Private Use of Public Community College Facilities

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Private Activity and Tax Exemption

- General Rule for Tax Exempt Financing:
  - Interest on any State or local government bond is not included in the gross income of the holder thereof for Federal income tax purposes
- Exception to General Rule:
  - Tax exemption does not apply to any “private activity bond”
- If tax exempt bond financed public property becomes subject to private use, the bonds could become taxable.
Private Use

- “Private Activity” occurs when a public facility is used in a private, nongovernmental trade or business
- This test is met when more than 5% of the proceeds of a bond issue are to be used in a private use
- Examples of private use:
  - Sale or transfer of property to private user
  - Lease of property to private user
  - Management of property by private user under a management contract
- If private use occurs above permissible limits, in order to avoid the bonds being declared taxable, the District should take a remedial action
Private Business Use Exceptions: Short Term Rentals

- Short-term rental arrangements
  - 50 days, negotiated arms length agreement
  - 100 days, according to a rate schedule, not reasonably available (i.e. too expensive) for use by individuals
  - 200 days, according to a rate schedule, primary use by individuals (rather than corporations)
Short Term Rentals

- **Example**
  - College rents out dorms/soccer facilities to soccer camp for a one-week period over the summer under a negotiated, arms length agreement
  - Meets the 50-day short term exception

- **Example**
  - College offers 6-month memberships to its gym facilities to members of the general public and the gym facilities are used by either students or members of the general public. Although gym members have a right of first refusal to renew the membership, the members aren’t guaranteed renewal. College charges a fair market value rate for the gym membership.
  - Meets the 200-day short term exception
Private Business Use Exceptions: Incidental Use

- Vending machines, payphones advertising displays involving not more than 2.5% of the bond financed property

- College finances a 4-story classroom building with tax-exempt bonds. Vending machines in the lobby are run by a third-party operator (that doesn’t use any other portion of the facility). The square footage of the area in which the vending machines are located is less than 1% of the total square footage of the financed property. Each square foot of the building cost the same dollar amount. The vending machine operator’s use is an incidental use.
Measurement of Private Business Use

- Example:
  - 20 year bonds financing the acquisition of land in Year 1. In Year 2, college building will be built on land. Prior to build-out, all the land is leased to farmers in Year 1. There will be no other private business use of property after the leases are up. During Year 1, 100% of the property is used in a private business use. After year one, no property is used in a private business use. Limit for the Private Business Use in this case is 5% (because leasing to farmers is unrelated to governmental purpose). However, private business use is not exceeded (100% in Year 1, 0% in Years 2-20 = 5% average).
Measurement of Private Use

- How to measure private business use:
  - Cost
  - Space
    - Square footage allocations (works well for leased spaces)
  - Time
    - For facilities used at certain times by private and other times by college. *E.g.*, Every Wed. and Sat. for 2 hours at a time, a private user uses a classroom that is used for 8 hours every other day by the college and 6 hours on Wed. and Sat. College use = 52 hours; private use: 4 hours. Private business use calculation (assuming 100% of bond proceeds used for classroom = 4/56): 7.15%. Not permissible.
Remediation of Private Business Use

- Remedial Actions:
  - Alternative use of disposition proceeds
  - Redemption/defeasance of nonqualified bonds
  - Alternative use of facility
**Remediation**

- **Redemption/Defeasance of Nonqualified Bonds**
  - Nonqualified bonds: amount of bonds of the issue that are allocable to the private business use of the facility that is over the applicable limit
  - If currently callable, redeem within 90 days
  - If not currently callable, establish a yield restricted defeasance escrow within 90 days of deliberate action

- Can only do this if bonds callable within 10.5 years of issue date

- Must notify IRS of the establishment of defeasance escrow (within 90 days of establishment of defeasance escrow)
Remediation

- Alternative Use of Disposition Proceeds
  - The issuer must reasonably expect to spend the disposition proceeds on good costs within two years of the date of the deliberate action
  - Disposition must be exclusively for cash (e.g., selling bond-financed building for cash)
  - The disposition proceeds must be not be used in a private business
Remediation

- Example:
  - Issuer issues $10,000,000 of bonds to finance a college building. Issuer no longer needs the building and a grocery store offers to buy it for $8,000,000 cash, which is fair market value at the time of the sale. The issuer takes the $8,000,000 cash and spends it to build a new classroom building for the college within 2 years of the sale.
Remediation

- Alternative Use of Facility
  - The facility with must be used in a qualifying alternative manner (no private use)
  - The nonqualified bonds are treated as reissued and the nonqualified bonds satisfy all of the applicable requirements for qualified bonds throughout the remaining term of the nonqualified bonds (e.g., turning governmental bonds into qualified 501(c)(3) bonds)
  - The deliberate action does not involve a disposition to a purchaser that finances the acquisition with proceeds of another issue of tax-exempt bonds
Example:

- College issues 20-year governmental bonds to finance the construction of a building, fully expecting on the issue date to be only user of the building. Six years later the college decides to lease the building to a 501(c)(3) entity for 10 years. Before entering into the lease a TEFRA hearing is held. As of the date of the deliberate action, the issue meets all of the requirements for qualified 501(c)(3) bonds.
Other Ways to Remediate Private Business Use

- Reallocation of bond proceeds to other expenditures for governmental purposes
- Within 18 months of original expenditures
- Example:
  - College issues taxable bonds and uses the proceeds to finance technology improvements. College then issues tax-exempt bonds, the proceeds of which are intended to be used in part to finance a baseball stadium for use by the College. College is approached by a AAA baseball team to use its baseball stadium in a manner that would cause the private business use limit to be exceeded and would require the College to finance a portion of the stadium. College reallocates a portion of the tax-exempt bond proceeds to the technology improvements and reallocates the taxable bond proceeds to the baseball stadium contribution.
If no remedial action is available, consider requesting a “voluntary closing agreement” ("VCAP") with the Internal Revenue Service.

Questions?
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