

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Refer Reply To:
CC:TEGE:EOEG:TEB-PLR-157028-01
Date:
November 2, 2001

RE:

LEGEND

Conduit Borrower

Bonds

Issuer

Vessel

The Expeditions

The Manager

Location 1

Location 2

Location 3

Time 1

Time 2

Time 3

Time 4

State

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a

b

c

d

e

Dear :

This is in response to your request for a ruling that the Agreement as described below is a management contract that meets the requirements of Revenue Procedure 97-13, 1997-1 C.B. 632.

FACTS AND REPRESENTATIONS

The Conduit Borrower is an exempt organization under § 501(c)(3) of the Internal Revenue Code and borrowed the proceeds of the Bonds from the Issuer to finance the construction and purchase of the Vessel. The Conduit Borrower has used, and plans to continue to use, the Vessel during a period of approximately a months each year to conduct the Expeditions. Until now, the Vessel has not been used in the remaining period of the year. The Conduit Borrower is proposing to use the Vessel in the upcoming period of months during which the Vessel would not be in use for the Expeditions to provide ferry service to the public.

The Conduit Borrower intends to enter into a nonrenewable agreement with the Manager (the "Agreement") under which the latter will manage certain operations of the Vessel to provide this ferry service. The ferry service would operate between Location 1 or Location 2 and Location 3 weekdays from Time 1 to Time 2 and from Time 3 to Time 4. The term of the Agreement will be for these weekday time periods for approximately b months, a term which is less than one year. The Conduit Borrower reserves the right to use the Vessel without the services of the Manager at all other times.

The Manager will be responsible to provide passenger services, maintain and clean the Vessel, operate the galley service, purchase needed fuel and supplies, provide dock and other shore facilities, and pay port and related charges. The Manager will pay the costs of positioning and repositioning the Vessel between its home port and State. The Conduit Borrower will supply a licensed captain and up to c back-up crew members.

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The Manager will collect passenger fees on behalf of the Conduit Borrower and will retain \$d per passenger carried on each one-way trip between Location 1 or Location 2 and Location 3 as payment for its services. The Manager will collect receipts from the galley service on behalf of the Conduit Borrower and retain e percent of the gross revenues from the galley service as payment for its services. The amounts retained by the Manager are reasonable compensation for the services provided.

The Conduit Borrower will reimburse the Manager for costs incurred by the Manager in operation of the galley services to the extent those costs are owed to third parties and do not exceed the remaining receipts from the galley service. These costs do not include amounts paid to the Manager's employees as salary or wages. The Conduit Borrower may reimburse the Manager for the following expenses if paid to third parties: fuel, shore power, and supplies; port and related charges; and temporary housing.

None of the voting power of the governing body of the Conduit Borrower is vested in the Manager, its directors, officers, shareholders or employees. There is no overlap in board members of the Manager and the Conduit Borrower. The Conduit Borrower and the Manager are not related parties under § 1.150-1(b) of the Income Tax Regulations.

LAW AND ANALYSIS

Section 103(a) provides, with certain exceptions, that gross income does not include interest on any State or local bond. Section 103(b) provides that § 103(a) does not apply to any private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) defines "private activity bond" to include any bond issued as part of an issue that meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2). An issue meets the private business use test of § 141(b)(1) if more than 10 percent of the proceeds of the issue are to be used for any private business use.

Section 141(e) provides that the term "qualified bond" includes any private activity bond if such bond is a qualified § 501(c)(3) bond and meets other specified requirements.

Section 145(a) provides that a "qualified § 501(c)(3) bond" means any private activity bond issued as part of an issue if (1) all property which 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--

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(A) § 501(c)(3) organizations were treated as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying § 513(a), and

(B) paragraphs (1) and (2) of § 141(b) 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(a) of the Income Tax Regulations provides generally that §§ 1.141-0 through 1.141-15 apply to § 145(a). Section 1.145-2(b) provides, in part, that in applying §§ 1.141-0 through 1.141-15 to § 145(a), (1) references to governmental persons include 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under § 513(a); and (2) references to “10 percent” and “proceeds” in the context of the private business use test and the private security and payments test mean “5 percent” and “net proceeds”.

Section 1.141-3(b)(4)(i) provides that, except as provided in § 1.141-3(d), a management contract with respect to financed property may result in private business use of that property, based on all the facts and circumstances. A management contract 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.* Section 1.141-3(b)(4)(ii) defines a 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 of, or any function of, a facility.

Revenue Procedure 97-13 sets forth conditions under which a management contract does not result in private business use under § 141(b). It also applies to determinations of whether a management contract causes the test in § 145(a)(2)(B) to be met for qualified 501(c)(3) bonds.

Section 5.01 of Rev. Proc. 97-13 provides that if the requirements of § 5 of this revenue procedure are satisfied, the management contract does not itself result in private business use. In addition, the use of financed property, pursuant to a management contract meeting the requirements of § 5 of this revenue procedure, is not private business use if that use is functionally related and subordinate to that management contract and that use is not, in substance, a separate contractual agreement.

Section 5.02(1) of Rev. Proc. 97-13 provides that the 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

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unrelated parties is not by itself treated as compensation.

Section 5.02(2) of Rev. Proc. 97-13 provides for purposes of §§ 1.141-3(b)(4)(i) and this revenue procedure, compensation based on (a) a percentage of gross revenues (or adjusted gross revenues) of a facility or a percentage of expenses from a facility, but not both; (b) a capitation fee; or (c) a per-unit fee is generally not considered to be based on a share of net profits.

Section 5.03 of Rev. Proc. 97-13 provides that the management contract must be described in § 5.03(1), (2), (3), (4), (5), or (6) of this revenue procedure.

Section 5.03(6) describes percentage of revenue or expense fee arrangements in certain 2-year contracts: All the compensation for services is based on a percentage of fees charged or a combination of a per-unit fee and a percentage of revenue or expense fee. During the start-up period, however, compensation may be based on a percentage of either gross revenues, adjusted gross revenues, or expenses of a facility. The term of the contract, including renewal options, must not exceed 2 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the first year of the contract term. This § 5.03(6) applies only to: (a) Contracts under which the service provider primarily provides services to third parties (for example, radiology services to patients); and (b) Management contracts involving a facility during an initial start-up period for which there have been insufficient operations to establish a reasonable estimate of the amount of the annual gross revenues and expenses (for example, a contract for general management services for the first year of operations).

Section 5.04(1) of Rev. Proc. 97-13 provides that 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, including cancellation rights, under the contract, based on all the facts and circumstances. Section 5.04(2) provides that this requirement is satisfied if (a) 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; (b) 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 (c) The qualified user and the service provider under the contract are not related parties, as defined in §§ 1.150-1(b).

Section 3.06 of Rev. Proc. 97-13 defines per-unit fee as 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, a car parked, or passenger mile is a per-unit fee.

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Section 3.07 of Rev. Proc. 97-13 defines qualified user as any state or local government unit as defined in § 1.103-1 or any instrumentality thereof. The term also includes a § 501(c)(3) organization if the financed property is not used in an unrelated trade or business under § 513(A).

We assume for purposes of this ruling that the proposed use of the Vessel is not an unrelated trade of business within the meaning of § 513(a).

We conclude that the Agreement meets the requirements of § 5 of Rev. Proc. 97-13. The Owner will pay the Manager as compensation for its services a set amount per passenger ride, *i.e.*, a per-unit fee, plus a percentage of the gross revenues from the galley service. The compensation of the Manager is not based on a share of net profits. The Issuer has represented that the compensation to be paid is reasonable compensation for the services to be provided. The reimbursement of expenses paid by the Manager to third parties is not considered as compensation to the Manager. Thus, the requirements of § 5.02 are met.

The requirements of § 5.03 are also met. The Agreement is described in § 5.03(6). The compensation is a combination of a per-unit fee and a percentage of revenues fee. The term of the Agreement is a period shorter than a year. This is the commencement of a new activity for the Vessel and the Conduit Borrower.

The Agreement meets the requirements of § 5.04 of Rev. Proc. 97-13, as it fits within the safe harbor provided in § 5.04(2).

CONCLUSION

The Agreement meets the requirements of § 5 of Rev. Proc. 97-13.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether the proposed use of the Vessel is an unrelated trade or business within the meaning of § 513(a), whether interest on the Bonds is excludable from gross income under § 103(a), or whether the Bonds are qualified 501(c)(3) bonds under § 145.

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.

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.

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In accordance with the power of attorney, a copy of this ruling is being sent to your authorized representative.

Sincerely,

Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)
By: Timothy L. Jones
Assistant Branch Chief
Tax Exempt Bond Branch