POST-ISSUANCE TAX COMPLIANCE
FOR
QUALIFIED 501(C)(3) BONDS:

Private Business Use
&
New Management Contract Rules

Presented by:

Jennifer V. Powers, Partner
Quarles & Brady LLP
411 East Wisconsin Avenue
Milwaukee, WI 53202
414-277-5141
jennifer.powers@quarles.com
www.quarles.com

March 20, 2017

2017©Quarles & Brady LLP

PRIVATE BUSINESS USE &
NEW MANAGEMENT CONTRACT RULES
FOR
QUALIFIED 501(C)(3) BONDS

I. BACKGROUND OF PRIVATE ACTIVITY BONDS AND QUALIFIED 501(C)(3) BONDS WITH RESPECT TO PRIVATE BUSINESS USE.

A. ***Private Activity Bonds:*** Tax-exempt bonds are "*private activity bonds*" if they *meet* either (a) both the private business use test <u>and</u> the private security or payments tests of §141(b) of the Internal Revenue Code of 1986, as amended (the "Code"), or (b) the private loan finance test of §141(c) of the Code.

- *Private Business Use Test*. This test is met if *more* than 10% of the proceeds (5% of the net proceeds in the case of qualified 501(c)(3) bonds) of the bonds is used, directly or indirectly, in a trade or business carried on by any person other than a governmental person.
- *Private Security or Payments Test*. These tests are met if the payment of the principal of or interest on more than 10% of the proceeds (5% of the net proceeds in the case of qualified 501(c)(3) bonds) of the bond issue is directly or indirectly (i) secured by property used or to be used for a private business use or payments in respect of such property or (ii) to be derived from payments in respect of property used for a private business use.
- *Private Loan Finance Test*. This test is met if more than the lesser of $5 million or 5% of the proceeds of the bonds are to be used to make or finance loans to persons other than governmental units.

B. ***Qualified Private Activity Bonds:*** The interest on a *private activity bond* is *not* excludable from federal gross income under §103(a) of the Code, unless it is a "*qualified private activity bond*." Qualified private activity bonds are tax-exempt bonds issued by a state or local government, the proceeds of which are used for a defined qualified purpose by an entity other than the governmental entity issuing the bonds. Such an entity is referred to as a "*conduit borrower*." For a private activity bond to be tax-exempt, 95% or more of the net bond proceeds must be used for one of the qualified purposes set forth in §§142-145 of the Code. §141(e)(1)(G) provides that "*qualified 501(c)(3) bonds*" are qualified bonds.

C. ***Qualified 501(c)(3) Bonds:*** Bonds issued on behalf of a 501(c)(3) organization would constitute private activity bonds on which the interest would be subject to federal income taxation if there was no exception for "*qualified 501(c)(3) bonds*." Qualified 501(c)(3) bonds must meet a number of requirements of §145 of the Code in order for the interest on such bonds to be excludable from federal income tax. Two of the tests are the ownership test and the 95% test (there are also other requirements which are not enumerated below).

- ***Ownership Test.*** §145(a)(1) of the Code provides that 100% of the property financed by the net proceeds of a qualified 501(c)(3) bond issue must be owned by either a 501(c)(3) organization or a governmental entity. *No part of the property financed may be owned by a private business*. This requirement applies for the entire life of

2017©Quarles & Brady LLP

the bonds. The sale of bond-financed property to a private business during the term of the bonds or the loss of status as a 501(c)(3) organization by the owner would violate this requirement. Problems with the ownership test could arise in connection with (1) facilities to be owned by joint ventures or partnerships, (2) ownership by limited liability corporations under certain circumstances and (3) financing of leasehold improvements.

- ***95% Test.*** §145(a)(2) of the Code contains the 95% requirement for qualified 501(c)(3) bonds. This section modifies the requirements of the private business use test and the private security or payment test of §§141(b)(1) and (2) of the Code for purposes of determining whether a 501(c)(3) bond is a qualified private activity bond:

  - ✓ the *10%* thresholds for private business use and private security are changed to *5%* and
  - ✓ the 5% threshold is applied against "*net proceeds*" (proceeds of the issue less amounts invested in a reasonably required reserve or replacement fund) rather than "*proceeds*" and
  - ✓ 501(c)(3) organizations are treated as "*governmental units*" only with respect to their exempt activities, but not with respect to activities unrelated to their exempt purposes.

The interest on a 501(c)(3) bond issue is *not* tax-exempt if it meets *both* the modified private business use test *and* the modified private payment or security test, *or* if it meets the private loan finance test. For purposes of applying these tests, the 501(c)(3) organization is treated as a state or local governmental entity to the extent that the use of the proceeds is not considered an "unrelated trade or business use."

The foregoing rules are complicated, and thus the generally accepted approach is to (i) prohibit the 501(c)(3) organization from loaning the bond proceeds to another entity so that the private loan finance test is not met and (ii) ensure that the private business use test is not met by restricting private business use to less than 5% of the net proceeds of the bonds. *This limits post-issuance compliance to tracking the amount of any private business use for each year and keeping the maximum private use below the 5% limit in order to simplify the demonstration of compliance with the regulations.*

2017©Quarles & Brady LLP

II. PRIVATE BUSINESS USE FOR QUALIFIED 501(C)(3) BONDS.

A. *Certain Definitions:*

- ***Private Business Use:*** Any direct or indirect use of bond proceeds or bond-financed property in a *trade or business* carried on by any person *other than a governmental unit.* Any activity carried on by a "person" other than a natural person is treated as a "trade or business".
- ***Governmental unit/person:*** Includes a state or local government or any instrumentality thereof but *excludes* the federal government. A 501(c)(3) organization is treated as a governmental unit but only with respect to activities that are within the scope of its exempt purposes (not with respect to activities unrelated to its exempt purposes.
- ***Qualified User:*** For property financed with the proceeds of tax-exempt qualified 501(c)(3) bonds, a "qualified user" is a governmental person.
- ***Nongovernmental person:*** Means any person/entity that is *not* a *governmental unit*.

B. ***Private Business Use Limitation:*** The *private business use test* for qualified 501(c)(3) bonds is met (the goal is to *fail* the test) if *more than 5% of the net proceeds* of the bonds is used (directly or indirectly) in a trade or business carried on by any person other than a governmental unit.

Private business use counted against the allowable 5% includes:

- the amount of bond proceeds used to pay for costs of issuance;
- direct or indirect use of bond proceeds or bond-financed property by a 501(c)(3) organization in an *unrelated trade or business* (determined in accordance with §513(a) of the Code) and
- direct or indirect use of proceeds or bond-financed property by any other *nongovernmental person* (i.e. for profit entity).

C. *Types of activities that may give rise to private business use of bond-financed property include:*

- sale of financed property to a nongovernmental person;
- leases of financed property (the duration of the lease does not affect whether or not private business use arises) to a nongovernmental person in an arrangement that constitutes a "lease" for federal income tax purposes (Treasury Regulation §1.141-3(b)(3));
- use by a nongovernmental person pursuant to a nonqualifying management contract with respect to all or a portion of financed property (IRS Rev. Proc. 2017-13; IRS Rev. Proc. 97-13, as modified and amplified);
- nonqualifying research arrangements that relate to the financed property (IRS Rev. Proc. 2007-47);
- use by limited liability corporations, joint ventures and partnerships under certain circumstances.

2017©Quarles & Brady LLP

III. BACKGROUND OF MANAGEMENT CONTRACT SAFE HARBOR RULES.

A. *Management Contract:* A "*management contract*" is described in Treasury Regulation §1.141-(3)(b) 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. ***See VI.A. below for a description of certain arrangements that are not treated as management contracts.***

A management contract that pertains to tax-exempt bond-financed property must comply with certain conditions in order to avoid giving rise to private business use.

B. *Revenue Procedure 1997-13, as modified and amplified:* Prior to August 22, 2016, Revenue Procedure 1997-13, as modified by Revenue Procedure 2001-39 and as amplified in Section 3.02 of IRS Notice 2014-67 (collectively, "***Modified 97-13***"), provided rules and safe harbor conditions under which a management contract would not result in private business use under the modified private business use test for property financed with qualified 501(c)(3) bonds under §145(a)(2)(B) of the Code to be met. ***These rules are still applicable to certain management contracts as set forth and summarized in V. below.***

C. Revenue Procedure 2016-44: In August 2016 the IRS released Revenue Procedure 2016-44 ("***2016-44***") which provided for new safe harbors for management contracts and superseded Modified 97-13. 2016-44 was applicable to any management contract entered into after August 22, 2016, but permitted continued application of Modified 97-13 to any contract entered into prior to August 18, 2017. ***Due to the number of questions that arose with respect to certain provisions of 2016-44, in January 2017 the IRS released Revenue Procedure 2017-13, which has superseded 2016-44. This outline does not contain any details on 2016-44 as it was superseded and has no continued applicability.***

D. Revenue Procedure 2017-13: In January 2017 the IRS released Revenue Procedure 2017-13 which superseded the provisions of 2016-14 and now provides the rules and safe harbor conditions under which a management contract does not result in private business use of tax-exempt bond financed property used directly or indirectly by a nongovernmental person. ***See IV. below for a summary of the new rules and the applicability of Rev. Proc. 2017-13.***

2017©Quarles & Brady LLP

IV. NEW QUALIFIED MANAGMENT CONTRACT RULES: *IRS Revenue Procedure 2017-13 ("17-13")*

A. Applicability of 17-13: 17-13 is applicable (1) to any management contract that is *entered into* ***on or after January 17, 2017*** and (2) to any management contract *entered into* ***before January 17, 2017 if the issuer has elected to apply 17-13 retroactively*** to any such contract. Notwithstanding the foregoing, for any management contract that is ***entered into before August 18, 2017*** an issuer may elect to apply Modified 97-13 to such contract so long as such contract is *not materially modified or extended* (except pursuant to a "renewal option") *on or after August 18, 2017.*

B. *In General:* §5.01 of 17-13 provides that if such a management contract meets all of the applicable conditions of §§5.02 through 5.07 of 17-13, or is an eligible expense reimbursement arrangement (which is 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), the contract does not result in private business use under §141(b) or 145(a)(2)(B) of the Code.

C. *Permitted Compensation:* Compensation paid to the service provider must be *"reasonable"*. For purposes of determining compensation, payments made to reimburse the service provider for actual and direct expenses, as well as administrative expenses, are included. (§5.02(1))

- ***No Net Profits Arrangements.*** (§5.02(2)) The service provider may not receive a share of net profits from the operation of the managed property. The (1) eligibility for, (2) the amount of and (3) the timing of the payment of the compensation may not take into account, or be contingent upon, either the managed property's net profits or both the revenues and expenses (other than any reimbursement of direct and actual expenses paid by the service provider to unrelated parties) of such property for any fiscal period.

  Incentive compensation does not violate this restriction if the eligibility for payment is determined by the service provider's performance meeting standards that measure quality of services, performance and/or productivity *and* the timing of the payment meets the requirements of §5.02(2).

- ***No Bearing of Net Losses.*** (§5.02(3)) The service provider may not be required to bear any share of the net losses from the operation of the managed property. An arrangement does not violate this restriction if:

  ✓ The determination of compensation and the amount of expenses to be reimbursed, separately and collectively, (1) 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* (2) the timing of the payment of the compensation is not contingent upon the managed property's net losses.

- ***Specific Types of Compensation.*** (§5.02(4)) If the compensation for services (without regard to whether the service provider pays expenses for the operation of the managed property without reimbursement) meets one of the following, such compensation will *not* be treated as providing a share of net profits or requiring the service provider to share in the net losses.

2017©Quarles & Brady LLP

- ✓ If the compensation is based *solely* on a ***capitation fee*** (which is a fixed periodic amount for each person for whom services are provided for a specified period so long as the quantity and type of services actually provided vary from person to person), a ***periodic fixed fee*** (which is a stated dollar amount for services rendered for a specified period of time, such as a fixed dollar amount per month), or a ***per-unit fee*** (which is 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 Medicare),
- ✓ If the compensation is ***incentive compensation*** described in §5.02(2), or
- ✓ If the compensation is a ***combination of the foregoing***.

- ***Timing of the Payment of Compensation.*** (§5.02(5)) Deferral of the payment of compensation due to insufficiency of cash flows from the operation of the managed property will not cause the deferred compensation to be treated as contingent upon net profits or net losses under §§5.02(2) and 5.02(3) of 17-13 so long as the compensation otherwise meets the requirements of such sections and the contract requires:
  - ✓ compensation to be payable at least annually,
  - ✓ qualified user is subject to reasonable consequences for late payment (i.e. reasonable interest or late payment fees), and
  - ✓ qualified user will pay such deferred compensation (including any interest or late payment fees) no later than the end of 5 years after the original due date.

D. ***<u>Term of Management Contract and Revisions</u>:*** The term of the management contract, including all "renewal options,"[1] may not exceed the lesser of (1) 80% of the weighted average reasonably expected economic life of the managed property *determined as of the beginning of the term of the contract* or (2) 30 years. (§5.03)

- Economic life is determined in the same manner as under §147(b) of the Code, which includes giving financed land an economic life of 30 years if 25% or more of the net proceeds of the issue that financed the managed property is used to finance the costs of such land.
- If the contract is materially modified with respect to any matters covered by §5.01 through §5.08 of 17-13 it must be *retested as a new contract* as of the date of the material modification.

E. ***<u>Control over use of Managed Property</u>:*** The qualified user must exercise a significant degree of control over the use of the managed property. (§5.04) *This requirement is met <u>if the contract requires</u> the qualified user to approve*:

- *the annual budget* of the managed property;
- *capital expenditures* with respect to the managed property (i.e. approval of an annual budget for capital expenditures described by functional purpose and specific maximum amounts satisfies this requirement);

[1] A "renewal option" is a provision that gives either party the legally enforceable right to renew the contract as described in Treasury Regulation §1.141-1(b)). An "evergreen" provision that provides for automatic renewal of the contract for a specified period absent prior cancellation by either party does not constitute a "renewal option" that must be counted when determining the contract term.

2017©Quarles & Brady LLP

- *each disposition of property* that is part of the managed property (i.e. approval of dispositions of property may be shown in a similar manner as the example above for capital expenditures);
- *rates charged* for the use of the managed property (i.e. approval of rates charged may be shown by expressly approving such rates or a general description of the methodology for setting such 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); and
- *the general nature and type of use* of the managed property.

F. ***Risk of Loss of the Managed Property:*** The qualified user must bear the risk of loss of damage to or destruction of the managed property. (§5.05) This does not prohibit the owner from insuring against risk of loss through a third party or imposing a penalty upon the service provider if it fails to operate the property in accordance with standards set forth in the management contract.

G. ***No Inconsistent Tax Position:*** The service provider *must agree in the management contract* that is it not entitled to and will not take any tax position that is inconsistent with being a service provider with respect to the managed property. (§5.06) By way of 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.

H. ***No Circumstances Substantially Limiting Exercise of Rights:*** The service provider may not have any relationship with the qualified user of the managed property that substantially limits the qualified user's ability to exercise its rights under the contract, based on all of the facts and circumstances. (§5.07(1)) This requirement is met if:

- no more than 20% of the voting power of the governing body of the qualified user of the managed property is vested in the directors, officers, shareholders, partners, members, and employees of the service provider, in the aggregate;
- the governing body of the qualified user does not include the CEO of the service provider or the chairperson (or equivalent executive) of the service provider's governing body; and
- the CEO of the service provider is not the CEO of the qualified user or any of the qualified user's related parties (under Regulation §1.150-(b)).

  For purposes of the foregoing conditions, "service provider" includes the service provider's related parties, and the term "chief executive officer" includes a person with equivalent management responsibilities.

I. ***Functionally Related and Subordinate Use:*** §5.08 of 17-13 provides that a service provider's use of a portion of a bond financed project that is functionally related and subordinate to the performance of its services under a management contract for managed property that meets the requirements of 17-13 does not result in private business use of that portion of the project.

2017©Quarles & Brady LLP

V. *IRS REVENUE PROCEDURE 1997-13, AS MODIFIED BY REVENUE PROCEDURE 2001-39 AND AS AMPLIFIED IN SECTION 3.02 OF IRS NOTICE 2014-67 (collectively, "Modified 97-13"):*

A. *Continued Applicability of Modified 97-13:* Modified 97-13 may still be applied to any management contract entered into prior to August 18, 2017 that is not materially modified or extended on or after August 18, 2017 (other than pursuant to a "renewal option" that gives either party the legally enforceable right to renew the contract as described in Treasury Regulation §1.141-1(b)).

B. *Specified Types of Permitted Compensation:* The compensation paid to the service provider *must be "reasonable"* and *may not be based*, in whole or in part, *on a share of net profits* from the operation of the managed property. Compensation based on any of the following is generally *not* considered to be based on a share of net profits:

- a ***percentage of gross revenues*** or adjusted gross revenues (gross revenues less allowances for bad debts and contractual and similar allowances) of the managed property or a *percentage of expenses* of the managed property, *but not both*;
- a ***capitation fee*** (which is a fixed periodic amount for each person for whom services are provided for a specified period so long as the quantity and type of services actually provided vary from person to person), such as an agreement to provide all needed medical services to each member of an HMO for a specified period of time at a fixed dollar amount per person; or
- a ***per-unit fee*** (which is 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 Medicare), such as a stated dollar amount for each specified medical procedure performed or car parked. Separate billing arrangements between doctors and hospitals are generally treated as per-unit fee arrangements.

Productivity Award: Additionally, under Modified 97-13 a "*productivity reward*" paid for services in any annual period during the term of the contract generally does not cause a compensation arrangement to be based on a share of net profits of the managed property if:

- the productivity reward is equal to a stated dollar amount based on increases or decreases in gross revenues or adjusted gross revenues; or
- the productivity reward is equal to a stated dollar amount based on reductions in total expenses (but not both increases in gross revenues *and* reductions in total expenses); or
- the productivity reward is based on the quality of the services provided rather than on increases in revenues or decreases in expenses of the managed property *and* the amount of the productivity reward 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.

C. *Permitted Contract Term:* The permissible duration of the management contract depends upon the type of compensation paid:

- ***periodic fixed fee*** (which is a stated dollar amount for services rendered for a specified period of time, such as a fixed dollar amount per month):

2017©Quarles & Brady LLP

- ✓ ***95% periodic fixed fee (up to 15 years):*** If at least 95% of the compensation in each annual period of the contract is based on a periodic fixed fee, the term of the contract, including all renewal options, may not exceed the lesser of (1) 80% of the reasonably expected useful life of the managed property or (2) 15 years;
- ✓ ***80% periodic fixed fee (up to 10 years) :*** If at least 80% of the compensation in each annual period of the contract is based on a periodic fixed fee, the term of the contract, including all renewal options, may not exceed the lesser of (1) 80% of the reasonably expected useful life of the managed property or (2) 10 years;

- ***5-year arrangements****:* If all of the compensation is based on:
  - ✓ a ***stated amount***,
  - ✓ a ***periodic fixed fee***,
  - ✓ a ***capitation fee***,
  - ✓ a ***per-unit fee***,
  - ✓ a ***percentage of gross revenues, adjusted gross revenues, or expenses*** of the managed property (but *not* both revenues and expenses), or
  - ✓ a ***combination of the foregoing***,

  the term of the contract, including all renewal options, may not exceed 5 years. The contract does not need to be terminable by the qualified user of the managed property prior to the end of the stated term.

For purposes of determining the duration of a contract, a "renewal option" is a provision where either party has a legally enforceable right to renew the contract. An "evergreen" provision that provides for automatic renewal of the contract for a specified period absent prior cancellation by either party does not constitute a "renewal option" that must be counted when determining the contract term.

D. ***No Circumstances Substantially Limiting Exercise of Rights:*** The service provider may not have any relationship with the qualified user of the managed property that substantially limits the qualified user's ability to exercise its rights under the contract, based on all of the facts and circumstances. This requirement is met if:

- no more than 20% of the voting power of the governing body of the qualified user of the managed property in the aggregate is vested in the service provider, its directors, officers, shareholders and employees,
- overlapping board members do not include the CEO of the qualified user or its governing body or of the service provider or its governing body, and
- the qualified user and the service provider are not related parties under Regulation §1.150-(b).

2017©Quarles & Brady LLP

VI. OTHER EXCEPTIONS TO PRIVATE BUSINESS USE.

A. *Incidental Use that is not treated as a Management Contract that gives rise to Private Business Use:*

In general, the following arrangements are not treated as management contracts that give rise to private business use (Treasury Regulation §1.141-3(b)(4)(iii)):

- contracts for services solely incidental to a facility's primary function (janitorial, office equipment repair, hospital billing and similar services);
- the mere granting of hospital admitting privileges to a doctor (even if the privileges are conditioned on the provision of de minimis services) if such privileges are available to all qualified physicians in the area, consistent with the size and nature of the hospital's facilities;
- 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.

B. *General Public Use:*

In General: Private business use does *not* include use by nongovernmental persons as members of the general public. (Treasury Regulation §1.141-3(c))

- If property is used by nongovernmental persons in their respective trades or businesses, such use is treated as general public use *only if the property is in fact reasonably available for use on the same basis by other members of the general public*. In other words, use of bond-financed property on the same basis as the general public (including use by a nongovernmental person in a business context) is not considered private business use.
- Example: Use of a bond-financed toll bridge by a business vehicle does not result in private business use because it is use on the same basis as use by the general public.

Use Must be on the Same Basis as General Public Use: Note that use by a nongovernmental person under an arrangement that conveys *priority rights* or *other preferential benefits* to the nongovernmental person is *not use on the same basis as use by the general public*. *Priority rights* will *not* result if the arrangement for use by a nongovernmental person is at no charge and the general public is also not charged, or if the rates charged for such use is on the basis as the rates that are generally applicable and uniformly applied to all users of the bond-financed property.

Certain Long-Term Arrangement not treated as General Public Use:

- Arrangements with a nongovernmental person for temporary *exclusive* use of general public use property for 200 days or less (including all *renewal options*) is *not private business use*. A right of first refusal to renew is *not counted in the initial term of the arrangement if* the renewal price is at generally applicable fair market value rates and the use of such property under the same or similar arrangements is predominantly by natural persons not engaged in a trade or business.

2017©Quarles & Brady LLP

- The 200-day limitation is an absolute top limit for such temporary exclusive use and the 200 days of use need not be consecutive. For example, an arrangement that contemplates 50 days of exclusive use of general public use property every year for 5 years would not meet this exception for private business use as it results in 250 days of exclusive use.
- Therefore, an arrangement for use by a nongovernmental person of exclusive use of bond-financed property, even if the rates charged (or not charged) are the same as to the general public, will result in private business use if the 200-day limitation is exceeded.

C. ***Other Short-Term Arrangements that are not General Public Use or Private Business Use:***

In General: The following short-term arrangements for the use of bond-financed property do not result in private business use. Note that the limitation on the duration of the arrangements described below (100 days or 50 days, as applicable) is the same as set forth above for certain 200-day exclusive use arrangements in that the permitted days of use are applied by reference to the aggregate total number of days of use contemplated over the duration of the arrangement. (Treasury Regulation §1.141-3(d)(3))

Permitted 100-Day Arrangements: An arrangement for the use of bond-financed property by a nongovernmental person for a period of *100 days or less* (including renewal options) is not private business use if:

- The term of the use by the nongovernmental person under the arrangement, including all renewal options, is *not longer than 100 days*;
- The arrangement would be treated as general public use, except that it is *not* available for use on the same basis by natural persons not engaged in a trade or business because generally applicable and uniformly applied rates are not reasonably available to natural persons not engaged in a trade or business (*such use is not reasonably offered to the general public*); and
- The property was not financed for the principal purpose of providing property for use by that nongovernmental person.

Permitted 50-Day Arrangements: An arrangement for the use of bond-financed property by a nongovernmental person for a period of *50 days or less* (including all renewal options) is not private business use if:

- The term of the use by the nongovernmental person under the arrangement, including all renewal options, is *not longer than 50 days*;
- The arrangement is a negotiated arm's-length arrangement;
- The compensation is at fair market value; and
- The property was not financed for the principal purpose of providing property for use by that nongovernmental person.

D. *Use by Agents of a Governmental Unit:* Use by nongovernmental persons solely in their capacity as agents of a governmental person is not private business use. (Treasury Regulation §1.141-3(d)(1))

2017©Quarles & Brady LLP

E. ***Use Incidental to Financing Arrangements:*** Use by a nongovernmental person that is solely incidental to a financing arrangement is not private business use if the nongovernmental person has no substantial rights to use bond proceeds or financed property other than as an agent of the bondholders. (Treasury Regulation §1.141-3(d)(2))

F. ***Certain Incidental Uses within the meaning of Treasury Regulation §1.141-3(d)(5):*** Incidental uses of a bond financed facility are disregarded to the extent that those uses to not exceed 2.5% of the proceeds of the issue of bonds used to finance the facility. Such use by a nongovernmental person is "incidental" if:

- the use does not involve the transfer to the nongovernmental person of possession and control of space that is separated from other areas by walls, partitions or other physical barriers (except for vending machines, pay telephones, kiosks and similar uses);
- the nonpossessory use is not functionally related to any other use of the facility by the same person (other than a different nonpossessory use); and
- all nonpossessory uses of the facility do not, in the aggregate, involve the use of more than 2.5% of the facility.

G. ***Research Agreements:*** Use by a nongovernmental person pursuant to a research agreement described in IRS Revenue Procedure 2007-47 is not treated as private business use.

2017©Quarles & Brady LLP