

Internal Revenue Service

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Person To Contact: _____, ID No.

Telephone Number:

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Date:
May 28, 2013

Legend

Hotel =
Issuer =
Bonds =

Manager =
Date 1 =
Date 2 =
a =
b =

Dear _____ :

This letter is in response to your request for a ruling that a management contract, as amended to include certain proposed compensation provisions described below, will not

result in private business use of the Hotel under section 1.141-3(b)(4) of the Income Tax Regulations.

Facts and Representations

The Issuer makes the following representations. The Issuer issued the Bonds in part to finance construction of a new portion of the Hotel and renovation of the existing portion of the Hotel. Pursuant to a contract between the Manager and the Issuer, the Manager supervises, direct, controls, manages, and operates the Hotel (the Original Management Contract). As required by the terms of the Original Management Contract, the Manager and the Issuer are currently negotiating an amendment to the compensation provisions of the Original Management Contract in connection with completing the improvements financed by the Bonds (as amended, the Amended Management Contract). The Amended Management Contract is expected to become effective on or around Date 1 and will remain in effect until Date 2, which period will exceed neither 80 percent of the useful life of the Hotel nor 15 years. The Amended Management Contract contains no renewal option (within the meaning of section 3.08 of Revenue Procedure 97-13, 1997-1 C.B. 632).

Under the Amended Management Contract, it is expected that the Issuer will pay the Manager an annual base fee and, upon satisfaction of certain criteria, an annual incentive fee. The proposed annual base fee is the greater of (1) an amount that would be a periodic fixed fee (within the meaning of section 3.05 of Revenue Procedure 97-13) if it were paid every year or (2) a percent of the Hotel's actual gross receipts (as defined in Attachment h to the Issuer's ruling request) for the fiscal year (the Base Fee). The amount of the proposed annual incentive fee is b percent of actual gross receipts for the fiscal year, which amount the Issuer will pay the Manager only if the Hotel's Achieved Revenue Per Available Room (RevPAR) is at least a set percentage of the Achieved RevPAR of a group of specific hotels that are comparable to the Hotel (the Incentive Fee). The term "Achieved RevPAR" means, for any fiscal year in question, the product of (1) the average daily occupancy rate for the Hotel or the comparable hotels, as applicable, multiplied by (2) the average daily room rental rate achieved by the Hotel or the comparable hotels, as applicable, for the fiscal year.

Law

Under section 103(a) of the Internal Revenue Code, gross income does not include interest on any state or local bond. Section 103(b) provides, however, that section 103(a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of section 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 section 141(b)(1) and the private security or payment test of section 141(b)(2); or (2) meets the private loan financing test of section 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, for purposes of section 141(b), the term “private business use” 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 section 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. For example, a contract for the provision of management services for an entire hospital, a contract for management services for a specific department of a hospital, and an incentive payment contract for physician services to patients of a hospital are each treated as a management contract.

Revenue Procedure 97-13, 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 section 141(b). Under section 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 section 5.02(2), for purposes of section 1.141-3(b)(4)(i) and Rev. Proc. 97-13, compensation that is 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. Under section 5.02(3), for purposes of section 1.141-3(b)(4)(i) and Rev. Proc. 97-13, a productivity reward equal to a stated dollar amount based on increases or decreases in gross revenues (or adjusted gross revenues), or reductions in total expenses (but not both increases in gross revenues (or adjusted gross revenues) and reductions in total expenses) in any annual period during the term of the contract, generally does not cause the compensation to be based on a share of net profits. Under section 5.02(4), in general, if the compensation arrangements of a management contract are materially revised, the requirements for compensation arrangements under section 5 of Rev. Proc. 97-13 are retested as of the date of the material revision, and the management contract is treated as one that was newly entered into as of the date of the material revision.

Section 3.01 of Rev. Proc. 97-13 defines “adjusted gross revenue” as gross revenues of all or a portion of a facility, less allowances for bad debts and contractual and similar allowances.

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 5.03 of Rev. Proc. 97-13 sets forth six permissible arrangements that satisfy the requirements of section 5. Under section 5.03(1), at least 95 percent of the compensation for services for each annual period during the term of the contract may 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 15 years. For purposes of section 5.03(1), 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.

Analysis

The Amended Management Contract will not meet the requirements of section 5 of Rev. Proc. 97-13. Therefore, whether it will result in private business use of the Hotel under

section 1.141-3(b)(4) depends on all of the facts and circumstances. In determining whether the facts and circumstances relating to a management contract indicate private business use, the factors set forth in Rev. Proc. 97-13 are useful reference points. As contemplated in section 5.02(4) of Rev. Proc. 97-13, amending the Original Management Contract to include the Base Fee and the Incentive Fee constitutes a material revision, so we treat the Amended Management Contract as one newly entered into as of the date of the material change. For the reasons described below, we conclude that the Amended Management Contract will not result in private business use of the Hotel.

The Base Fee is the greater of (1) an amount that would be a periodic fixed fee if it were paid every year or (2) a percent of the Hotel's actual gross receipts for the fiscal year. Here, gross receipts are gross revenue within the meaning of Rev. Proc. 97-13. Under section 5.02(2)(a) of Rev. Proc. 97-13, therefore, in a year when it is a percentage of gross receipts, the Base Fee is not based on a share of net profits. In a year when it is a fixed fee, the Base Fee fails to satisfy the requirements of section 5.03(1) of Rev. Proc. 97-13 only because of the Incentive Fee.

The Incentive Fee, however, is based exclusively on gross revenues: Achieved RevPAR is a trigger based solely on gross revenue from room rentals and the amount paid is a percentage of gross revenue. Under section 5.02(2)(a) of Rev. Proc. 97-13, such compensation is not considered to be based on a share of net profits. Furthermore, when the Incentive Fee is combined with either form of the Base Fee, the resulting compensation arrangement is not based on a share of net profits because none of these fees is based on expenses.

Because the Base Fee and the Incentive Fee, both independently and in combination, are not based on a share of net profits, we conclude that the Amended Management Contract will not result in private business use of the Hotel.

Conclusion

We conclude that the Amended Management Contract, as defined herein, will not result in private business use of the Hotel under section 1.141-3(b)(4).

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.

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 your authorized representative.

Sincerely,

Associate Chief Counsel
(Financial Institutions and Products)

/S/

By: _____
Timothy L. Jones
Senior Counsel
(Financial Institutions & Products)