Dear : 

This responds to your request for a ruling that the contract described below for management of a bond-financed facility will not result in private business use under § 141(b) of the Internal Revenue Code.
Facts and Representations

You make the following representations. The County is a governmental unit in State. The County is located in the southeast part of State and encompasses an area of approximately square miles. The County is governed by the Board.

The County owns and operates facilities and equipment used in solid waste collection and disposal, and waste recycling, for the residents and businesses located in its service district. The County owns a solid-waste disposal facility, consisting of acres, including a -acre landfill, a -acre waste compost site, an -acre construction and demolition debris recycling facility and various other storage and collection facilities (the “Facility”). The Facility was financed with the proceeds of the Bonds. The County intends to enter into a management contract (the “Contract”) to operate portions of the Facility with a nongovernmental person (the “Manager”).

The County represents that under the terms of the Contract, the County will maintain significant controls over, and responsibility for, the operation of the Facility. All solid waste delivered to the Facility will be weighed at a scale house operated by the County before entering the Facility. The County will impose and collect a tipping fee for each ton of commercial refuse delivered. The County will set annual assessments for residential solid waste collection and disposal, as well as the tipping fees for commercial waste, without any input from the Manager. The Manager will be required to process solid waste delivered to the Facility according to environmental and other standards provided in the Contract. There will be approximately eleven County employees located at the Facility, two of which will be full-time inspectors who monitor the performance of the Manager. In addition, an employee of the County will have the authority to disapprove or to reject work that is defective, waive certain notice provisions under the Contract, approve all contracts over a given dollar amount, and exercise rights over subcontractors that the Manager can hire. The County will be responsible for obtaining, renewing and modifying, as necessary, environmental permits required for operation of the Facility.

The County is located in an area of the State that is frequently affected by severe variations in rainfall, and potentially affected by hurricanes and other major storm events. The increase in rainfall and other storm-related damage associated with weather conditions results in increases to the amount and weight of waste delivered to the Facility. In the event of excess rain, there is an increase in waste for a relatively short period of time (i.e., a month or two). In the event of a hurricane or other major storm event, the increase could potentially last for a longer period of time (i.e., many months or even years depending on the severity of the hurricane or major storm event).
The County is located in an area of the country that has experienced significant growth in the last twenty years. The growth, however, has not been constant. During some years there has been significantly more construction than in other years. These variations in the amount of construction in the County result in variations in the amount of waste delivered to the Facility.

The County represents that under the terms of the Contract, compensation paid to the Manager will consist of: (1) a stated dollar amount which compensates the Manager for processing a minimum annual tonnage of waste (the “base fee”), and (2) a variable fee based on solid waste in excess of the minimum tonnage, determined by multiplying the tons of waste delivered for each category of waste in excess of the minimum tonnage by the contract price for each category of waste (the “per-unit fee”). The per-unit fee will be limited to 20 percent of the total compensation received by the Manager in any annual period (the “cap”), except with respect to periods covered by an excessive rainfall exception or a force majeure exception described below.

The base fee will be a stated dollar amount for the first year of the Contract. In subsequent years, the amount of the base fee will automatically adjust each year. The adjustment each year will be determined by taking the total amount of solid waste delivered to the Facility during the previous twelve-month period (less solid waste in excess of the cap that is attributable to any excessive rainfall exception or force majeure exception described below that may have been in effect) and multiplying it by a percentage set forth in the Contract (the “look-back provision”). The percentage will be a predetermined percentage that will be specified in the Contract and that will not be subject to change during the term of the Contract.

The Contract will contain an excessive rainfall exception (the “excessive rainfall exception”). This exception will provide that in the event rainfall in any calendar month exceeds 1 inches per month, the compensation paid to the Manager for a two-month period of time that includes that month and the immediately following month will be based on the base fee plus the per-unit fee, but with no cap on the per-unit fee during that period. Based on historic rainfall figures in the County, this exception would have been utilized in four instances during the past approximately 9 years.

The Contract will also contain a force majeure exception (the “force majeure exception”). This exception will provide that in the event of a declaration of emergency by the State relating to a hurricane or other major storm event pursuant to State Statute A or a declaration of emergency by the County relating to a hurricane or other major storm event pursuant to State Statute B (each, a “Triggering Event”), the compensation paid under the Contract would be based on the base fee plus the per-unit fee, with no cap on the per-unit fee during that period. The force majeure exception would continue from the Triggering Event to the beginning of the calendar quarter immediately following the calendar quarter in which the amount of waste delivered to the Facility is less than
105% of the projected waste for that quarter. The projected waste for that quarter is the amount of waste that is reasonably expected to be delivered to the Facility for that quarter based on the assumption that the average increases or decreases in waste delivered to the Facility (excluding for this purpose waste delivered during a period when either an excessive rainfall exception or a *force majeure* exception is in effect) for the immediately preceding quarters continues during the period of the *force majeure* exception. Other than per-unit compensation in excess of the cap attributable to the excessive rainfall exception and the *force majeure* exception, the per-unit compensation paid under the Contract will be limited to the cap during any particular annual period.

The County represents that any compensation paid to the Manager will be the result of arms-length negotiations, and the compensation will be reasonable for the solid waste disposal services rendered to the County. The County represents that no portion of the compensation paid to the Manager for services rendered under the Contract will be based, in whole or in part, on a share of net profits from the operation of the Facility.

The Contract will have a term that does not exceed ten years. The Manager will not have a legally enforceable right to renew the Contract beyond the initial term. The County represents that the Facility has a reasonably expected useful life of at least 1 year.

The County represents that the Manager will not have any role or relationship with the County that, in effect, substantially limits the County’s ability to exercise its rights under the Contract. The County also represents that none of the voting power of the Board in the aggregate will be vested in the Manager and its directors, officers, shareholders, and employees. Also, there will be no overlapping board members of the County and the Manager. The County represents that the County and the Manager will not be related parties as defined in § 1.150-1(b) of the Income Tax Regulations.

**Law**

Under § 103(a), gross income does not include interest on any state or local bond. Section 103(b) provides, however, that § 103(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 which: (1) meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2); or (2) 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.

Section 141(b)(6) provides that the term "private business use" for purposes of
§ 141(b), means 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(a)(1) provides that the private business use test relates to the use of the proceeds of an issue. The 10 percent private business use test of section 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.

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; or certain other arrangements such as a take or pay or other output-type contract.

Section 1.141-3(b)(4)(i) provides that, except as provided in § 141-3(d), 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 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.

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, 1997-1 C.B. 632, as modified by Revenue Procedure 2001-39, 2001-2 C.B. 38 (“Rev. Proc. 97-13”), sets forth conditions under which a management contract does not result in private business use under § 141(b). Under § 5.01 of Rev. Proc. 97-13, if the requirements of § 5 are satisfied, the management contract does not itself result in private business use. Under § 5.02(1), the management 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 unrelated parties is not by itself treated as compensation. Under § 5.02(2)(c), for purposes of § 1.141-3(b)(4)(i) and Rev. Proc. 97-13, compensation based on 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 sets forth six permissible arrangements that satisfy the requirements of § 5. Under § 5.03(2), a permissible arrangement is provided for 80 percent periodic fixed fee arrangements. Under this arrangement, at least 80 percent of the compensation for services for each annual period during the term of the contract must be based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80 percent of the reasonably expected useful life of the financed property and 10 years. For purposes of § 5.03(2), a fee does not fail to qualify as a periodic fixed fee as a result of a one-time incentive award during the term of the contract under which compensation automatically increases when a gross revenue or expense target (but not both) is reached if that award is equal to a single, stated dollar amount.

Section 3.05 of Rev. Proc. 97-13 defines a "periodic fixed fee" as 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 a facility. 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.

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

Section 3.08 of Rev. Proc. 97-13 provides that a renewal option means a provision under which the service provider has a legally enforceable right to renew the contract. Thus, for example, a provision under which a contract is automatically renewed for one year periods absent cancellation by either party is not a renewal option (even if it is expected to be renewed).

Section 5.04(1) of Rev. Proc. 97-13 provides in general that a service provider must not have any role or relationship with the qualified user that substantially limits the qualified
user’s ability to exercise its rights, including cancellation rights, based on all the facts and circumstances. Under § 5.04(2), the qualified user’s rights are not substantially limited if the following requirements are satisfied: (1) 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; (2) 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 (3) the qualified user and the service provider under the contract are not related parties, as defined in § 1.150-1(b).

Analysis

Although the Contract meets the requirements of § 5.02 and § 5.04 of Rev. Proc. 97-13, the Manager’s compensation under the Contract does not meet the requirements of § 5.03 for the reasons stated below. Therefore, whether the Contract results in private business use of the Facility under § 141(b)(1) and § 1.141-3(b)(4) depends on all of the facts and circumstances. In determining whether the facts and circumstances indicate private business use, the factors set forth in Rev. Proc. 97-13 are useful reference points. In the case of the Contract, the base fee, the excessive rainfall exception and the *force majeure* exception must be examined to determine if they result in private business use of the Facility.

A permissible fee arrangement for purposes of a ten-year contract under § 5.03(2) requires that at least 80 percent of the Manager’s compensation during any annual period be a periodic fixed fee. In the case of the Contract, the base fee is not fixed for the duration of the Contract but rather will automatically adjust each year after the first year based on a pre-determined percentage. While this compensation arrangement does not meet the requirements of § 5.03(2) of Rev. Proc. 97-13, we nevertheless conclude based on the facts and circumstances of this case that the base fee does not result in private business use of the Facility for purposes of § 141. The adjustments to the base fee pursuant to the look-back provision will be based on increases or decreases in the flow of solid waste into the Facility. While this is not an external standard within the meaning of § 3.05 of Rev. Proc. 97-13, it is a factor that is beyond the control of the Manager and is not linked to the output or efficiency of the Facility. The adjustment is also not based on a share of net profits of the Facility. Once the adjustment has been made, the base fee to be paid to the Manager for a particular annual period will be a fixed amount for that period. Moreover, other than during periods when the excessive rainfall exception or the *force majeure* exception apply, the base fee as adjusted will be at least 80 percent of the compensation paid to the Manager for each annual period during the term of the Contract, which is consistent with the requirements of § 5.03(2) of Rev. Proc. 97-13.

In addition to the base fee, the Manager will be paid a per-unit fee, but the per-unit fee
will not be limited to the 20 percent cap during periods when the excessive rainfall exception or the force majeure exception apply. As a result, the compensation during an annual period in which either exception applies may result in per-unit fees in excess of the cap. While this compensation arrangement does not meet the requirements of § 5.03(2) of Rev. Proc. 97-13, we nevertheless conclude based on the facts and circumstances of this case that the payments under the Contract do not result in private business use of the Facility for purposes of § 141. The per-unit fees paid pursuant to the excessive rainfall exception and the force majeure exception represent payment for processing additional tons of solid waste generated as a result of events that are beyond the control of either the Manager or the County. The per-unit fees paid under these exceptions are not based on a share of net profits of the Facility. Moreover, in annual periods when neither the excessive rainfall exception nor the force majeure exception apply, the per-unit fees paid under the Contract will not exceed the 20 percent cap in any annual period under the Contract, which is consistent with the requirements of § 5.03(2) of Rev. Proc. 97-13.

Finally, neither the length of the Contract nor any relationship between the Manager and the County will cause there to be private business use of the Facility. The term of the Contract will not exceed the ten-year term allowable under § 5.03(2) of Rev. Proc. 97-13, and the Manager will have no role or relationship with the County that will substantially limit the County’s ability to exercise its rights under the Contract.

Conclusion

Although the Contract does not satisfy the requirements of § 5.03(2) of Rev. Proc. 97-13, we nevertheless conclude based on the facts and circumstances of this case that the Contract does not result in private business use under § 141(b) or § 1.141-3(b)(4).

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. In addition, no opinion is expressed regarding terms of the Contract that are not specifically discussed herein, or changes to the terms of the Contract that are specifically discussed herein.

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 County 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.

Sincerely,

Associate Chief Counsel
Financial Institutions & Products

By __________________________
Timothy L. Jones
Senior Counsel, Branch 5