



## MEMORANDUM\*

### SHORT-TERM USE AGREEMENTS AND PRIVATE BUSINESS USE

March 1, 2012

#### *Overview*

As a general proposition, the federal income tax laws permit a state or local government (an “issuer”) to finance any type of facility with tax exempt “governmental bonds.” However, the federal tax laws do place some significant restrictions on financing a facility that will be used by a private business under circumstances which convey any type of special legal entitlement to use that facility. Use of a bond-financed facility by an individual or a business under these circumstances is generally referred to in the Internal Revenue Code and the United States Treasury Regulations (the “Regulations”) as “private business use.” If there is “private business use” of a facility, the tax rules generally will permit tax-exempt governmental bonds to be issued to finance the facility only if (i) no person pays the issuer or any related entity any amount in connection with the use of the facility (e.g. the facility generates no revenues for the issuer or any related entity) and (ii) the facility itself is not pledged as security for the bonds.

Most revenue bond or lease financing involves the construction of a revenue-generating facility. Therefore, it usually is critical that the issuer avoid any arrangement with a private business or person that constitutes “private business use” if it wishes to finance the facility using tax-exempt debt. The Regulations contain a number of exceptions for common arrangements which may involve the grant of some form of “legal entitlement” to use a bond-financed facility but which, for a variety of reasons, are not treated as “private business use.” One set of exceptions that can be particularly useful to issuers that operate revenue generating facilities is found at Regulations § 1.141-3(c) and (d), and apply to certain short-term lease or other exclusive use arrangements.

#### *Exceptions for Short-Term Private Use*

The Treasury Regulations provide three specific exceptions for situations that convey rights to use a bond-financed facility for relatively short periods of time. If the specific requirements of the Regulations are met, then during the term of the agreement these short-term use arrangements can convey to the private person any set of rights to use the facility short of tax ownership and the use will *not* be treated as private business use. The form of the agreement (e.g. a lease, license, use agreement, etc.) typically is irrelevant.

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\* This memorandum is for general information purposes only. For legal advice concerning how these rules may apply to your specific facts, please contact a Gilmore & Bell attorney or your issuer’s regular legal counsel.

The short-term use agreement exceptions are particularly useful for public parking garages, trade or convention facilities, recreation facilities, private aviation airports or other publicly-owned facilities which are regularly leased out in whole or in part to members of the public or to a large number of business entities on a short-term basis. The three exceptions can be summarized as follows:

1. Use pursuant to rate scale agreements for not more than 200 days use, but only under circumstances where such contracts are entered into primarily with individuals not engaged in a private business.
2. Use pursuant to rate scale agreements for not more than 100 days use, which are entered into with individuals or a group of businesses, if the bond-financed property was not financed for a principal purpose of making the property available to the person entering into the agreement.
3. Use pursuant to separately negotiated, arm's-length agreements for not more than 50 days use, if the bond-financed property was not financed for a principal purpose of making the property available to the person entering into the agreement.

Even though the term of these contracts must be limited to the particular number of days described, the issuer and the nongovernmental person may renew a 200 or 100 day agreement, based on the "rate scale" in effect on the renewal date, or may enter into a new separately negotiated agreement of 50 days or less. In addition, with respect to the 100 or 200 day use exceptions described above, the nongovernmental person may have a right of first refusal to renew the arrangement (at the then applicable rate scale). Finally, it is often useful that the agreement need not require that the use of the bond-financed facility be for a consecutive number of days. For example, a city-owned convention center could be reserved for use by a single trade association for 5 days a year for a ten year period pursuant to an arm's-length negotiated agreement and still meet the 50-day agreement exception described above. Thus, the period of time that the agreement is in effect can be indefinite, so long as the use of the bond-financed facility pursuant to that agreement is limited to not more than 50 days.

While these exceptions can be extremely useful, it is important to recognize that they do have some important requirements that may not be obvious at first blush. First, both the 200-day and the 100-day contracts are subject to the requirement that the user pay for the use on the basis of "rates that are generally applicable and uniformly applied" ("rate scale agreements") Any differences in rates charged different classes of users, such as volume purchasers must be "customary and reasonable " or must be mandated by federal law. Thus, both the 200 day and 100 day exceptions are limited to situations where the issuer sets the applicable rates for a number of similar types of property (e.g. parking spaces in a public garage) or for the entire facility for a particular term (e.g. hourly rental rates for a public skating rink) pursuant to a uniformly applied rate scale. Second, in order to use the 200 day exception, the property subject to the agreement must be intended and actually available for use by members of the general public who are not engaged in a trade or business. Thus, facilities or portions of a facility that by their nature are not used or intended for use by members of the general public typically do not qualify for the 200 day exception, but may be able to satisfy criteria for the 100 day use agreement exception. Third, both the 100 day agreement exception and the 50 day agreement exception require that a principal purpose of the financing not have been to make the property available to the private user. Thus, situations where a facility is specifically constructed for the use of an identified private user (e.g. a stadium constructed in part for use by a single profession sports team) may not be able to use these exceptions, even if in form they do not exceed the 50 day or 100 day time limit.

## ***Conclusion***

The forgoing is intended as a general overview of the short-term use agreement exceptions to the private business use restriction. Other exceptions to private business use may also apply to certain arrangements. In addition, certain facilities, such as airports, public ports, water systems, and schools can be financed on a tax-exempt basis as qualified private activity bonds and are not subject to the private business use restriction. Issuers may wish to consider these alternatives along with the possibility of using one or more of the short-term use exceptions outlined above.