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LEGEND

Authority =

Bonds =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Facility =

Manager =

a =

b =

Dear :

This responds to the Authority's request for a ruling that the management contract more fully described below (the "Management Contract") does not cause private business use of the Facility under § 1.141-3(b)(4) of the Income Tax Regulations.

Facts and Representations

The Authority issued the Bonds and used a portion of the proceeds to finance the construction and rehabilitation of a part of the Facility, an exhibition and convention facility. The Authority, a political subdivision, owns the Facility.

The Authority and the Manager entered into the Management Contract on Date 1, under which the Manager will manage the Facility. The term of the Management Contract begins on Date 1 and continues until Date 4, a date which is five years and approximately two months from Date 1. The Authority's first fiscal year under the Management Contract begins on Date 2.

The Manager will be paid the following amounts under the Management Contract: (1) the base fee, (2) the incentive fee, and (3) reimbursement of certain expenses.

(1) Base fee: The annual base fee for each of the first and second fiscal years of the term of the Management Contract is $a, only a part of which will be paid during the first fiscal year. Beginning in the third fiscal year of the term of the Management Contract, the amount of the base fee in effect the previous fiscal year will be adjusted by the percentage change in the Consumer Price Index ("CPI"), but in no event by more than b% in any one fiscal year.

(2) Incentive fee: If the Manager satisfies all three prongs of the incentive fee test (as described below) in any fiscal year, it will qualify to receive a set incentive fee from the Authority for that fiscal year. The annual incentive fee for each of the first and second fiscal years of the term of the Management Contract will be predetermined by the

Authority and the Manager through negotiation before Date 3, which is one month after the beginning of the first fiscal year of the term of the Management Contract, in an amount not greater than the fixed base fee amount for that same fiscal year. Beginning in the third fiscal year of the term of the Management Contract, the amount of the incentive fee in effect the previous fiscal year will be adjusted by the percentage change in CPI, but in no event by more than b% in any one fiscal year; provided, however, that the incentive fee will never exceed the amount of the base fee paid to the Manager for the same fiscal year.

The Manager will qualify to receive the incentive fee for any given fiscal year solely if the Manager meets all three of the criteria of the incentive fee test, which are as follows: (i) the Manager must produce certain total operating revenues at the Facility equal to or greater than a stated amount for the applicable fiscal year that is established in advance of each fiscal year of the term of the Management Contract in the approved budget for such fiscal year (the "revenue benchmark"); (ii) the Manager must at least meet a stated net operating surplus/deficit level for the applicable fiscal year that is established in advance of each fiscal year of the term of the Management Contract in the approved budget for such fiscal year (the "net operating surplus/deficit benchmark"); and (iii) the Manager must achieve an average overall score for customer satisfaction surveys that is equal to or greater than the customer satisfaction benchmark established in advance of each fiscal year (other than the first fiscal year) of the term of the Management Contract for the applicable fiscal year (the "customer satisfaction benchmark"). Because of several factors, the revenue benchmark and the net operating surplus/deficit benchmark may increase or decrease from year to year. Thus, the net operating surplus/deficit benchmark in one year may reflect a decrease, and in a subsequent year an increase, in the deficit from that of the prior year.

(3) Reimbursement of Certain Expenses: The Authority will reimburse expenses of the Manager, only to the extent such expenses are operating expenses and included in the current approved budget, or are emergency expenditures. Operating expenses include employee compensation and related expenses, among other things. Several employees are eligible to receive bonuses as a part of these operating expenses (the "bonus-eligible employees"). Each bonus-eligible employee may earn a set maximum percentage of his or her respective base salary as a bonus. Bonus eligibility is based on a variety of qualifications that do not mirror but are similar to the components of the incentive fee test. The Authority represents that the bonus-eligible employees of the Manager do not have any ownership interest in the Manager. Emergency expenditures include those necessary to correct or repair a condition, which in the reasonable judgment of the Manager, if not corrected or repaired immediately, would create an imminent danger to persons or property and/or an unsafe condition threatening persons or property to the extent such expenditure is not included in the approved budget for such fiscal year.

None of the voting power of the governing body of the Authority in the aggregate is vested in the Manager or its directors, officers, shareholders, and employees. There are no overlapping board members or officers between the Authority and the Manager. The Manager is not a related party to the Authority within the meaning of § 1.150-1(b).

Law

Section 103(a) of the Internal Revenue Code (the "Code") 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 (as defined under § 141). Section 141(a) provides that a bond is a private activity bond if the bond satisfies the private business tests of § 141(b).

Under §§ 141(b)(1) and 141(b)(6)(A), private business use occurs if more than 10 percent of the proceeds of the bonds are used, directly or indirectly, in a trade or business carried on by any person other than a governmental unit. Under § 141(b)(6)(B), any activity carried on by a person other than a natural person is treated as a trade or business. Under § 1.141-3(b)(1), in general, a nongovernmental person is treated as a private business user of the 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.

Section1.141-3(b)(4)(i) provides 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 operation of the facility. *Id.* Under § 1.141-3(b)(4)(iii)(D), a contract to provide for services, if the only compensation is the reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties, is generally not treated as a management contract that gives rise to private business use.

Revenue Procedure 97-13, 1997-1 C.B. 632, as modified by Revenue Procedure 2001-39, 2001-2 C.B. 38 ("Rev. Proc. 97-13"), sets forth conditions under which a management contract does not result in private business use under § 141(b). Section 5.01 provides that if the requirements of § 5 are satisfied, the management contract does not itself result in private business use. Under § 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. Reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties is not by itself treated as compensation. *Id.* Section 5.02(3) of Rev. Proc. 97-13 provides that for purposes of

§ 1.141-3(b)(4)(i) and Rev. Proc. 97-13, 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 sets forth six specific arrangements that satisfy the requirements of § 5. Under § 5.03(4), either at least 50 percent of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee or all of the compensation for services is based on a capitation fee or a combination of a capitation fee and a periodic fixed fee. Section 5.03(4) further provides that the term of the contract, including all renewal options, must not exceed five years. The contract must be terminable by the qualified user (the state or local government or instrumentality that is a party to the management contract) on reasonable notice, without penalty or cause, at the end of the third year of the contract term. *Id.*

Section 3.05 of Rev. Proc. 97-13 provides as follows. A “periodic fixed fee” means a stated dollar amount for services rendered for a specified period of time. For example, a stated dollar amount per month is a periodic fixed fee. The stated dollar amount may automatically increase according to a specified, objective, external standard that is not linked to the output or efficiency of a facility. For example, the CPI and similar external indices that track increases in prices in an area or increases in revenues or costs in an industry are objective external standards.

Section 5.04(1) of Rev. Proc. 97-13 generally provides that a service provider must not have any role or relationship with the qualified user that, in effect, substantially limits the qualified user’s ability to exercise its rights, including cancellation rights, under the contract, based on all the facts and circumstances. Under § 5.04(2), the qualified user’s rights are not substantially limited if the following requirements are satisfied: not more than 20 percent of the voting power of the governing body of the qualified user in the aggregate is vested in the service provider and its directors, officers, shareholders, and employees; overlapping board members do not include the chief executive officers of the service provider or its governing body or the qualified user or its governing body; and the qualified user and the service provider under the contract are not related parties, as defined in § 1.150-1(b).

Analysis

The Management Contract does not meet all of the requirements of § 5 of Rev. Proc. 97-13. Therefore, whether the Management Contract results in private business use of the Facility under § 1.141-3(b)(4) depends on all of the facts and circumstances. In determining whether the facts and circumstances relating to a management contract

indicate private business use, the factors set forth in Rev. Proc. 97-13 are useful reference points. Based on our analysis of the facts and circumstances, we conclude that the Management Contract does not result in private business use of the Facility.

Under the circumstances presented, the incentive fee, particularly the revenue benchmark and the net operating surplus/deficit benchmark of the test for this fee, raise the issue of whether the fee demonstrates private business use of the Facility by the Manager. We conclude that it does not. Although the net operating surplus/deficit benchmark takes into account both expenses and revenues, it is not based on increases in revenues and decreases in expenses, but on stated surplus/deficit amounts that may reflect decreasing revenues and increasing expenses. A similar analysis applies to the net operating surplus/deficit benchmark and the revenue benchmark when the two are taken together.

Moreover, the amount of the incentive fee paid to the Manager will not vary depending on the margin of increase in revenues and/or decrease in expenses or be based on a percentage of revenue increases, a percentage of expense decreases, or some combination of both. Instead, the incentive fee will be set before Date 3 in an amount that will depend on negotiations between the Authority and the Manager and on the budget process; thereafter, adjustments of the fee will be based on CPI. The amount of the incentive fee in any fiscal year will not exceed that of the base fee.

The base fee satisfies the definition of a periodic fixed fee in § 3.05 of Rev. Proc. 97-13 because it is a stated dollar amount for a period specified in the Management Contract and is adjusted, beginning in the third fiscal year of the Management Contract, only by a specified, objective, external standard, which in this instance is CPI.

The payments for reimbursable expenses are reimbursements for the Manager's actual and direct expenses to employees and unrelated parties and are not treated as compensation to the Manager. Although the salaries and bonuses to bonus-eligible employees of the Manager require additional scrutiny, we conclude that these expenses are not treated as compensation to the Manager. These employees have no ownership interest in the Manager, and the bonuses are paid to the bonus-eligible employees on a basis similar to that of the incentive fee paid to the Manager.

Although the term of the Management Contract is approximately two months longer than five years, it is only slightly greater than the permissible term under § 5.03(4) of Rev. Proc. 97-13 and therefore the deviation is insignificant for our purposes.

The relationship between the Authority and the Manager also does not suggest any private business use of the Facility by the Manager. The Manager will have no role or relationship with the Authority that will substantially limit the Authority's ability to exercise any rights under the Management Contract, including cancellation rights. None of the voting power of the governing body of the Authority in the aggregate is

vested in the Manager or its directors, officers, shareholders, and employees. There are no overlapping board members of the Authority and the Manager, and the Authority and the Manager are not related parties as defined in § 1.150-1(b).

Conclusion

Based on all facts and circumstances, we conclude that the Management Contract does not result in private business use of the Facility under § 1.141-3(b)(4). This conclusion is based upon information and representations submitted by the Authority and accompanied by a penalty of perjury statement executed by an appropriate party. This ruling is specifically made contingent upon the above described provisions of the Management Contract being effective and binding upon the Authority and the Manager. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination.

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, including whether any agreements other than the Management Contract fail to meet the private business use test under § 1.141-3(b)(4) or whether the Bonds are tax exempt for purposes of § 103 of the Code.

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

Sincerely,

Associate Chief Counsel
(Financial Institutions and Products)

By:_____
Timothy L. Jones
Senior Counsel
Branch 5