to which bond proceeds have been allocated is determined according to the average percentage of private business use of that property during the measurement period. Section 1.141-3(g)(2) provides that, in general, the measurement period of property financed by an issue begins on the later of the issue date of that issue or on

the date the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the Issue financing the property (determined without regard to any optional redemption dates).

Section 1.141-3(g)(3) provides that the average percentage of private business use is the average of the percentages of private business use during the one-year periods within the measurement period. Section 1.141-3(g)(4) provides that the percentage of private business use of property for any one-year period is the average private business use during that year. This average is determined by comparing the amount of private business use during the year to the total amount of private business use and use that is government use during that year.

Section 1.141-3(g)(4)(iii) provides, in general, that for a facility in which government use and private business use occur simultaneously, the entire facility is treated as having private business use. For example, a governmentally owned facility that is leased or managed by a nongovernmental person in a manner that results in private business use is treated as entirely used for a private business use. If, however, there is also private business use and actual government use on the same basis, the average amount of private business use may be determined on a reasonable basis that properly reflects the proportionate benefit to be derived by the various users of the facility (e.g., reasonably expected fair market value of use). For example, the average amount of private business use of a garage with unassigned spaces that is used for government use and private business use is generally based on the number of spaces used for private business use as a percentage of the total number of spaces.

Section 1.141-3(g)(4)(iv) provides that the measurement of the use of proceeds allocated to a discrete portion of a facility is determined by treating that discrete portion as a separate facility. Section 1.141-1(b) provides that the term discrete portion means a portion of a facility that consists of any separate and discrete portion of a facility to which use is limited, other than common areas.

Section 1.141-3(g)(5) provides rules for common areas. The amount of private business use of common areas within a facility is generally based on a reasonable method that properly reflects the proportionate benefit to be derived by the users of the facility. Section 1.141-1(b) defines "common areas" as portions of a facility that are equally available to all users of a facility on the same basis for uses that are incidental to the primary use of the facility. For example, hallways and elevators generally are treated as common areas if they are used by the different lessees of a facility in connection with the primary use of that facility.

The Report of the Committee of Ways and Means of the House of Representatives on H.R. 3838, H.R. Rep. No. 99-426, at 538 (1985), 1986-3 (Vol. 2)

C.B. 538 (the "1985 House Report"), states as follows:

> The committee understands that certain facilities eligible for financing with section 501(c)(3) organization bonds may comprise part of a larger facility otherwise ineligible for such financing or that portions of a section 501(c)(3) organization facility may be used for activities of persons other than section 501(c)(3) organizations. The committee intends that the Treasury Department may adopt rules for allocating the costs of such mixed use facilities (including common elements) according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the various users of the facility. Only the portions of such mixed use facilities owned and used by a section 501(c)(3) organization may be financed with bonds for such organizations.

Section 147(e) provides that a private activity bonds shall not be a qualified bond if issued as part of an issue and any portion of the proceeds of such issue is to be used to provide any airplane, skybox or other private luxury box, health club facility, facility primarily used for gambling, or store the principal business of which is the sale of alcoholic beverages for consumption off premises.

The predecessor to section 147(e), section 103(b)(18) of the Internal Revenue Code of 1954 (the "1954 Code"), was added to the 1954 Code by the Tax Reform Act of 1984, section 627(c), 1984-3 C.B. (Vol. 1) 1, 438. The Supplemental Report of the Committee on Ways and Means of the U.S. House of Representatives on H.R. 4170, H. Rep. No. 98-432 (Part 2), at 1693 (1984), (the "1984 House Report") states:

> In the case of skyboxes or other private luxury boxes, the committee does not intend to prohibit the use of IDBs to finance the construction, renovation or refurbishing of a facility solely because skyboxes are included in the project, so long as the project otherwise qualifies for tax-exempt financing. Rather, no portion of the proceeds of the IDB may be used to provide any skybox. For this purpose, the skybox shall be deemed to include the interior furnishing of the box (e.g., the box's plumbing, electrical and decorating costs) and the structural components required for the box (e.g., the box's walls, ceilings, special enclosures), but does not include the normal components of the stadium, such as structural supports, to the extent they would have been required for the remaining portion of the stadium if no skyboxes (and no regular seats in lieu of skyboxes) had been built.

Section 1.141-4 provides rules pertaining to the private security or payment test. Section 1.141-4(a)(1) provides that the private security or payment test relates to the nature of the security for, and the source of, the payment of debt service on an issue. The private payment portion of the test takes into account the payment of debt service on the issue that is directly or indirectly to be derived from payments (whether or not to the issuer or any related party) in respect of property, or borrowed money, used or to be used for a private use**.** The private security portion of the test takes into account the payment of the debt service on the issue that is directly or indirectly secured by any interest in property used or to be used for a private business use or payments in respect of property used or to be used for a private business use.

Section 1.141-4(b) provides that in determining whether an issue meets the private security or payment test, the present value of the payments or property taken into account is compared to the present value of the debt service to be paid over the term of the issue. For this purpose, present values are determined by using the yield on the issue as the discount rate and by discounting all amounts to the issue date.

Under section 1.141-4(c)(2)(i)(A), both direct and indirect payments made by any nongovernmental person that is treated as using proceeds of the issue are taken into account as private payments to the extent allocable to the proceeds used by that person. Payments are taken into account as private payments only to the extent that they are made for the period of time that proceeds are used for a private business use. Payments for a use of proceeds include payments (whether or not to the issuer) in respect of property financed (directly or indirectly) with those proceeds, even if not made by a private business user. Payments are not made in respect of financed property if those payments are directly allocable to other property being directly used by the person making the payment and those payments represent fair market value compensation for that other use.

Section 1.141-4(c)(2)(i)(C) further provides that payments by a person for a use of proceeds do not include the portion of any payment that is properly allocable to the payment of ordinary and necessary expenses (as defined under section 162) directly attributable to the operation and maintenance of the financed property used by that person. For this purpose, general overhead and administrative expenses are not directly attributable to those operations and maintenance.

Under section 1.141-4(c)(3)(i), private payments for the use of property are allocated to the source or different sources of funding of property. For this purpose, different sources of funding may include taxable issues and amounts that are not derived from a borrowing, such as revenues of an issuer (equity). Section 1.141-4(c)(3)(ii) provides that payments for the use of a discrete facility (or a discrete portion

of a facility) are allocated to the source or different sources of funding of that discrete property.

Section 1.141-4(c)(3)(iii) further provides that, in general, except as provided in section 1.141-4(c)(3)(iv) or (v), if a payment is made for the use of property financed with two or more sources of funding, that payment must be allocated to those sources of funding in a manner that reasonably corresponds to the relative amounts of those sources of funding that are expended on that property.

ANALYSIS:

1) Allocation of Proceeds to Costs of the Project

The City proposes to allocate the proceeds of the Bonds to a portion of the costs of constructing the Parking Ramp. The City represents that no Bond proceeds will be used to finance costs of the Retail Units or the Roof Deck. Rather, the City proposes to use the City's Equity to finance the portions of the Project that are expected to be used by nongovernmental persons; the Retail Units and the Roof Deck. The costs of the Roof Deck that will be financed with the City's Equity include the cost of structural components of the Parking Ramp that are required solely because of the location of the Roof Deck. *See generally* the 1984 House Report.

Based on the facts described above, the Parking Ramp, the Retail Units, and the Roof Deck will be separate and discrete portions of the Project with limited and specific use. We conclude that the proposed method of allocating proceeds of the Bonds to the costs of the discrete portions of the project is a reasonable allocation method that reflects the expected use of those discrete portions of the Project. The proposed allocations will also be made consistently for purposes of section 141 and 148.

2) Application of the Private Business Tests to the Agreements for Use of the Project

The Parking Agreements

The Parking Agreements provide special legal entitlements to use a total of p of the c parking spaces in the Parking Ramp by nongovernmental persons during the term of the agreements. As a result, the private business use test is met because there is expected to be more than 10 percent private business use of the Parking Ramp.

Measurement of the exact amount of private business use is relevant in this case, however, because it will impact the application of the private payment test. On the facts presented, private business use and actual government use of the Parking Ramp occur simultaneously on the same basis. Therefore, the average amount of private business use may be determined on a reasonable basis that properly reflects

the proportionate benefit to be derived by the various users of the facility. In this case, the average amount of private business use of the Parking Ramp resulting from the Parking Agreements is the number of spaces used for private business use pursuant to the Parking Agreements as a percentage of the total number of spaces in the Parking Ramp. This approach is consistent with the parking garage example in section 1.141-3(g)(4)(iii).

For purposes of section 141, private payments are taken into account to the extent that they are made for the period of time that proceeds are used for a private business use. Thus, private payments taken into account in this case will include payments for the parking spaces privately used pursuant to the Parking Agreements. Moreover, for purposes of determining the amount of private payments, the City assumes that the Partnership will exercise its option under the Supplemental Lease. Thus, payments under the option are also taken into account.

Under section 1.141-4(c)(3)(i), private payments for the use of property are allocated to the source or different sources of funding of property. In this case, there are two sources of funding for the costs of the Parking Ramp; the proceeds of the Bonds and the City's Equity. The proceeds of the Bonds financed f percent of the Parking Ramp. The remaining costs were financed with the City's Equity. The proceeds of the Bonds and the City's Equity proportionately financed the costs of the Parking Ramp.

For purposes of the private security or payment test, payments received pursuant to the Parking Agreements are allocated to the Bond proceeds and the City's Equity in the same proportion as those funds were used to finance the Parking Ramp in accordance with section 1.141-4(c)(3)(iii). Moreover, under section 1.141-4(c)(2)(i)(C), the private payments for the use of the Parking Ramp are reduced by ordinary and necessary expenses to the extent that those expenses are directly attributable to the operation and maintenance of the Parking Ramp related to the use under the Parking Agreements. Accordingly, we conclude that, based on the City's expectations regarding the payments under the Parking Agreements and the related operating expenses, the Parking Agreements will not cause the Bonds to meet the private payment or security test.

The Development Agreement

The Development Agreement provides that ownership of the Retail Units will be transferred to the Developer after payment of the Initial Development Fee. However, no Bond proceeds were used to finance the construction of the Retail Units. Thus, the Developer's ownership of the Retail Units does not, in and of itself, result in private business use of the Project.

Under the Development Agreement, however, the Developer also receives an option to lease an additional k parking spaces in the Parking Ramp. For purposes of the private business tests, the City assumes that the option will be exercised and that there will be private business use of the specified number of parking spaces.

The Development Agreement also provides that the City agrees to reserve no less than l parking spaces in the Parking Ramp for general public use. Although the Developer receives no special legal entitlements with respect to the reserved spaces, it may receive an indirect benefit from the City's reservation of spaces for public parking. In this case, however, this indirect benefit does not rise to the level of private business use because the spaces will be reserved for the general public and will be available for use on the same basis by persons not engaged in a trade or business.

For purposes of the private payment test, the portion of the Annual Development Fee that is equal to the expected fair market value of the k optioned parking spaces is taken into account. Nonetheless, when these payments are aggregated with the payments made under the Parking Agreements, the aggregate payments do not cause the private payment or security test to be met.

The City proposes to allocate the remaining payments under the Development Agreement (including the Initial Development Fee and the portion of the Annual Development Fee not allocated to the k parking space option) to the Developer's use of the Retail Units, a discrete portion of the Project that will be financed entirely with the City's Equity. The present value of the Development Agreement payments also approximates the City's cost of constructing the Retail Units. Based on the facts and circumstances presented here, the proposed allocation of the Developer's payments is consistent with the purposes of section 141 and does not cause the private security or private payments test to be met.

Thus, based on the City's representations and current expectations, the agreements for the use of the Project discussed herein do not cause the Bonds to meet the private business tests

CONCLUSIONS:

Based on the information submitted and representations made, we conclude that the proposed allocation of Bond proceeds and City's Equity to the costs of the Parking Ramp, the Retail Units, and the Roof Deck is reasonable. Furthermore, we conclude that the contracts for the use of the Project discussed herein will not cause the Bonds to meet the private business tests under section 141. We express no opinion as to the result if the actual payments or expenses related to the Parking Agreements or Development Agreement differ from the City's representations made in connection with

this ruling request. We also express no opinion as to whether any future arrangements for use of the Roof Deck may cause the Bonds to meet the private business tests.

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(s) 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,
Assistant Chief Counsel (Exempt Organizations/Employment Tax/Government Entities)

By: _____
Timothy L. Jones
Senior Counsel
Tax Exempt Bond Branch