

Internal Revenue Service
Department of the Treasury
Washington, DC 20224
October 18, 2002

Number: 200304015
Release Date: 01/24/2003
Index Number: 141.01-00
Person to Contact:
Telephone Number:
Refer Reply To:

CC:TEGE:EOEG:TEB-PLR-121800-02

This is in response to the request on behalf of the Issuer for a ruling regarding the qualified 501(c)(3) bonds (the "Bonds") that it proposes to issue to finance a portion of the construction of the Facility. You have requested a ruling that the proceeds of the Bonds may be allocated to University and government use of the Facility.

FACTS AND REPRESENTATIONS

The Facility will be a multi-purpose arena that is part of a larger redevelopment project in City's downtown area. The Issuer will issue the Bonds along with taxable bonds (the "Taxable Bonds") to finance the construction of the Facility and will lease the Facility to City under a financing lease.

University, a tax-exempt organization under § 501(c)(3) of the Internal Revenue Code (the "Code"), is located in the vicinity of the proposed Facility and wishes to use the Facility for its home basketball games and practices and for commencement exercises. City has agreed to sublease the Facility to University for these activities in return for rent payments based on a portion of the debt service on the Bonds. The Issuer reasonably expects that University's use of the Facility each year during the term of the Bonds will be approximately a percent of the total time the Facility will be in actual use. University represents that its use of the Facility will not constitute unrelated trade or business for University within the meaning of § 513(a) of the Code.

In addition, University will have naming rights to the Facility and the right to select the decor to match University's colors and emblems. It will not transfer the naming rights to a nongovernmental person engaged in a trade or business. University itself will name the Facility after one of the following: University; a benefactor of University who is a natural person; or a natural person who is designated by such benefactor. Any gift by a benefactor to University for the Facility will not be conditioned upon the naming of the Facility after such benefactor or its designee. The benefactor or a related person is expected to be a private business user of the Facility.

City also has agreed to sublease the Facility to Team Owner to be used for home games played by the Team, a minor league sports team, in exchange for rent payments equal to the debt service on the Taxable Bonds. The Issuer reasonably expects the Team's use of the Facility each year during the term of the Bonds will be approximately b percent (a percentage greater than 10 percent) of the total time the Facility will be in actual use. City does not expect the fair market value of this private business use to be significantly greater than that of the government or University use.

The Issuer reasonably expects that government use each year during the term of the Bonds will account for the rest, or approximately c percent, of the total time the Facility will be in actual use.

To build the Facility, the Issuer plans to issue the Bonds and the Taxable Bonds simultaneously. The Issuer will issue the Taxable Bonds in an amount sufficient to finance at least: (1) the costs of any discrete portions of the Facility the actual use of which the Issuer expects to be solely by private business users, such as concession areas, (2) the costs of any discrete portions of the Facility that are not otherwise eligible for tax-exempt financing as qualified 501(c)(3) bonds, such as luxury boxes, (3) a portion of the costs of the remainder of the Facility, other than the common areas within the Facility (the "Remainder"), equal to the percentage of total time in actual use that the Issuer reasonably expects the Remainder to be used for private business use by the Team (the "Private Time Percentage"), and (4) a portion of the costs of the common areas within the Facility (the "Common Costs"), equal to the sum of (a) the product of the Common Costs and the percentage of the usable space of the Facility used for the purposes described in (1) and (2) (the "Discrete Common Costs"), and (b) the product of the difference between the Common Costs and the Discrete Common Costs and the Private Time Percentage. The Issuer will issue the Bonds to finance the balance of the costs, i.e., an amount equal to or less than the sum of the costs of the Remainder not described in (3) above and any Common Costs not described in (4) above

LAW AND ANALYSIS

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) provides, in part, that § 141(a) shall not apply to any private activity bond which 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) which meets the private business use test of § 141(b)(1), and the private security or payment test of § 141(b)(2), or (2) which meets the private loan financing test of § 141(c). Section 141(b)(1) provides that, except as otherwise provided, an issue meets the 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(b)(2) provides that, except as otherwise provided, an issue meets the test of § 141(b)(2) if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by

any interest in (i) property used or to be used for a private business use, or (ii) 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 141(b)(6)(A) defines “private business use” as use (directly or indirectly) in a trade or business carried on by a person other than a governmental unit. For purposes of the preceding sentence, use as a member of the general public shall not be taken into account. Section 141(b)(7) defines “government use” as any use other than a private business use.

Section 141(e) provides, in part, that the term “qualified bond” means a qualified 501(c)(3) bond. Section 145(a) provides in general that the term "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 (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) §§ 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 1.141-1(b) of the Income Tax Regulations provides that the term common areas means 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 the 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. A floor of a building and a portion of a building separated by walls, partitions, or other physical barriers are examples of a discrete portion.

Section 1.141-3(a) provides, in part, that the use of the financed property is treated as the direct use of proceeds.

Section 1.141-3(g)(1) provides that, in general, the private business use of proceeds is allocated to property under § 1.141-6. The amount of private business use of that property is determined according to the average percentage of private business use of that property during the measurement period.

Section 1.141-3(g)(2)(i) 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 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). In

general, the period of reasonably expected economic life of the property for this purpose is based on reasonable expectations as of the issue date.

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 1-year periods within the measurement period. Appropriate adjustments must be made for beginning and ending periods of less than 1 year.

Section 1.141-3(g)(4)(i) provides that the percentage of private business use of property for any 1-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 not private business use (government use) during that year. Section 1.141-3(g)(4)(ii) through (v) apply to determine the average amount of private business use for a 1-year period.

Section 1.141-3(g)(4)(ii) provides that, for a facility in which actual government use and private business use occur at different times (for example, different days), the average amount of private business use generally is based on the amount of time that the facility is used for private business use as a percentage of the total time for all actual use. In determining the total amount of actual use, periods during which the facility is not in use are disregarded.

Section 1.141-3(g)(4)(iv) provides that, for purposes of § 1.141-3(g), 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 1.141-3(g)(4)(v) provides that, for purposes of § 1.141-3(g)(4) (ii) through (iv), if private business use is reasonably expected as of the issue date to have a significantly greater fair market value than government use, the average amount of private business use must be determined according to the relative reasonably expected fair market values of use rather than another measure, such as average time of use. This determination of relative fair market value may be made as of the date the property is acquired or placed in service if making this determination as of the issue date is not reasonably possible (for example, if the financed property is not identified on the issue date). In general, the relative reasonably expected fair market value for a period must be determined by taking into account the amount of reasonably expected payments for private business use for the period in a manner that properly reflects the proportionate benefit to be derived from the private business use.

Section 1.141-3(g)(5) provides that the amount of private business use of common areas within a facility is based on a reasonable method that properly reflects the proportionate benefit to be derived by the users of the facility. For example, in general, a method that is based on the average amount of private business use of the remainder of the entire facility reflects proportionate benefit.

Section 1.141-6(a) provides that, for purposes of §§ 1.141-1 through 1.141-15, the provisions of §§ 1.148-6(d) apply for purposes of allocating proceeds to expenditures. Thus, allocations generally may be made using any reasonable, consistently applied accounting method, and allocations under § 141 and § 148 must be consistent with each other.

Section 1.145-2(a) provides generally that §§ 1.141-0 through 1.141-15 apply to § 145(a). Section 1.145-2(b) provides 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); (2) references to "10 percent" and "proceeds" in the context of the private business use test and the private security or payment test mean "5 percent" and "net proceeds"; and (3) references to the private business use test in §§ 1.141-2 and 1.141-12 include the ownership test of § 145(a)(1). Section 1.145-2(c)(2) provides that § 1.141-3(g)(6) does not apply to § 145(a)(2) to the extent that it provides that costs of issuance are allocated ratably among the other purposes for which the proceeds are used. For purposes of § 145(a)(2), costs of issuance are treated as private business use.

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.

The same language appears in the Report of the Committee on Finance of the Senate on H.R. 3838, S. Rep. No. 99-313, at 841 (1986), 1986-3 (Vol. 3) C.B. 841 (the "Senate Report").

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 § 147(e), § 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, § 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.

The Issuer proposes to use proceeds of the Taxable Bonds to cover the costs attributable to any discrete portions of the Facility the actual use of which the Issuer expects to be solely by private business users and any discrete portions used for other purposes, such as luxury boxes, not eligible for financing with the proceeds of tax-exempt 501(c)(3) bonds. The Issuer proposes to finance the Remainder with a combination of proceeds of the Taxable Bonds and of the Bonds based on the expected percentage of time that the Remainder is actually used, respectively, for (1) private business use and (2) combined government and University use. The Issuer proposes to finance the Common Costs with a combination of proceeds of the Taxable Bonds and of the Bonds based on the expected percentage of the Facility that is actually used, respectively, for (1) private business use and (2) combined government and University use.

We first consider the two types of discrete portions mentioned above. It is clear from the 1984 House Report cited above that while luxury boxes may not be funded with tax-exempt private activity bonds, the other parts of a facility that include luxury boxes may be so funded if otherwise eligible. We think that treating discrete portions used for private business use in a similar fashion as luxury boxes is appropriate. Accordingly, because the Issuer will fund the discrete portions described above with proceeds of the Taxable Bonds, the presence of these discrete portions within the Facility will not preclude the Bonds from being tax-exempt.

We next consider the Remainder. The projected private business use of the Remainder, as measured in accordance with § 1.141-3(g)(4)(ii), will exceed ten percent. The issue is whether the Issuer may use a time-based allocation method to allocate the proceeds of the Bonds to University and government use, so that a portion of the Remainder may qualify for tax-exempt financing under § 145.

The 1985 House Report and the Senate Report recognize that portions of facilities used by 501(c)(3) organizations also may be used by other persons. While the larger facility so used may not qualify for tax-exempt financing, the legislative history indicates that tax-exempt financing under § 145 is permitted for the portion owned and used by the 501(c)(3) organization to the extent that the allocation of the costs of the facility is made using a reasonable method that properly reflects the proportionate benefit to be derived by the various users of the facility.

Even though the legislative history refers to the portion owned and used by a 501(c)(3) organization, we can see no reason not to extend this treatment to government ownership and use. Foremost, § 145 permits government use and ownership of financed property. Further, the legislative history appears to be addressing those situations where a facility otherwise would not be eligible for tax-exempt financing under § 145. Use and ownership by a governmental unit would not lead to such a situation.

The time-based method of allocation of use proposed by the Issuer is a reasonable method to allocate use. It would be applied in the same way as the time-based method of measuring private business use, thus reflecting the proportionate benefit to the various users. The fair market value of the private business use is not significantly greater than that of the government or 501(c)(3) use. Further, the percentages of use by the various users are expected to be substantially level over the term of the Bonds. Thus, we need not consider the situation where the percentages of use vary over the measurement period. The allocation of the costs of the Remainder is a reasonable method that reflects the proportionate benefit derived by the users of the Remainder, because the Issuer's proposed allocations of costs are consistent with the allocations of use, both using the time-based method. As a result, the portions of the Remainder allocated to University and government use, i.e., a + c percent, or a total of d percent, of the Remainder, are eligible for financing under § 145.

Finally, we consider the common areas within the Facility. Consistent with our treatment of the Remainder, it is appropriate to allocate the proceeds of the Bonds to a portion of the Common Costs based on the amount of University and government use of the rest of the Facility, so that a portion of the common areas may qualify for tax-exempt financing under § 145.

The Issuer proposes to determine the portion of the common areas that may be financed with the Bonds based on the rules set forth in § 1.141-3(g)(5), treating the discrete portions of the Facility that may not be financed with qualified 501(c)(3) bonds (i.e., the luxury boxes) as giving rise to private business use. The allocation of the costs using the methodology set forth in § 1.141-3(g)(5) is a reasonable method that reflects the proportionate benefit derived by the users of the Facility. The method of allocation of use proposed by the Issuer would be applied in the same way as the method of measuring private business use of common areas. In particular, the computation reflects both the private business use of the discrete portions of the Facility and the private business use of the Remainder based on the amount of time that it is used for a private business use.

CONCLUSIONS

We conclude as follows:

(1) Because the Issuer will fund the discrete portions described above with proceeds of the Taxable Bonds, the presence of these discrete portions within the Facility will not preclude the Bonds from being tax-exempt.

(2) The proceeds of the Bonds may be allocated to University and government use of the Remainder using a time-based method of allocation. As a result, the portions of the Remainder allocated to University and government use, i.e., a total of d percent of the Remainder, are eligible for financing under § 145.

(3) The proceeds of the Bonds may be allocated to the common areas within the Facility based on the portion of the Facility not used for a private business use under § 1.141-3(g)(5). As a result, a portion of the common areas within the Facility, based on the amount of the Facility used for University and government use are eligible for financing under § 145.

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.

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 interest on the Bonds will be excludable from gross income under § 103(a).

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 the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

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

By:

Bruce M. Serchuk

Senior Technician Reviewer
Tax Exempt Bond Branch