

26 CFR 601.601: Rules and regulations.
(Also: §§ 141, 145, 1.141-3, 1.145-2)

Rev. Proc. 2017-13

SECTION 1. PURPOSE

This revenue procedure provides safe harbor conditions under which a management contract does not result in private business use of property financed with governmental tax-exempt bonds under § 141(b) of the Internal Revenue Code or cause the modified private business use test for property financed with qualified 501(c)(3) bonds under § 145(a)(2)(B) to be met. This revenue procedure modifies, amplifies, and supersedes Rev. Proc. 2016-44, 2016-36 IRB 316, to address certain types of compensation, the timing of payment of compensation, the treatment of land, and methods of approval of rates. Sections 2.11 through 2.14 of this revenue procedure generally describe the modifications and amplifications made to Rev. Proc. 2016-44 by this revenue procedure.

SECTION 2. BACKGROUND

.01 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)(1) provides that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(a) 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.

.02 Section 141(b)(1) 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) 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.

.03 Section 1.141-3(a)(1) of the Income Tax Regulations provides, in part, that the 10 percent private business use test of § 141(b)(1) 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 1.141-3(a)(2) provides that, in determining whether an issue meets the private business use test, it is necessary to look at both indirect and direct use of proceeds. Proceeds are treated as used in the trade or business of a nongovernmental person if a nongovernmental person, as a result of a single transaction or a series of related transactions, uses property acquired with the proceeds of an issue.

.04 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.

.05 Section 1.141-3(b)(3) provides generally that the lease of financed property to a nongovernmental person is private business use of that property. For this purpose, any arrangement that is properly characterized as a lease for federal income tax purposes is treated as a lease. Section 1.141-3(b)(3) further provides that, in determining whether a management contract is properly characterized as a lease, it is necessary to consider all the facts and circumstances, including the following factors: (1) the degree of control over the property that is exercised by a nongovernmental person; and (2) whether a nongovernmental person bears the risk of loss of the financed property.

.06 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)(iv) provides generally that a management contract with respect to financed property results in private business use of that property if the service provider is treated as the lessee or owner of financed property for federal income tax purposes.

.07 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.

.08 Section 1.141-3(b)(4)(iii) provides that the following arrangements generally are not treated as management contracts that give rise to private business use:

(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); (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; (C) a contract to provide for the operation of a facility or system of facilities that consists primarily of public utility property, if the only compensation is the reimbursement of actual and direct expenses of the service provider and reasonable administrative overhead expenses of the service provider; and (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.

.09 Section 141(e) 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) provides generally that "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), and (B) § 141(b)(1) and (2) 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 1.145-2 provides that, with certain exceptions and modifications, §§ 1.141-0 through 1.141-15 apply to § 145(a).

.10 Rev. Proc. 2016-44 provides safe harbor conditions under which a management contract does not result in private business use of property financed with governmental tax-exempt bonds under § 141(b) or cause the modified private business use test for property financed with qualified 501(c)(3) bonds under § 145(a)(2)(B) to be met. Rev. Proc. 2016-44 modified and superseded Rev. Proc. 97-13, 1997-1 C.B. 632; Rev. Proc. 2001-39, 2001-2 C.B. 38; and section 3.02 of Notice 2014-67, 2014-46 I.R.B. 822.

.11 Section 5.02 of Rev. Proc. 2016-44 sets forth general financial requirements for management compensation arrangements eligible for the safe harbor. Sections 5.02(2) and 5.02(3) of Rev. Proc. 2016-44 provide that the contract must neither provide to the service provider a share of net profits nor impose on the service provider the burden of bearing any share of net losses from the operation of the managed property. Before the publication of Rev. Proc. 2016-44, previously applicable revenue procedures expressly treated certain types of compensation, including capitation fees, periodic fixed fees, and per-unit fees (as defined therein), as not providing a share of net profits. Questions

have arisen regarding whether these common types of compensation continue to be treated in a similar manner under Rev. Proc. 2016-44. Related questions have arisen about whether a service provider's payment of expenses of the operation of the managed property without reimbursement from the qualified user (as defined in section 4.04 of Rev. Proc. 2016-44) affects the treatment of these types of compensation. To provide continuity with the previous safe harbors, this revenue procedure clarifies that these types of compensation and certain incentive compensation will not be treated as providing a share of net profits or requiring the service provider to bear a share of net losses.

.12 Sections 5.02(2) and 5.02(3) of Rev. Proc. 2016-44 also provide that the timing of payment of compensation cannot be contingent upon net profits or net losses from the operation of the managed property. Questions have arisen about the effect of these restrictions on the timing of payment of compensation. This revenue procedure clarifies that compensation subject to an annual payment requirement and reasonable consequences for late payment (such as interest charges or late payment fees) will not be treated as contingent upon net profits or net losses if the contract includes a requirement that the qualified user will pay the deferred compensation within five years of the original due date of the payment.

.13. Section 5.03 of Rev. Proc. 2016-44 provides that the term of the contract, including all renewal options (as defined in § 1.141-1(b)), must be no greater than the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property. For this purpose, under Rev. Proc. 2016-44,

economic life is determined in the same manner as under § 147(b), but without regard to §147(b)(3)(B)(ii), as of the beginning of the term of contract. Section 147(b)(3)(B)(i) provides that generally land is not taken into account, but § 147(b)(3)(B)(ii) provides that if 25 percent or more of the net proceeds of any issue is to be used to finance the acquisition of land, such land shall be taken into account and treated as having an economic life of 30 years. Questions have arisen about excluding land when the cost of the land accounts for a significant portion of the managed property. This revenue procedure provides that economic life is determined in the same manner as under § 147(b) as of the beginning of the term of the contract. Thus, land will be treated as having an economic life of 30 years if 25 percent or more of the net proceeds of the issue that finances the managed property is to be used to finance the costs of such land.

.14 Section 5.04 of Rev. Proc. 2016-44 provides that the qualified user must exercise a significant degree of control over the use of the managed property. Section 5.04 of Rev. Proc. 2016-44 further provides that this requirement is met if the contract requires the qualified user to approve, among other things, the rates charged for use of the managed property. Section 5.04 of Rev. Proc. 2016-44 also provides that a qualified user may show approval of rates charged for use of the managed property by either expressly approving such rates (or the methodology for setting such rates) or by including in the contract a requirement that service provider charge rates that are reasonable and customary as specifically determined by an independent third party. Questions have arisen about the requirement to approve the rates in various

circumstances in which it may not be feasible to approve each specific rate charged, such as for a physician's professional services at a § 501(c)(3) hospital or hotel room rates at a governmentally-owned hotel. This revenue procedure clarifies that a qualified user may satisfy the approval of rates requirement by approving a reasonable general description of the method used to set the rates or by requiring that the service provider charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party.

SECTION 3. SCOPE

This revenue procedure applies to a management contract (as defined in section 4.03 of this revenue procedure) involving managed property (as defined in section 4.04 of this revenue procedure) financed with the proceeds of an issue of governmental bonds (as defined in § 1.141-1(b)) or qualified 501(c)(3) bonds (as defined in § 145).

SECTION 4. DEFINITIONS

For purposes of this revenue procedure, the following definitions apply:

.01 Capitation fee means a fixed periodic amount for each person for whom the service provider or the qualified user assumes the responsibility to provide all needed services for a specified period so long as the quantity and type of services actually provided to such persons varies substantially. For example, a capitation fee includes a fixed dollar amount payable per month to a medical service provider for each member of a health maintenance organization plan for whom the provider agrees to provide all needed medical services for a specified period. A fixed periodic amount may include an automatic increase according to a specified, objective, external standard that is not

linked to the output or efficiency of the managed property. For example, the Consumer Price Index 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. A capitation fee may include a variable component of up to 20 percent of the total capitation fee designed to protect the service provider against risk such as risk of catastrophic loss.

.02 Eligible expense reimbursement arrangement means a management contract under which the only compensation consists of reimbursements of actual and direct expenses paid by the service provider to unrelated parties and reasonable related administrative overhead expenses of the service provider.

.03 Management contract means a management, service, or incentive payment contract between a qualified user and a service provider under which the service provider provides services for a managed property. A management contract does not include a contract or portion of a contract for the provision of services before a managed property is placed in service (for example, pre-operating services for construction design or construction management).

.04 Managed property means the portion of a project (as defined in § 1.141-6(a)(3)) with respect to which a service provider provides services.

.05 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 the

managed property. For example, the Consumer Price Index 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. Capitation fees and per-unit fees are not periodic fixed fees.

.06 Per-unit fee means a fee based on a unit of service provided specified in the contract or otherwise specifically determined by an independent third party, such as the administrator of the Medicare program, or the qualified user. For example, a stated dollar amount for each specified medical procedure performed, car parked, or passenger mile is a per-unit fee. Separate billing arrangements between physicians and hospitals are treated as per-unit fee arrangements. A fee that is a stated dollar amount specified in the contract does not fail to be a per-unit fee as a result of a provision under which the fee may automatically increase according to a specified, objective, external standard that is not linked to the output or efficiency of the managed property. For example, the Consumer Price Index 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.

.07 Qualified user means, for projects (as defined in § 1.141-6(a)(3)) financed with governmental bonds, any governmental person (as defined in § 1.141-1(b)) or, for projects financed with qualified 501(c)(3) bonds, any governmental person or any 501(c)(3) organization with respect to its activities which do not constitute an unrelated trade or business, determined by applying § 513(a).

.08 Service provider means any person other than a qualified user that provides services to, or for the benefit of, a qualified user under a management contract.

.9 Unrelated parties means persons other than either: (1) a related party (as defined in § 1.150-1(b)) to the service provider or (2) a service provider's employee.

SECTION 5. SAFE HARBOR CONDITIONS UNDER WHICH MANAGEMENT CONTRACTS DO NOT RESULT IN PRIVATE BUSINESS USE

.01 In general. If a management contract meets all of the applicable conditions of sections 5.02 through section 5.07 of this revenue procedure, or is an eligible expense reimbursement arrangement, the management contract does not result in private business use under § 141(b) or 145(a)(2)(B). Further, under section 5.08 of this revenue procedure, use functionally related and subordinate to a management contract that meets these conditions does not result in private business use.

.02 General financial requirements.

(1) In general. The payments to the service provider under the contract must be reasonable compensation for services rendered during the term of the contract. Compensation includes payments to reimburse actual and direct expenses paid by the service provider and related administrative overhead expenses of the service provider.

(2) No net profits arrangements. The contract must not provide to the service provider a share of net profits from the operation of the managed property. Compensation to the service provider will not be treated as providing a share of net profits if no element of the compensation takes into account, or is contingent upon, either the managed property's net profits or both the managed property's revenues and

expenses (other than any reimbursements of direct and actual expenses paid by the service provider to unrelated third parties) for any fiscal period. For this purpose, the elements of the compensation are the eligibility for, the amount of, and the timing of the payment of the compensation. Incentive compensation will not be treated as providing a share of net profits if the eligibility for the incentive compensation is determined by the service provider's performance in meeting one or more standards that measure quality of services, performance, or productivity, and the amount and the timing of the payment of the compensation meet the requirements of this section 5.02(2).

(3) No bearing of net losses of the managed property.

(a) The contract must not, in substance, impose upon the service provider the burden of bearing any share of net losses from the operation of the managed property. An arrangement will not be treated as requiring the service provider to bear a share of net losses if:

(i) The determination of the amount of the service provider's compensation and the amount of any expenses to be paid by the service provider (and not reimbursed), separately and collectively, do not take into account either the managed property's net losses or both the managed property's revenues and expenses for any fiscal period; and

(ii) The timing of the payment of compensation is not contingent upon the managed property's net losses.

(b) For example, a service provider whose compensation is reduced by a stated dollar amount (or one of multiple stated dollar amounts) for failure to keep the managed

property's expenses below a specified target (or one of multiple specified targets) will not be treated as bearing a share of net losses as a result of this reduction.

(4) Treatment of certain types of compensation. Without regard to whether the service provider pays expenses with respect to the operation of the managed property without reimbursement by the qualified user, compensation for services will not be treated as providing a share of net profits or requiring the service provider to bear a share of net losses under sections 5.02(2) and 5.02(3) of this revenue procedure if the compensation for services is: (a) based solely on a capitation fee, a periodic fixed fee, or a per-unit fee; (b) incentive compensation described in the last sentence of section 5.02(2) of this revenue procedure; or (c) a combination of these types of compensation.

(5) Treatment of timing of payment of compensation. Deferral due to insufficient net cash flows from the operation of the managed property of the payment of compensation that otherwise meets the requirements of sections 5.02(2) and 5.02(3) of this revenue procedure will not cause the deferred compensation to be treated as contingent upon net profits or net losses under sections 5.02(2) and 5.02(3) of this revenue procedure if the contract includes requirements that:

(a) The compensation is payable at least annually;

(b) The qualified user is subject to reasonable consequences for late payment, such as reasonable interest charges or late payment fees; and

(c) The qualified user will pay such deferred compensation (with interest or late payment fees) no later than the end of five years after the original due date of the payment.

.03 Term of the contract and revisions. The term of the contract, including all renewal options (as defined in § 1.141-1(b)), must not be greater than the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property. For this purpose, economic life is determined in the same manner as under § 147(b) as of the beginning of the term of the contract. A contract that is materially modified with respect to any matters relevant to this section 5 is retested under this section 5 as a new contract as of the date of the material modification.

.04 Control over use of the managed property. The qualified user must exercise a significant degree of control over the use of the managed property. This control requirement is met if the contract requires the qualified user to approve the annual budget of the managed property, capital expenditures with respect to the managed property, each disposition of property that is part of the managed property, rates charged for the use of the managed property, and the general nature and type of use of the managed property (for example, the type of services). For this purpose, for example, a qualified user may show approval of capital expenditures for a managed property by approving an annual budget for capital expenditures described by functional purpose and specific maximum amounts; and a qualified user may show approval of dispositions of property that is part of the managed property in a similar manner. Further, for example, a qualified user may show approval of rates charged for use of the managed property by expressly approving such rates or a general description of the methodology for setting such rates (such as a method that establishes hotel room rates using specified revenue goals based on comparable properties), or by requiring that the

service provider charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party (such as a medical insurance company).

.05 Risk of loss of the managed property. The qualified user must bear the risk of loss upon damage or destruction of the managed property (for example, due to force majeure). A qualified user does not fail to meet this risk of loss requirement as a result of insuring against risk of loss through a third party or imposing upon the service provider a penalty for failure to operate the managed property in accordance with the standards set forth in the management contract.

.06 No inconsistent tax position. The service provider must agree that it is not entitled to and will not take any tax position that is inconsistent with being a service provider to the qualified user with respect to the managed property. For example, the service provider must agree not to claim any depreciation or amortization deduction, investment tax credit, or deduction for any payment as rent with respect to the managed property.

.07 No circumstances substantially limiting exercise of rights.

(1) In general. The 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 under the contract, based on all the facts and circumstances.

(2) Safe harbor. A service provider will not be treated as having a role or relationship prohibited under section 5.07(1) of this revenue procedure if:

(a) No more than 20 percent of the voting power of the governing body of the qualified user is vested in the directors, officers, shareholders, partners, members, and employees of the service provider, in the aggregate;

(b) The governing body of the qualified user does not include the chief executive officer of the service provider or the chairperson (or equivalent executive) of the service provider's governing body; and

(c) The chief executive officer of the service provider is not the chief executive officer of the qualified user or any of the qualified user's related parties (as defined in §1.150-1(b)).

(3) For purposes of section 5.07(2) of this revenue procedure, the phrase "service provider" includes the service provider's related parties (as defined in §1.150-1(b)) and the phrase "chief executive officer" includes a person with equivalent management responsibilities.

.08 Functionally related and subordinate use. A service provider's use of a project (as defined in § 1.141-6(a)(3)) that is functionally related and subordinate to performance of its services under a management contract for managed property that meets the conditions of this section 5 does not result in private business use of that project. For example, use of storage areas to store equipment used to perform activities required under a management contract that meets the requirements of this section 5 does not result in private business use.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2016-44 is modified, amplified, and superseded.

SECTION 7. DATE OF APPLICABILITY

This revenue procedure applies to any management contract that is entered into on or after January 17, 2017, and an issuer may apply this revenue procedure to any management contract that was entered into before January 17, 2017. In addition, an issuer may apply the safe harbors in Rev. Proc. 97-13, as modified by Rev. Proc. 2001-39 and amplified by Notice 2014-67, to a management contract that is entered into before August 18, 2017 and that is not materially modified or extended on or after August 18, 2017 (other than pursuant to a renewal option as defined in § 1.141-1(b)).

SECTION 8. DRAFTING INFORMATION

The principal authors of this revenue procedure are Johanna Som de Cerff and David White of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact David White on (202) 317-6980 (not a toll free call).