



## **Facts and Representations**

You make the following representations. Area is located within the boundaries of City. On Date 1, City entered into an agreement to acquire a portion of Area (the "Property") by and through Authority, an instrumentality of City. The prior owner of Property will retain ownership of the remaining portion of Area for its use. City will issue the Bonds to finance certain public improvements (described below) (the "Public Improvements") to the Property. The Bonds will be secured by special taxes to be paid by property owners that will have acquired their respective parcels of the Property from Authority.

All of the Public Improvements will be owned and operated by City or Authority, and no person or entity other than State or its political subdivisions will have any special rights or privileges with respect to any portion of the Public Improvements. Certain land within the Property will be sold or leased to private persons for use in their trades or businesses, and certain buildings, structures, and other facilities, which will be owned, leased or operated by private persons in their trades or businesses, will be built on such land (the "Private Use Facilities"). The Private Use Facilities will not be financed with proceeds of the Bonds.

Area, including the Property, is reclaimed land consisting of sand fill on top of native soil. Delimiting Area is a revetment built from large rocks (the "Revetment"), which helps prevent water from eroding and undermining Area. The Public Improvements will consist of (i) Revetment strengthening, as further described below, (ii) public and governmental use structures, including new joint police/fire station and upgraded school facilities, and new or upgraded utilities, including a water distribution system, a wastewater treatment facility and collection system, a recycled water storage and distribution system, and various storm water collection and management controls (the "Governmental Structures"), and (iii) public roads, rights of ways, curbs, gutters, sidewalks, streetlights, storm drains and related improvements, and public parks and open space areas (the "Public Access Facilities"). Because of the instability of the soils (both sand fill and native soil) and the risk of recurring flooding or seismic events affecting Area, the Public Improvements cannot be constructed, improved, or redeveloped without certain ground improvements (the "Ground Improvements"), which are part of the Public Improvements. The Ground Improvements will consist of Revetment strengthening, demolition of existing structures and soil remediation, and soil stabilization and level raising, as further described below.

First, as part of the Ground Improvements, the Revetment must be strengthened (the "Revetment Strengthening"). The Revetment Strengthening will consist of adding rock and stabilizing materials to the Revetment and adjacent areas and raising the Revetment to reduce the risk of flooding. The Revetment is public property that will be owned by Authority.

Next, as part of the Ground Improvements and before the rest of the Public Improvements can be constructed, the ground under and around the projected Public

Improvements must be stabilized (the “Soil Stabilization”) and the level of that ground must be raised (the “Public Improvements Elevation”). Prior to, and as necessary preparatory work for, the Soil Stabilization and the Public Improvements Elevation, existing structures in and around the areas of the Property where the Public Improvements are to be constructed must be demolished and any contaminated soil must be remediated (the “Demolition and Abatement”). Other than as part of the Public Improvements, no replacements of demolished structures are to be constructed using the proceeds of the Bonds. The Demolition and Abatement to be financed with the Bonds is limited to the remediation necessary to perform the Soil Stabilization and the Public Improvements Elevation. The prior owner does not have any obligation to perform, or pay for, the Demolition and Abatement.

The Soil Stabilization involves densification of the sand fills which comprise the surface of the Property upon and around which the Public Improvements are to be constructed. This will reduce the risk of liquefaction of the soil in case of a seismic event. The next step in the Soil Stabilization and the Public Improvements Elevation involves consolidation of the native soils under the surface sand fill layer to minimize future settlement. The consolidation will be completed by surcharging, a commonly used method consisting of placing a large amount of temporary fill over the area targeted for stabilization. After the requisite amount of settlement of the native soil is reached, a portion of the surcharge fill will be removed leaving the new surface level of the Property upon which the Public Improvements are to be constructed at a required elevation.

The most economical method of the Soil Stabilization and the Public Improvements Elevation requires that densification and surcharge fill extend beyond the footprint of the Public Improvements by approximately a feet on each side of the Public Improvements (the “Stabilization Area”) to compensate for the dissipation of surcharge weight through the existing sand fill and native soil and account for future loading conditions. Because the Public Improvements are to be located adjacent to or near the Private Use Facilities, the Soil Stabilization, and the Public Improvements Elevation, including the Demolition and Abatement, will be performed on certain portions of the Property upon which the Private Use Facilities, in whole or in part, are or will be located within the Stabilization Area, but only to the extent necessary to complete the Ground Improvements required to construct the Public Improvements. The design of the Ground Improvements does not consider the needs or requirements of the Private Use Facilities.

### **Law and Analysis**

Under § 103(a), gross income does not include interest on any state or local bond. Section 103(b)(1) provides in part, 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 a private activity bond as any bond issued as part of an issue that meets either (1) the private business use test of § 141(b)(1) and the private security or payment test of §141(b)(2), or (2) the private loan financing test of § 141(c).

Section 141(b)(1) provides that generally a bond 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)(A) provides that 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, use as a member of the general public shall not be taken into account. Section 141(b)(6)(B) provides that, for purposes of § 141(b)(6)(A), any activity carried on by a person other than a natural person shall be treated as a trade or business.

Section 1.141-3(a)(1) of the Income Tax Regulations provides 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. Section 1.141-3(a)(2) provides that in determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct use of proceeds.

Section 1.141-1(b) defines a nongovernmental person as a person other than a governmental person, and a governmental person as a state or local governmental unit as defined in § 1.103-1 or any instrumentality thereof. Section 1.103-1(a) defines a state or local governmental unit as a state, territory, a possession of the United States, the District of Columbia, or any political subdivision thereof.

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)(7)(i) provides that any other arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property comparable to those otherwise described in § 1.141-3(b) results in private business use.

Section 1.141-3(b)(7)(ii) provides that in the case of financed property that is not available for use by the general public (within the meaning of § 1.141-3(c)), private business use may be established solely on the basis of a 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 financed property is treated as depreciable by any nongovernmental person.

Section 1.141-3(c)(1) provides that use of a bond-financed facility as a member of the general public (general public use) is not private business use. 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 on the same basis by natural persons not engaged in a trade or business. Under § 1.141-3(c)(2), generally use under an arrangement that conveys priority rights or other preferential benefits is not use on the same basis as the general public. Arrangements providing for use that is available to the general public at no charge or on the basis of rates that are generally applicable and uniformly applied do not convey priority rights or other preferential benefits.

The examples in § 1.141-3(f) illustrate the application of the rules contained in § 1.141-3. In Example 6, bond proceeds are used to finance fish preservation and public recreation facilities required under federal regulations. The private business user of the hydroelectric plant with respect to which the financed facilities are constructed has no special legal entitlements for beneficial use of the facilities. The fish preservation facilities are functionally related to the operation of the plant. The recreation facilities are available to natural persons on a short-term basis according to generally applicable and uniformly applied rates. Under § 1.141-3(c), the recreation facilities are treated as used by the general public. Under § 1.141-3(b)(7), the private business user's use is not treated as private business use of the recreation facilities because it has no special legal entitlements for beneficial use of the recreation facilities. The fish preservation facilities are not of a type reasonably available for use on the same basis by natural persons not engaged in a trade or business. Under all of the facts and circumstances (including the functional relationship of the fish preservation facilities to property used in the private business user's trade or business) under § 1.141-3(b)(7)(ii), the private business user derives a special economic benefit from the fish preservation facilities. Therefore, private business use may be established solely on the basis of that special economic benefit, and the private business user's use of the fish preservation facilities is treated as private business use.

In § 1.141-3(f), Example 7, City B issues obligations to finance construction of a specialized pollution control facility on land that it owns adjacent to a factory owned by Corporation N. B will own and operate the pollution control facility, and N will have no special legal entitlements to use the facility. B, however, reasonably expects that N will be the only user of the facility. The facility will not be reasonably available for use on the same basis by natural persons not engaged in a trade or business. Under § 1.141-3(b)(7)(ii), because under all of the facts and circumstances the facility is functionally related and is physically proximate to property used in N's trade or business, N derives a special economic benefit from the facility. Therefore, N's private business use may be established solely on the basis of that special economic benefit, and N's use is treated as private business use of the facility.

The Revetment Strengthening will protect Area as a whole from flooding and erosion without distinction between public or private property or type of Area occupant or user. The Revetment is owned by a governmental person. No nongovernmental person engaged in a trade or business will have any priority rights for the use of or interests in the Revetment. Under § 1.141-3(b)(7)(ii), based on all the facts and circumstances, we conclude that the benefit to the owners, lessees, and operators of the Private Use Facilities from the Revetment Strengthening will not be a special economic benefit because it will be the same as the benefit derived by any other occupant or user of Area.

The next question is whether the Soil Stabilization and the Public Improvement Elevation, including the appurtenant Demolition and Abatement, performed to construct the Governmental Structures and the Public Access Facilities will give rise to private business use of the Bond proceeds.

The owners, lessees, and operators of the Private Use Facilities have no special legal entitlements to the Soil Stabilization and the Public Improvement Elevation, including the appurtenant Demolition and Abatement. Thus, private business use may only arise if these Ground Improvements, to the extent that these will not be available for general public use, provide a special economic benefit to the private business users. The Soil Stabilization, Public Improvement Elevation, and Demolition and Abatement are a necessary part of the Public Improvements in design and function and will be limited to the requirements of the corresponding Public Improvements. The design of the Ground Improvements does not consider the needs or requirements of the Private Use Facilities. Thus, any benefit to any private business user will be coincidental and will vary based on the nature of the future private business use of the property adjacent to or near the Public Improvement.

In addition, when completed, the Soil Stabilization, Public Improvement Elevation, and Demolition and Abatement will provide some benefit to all of the owners, lessees, and operators of the Private Use Facilities in Area (and not only a small number of private business users). Thus, unlike the fish preservation facilities in Example 6 and the pollution control facilities in Example 7 of § 1.141-3(f), the Ground Improvements are not performed to directly enable or facilitate the trade or business of a small number of proximately located private business users. Although we do not decide whether there will be a special economic benefit to the owners, lessees, and operators of the Private Use Facilities, even if there would be, under § 1.141-3(b)(7)(ii) and all the facts and circumstances of this case, the benefit to such private business users would be insufficient to give rise to private business use.

### **Conclusion**

Under the facts and circumstances of this case, we conclude that the use of the Ground Improvements in the manner described above will not result in private business use of the proceeds of the Bonds.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter, including whether the Bonds are tax-exempt under § 103. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

The ruling contained in this letter is based upon information and representations submitted by City and accompanied by penalty of perjury statements executed by the appropriate parties. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel  
(Financial Institutions and Products)

By: \_\_\_\_\_  
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Assistant to the Branch Chief  
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cc: