UCONN
UNIVERSITY OF CONNECTICUT

Office of the Executive Vice President for
Administration and Chief Financial Officer
Treasury Services
John D. Sullivan, MBA, CFA
Manager of Treasury Services

To: Scott Jordan, Executive Vice President for Administration and Chief Financial Officer
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Alan Calandro, Sr. Advisor & Special Projects Manager
Laura A. Cruickshank, AIA, University Master Planner and Chief Architect
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Katrina Spencer, Associate Vice President for Budget & Planning
Andrew Zehner, Associate Vice President, Technology Commercialization and Industry Relations

From: John D. Sullivan, CFA
Manager of Treasury Services

Date: August 31, 2017

RE: UCONN 2000 DEBT TAX-EXEMPT COMPLIANCE: PRIVATE USE OF UCONN 2000 FINANCED PROJECTS

<u>Review of Potential Private Activity/Use</u>

We appreciate continued assistance in keeping us informed on private activity/use related to any UCONN 2000 debt financed assets by forwarding any documents concerning any private use of any tax-exempt bond funded asset including leases, management contracts, private payments, provisions of services (e.g. utility or other services), Technology incubation and cooperative ventures to the Office of Treasury Services. Greater detail is attached for those of you who wish for additional information.

The IRS issued new rules for all contracts entered into or substantially modified after August 17, 2017 and now specifically differentiates leases from management contracts. Please note the rights of the parities determines the IRS interpretation of private use, no matter what it is called. The new rules impose new requirements such as the service provider must agree not to take any tax position that is inconsistent with UConn's tax ownership of the managed property (please see Pullman & Comley letter attached).

It is best if the EVPA/CFO's Office of Treasury Services working with the UConn 2000 Tax-Exempt Counsel to review such potential uses prior to entering into an agreement. Please continue to forward these contracts, leases,

Management use agreements and other types of uses to Treasury Services for review and inclusion in the tax-exempt compliance process. Even if private use is safe harbored, the University must report the private use in its tax-exempt analysis.

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Once again our goal is to accommodate the University wishes within the tax-exempt debt regulatory compliance framework.

Private Activity/Use/Payment/Tracking & Analysis

UConn's Executive Vice President for Administration and Chief Financial Officer signs the tax regulatory certificate and the ability to issue tax-exempt debt is at the heart of the UCONN 2000 program. The IRS has many complicated regulations and requirements that we must comply with in order for the debt to remain tax-exempt. This memo is intended to provide a brief overview of the private activity/sponsored research tax-exempt compliance use of UCONN 2000 debt funded assets by other entities.

Basically, we need to know what private activity/use is going on with UCONN 2000 assets so we can be sure that we do not exceed the IRS limits on private use. For example, generally speaking a bond is only tax exempt if 10% or less of bond proceeds are used for any related private business use and 10% or less of principal or interest costs of the bonds are paid off with private funds.

Private Activity/Use

Private activity/use can be thought of as the use of any tax-exempt debt funded asset by any private entity. Some examples of possible private activity/use are: a food restaurant leasing space in the Stamford Campus, a private company managing one of the UConn Parking garages, or an entity occasionally using space in a building on terms other than those available to the general public. We rely on UConn & UConn Health departments including, Office of Research, Sponsored Research Services, University Planning, Design and Construction, General Counsel, and/or the Attorney General's Office to forward private activity/use information to us usually in the form of leases, management contracts, and agreements for UConn owned assets. For these and any other private activity/use of a UCONN 2000 debt funded asset, we need to know about it to conform to the tax-code exceptions and to update our Tax-Compliance questionnaires that are filed with Tax Counsel and the State.

Another type of Private activity/use is related to research, such as a private or federal entity having use of research space/assets at the University. Some of the reporting for this type of private activity has flowed from the Office of Research and Office of Sponsored Program Services. Often UConn internal policies may meet the IRS safe harbors.

Please note that some uses considered to be private activity by the IRS are not intuitive, such as the use of UConn tax-exempt funded assets by other tax-exempt entities such as the UConn Co-Op and the U.S. Government. The sale of an asset that was funded with tax-exempt debt can also be considered private activity. For example if one provides certain tax-exempt debt funded services such as water, sewer, or electricity to private entities, it could be considered private activity.

IRS Compliance is Important – Downside Risk

While the IRS tax-exempt debt rules and regulations are complicated, it is important to comply with them. The downside risk is onerous, and in these circumstances, an ounce of prevention is worth a pound of cure. For example, failure to comply can result in the loss of tax-exemption on the University's debt in arrears which can engender bondholder lawsuits for damages, regulatory penalties, indenture non-compliance, credit rating downgrades, adverse impacts nationally for UConn debt in capital markets, loss of international reputation,

inability to sell new debt, adverse audit reports, increased debt service costs, and the State's revocation of the ability to issue debt, and other collateral damage, etc.

Treasury Services IRS Compliance Program

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Fortunately, Treasury Services has a program in place for compliance, including the use of allowed private activity percentages and safe harbors that if followed, meet the IRS requirements and regulations.

Attached for your informational use please find:

1.) Treasury Services Private Activity Tax-Exempt Compliance Procedures

2.) Safe-Harbor Management Contract Guidelines

3.) Safe-Harbor Guidelines For Research Agreements

4.) Private Use – Short Term Use Exceptions

Percentage of Bond Proceeds Available for Private Activity is Restricted

Certain small percentages of bond issues can be used for related and unrelated private activity ("bad use"). Because of the complicated nature of the IRS regulations, and other factors, such as Connecticut General Statues and the indentures, that we must follow, the application of these allowed percentages needs to be considered case by case for each use and each debt issue.

Safe Harbors

The IRS allows safe harbors for private activity that does not use up the restricted percentages. If possible it may be best to maximize the University's use of these safe harbors. It may be the case that most of the University's present and planned private activity and research use already meets the guidelines. Additionally, it is respectfully offered for your consideration, that perhaps many University contracts can incorporate the IRS safe harbor requirements without losing the business and other opportunities that the University wishes to achieve. If so, this could free up the limited "bad use" options available to us.

Thank you for your assistance in making the UCONN 2000 program a successful one!

If you have any questions, comments, or suggestions or if I may be of any assistance, please do not hesitate to contact me at 860-486-5907.

JDS/kjm
Enclosures

c: Carolle Andrews, Chief Administrative Officer, UConn Health
Erin Beatty, Attorney, General Counsel
Jeffrey Blumenthal, Assistant Attorney General, UConn Health
Holly Bray, Assistant Attorney General
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PULLMAN
& COMLEY LLC
ATTORNEYS

MEMORANDUM

TO:	John D. Sullivan, Manager of Treasury Services
FROM:	Frank B. Cleary
DATE:	July 31, 2017
CLIENT	University of Connecticut
SUBJECT:	New Management Contract Rules- Rev. Proc. 2017-13

We have discussed the new management contract rules a number of the times. These are presently set forth in Rev. Proc. 2017-13, a copy of which is attached. While we have concluded that they will not have a material impact on the tax classification of the UCONN 2000 projects, they may require the updating of certain documents such as the tax questionnaire. The purpose of this letter is to summarize new rules to help you determine what if any changes should be made. They are intended to be more flexible and less formulaic than their predecessors. They do not contain special rules based on the term of the management contract and type of compensation e.g. fixed, per capita or per unit. While the old formulaic rules where complex and unwieldy, they provided a level of certainty in many circumstance that new rules do not. It also should be noted the new rules impose new requirements. An example is that under the new rules the service provider must agree not to take any tax position that is inconsistent with qualified user's (the University's) tax ownership of the managed property.

The new rules also specifically differentiate leases from management contracts. A lease always gives rise to a private use. If an arrangement is properly characterized as lease under federal tax law, the lessee's use of the property pursuant to it is a private use. Under federal tax law, classification as lease is based upon the rights of parties not how the parties classify the arrangement. Word games do not affect the classification.

The new rules govern all contracts entered into or after August 17, 2017. The old rules can applied be applied to contracts arising prior to such date; however if there is any substantial modification of a contract occurring on or after August 17, 2017, the modified contract shall be treated as if it was a new contract and would be subject to the new rules. There are a number of transition rules permitting the earlier application of the new rules. The old rules can be applied to the extension of pre-August 17, 2017 management contract occurring after that date, where the term of such contract is extended by a party exercising its unilateral legally enforceable right to extend.

Below is a brief overview of the new rules.

1. Fiscal Requirements.

(a) Compensation. Compensation must be reasonable and cannot be based on the net profits of the managed property. This requirement is substantially the same as the old rule except there are no special rules based on the term of the contract and type of compensation. A 'Per-unit fee" and "per capita fee" are specifically defined in the new rules and are especially important for hospitals and medical facilities. The rules relating to indexing of compensation based on an objective standard such as CPI have not been substantially changed.

(b) Timing of Payments. The new rule imposes time requirements by which compensation must be paid. Generally payments must be made within a year and payments of incentive compensation within in five years.

(c) Incentive Compensation. The rules relating to permitted incentive payments are not substantially modified.

(d) Term. The term of the management contract cannot exceed 80% of the reasonable expected economic life of the managed property. This is a substantial liberalization of the prior rules.

2. Control Over Property. This requirement is a substantial change from the prior rules.

(a) General Rule. The qualified user must maintain substantial control over the property. These requirements have a number of components. It must control rates changed by the service provider for services rendered at the managed property capital expenditures on the property, its deposition, the general nature and type of its use. The control of rates charged can be satisfied by the qualified user establishing in the management contract the general methodology for setting such rates- such as method of setting hotel room rates by setting specific revenue goals based on comparable properties.

(b) Per Unit Fees. The new rules contain specific guidance as to per-unit fees specified in management contracts. Such fees include a stated dollar amount for each medical procedure, car parked, or item delivered. Separate billing arrangements between physicians and hospitals are treated as per-unit fee arrangements. The per-unit fee must be set forth in the management contract or otherwise must be specifically determined by the Qualified User or by an independent party, such as determined by the administrator of the Medicare or insured program. This rule would be addressed by adding a provision to a management contract with physicians similar to the following:

> "Except as specifically provided herein, the rates charged for the services provided by the [service provider] pursuant to this agreement, shall be determined by the University or shall be reasonable or customary as determined or negotiated with an independent party such as a medical insurer or the administrator of Medicare program."

3. Risk of Loss. Generally the qualified user must bear the risk of loss upon the damage or destruction of the managed property; however, the qualified user may require the service provider to maintain insurance protecting the qualified user from loss.

4. No Inconsistent Tax Position. The service provider must agree that it is not entitled to and will not take a position that is inconsistent with it being a service provider for property owned by the qualified user. The service provider must agree not to claim any depreciation or amortization deduction, investment tax credit or deduction for rent paid with respect to the managed property. This is a new requirement. Its satisfaction requires that new language (boilerplate) should be added to management contracts for them to qualify for the safe harbor. An example of such language follows:

   > "The [Service Provider] agrees it is not entitled to and will not take any tax position than its position as a provider of services with respect to the managed property for the benefit of the University and it specifically agrees not to claim any depreciation or amortization deductions, investment tax credits or deductions of any payments as rent with respect to the managed property."

5. Affinity Rules. These are basically unchanged. Under them a contract cannot qualify for the safe harbor if the service provider has relationship with the qualified user that substantially limits its ability to exercise its rights. This rule is satisfied if the service provider does not directly or indirectly hold voting power of more than 20% in the qualified user and if executive officers of the service provider or qualified user do not sit on the board of the other.

Rev. Proc. 2017-13 (IRS RPR), 2017-6 I.R.B. 787, 2017 WL 189797

Internal Revenue Service (I.R.S.)

IRS RPR
Revenue Procedure
Released: January 18, 2017
Published: February 6, 2017

26 CFR 601.601: Rules and regulations.(Also: §§ 141, 145, 1.141-3, 1.145-2)
This revenue procedure provides safe harbor conditions under which a management contract does not result in private business use of property financed with governmental tax-exempt bonds under section 141(b) of the Internal Revenue Code or cause the modified private business use test for property financed with qualified 501(c)(3) bonds under section 145(a)(2)(B) to be met.

SECTION 1. PURPOSE

This revenue procedure provides safe harbor conditions under which a management contract does not result in private business use of property financed with governmental tax-exempt bonds under § 141(b) of the Internal Revenue Code or cause the modified private business use test for property financed with qualified 501(c)(3) bonds under § 145(a)(2)(B) to be met. This revenue procedure modifies, amplifies, and supersedes Rev. Proc. 2016-44, 2016-36 IRB 316, to address certain types of compensation, the timing of payment of compensation, the treatment of land, and methods of approval of rates. Sections 2.11 through 2.14 of this revenue procedure generally describe the modifications and amplifications made to Rev. Proc. 2016-44 by this revenue procedure.

SECTION 2. BACKGROUND

.01 Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any State or local bond. Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond that 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 (1) that meets the private business use test and private security or payment test, or (2) that meets the private loan financing test.

.02 Section 141(b)(1) provides generally 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) defines "private business use" 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 must be treated as a trade or business.

.03 Section 1.141-3(a)(1) of the Income Tax Regulations provides, in part, that the 10 percent 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. Section 1.141-3(a)(2) provides that, in determining whether an issue meets the private business use test, it is necessary to look at both indirect and direct use of proceeds. Proceeds are treated as used in the trade or business of a nongovernmental person if a nongovernmental person, as a result of a single transaction or a series of related transactions, uses property acquired with the proceeds of an issue.

.04 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 as a result of ownership; actual or beneficial use of property pursuant to a lease, a management contract, or an incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

.05 Section 1.141-3(b)(3) provides generally that the lease of financed property to a nongovernmental person is private business use of that property. For this purpose, any arrangement that is properly characterized as a lease for federal income tax purposes is treated as a lease. Section 1.141-3(b)(3) further provides that, in determining whether a management contract is properly characterized as a lease, it is necessary to consider all the facts and circumstances, including the following factors: (1) the degree of control over the property that is exercised by a nongovernmental person; and (2) whether a nongovernmental person bears the risk of loss of the financed property.

.06 Section 1.141-3(b)(4)(i) provides generally that 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 with respect to financed property 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 operations of the facility. Section 1.141-3(b)(4)(iv) provides generally that a management contract with respect to financed property results in private business use of that property if the service provider is treated as the lessee or owner of financed property for federal income tax purposes.

.07 Section 1.141-3(b)(4)(ii) defines "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, 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.

.08 Section 1.141-3(b)(4)(iii) provides that the following arrangements generally are not treated as management contracts that give rise to private business use: (A) contracts for services that are solely incidental to the primary governmental function or functions of a financed facility (for example, contracts for janitorial, office equipment repair, hospital billing, or similar services); (B) the mere granting of admitting privileges by a hospital to a doctor, even if those privileges are conditioned on the provision of de minimis services if those privileges are available to all qualified physicians in the area, consistent with the size and nature of the hospital's facilities; (C) a contract to provide for the operation of a facility or system of facilities that consists primarily of public utility property, if the only compensation is the reimbursement of actual and direct expenses of the service provider and reasonable administrative overhead expenses of the service provider; and (D) a contract to provide for services, if the only compensation is the reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties.

.09 Section 141(e) provides, in part, that the term "qualified bond" includes a qualified 501(c)(3) bond if certain requirements stated therein are met. Section 145(a) provides generally that "qualified 501(c)(3) bond" means any private activity bond issued as part of an issue if (1) all property that is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and (2) such bond would not be a private activity bond if (A) 501(c)(3) organizations were treated as governmental units with respect to their activities that do not constitute unrelated trades or businesses, determined by applying § 513(a), and (B) § 141(b)(1) and (2) were applied by substituting "5 percent" for "10 percent" each place it appears and by substituting "net proceeds" for "proceeds" each place it appears. Section 1.145-2 provides that, with certain exceptions and modifications, §§ 1.141-0 through 1.141-15 apply to § 145(a).

.10 Rev. Proc. 2016-44 provides safe harbor conditions under which a management contract does not result in private business use of property financed with governmental tax-exempt bonds under § 141(b) or cause the modified private business use test for property financed with qualified 501(c)(3) bonds under § 145(a)(2)(B) to be met. Rev. Proc. 2016-44 modified and superseded Rev. Proc. 97-13, 1997-1 C.B. 632; Rev. Proc. 2001-39, 2001-2 C.B. 38; and section 3.02 of Notice 2014-67, 2014-46 I.R.B. 822.

.11 Section 5.02 of Rev. Proc. 2016-44 sets forth general financial requirements for management compensation arrangements eligible for the safe harbor. Sections 5.02(2) and 5.02(3) of Rev. Proc. 2016-44 provide that the contract must neither provide to the service provider a share of net profits nor impose on the service provider the burden of bearing any share of net losses from the operation of the managed property. Before the publication of Rev. Proc. 2016-44, previously applicable revenue procedures expressly treated certain types of compensation, including capitation fees, periodic fixed fees, and per-unit fees (as defined therein), as not providing a share of net profits. Questions have arisen regarding whether these common types of compensation continue to be treated in a similar manner under Rev. Proc. 2016-44. Related questions have arisen about whether a service provider's payment of expenses of the operation of the managed property without reimbursement from the qualified user (as defined in section 4.04 of Rev. Proc. 2016-44) affects the treatment of these types of compensation. To provide continuity with the previous safe harbors, this revenue procedure clarifies that these types of compensation and certain incentive compensation will not be treated as providing a share of net profits or requiring the service provider to bear a share of net losses.

.12 Sections 5.02(2) and 5.02(3) of Rev. Proc. 2016-44 also provide that the timing of payment of compensation cannot be contingent upon net profits or net losses from the operation of the managed property. Questions have arisen about the effect of these restrictions on the timing of payment of compensation. This revenue procedure clarifies that compensation subject to an annual payment requirement and reasonable consequences for late payment (such as interest charges or late payment fees) will not be treated as contingent upon net profits or net losses if the contract includes a requirement that the qualified user will pay the deferred compensation within five years of the original due date of the payment.

.13 Section 5.03 of Rev. Proc. 2016-44 provides that the term of the contract, including all renewal options (as defined in § 1.141-1(b)), must be no greater than the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property. For this purpose, under Rev. Proc. 2016-44, economic life is determined in the same manner as under § 147(b), but without regard to § 147(b)(3)(B)(ii), as of the beginning of the term of contract. Section 147(b)(3)(B)(i) provides that generally land is not taken into account, but § 147(b)(3)(B)(ii) provides that if 25 percent or more of the net proceeds of any issue is to be used to finance the acquisition of land, such land shall be taken into account and treated as having an economic life of 30 years. Questions have arisen about excluding land when the cost of the land accounts for a significant portion of the managed property. This revenue procedure provides that economic life is determined in the same manner as under § 147(b) as of the beginning of the term of the contract. Thus, land will be treated as having an economic life of 30 years if 25 percent or more of the net proceeds of the issue that finances the managed property is to be used to finance the costs of such land.

.14 Section 5.04 of Rev. Proc. 2016-44 provides that the qualified user must exercise a significant degree of control over the use of the managed property. Section 5.04 of Rev. Proc. 2016-44 further provides that this requirement is met if the contract requires the qualified user to approve, among other things, the rates charged for use of the managed property. Section 5.04 of Rev. Proc. 2016-44 also provides that a qualified user may show approval of rates charged for use of the managed property by either expressly approving such rates (or the methodology for setting such rates) or by including in the contract a requirement that service provider charge rates that are reasonable and customary as specifically determined by an independent third party. Questions have arisen about the requirement to approve the rates in various circumstances in which it may not be feasible to approve each specific rate charged, such as for a physician's professional services at a § 501(c)(3) hospital or hotel room rates at a governmentally-owned hotel. This revenue procedure clarifies that a qualified user may satisfy the approval of rates requirement by approving a reasonable general description of the method used to set the rates or by requiring that the service provider charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party.

SECTION 3. SCOPE

This revenue procedure applies to a management contract (as defined in section 4.03 of this revenue procedure) involving managed property (as defined in section 4.04 of this revenue procedure) financed with the proceeds of an issue of governmental bonds (as defined in § 1.141-1(b)) or qualified 501(c)(3) bonds (as defined in § 145).

SECTION 4. DEFINITIONS

For purposes of this revenue procedure, the following definitions apply:

.01 *Capitation fee* means a fixed periodic amount for each person for whom the service provider or the qualified user assumes the responsibility to provide all needed services for a specified period so long as the quantity and type of services actually provided to such persons varies substantially. For example, a capitation fee includes a fixed dollar amount payable per month to a medical service provider for each member of a health maintenance organization plan for whom the provider agrees to provide all needed medical services for a specified period. A fixed periodic amount may include an automatic increase according to a specified, objective, external standard that is not linked to the output or efficiency of the managed property. 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. A capitation fee may include a variable component of up to 20 percent of the total capitation fee designed to protect the service provider against risk such as risk of catastrophic loss.

.02 *Eligible expense reimbursement arrangement* means a management contract under which the only compensation consists of reimbursements of actual and direct expenses paid by the service provider to unrelated parties and reasonable related administrative overhead expenses of the service provider.

.03 *Management contract* means a management, service, or incentive payment contract between a qualified user and a service provider under which the service provider provides services for a managed property. A management contract does not include a contract or portion of a contract for the provision of services before a managed property is placed in service (for example, pre-operating services for construction design or construction management).

.04 *Managed property* means the portion of a project (as defined in § 1.141-6(a)(3)) with respect to which a service provider provides services.

.05 *Periodic fixed fee* means 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 the managed property. 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.

.06 *Per-unit fee* means 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. Separate billing arrangements between physicians and hospitals are treated as per-unit fee arrangements. 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 the managed property. 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.

.07 *Qualified user* means, for projects (as defined in § 1.141-6(a)(3)) financed with governmental bonds, any governmental person (as defined in § 1.141-1(b)) or, for projects financed with qualified 501(c)(3) bonds, any governmental person or any 501(c)(3) organization with respect to its activities which do not constitute an unrelated trade or business, determined by applying § 513(a).

.08 *Service provider* means any person other than a qualified user that provides services to, or for the benefit of, a qualified user under a management contract.

.09 *Unrelated parties* means persons other than either: (1) a related party (as defined in § 1.150-1(b)) to the service provider or (2) a service provider's employee.

SECTION 5. SAFE HARBOR CONDITIONS UNDER WHICH MANAGEMENT CONTRACTS DO NOT RESULT IN PRIVATE BUSINESS USE

.01 *In general.* If a management contract meets all of the applicable conditions of sections 5.02 through section 5.07 of this revenue procedure, or is an eligible expense reimbursement arrangement, the management contract does not result in private business use under § 141(b) or 145(a)(2)(B). Further, under section 5.08 of this revenue procedure, use functionally related and subordinate to a management contract that meets these conditions does not result in private business use.

.02 *General financial requirements.*

(1) *In general.* The payments to the service provider under the contract must be reasonable compensation for services rendered during the term of the contract. Compensation includes payments to reimburse actual and direct expenses paid by the service provider and related administrative overhead expenses of the service provider.

(2) *No net profits arrangements.* The contract must not provide to the service provider a share of net profits from the operation of the managed property. Compensation to the service provider will not be treated as providing a share of net profits if no element of the compensation takes into account, or is contingent upon, either the managed property's net profits or both the managed property's revenues and expenses (other than any reimbursements of direct and actual expenses paid by the service provider to unrelated third parties) for any fiscal period. For this purpose, the elements of the compensation are the eligibility for, the amount of, and the timing of the payment of the compensation. Incentive compensation will not be treated as providing a share of net profits if the eligibility for the incentive compensation is determined by the service provider's performance in meeting one or more standards that measure quality of services, performance, or productivity, and the amount and the timing of the payment of the compensation meet the requirements of this section 5.02(2).

(3) *No bearing of net losses of the managed property.*

(a) The contract must not, in sub stance, impose upon the service provider the burden of bearing any share of net losses from the operation of the managed property. An arrangement will not be treated as requiring the service provider to bear a share of net losses if:

(i) The determination of the amount of the service provider's compensation and the amount of any expenses to be paid by the service provider (and not reimbursed), separately and collectively, do not take into account either the managed property's net losses or both the managed property's revenues and expenses for any fiscal period; and

(ii) The timing of the payment of compensation is not contingent upon the managed property's net losses.

(b) For example, a service provider whose compensation is reduced by a stated dollar amount (or one of multiple stated dollar amounts) for failure to keep the managed property's expenses below a specified target (or one of multiple specified targets) will not be treated as bearing a share of net losses as a result of this reduction.

(4) *Treatment of certain types of compensation.* Without regard to whether the service provider pays expenses with respect to the operation of the managed property without reimbursement by the qualified user, compensation for services will not be treated as providing a share of net profits or requiring the service provider to bear a share of net losses under sections 5.02(2) and 5.02(3) of this revenue procedure if the compensation for services is: (a) based solely on a capitation fee, a periodic fixed fee, or a per-unit fee; (b) incentive compensation described in the last sentence of section 5.02(2) of this revenue procedure; or (c) a combination of these types of compensation.

(5) *Treatment of timing of payment of compensation.* Deferral due to insufficient net cash flows from the operation of the managed property of the payment of compensation that otherwise meets the requirements of sections 5.02(2) and 5.02(3) of this revenue procedure will not cause the deferred compensation to be treated as contingent upon net profits or net losses under sections 5.02(2) and 5.02(3) of this revenue procedure if the contract includes requirements that:

(a) The compensation is payable at least annually;

(b) The qualified user is subject to reasonable consequences for late payment, such as reasonable interest charges or late payment fees; and

(c) The qualified user will pay such deferred compensation (with interest or late payment fees) no later than the end of five years after the original due date of the payment.

.03 *Term of the contract and revisions.* The term of the contract, including all renewal options (as defined in § 1.141-1(b)), must not be greater than the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property. For this purpose, economic life is determined in the same manner as under § 147(b) as of the beginning of the term of the contract. A contract that is materially modified with respect to any matters relevant to this section 5 is retested under this section 5 as a new contract as of the date of the material modification.

.04 *Control over use of the managed property.* The qualified user must exercise a significant degree of control over the use of the managed property. This control requirement is met if the contract requires the qualified user to approve the annual budget of the managed property, capital expenditures with respect to the managed property, each disposition of property that is part of the managed property, rates charged for the use of the managed property, and the general nature and type of use of the managed property (for example, the type of services). For this purpose, for example, a qualified user may show approval of capital expenditures for a managed property by approving an annual budget for capital expenditures described by functional purpose and specific maximum amounts; and a qualified user may show approval of dispositions of property that is part of the managed property in a similar manner. Further, for example, a qualified user may show approval of rates charged for use of the managed property by expressly approving such rates or a general description of the methodology for setting such rates (such as a method that establishes hotel room rates using specified revenue goals based on comparable properties), or by requiring that the service provider charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party (such as a medical insurance company).

.05 *Risk of loss of the managed property.* The qualified user must bear the risk of loss upon damage or destruction of the managed property (for example, due to force majeure). A qualified user does not fail to meet this risk of loss requirement as a result of insuring against risk of loss through a third party or imposing upon the service provider a penalty for failure to operate the managed property in accordance with the standards set forth in the management contract.

.06 *No inconsistent tax position.* The service provider must agree that it is not entitled to and will not take any tax position that is inconsistent with being a service provider to the qualified user with respect to the managed property. For example, the service provider must agree not to claim any depreciation or amortization deduction, investment tax credit, or deduction for any payment as rent with respect to the managed property.

.07 *No circumstances substantially limiting exercise of rights.*

(1) *In general.* The service provider must not have any role or relationship with the qualified user that, in effect, substantially limits the qualified user's ability to exercise its rights under the contract, based on all the facts and circumstances.

(2) *Safe harbor.* A service provider will not be treated as having a role or relationship prohibited under section 5.07(1) of this revenue procedure if:

(a) No more than 20 percent of the voting power of the governing body of the qualified user is vested in the directors, officers, shareholders, partners, members, and employees of the service provider, in the aggregate;

(b) The governing body of the qualified user does not include the chief executive officer of the service provider or the chairperson (or equivalent executive) of the service provider's governing body; and

(c) The chief executive officer of the service provider is not the chief executive officer of the qualified user or any of the qualified user's related parties (as de fined in § 1.150-1(b)).

(3) For purposes of section 5.07(2) of this revenue procedure, the phrase ""service provider" includes the service provider's related parties (as defined in § 1.150-1(b)) and the phrase "chief executive officer" includes a person with equivalent management responsibilities.

.08 *Functionally related and subordinate use.* A service provider's use of a project (as defined in § 1.141-6(a)(3)) that is functionally related and subordinate to performance of its services under a management contract for managed property that meets the conditions of this section 5 does not result in private business use of that project. For example, use of storage areas to store equipment used to perform activities required under a management contract that meets the requirements of this section 5 does not result in private business use.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2016-44 is modified, amplified, and superseded.

SECTION 7. DATE OF APPLICABILITY

This revenue procedure applies to any management contract that is entered into on or after January 17, 2017, and an issuer may apply this revenue procedure to any management contract that was entered into before January 17, 2017. In addition, an issuer may apply the safe harbors in Rev. Proc. 97-13, as modified by Rev. Proc. 2001-39 and amplified by Notice 2014-67, to a management contract that is entered into before August 18, 2017 and that is not materially modified or extended on or after August 18, 2017 (other than pursuant to a renewal option as defined in § 1.141-1(b)).

SECTION 8. DRAFTING INFORMATION

The principal authors of this revenue procedure are Johanna Som de Cerff and David White of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact David White on (202) 317-6980 (not a toll-free number).

TAX-EXEMPT COMPLIANCE QUESTIONAIRES: PRIVATE ACTIVITY AND PRIVATE RESEARCH USE OF UCONN 2000 TAX-EXEMPT DEBT FINANCED ASSETS

TREASURY SERVICES TAX EXEMPT DEBT PRIVATE ACTIVITY/USE COMPLIANCE PROGRAM

In order to meet the stringent IRS regulations the Tax-Exempt Questionnaires request certain information that includes the actual and/or expected private activity use or research use of any bond funded asset. Fortunately, the IRS does allow such private activity or research use if they meet certain IRS "safe harbors". If the safe harbors are not met, only a small percentage of the University's tax-exempt bond funded assets may be used for private activity or research use.

Fortunately we have a program in place for compliance, including the use of allowed percentages by the IRS and safe harbors, that if followed meet the IRS requirements and regulations.

The General Tax-Exempt Private Activity/Use/Payments Compliance Program Steps Are:

(1) The University should try to make use of the attached safe harbors where possible including those for sponsored research. General University policies that incorporate these safe harbors will go along way towards meeting the IRS regulations.

(2) Information for each UCONN 2000 Project is provided to Treasury Services including private activity and sponsored research uses, such as contracts, square footage, the use of space, leases, payments, etc.

(3) Treasury Services analyses the information, and shares it with tax (bond) counsel for their analysis.

(4) Bond Counsel updates their records accordingly and may supply a tax-exempt compliance letter when requested. This is required for State contract approval in many instances.

(5) Treasurer Services produces a Tax-Exempt Questionnaire for each UCONN 2000 project for signature of the CFO, etc. and filing with bond counsel. These forms serve as the basic document for the University's Tax Regulatory Certificate/Agreement/Certificate, and also meet certain State filing requirements.

(6) Tax-Counsel relies on the questionnaires to produce the Tax Regulatory Certificate/Agreement which is a prerequisite for any UCONN 2000 tax-exempt debt can be issued. This serves as the compliance document to meet the Internal

Revenue Service regulations and requirements. It is generally attested to by UConn and the State Treasurer.

(7) The TRA is an essential document behind tax-counsel granting a tax-exempt opinion which allows the University to issue bonds that are exempt from federal taxes.

(8) This is a reiterative process as the information changes and projects are added or reallocated.

(9) The University's senior management signs the Tax Regulatory Certificate/Agreement and other tax-exempt debt documents and are ultimately responsible for them. Treasury Services relies on other areas of the University to provide the required information.

RELATED INFORMATION:

Private Activity/Use: Private activity and private use, can be thought of as the use of any tax-exempt debt funded asset by any private entity. For example if a food restaurant leases space in the Stamford Campus, or a private company manages a UConn Parking garage, both can be considered private activity. Also if a private entity has use of research space at the University that can be considered private use. Some uses considered to be private activity by the IRS are not so intuitive, such as the use of UConn tax-exempt funded assets by other tax-exempt entities such as the UConn Co-Op and the U.S. Government. Also, for example if one provides certain tax-exempt debt funded services such as water, sewer, or electricity to private entities, you can have private activity/use.

Downside Risk of Failure to Comply with IRS Rules: The IRS regulations are quite complicated. Failure to follow them can have onerous consequences such as: the loss of tax-exemption on the University's debt in arrears which can engender bondholder lawsuits for damages, regulatory penalties, indenture non-compliance, credit rating downgrades, adverse impacts nationally for UConn debt in capital markets, loss of international reputation, inability to sell new debt, adverse audit reports, increased debt service costs, and the State's revoking of the ability to issue debt, and other collateral damage, etc.. The downside risk is onerous, and in these circumstances, an ounce of prevention is worth a pound of cure. Fortunately we have developed a compliance system that includes certain "safe harbors" that if met automatically satisfy the IRS requirements.

Safe Harbors - The University can meet IRS requirements by meeting the safe harbors for private activity use and research use in the attached "The Safe-Harbor Management Contract Guidelines" for private activity, and the "Safe Harbor Guidelines for Research Agreements".

For projects that do not meet the safe harbor guidelines, there is a threshold on the amount of private activity use and/or research use that is permitted with tax-exempt bond funded assets. However, it may be that most of the University's present and planned private activity and research use already meet the guidelines. If so, this would free up the limited amount of allowable "bad" use for where it is unavoidable.

Contact people should be made aware that "safe-harbors" and other exceptions to the IRS requirements exist for private use and research use, and that they should not enter into any agreement that would jeopardize the tax-exemption of the UCONN 2000 Bonds. Consequently, as people enter into agreements, etc. and provide the information to fill out the questionnaires, they should be cognizant of any private use or research use that meets these safe-harbors or other exemptions to the IRS requirements.

Allowable Percentages: If they do not meet the safe harbor guidelines, certain small percentages of bond issues can be used for related and unrelated private activity. Because of the complicated nature of the IRS regulations any such application of percentages should be uniquely considered for each use and each bond issue by Treasury Services and tax-counsel.

Safe-Harbor Management Contract Guidelines

General Rule.

A contract for the management, services rendered at or incentive payment in respect of, a bond-financed facility that meets the safe-harbor guidelines summarized below would be permitted. Conversely, a contract that does not meet such guidelines would generally not be permitted. All contracts must be reviewed on a case-by-case basis.

Permitted Compensation Arrangements.

The compensation paid to the service provider must be reasonable and no compensation may be 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 persons is not by itself treated as compensation. Compensation based on (a)(i) a percentage of gross revenues or adjusted gross revenues of a facility or (ii) 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. 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. "Adjusted gross revenues" is defined to mean all gross revenues of all or a portion of a facility, less allowances for bad debt and contractual and similar allowances.

If the compensation agreements of a management contract are materially revised, the requirements for compensation arrangements 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.

The types of compensation arrangements permitted to be entered into are as follows:

(a) 95% periodic fixed fee arrangements, wherein at least 95% of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee which is a stated dollar amount for services rendered for a specified period of time. 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, *e.g.*, 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. A fee shall 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 a single stated dollar amount. The term of the contract, including all renewal options, must not exceed the lesser of 80% of the reasonably expected useful life of the financed property and 15 years.

(b) 80% periodic fixed fee arrangements, wherein at least 80% of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80% of the reasonably expected useful life of the financed property and 10 years. A one-time incentive award during the term of the contract similar to the award described above is permitted under this option as well.

(c) 50% periodic fixed fee arrangements, wherein either at least 50% of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee or all of the compensation for services is based on a capitation fee or combination of a periodic fixed fee and a capitation fee. A capitation fee is a fixed periodic amount for each person for whom the service provider or the State and local governmental unit assumes the responsibility to provide all needed services for a specified period so long as the quantity and type of services actually provided to covered persons varies substantially; *e.g.*, a fixed dollar amount payable per month to a medical provider for each member of a health maintenance organization plan for whom the provider agrees to provide all needed medical services for a specified period. A capitation fee may include a variable component of up to 20% of the total capitation fee designed to protect the service provider against risks such as catastrophic loss. The term of the contract, including all renewal options, must not exceed five years. The contract must be terminable by the State and local governmental unit upon reasonable notice without penalty or cause, at the end of the third year of the contract.

(d) Per-unit fee arrangements, wherein all of the compensation for services is based on a per-unit fee or a combination of a per-unit fee and a periodic fee. A per-unit fee is defined to mean 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 State and local governmental unit; *e.g.*, a stated dollar amount for each specified medical procedure performed, car parked or passenger mile is a per-unit fee. Separate billing arrangements between physicians and hospitals generally are treated as per-unit fee arrangements. The term of the contract, including all renewal options, must not exceed three years. The contract must be terminable by the State and local governmental unit on reasonable notice, without penalty or cause, at the end of the second year of the contract term.

(e) Percentage of revenue or expense fee arrangements, wherein all of the compensation for services is based on a percentage of fees charged or a combination of a per-unit fee and a percentage of revenue or expense fee. During the start up period, however, compensation may be based on a percentage of either gross revenues, adjusted gross revenues or expenses of a facility. The term of the contract, including renewal options, must not exceed two years. The contract must be terminable by the State and local governmental unit on reasonable notice without penalty or cause, at the end of the first year. This type of contract is permissible only with respect to contracts under which the service provider primarily provides services to third parties (*e.g.*, radiology services to patients), and management contracts involving a facility during an initial start up period for which there have been insufficient operations to establish a reasonable estimate of the amount of the annual gross revenues and expenses (*e.g.*, a contract for general management services for the first year of the operations).

Renewal Option.

A renewal option, for purposes of the foregoing, is defined to mean 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.

Cancellation Penalty.

A cancellation penalty is defined to include a limitation on the State and local governmental unit's ability to compete with the service provider, a requirement that the State and local governmental unit purchase equipment, goods or services from the service provider; and a requirement that the State and local governmental unit pay liquidated damages for cancellation of the contract; compare a requirement effective on cancellation that the qualified user reimburse the service provider for ordinary and necessary expenses or a restriction against the State and local governmental unit hiring key personnel of the service provider is generally not a contract termination penalty. Another contract between the service provider and the State and local governmental unit, such as a loan or guarantee by the service provider, is treated as creating a contract termination penalty if that contract contains terms that are not customary or arm's length, that could operate to prevent the State and local governmental unit from termination the contract (*e.g.*, provisions under which the contract terminates if the management contract is terminated or that places substantial restrictions on the selection of a substitute service provider).

No Relationship with State and Local Governmental Unit.

The service provider must not have any role or relationship with the State and local governmental unit, that, in effect, substantially limits the qualified user's ability to exercise its rights, including cancellation rights, under the contract, based on all the facts and circumstances. This requirement, amongst others, is satisfied if (a) not more than 20% of the voting power of the State and local governmental unit in the aggregate is vested in the service provider and its directors, officers, shareholders and employees; (b) overlapping board members do not include the chief executive officers of the service provider or its governing body or the State and local governmental unit or its governing body; and (c) State and local governmental unit and the service provider under the contract are not related persons. A related person means, generally, a member of a controlled group, or any person having a 50% ownership or voting interest in the subject entity.

Safe-harbor Guidelines for Research Agreements

Revenue Procedure 97-14:	Revenue Procedure 97-14 provides the safe-harbor guidelines for research agreements involving the use of facilities financed with proceeds of tax-exempt bonds.
Consequence of Failure to Comply with Guidelines:	If the guidelines are met, a research agreement is considered not to create any impermissible private activity. Conversely, if the guidelines are not met, impermissible private activity may be considered to be created. If the research agreement causes the applicable private activity limits to be exceeded and no remedial action is taken to cure the violation, interests on the bonds may become subject to federal income taxation retroactive to the date of issue of the bonds.
Certain Caveats:	All facts and circumstances must be analyzed in determining whether private activity is created by any research agreement. Private activity will result from research agreements with respect to bond financed property if the nongovernmental sponsor is treated as the lessee or owner of such property for federal income tax purposes.
Basic Research Requirement:	The research agreement must be for "basic research." Basic research means any original investigation for the advancement of scientific knowledge not having a specific commercial objective. For example, product testing supporting the trade or business of a specific nongovernmental person is not treated as basic research.
Definition of Sponsor and Qualified User:	A sponsor means any person, other than a qualified user, that supports or sponsors research under a contract. A qualified user means any state or local governmental unit or a section 501(c)(3) organization if the financed property is not used in an unrelated trade or business of such section 501(c)(3) organization. The federal government, including any federal agency or instrumentality, is not a qualified user.
Two Permitted Arrangements:	*Corporate Sponsored Research.* Under this arrangement, the research agreement must provide that any license or other use of the resulting technology by the sponsor of the research be on the same terms and for the same price as UConn or the State would enter into with any unrelated, non-sponsoring party. The sponsor must pay a competitive price (*i.e.*, fair market price) for its use. The price paid for that use must be determined at the time the license or other resulting technology is available for use. Although UConn or the State need not permit persons other than the sponsor to use any license or other resulting technology, the price paid by the sponsor must be no less than the price that would be paid by any non-sponsoring party for those same rights.

Cooperative Joint-Industry-Governmental Research. Under this arrangement, the agreement must provide that:

(a) multiple, unrelated industry sponsors agree to fund governmentally performed basic research;
(b) UConn or the State determines the research to be performed and the manner in which it is to be performed (*e.g.*, selection of the personnel to perform the research);
(c) title to any patent or other product incidentally resulting from the basic research lies exclusively with UConn or the State; and
(d) the multiple, unrelated industry sponsors are entitled to no more than a non-exclusive, royalty-free license to use the product of any such research.

Special Rule for Federally-Sponsored Research:

Applicable federal government contracting principles may require with respect to a research agreement with the federal government that:

(a) federal agencies receive a non-exclusive, royalty-free license in certain intellectual property developed or discovered in the course of performing research (*e.g.*, technical data, software and patents) on behalf of any federal agency;
(b) UConn or the State retains publication rights in any such property and the right to use such property in any future work performed for other clients without requiring the approval of the federal government; and
(c) UConn or the State may register copyrights and trademarks and apply for patents with respect to such property, without federal government consent.

Such agreement is treated as meeting the safe-harbor guidelines of Rev. Proc. 97-14 if:

(a) the agreement is for basic research;
(b) the research under the agreement enters the public domain;
(c) the use of the property by any federal agency is on the same terms and for the same price (determined at the time property is available for use) as UConn or the State would enter into with any unrelated, non-sponsoring party (*i.e.*, if a non-exclusive, royalty-free license is granted to federal agencies, the same must be granted any unrelated, non-sponsoring party); and
(d) neither any federal agency nor any other client is granted ownership of such property.

Treas Reg 1.141-3 Private Use – Short Term Use Exceptions.

(d) Other exceptions

(3) Exceptions for arrangements other than arrangements resulting in ownership of financed property by a nongovernmental person—(i) Arrangements not available for use on the same basis by natural persons not engaged in a trade or business. Use by a nongovernmental person pursuant to an arrangement, other than an arrangement resulting in ownership of financed property by a nongovernmental person, is not private business use if—

(A) The term of the use under the arrangement, including all renewal options, is not longer than 100 days;

(B) The arrangement would be treated as general public use, except that it is not available for use on the same basis by natural persons not engaged in a trade or business because generally applicable and uniformly applied rates are not reasonably available to natural persons not engaged in a trade or business; and

(C) The property is not financed for a principal purpose of providing that property for use by that nongovernmental person.

(ii) Negotiated arm's-length arrangements. Use by a nongovernmental person pursuant to an arrangement, other than an arrangement resulting in ownership of financed property by a nongovernmental person, is not private business use if—

(A) The term of the use under the arrangement, including all renewal options, is not longer than 50 days;

(B) The arrangement is a negotiated arm's-length arrangement, and compensation under the arrangement is at fair market value; and

(C) The property is not financed for a principal purpose of providing that property for use by that nongovernmental person.

(4) Temporary use by developers. Use during an initial development period by a developer of an improvement that carries out an essential governmental function is not private business use if the issuer and the developer reasonably expect on the issue date to proceed with all reasonable speed to develop the improvement and property benefited by that improvement and to transfer the improvement to a governmental person, and if the improvement is in fact transferred to a governmental person promptly after the property benefited by the improvement is developed.

(ii) Illustrations. Incidental uses may include pay telephones, vending machines, advertising displays, and use for television cameras, but incidental uses may not include output purchases.

(f) Examples. The following examples illustrate the application of paragraphs (a) through (e) of this section. In each example, assume that the arrangements described are the only arrangements with nongovernmental persons for use of the financed property.......

Example 15. Arrangements not available for use by natural persons not engaged in a trade or business—federal use of prisons. Authority E uses all of the proceeds of its bonds to construct a prison. E contracts with federal agency F to house federal prisoners on a space-available, first-come, first-served basis, pursuant to which F will be charged approximately the same amount for each prisoner as other persons that enter into similar transfer agreements. It is reasonably expected that other persons will enter into similar agreements. The term of the use under the contract is not longer than 100 days, and F has no right to renew, although E reasonably expects to renew the contract indefinitely. The prison is not financed for a principal purpose of providing the prison for use by F. It is reasonably expected that during the term of the bonds, more than 10 percent of the prisoners at the prison will be federal prisoners. F's use of the facility is not general public use because this type of use (leasing space for prisoners) is not available for use on the same basis by natural persons not engaged in a trade or business. The issue does not meet the private business use test, however, because the leases satisfy the exception of paragraph (d)(3)(i) of this section.

Example 16. Negotiated arm's-length arrangements—auditorium reserved in advance. (i) City Z issues obligations to finance the construction of a municipal auditorium that it will own and operate. The use of the auditorium will be open to anyone who wishes to use it for a short period of time on a rate-scale basis. Z reasonably expects that the auditorium will be used by schools, church groups, sororities, and numerous commercial organizations. Corporation H, a nongovernmental person, enters into an arm's-length arrangement with Z to use the auditorium for 1 week for each year for a 10-year period (a total of 70 days), pursuant to which H will be charged a specific price reflecting fair market value. On the date the contract is entered into, Z has not established generally applicable rates for future years. Even though the auditorium is not financed for a principal purpose of providing use of the auditorium to H, H is not treated as using the auditorium as a member of the general public because its use is not on the same basis as the general public. Because the term of H's use of the auditorium is longer than 50 days, the arrangement does not meet the exception under paragraph (d)(3)(ii) of this section.

(ii) The facts are the same as in Example 16(i), except that H will enter into an arm's-length arrangement with Z to use the auditorium for 1 week for each year for a 4-year period (a total of 28 days), pursuant to which H will be charged a specific price reflecting fair market value. H is not treated as a private business user of the auditorium because its contract satisfies the exception of paragraph (d)(3)(ii) of this section for negotiated arm's-length arrangements.