

**Internal Revenue Service**

Department of the Treasury

Number: **200250004**  
Release Date: 12/13/2002  
Index Number: 141.01-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

**CC:TEGE:EOEG:TEB/PLR-123416-02**

Date:

August 23, 2002

**LEGEND:**

Port =

State =

City 1 =

City 2 =

Management  
Company =

Company =

Bonds =

Dear

This letter is in response to your request for a ruling that bonds to be issued to finance certain costs incurred by Port in connection with a project to improve the channels and turning basins of Port's harbor will not meet the private business use test of § 141(b)(1) of the Internal Revenue Code.

**Facts and Representations**

Port makes the following factual representations. Port is a subdivision of City 1. Port owns, manages, and markets certain seaport facilities in State (the "Harbor"). The Harbor includes channels and turning basins located within those channels.

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The channels, including the turning basins, and the land underlying the channels are navigable waterways, which means that they are required to be open to all persons for navigation at no charge. There are private interests in some of the land underlying the channels, but those interests are restricted by special rules and cannot impede the general public use of the channels. No person that is not a governmental person (as that term is defined in § 1.141-1(b) of the Income Tax Regulations) has any priority rights or other special legal entitlements to the channels in the Harbor.

Port proposes to finance certain improvements to the Harbor, some of which will be financed with the Bonds. The improvements include dredging certain channels and turning basins (the “Dredging Project”), demolition and reconstruction of various improvements along the shoreline at a turning basin in the Harbor (the “Demolition Project”), and disposal of sediment materials produced by the dredging (the “Disposal Project”). These three projects, collectively referred to as the “Project,” are necessary to permit the Harbor to safely accommodate more recent generations of container ships.

The Dredging Project involves widening and deepening certain channels, including two turning basins in the Harbor. Port will finance the Dredging Project with Bond proceeds. While some of the land underlying the channels is privately owned, Port represents that this ownership will not cause the Bond proceeds to be privately used. The Disposal Project involves disposal of the sediment at certain wetlands and construction and landfill sites. Bond proceeds will be used for this project, but Port represents that the Disposal Project will not cause private business use of the Bond proceeds.

The Demolition Project consists of several components. It includes construction of a retaining wall, bulkheads, and a concrete apron, none of which will be financed with the Bonds. It may also include modification to certain ferry facilities. While Bond proceeds may be used for these modifications, Port represents that there will be no private business use of the ferry facilities.

The last component of the Demolition Project (the “Leased Property Improvements”) involves the acquisition of certain interests in real property, and the demolition and replacement of certain property, located at the shoreline of one of the turning basins that is to be enlarged as part of the Project. The shoreline along this turning basin is either owned by City 2 and leased to Management Company or owned by Management Company. Port will use Bond proceeds to acquire either the permanent or temporary use of some of this land. Port, City 2, and Management Company have agreed to provide all real estate interests (subject to any leases or other encumbrances thereon) that might be required for the Project in exchange for the fair market value of such interests.

In addition, Management Company owns and leases to Company a heavy industrial building and pier space on the shoreline at the turning basin. The lease provides Company with access to the water, pier space, and the ability to park mobile dry docks in the waters adjacent to the existing turning basin. Many of the facilities Company leases

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must be demolished as part of the Project. Port has entered into agreements with City 2, Management Company and Company, under which Port is obligated to either pay to relocate the facilities it demolishes or to construct replacement facilities, but only to the extent necessary to restore City 2, Management Company, and Company, to the degree possible, to the same position they would have held if the dredging and demolition never occurred. Port will use Bond proceeds to pay for the demolition and relocation costs.

Port requests a ruling that the Dredging Project and the Leased Property Improvements will not result in the Bonds meeting the private business use test of § 141(b)(1).

### **Law and Analysis**

Section 103(a) of the Internal Revenue Code provides that gross income does not include interest on a State or local bond. Section 103(b)(1) provides that § 103(a) does not apply to any private activity bond, unless it is a qualified bond under § 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 in general 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. Private business use is defined in § 141(b)(6) 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 is treated as a trade or business.

Section 1.141-3 provides rules pertaining to the definition of private business use. Section 1.141-3(a) generally states that the 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. Any activity carried on by a person other than a natural person is treated as a trade or business. In determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct use of the proceeds. § 1.141-3(a)(2).

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 of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; certain other arrangements such

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as a take or pay or other output-type contract; or any other comparable arrangement that conveys special legal entitlements for beneficial use of the bond proceeds or of financed property. § 1.141-3(b)(1), -3(b)(7)(i).

Section 1.141-3(b)(7)(ii) provides a special rule that applies to financed property that is not available for use by the general public. Private business use of this type of property may be established solely on the basis of special economic benefit to one or more nongovernmental persons, even if those nongovernmental persons have no special legal entitlements to use of the property. In determining whether special economic benefit gives rise to private business use it is necessary to consider all of the facts and circumstances, including one or more of the following factors – (A) Whether the financed property is functionally related to or physically proximate to property used in the trade or business of a nongovernmental person; (B) Whether only a small number of nongovernmental persons receive the special economic benefit; and (C) Whether the cost of the financed property is treated as depreciable by any nongovernmental person.

Although use of a bond-financed facility as a member of the general public is not private business use, § 1.141-3(c) provides that use of financed property by nongovernmental persons in their trades or businesses is treated as general public use only if that property is intended to be available and in fact is reasonably available for use by natural persons not engaged in a trade or business. In general, use under an arrangement that conveys priority rights or other preferential benefits is not use on the same basis as the general public.

The examples in § 1.141-3(f) illustrate the application of the rules contained in § 1.141-3. In Example 8(i), bond proceeds are used to finance a runway at a city-owned airport. Although it is reasonably expected that most use of the runway will be by private air carriers, the runway will be available to any operator of an aircraft, including general aviation operators not engaged in a trade or business. The private carriers have no priority rights or other preferential benefits for use of the runway. Also, the private air carriers' lease payments for use of the terminal space at the airport are determined without regard to the revenues generated by runway landing fees (i.e., the lease payments are not determined on a "residual" basis). Because the runway is available for general public use, the special economic benefit received by the carriers from their use of the runway is not sufficient to cause the air carriers to be private business users of the bonds.

In § 1.141-3(f), Example 9, bond proceeds are used to finance a parking garage at a city-owned airport. It is reasonably expected that more than 10 percent of the use of the garage will be by employees of private air carriers. However, the air carriers will have no priority rights to the parking garage, and their use will be on the same basis as any member of the general public. Because the garage is available for general public use, the air carriers are not private business users even though they receive a special economic benefit from using the parking garage.

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In § 1.141-3(f), Example 11, bond proceeds are used to finance a 25-mile road to connect Corporation Y's industrial port with existing public roads. Other than the port, the nearest residential or commercial development to the new road is 12 miles away. There is no reasonable expectation of any development occurring in the area surrounding the new road. Y has no special legal entitlements to use the new road and the road will be available without restriction to all users, including natural persons not engaged in a trade or business. The bonds do not meet the private business use test because the road is treated as used only by the general public.

Section 1.141-4(g), Example 4, describes a situation in which a city issues assessment bonds, the proceeds of which are used to move existing utility lines underground to further public safety. The private utility that owns the lines is under no obligation to move the lines. In the example, the bonds are to be paid from assessments levied by the city on customers of the utility. Although the utility lines are privately owned and the utility customers make payments to the company, the example concludes that the payments are in respect of the relocation costs and are not made in respect of property used for a private business use. The example also concludes, however, that any direct or indirect payments to the city by the utility company for the undergrounding must be taken into account as private payments.

Section 263(a)(1) provides the general rule that no deduction shall be allowed for any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263(a)-2(a) provides in part that capital expenditures include the cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

### The Dredging Project

The Dredging Project will result in deeper and wider channels and turning basins to accommodate the newer generations of container ships. However, the channels and turning basins are available to the general public on the same basis as the container ships. No person has any priority rights or other special legal entitlements to the channels or turning basins in the Harbor.

In § 1.141-3(f), Example 11, the new road is treated as used by the general public on the same basis as the private business despite the fact that the new road was built to connect the private business' industrial port to existing public roads and that there was no reasonable expectation that development would occur around the new road. Similarly, in Example 8(i), even though the private air carriers are the primary users of the airport runway and receive a special economic benefit from their use of the runway, there is no private business use because the runway is available to general aviation operators not engaged in a private business, and the private carriers have no priority rights or other

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preferential benefits to the runway. And in Example 9 of § 1.141-3(f), even though employees of private air carriers are expected to use more than 10 percent of the parking garage, there is no private business use because these employees will have no priority rights over the general public.

Thus, while the Dredging Project will result in channels and turning basins in the Harbor that are deeper and wider than may be needed by any user of the Harbor other than the container ships, the channels and turning basins are available to the general public and no person engaged in a trade or business will have any special legal entitlements or other priority use to the channels and turning basins.

### The Leased Property Improvements

Port will use Bond proceeds for the Leased Property Improvements, which means that Port will use proceeds to acquire interests in land leased to or owned by a private business, and to either relocate the industrial building and pier or make a payment in lieu of relocation to private businesses. Port, however, will pay fair market value for the land, and any relocation or payment in lieu of relocation will only put the affected entities (i.e., City 2, Management Company, and Company) in the same position, to the extent possible, that these entities would have been in had the dredging and demolition never occurred.

We conclude that the costs associated with the Leased Property Improvements are costs of the Project and do not themselves give rise to private business use. See § 263 (a)(1); Peerless Weighing and Vending Machine Corporation v. Commissioner, 52 T.C. 850 (1969) (amounts paid to relocate tenant, including costs to remodel tenant's new space and payments of portion of tenant's rent for new space were capital expenditures because incurred as part of acquisition of building from which tenant was removed so building could be demolished). See also § 1.141-4(g) Example 4 (while example concerns application of private security or payment test, it implies relocating existing private utility lines to accomplish governmental project does not necessarily result in private business use).

### Conclusion

We conclude that the Dredging Project and the Leased Property Improvements will not result in private business use of the Bonds under § 141(b)(1).

The ruling contained in this letter is 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 a ruling, it is subject to verification on examination.

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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.

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 Port.

Sincerely yours,

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

By: \_\_\_\_\_  
Rebecca L. Harrigal  
Chief, Tax Exempt Bond Branch