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Management Contracts & Private Business Use—IRS Releases Favorable Guidance

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Coming as welcome news to those involved in the municipal bond market, Revenue Procedure 2016-44 (scheduled to be published on September 6, 2016 and available [here](#)) provides helpful guidance for governmental issuers and 501(c)(3) borrowers entering into long-term contracts with private entities for the management and operation of facilities financed with tax-exempt bonds by allowing more flexible arrangements than were previously permitted as safe harbors in Revenue Procedure 97-13. Recognizing the changing market and emergence of public-private partnerships, Revenue Procedure 2016-44 sets forth safe harbors that take “a more flexible and less formulaic approach” than Revenue Procedure 97-13 in determining whether a management contract gives rise to private business use.

Examples of bond-financed facilities that are often subject to management contracts include parking lots and garages, cafeterias, hotels, convention centers, and health care facilities.

Under Revenue Procedure 2016-44, a management contract generally will not give rise to private business use so long as:

- The payments to be made to the service provider qualify as “reasonable compensation” and are not based on “net profits” of the managed property;
- The contract does not, in substance, impose upon the service provider the burden of bearing any share of net losses from the operation of the managed property;
- The term of the contract (including all renewal options) is no greater than the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property;
- The governmental issuer or 501(c)(3) borrower exercises a significant degree of control over the use of the managed property and bears the risk of loss upon damage or destruction of the managed property;
- The service provider agrees not to take an inconsistent tax position (e.g., claiming depreciation or amortization) with respect to the managed property; and
- The service provider does not have any role or relationship with the governmental issuer or 501(c)(3) borrower that, in effect, substantially limits the issuer’s or borrower’s ability

to exercise its rights under the management contract.

Revenue Procedure 2016-44 replaces the more rigid requirements of Revenue Procedure 97-13, which required the parties to adhere to certain restrictive types of compensatory arrangements depending upon the length of the contract term, often resulting in unnecessarily complicated agreements that were not economically efficient for either party.

The safe harbors under Rev. Proc. 2016-44 apply to any management contract that is entered into on or after August 22, 2016, but may also be applied by governmental issuers (and presumably 501(c)(3) borrowers, although clarification may be needed) to any management contract that was entered into before August 22, 2016.

For more information, please contact [Brian Teaff](#).