Tax-Exempt Bond Private Use Monitoring Procedures
Effective Date: August 27, 2010

Overview

Federal tax law generally requires that property financed by a nonprofit with tax-exempt bonds be owned by the nonprofit and used to further its charitable, educational or other exempt purposes. Only an insubstantial use of the property (generally 3%) may be for non-exempt or private business purposes. Such inappropriate usage includes use by persons other than the nonprofit for private business purposes and use of an Emory facility or asset in an unrelated business activity. Use by state or local governments is considered appropriate, but use by the federal government can be deemed private business use.

The principal advantage of this financing method is the lower interest cost in comparison to the interest rate on conventional debt available to the borrower. Because investors in tax-exempt bonds do not pay federal income tax on interest payments received on the bonds, these investors are willing to accept an interest rate lower than the interest rate on comparable taxable bonds, the interest on which is subject to federal income tax.

The Internal Revenue Service (IRS) imposes strict limits on the "private business use" of proceeds derived from the sale of tax-exempt bonds. Private business use, generally speaking, is the use of a facility by a person in a private trade or business where the construction or renovation of the facility was financed with tax-exempt bond proceeds. Private business use may also include affiliation agreements with a nongovernmental entity where the other party occupies space, in conjunction with the affiliation agreement, in an Emory tax-exempt financed facility, and research agreements pursuant to which research is conducted for the benefit of a private business in an Emory tax-exempt financed facility. Use of such facilities by another section 501(c)(3) organization in furtherance of Emory’s exempt purposes is permitted and does not constitute private business use.

Private business use of facilities and equipment financed with tax-exempt bonds requires monitoring procedures to ensure that the private use stays within the allowable limitations. Excessive private use may require refinancing of a debt issuance.

Requests for Tax-Exempt Bond Financing

In order to be eligible for tax-exempt financing each project must contain projected plans for private business use activity over the life of the outstanding debt. Specifics, including the nature of private use activity, the square footage planned for the activity, the location of the activities and the estimated financial benefit for the University by engaging in the activity, must be provided to the VP for Finance at the point the original funding request is made. As circumstances change, the revised estimates must be forwarded to the VP for Finance.

The VP for Finance will accumulate the private business use activity estimates for all requests under the bond issue. If private use is greater than the allowable IRS limits, taxable bonds will be issued for that portion of the project in excess of the private activity limitation. Failure to provide this information in a timely manner by the project owners could result in the issuance of higher cost bonds.
taxable bonds for the facility to ensure that Emory does not endanger its tax-exempt status and the IRS does not declare the total tax-exempt issue and other Emory related debt to be taxable.

**Monitoring Activities after Facility Completion**

The private use of tax-exempt bond proceeds must be monitored for the life of the bond series (generally 30 years) plus an additional three years. As such, at the time tax-exempt bonds are issued, the VP for Finance will require information related to each project on uses of the facilities that would be considered to benefit a private party.

In addition the primary facility users must provide information on an ongoing basis to allow private business use to be continually monitored. Any time there is a potential change in use of a tax-exempt bond funded facility the parties must discuss the change in advance to ensure that there is no impact on maintenance of the tax-exempt status of the bonds. The University will consult with its bond counsel on any potential change in the tax status of a tax-exempt issue.

**Sponsored Research Monitoring**

When Emory engages in privately-sponsored research in facilities or using assets financed with tax-exempt bonds, the Internal Revenue Service may view the arrangement as an indirect private business use of the facilities or assets by the sponsor. However, the IRS will not deem the conduct of such privately-sponsored research as inappropriate private business use under certain conditions. One such condition is when the research is considered “basic research” and the private sponsor has no rights to any resulting technology. Another is when the research is considered “basic research” and the private sponsor receives no more than a license to the results of the research activity for which a competitive arms-length rate is paid, determined at the time the technology becomes available for use.

Finance needs to know whether sponsored research will be undertaken with the assets being financed with tax-exempt debt and, if so, which funding sources are initially sponsoring the activity and the arrangements for use of the research product(s). Because funding sources can change over time, Finance will also separately survey debt-financed projects that support research activity on an annual basis throughout the term of the loan to determine what sources are currently funding the research and under what arrangements.

**Examples of Private Business Use**

*Unrelated Trade or Business*

The general unrelated business use principles under Section 513 of the Internal Revenue Code are applied to analyze the use of tax-exempt bond financed facilities for this purpose.

Potential problem areas include laboratory services or pharmacy sales to the public, parking lots open to the general public, museum gift shops selling items unrelated to exempt purposes, facilities used for unrelated summer camps, and performing arts facilities used for meetings unrelated to its exempt purposes.
The use of a facility in an unrelated trade or business does not need to generate any income to be private business use.

**Naming Rights of Facilities**

Private use is generally not created when a building, or a room or an area within a building, is named for an individual or individuals when the name is not that of a company or a commercial name, e.g., the John and Mary Doe Building. Private use could result when a naming situation involves a company or commercial name such as the XYZ Bank Building.

A naming rights situation involving a company or a commercial name may require outside bond tax counsel review and/or a ruling request from the Internal Revenue Service. If such review or ruling indicates the need for refinancing, increased interest costs should also be considered in the naming rights negotiation.

**Management Contracts**

Revenue Procedure 97-13 provides the following safe harbors for management or service contract arrangements to avoid private business use:

(a) 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 (defined as a stated dollar amount for services rendered for a specified period of time). 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. 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 equal to a single, stated dollar amount.

(b) 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 as described in (a) is permitted.

(c) 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 (defined as a fixed periodic amount for each person for whom the service provider assumes the responsibility to provide all needed services for a specified period) or a combination of a capitation fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 5 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the third year of the contract.

(d) All of the compensation for services is based on a per-unit fee (defined as a fee based on a unit of service provided) or a combination of a per-unit fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 3 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the second year of the contract term.
(e) All 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. The term of the contract, including all renewal options, must not exceed 2 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the first year of the contract term.

Research Agreements
Research performed in bond-financed facilities may constitute private business use if a commercial business funds the research and receives particular benefits from the results of the research. Revenue Procedure 2007-47 provides three safe harbors for research agreements. If a research agreement meets the requirements of the applicable safe harbor, use of the research facility or equipment subject to the research agreement is considered not to result in private business use.

Research agreements with a corporate sponsor:

1. the qualified user permits any license or other use of resulting technology by the sponsor on the same terms as such use by any unrelated, non-sponsoring party (that is, the sponsor must pay a competitive price for its use), and

2. the price paid for use of any license or other use of resulting technology is determined at the time the license or other resulting technology is available for use. (NOTE: the qualified user need not permit persons other than the sponsor to use any license or other resulting technology, but 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.)

Research agreements with industry sponsors:

1. one or more sponsors agree to fund basic research performed by a qualified user;

2. the qualified user determines the research to be performed and the manner in which it is to be performed (for example, selection of the personnel to perform the research);

3. the qualified user retains exclusive title to any patent or other product incidentally resulting from the basic research; and

4. the sponsor or sponsors receive no more than a nonexclusive, royalty-free license to use the product of any of that research.

Research agreements with federal government sponsors:

1. the qualified user determines the research to be performed and the manner in which it is to be performed (for example, selection of the personnel to perform the research);

2. the qualified user retains exclusive title to any patent or other product incidentally resulting from the basic research; and

3. any party other than the qualified user is entitled to no more than a nonexclusive, royalty-free license to use the product of any of that research.
Record Retention

It is the policy of the University to comply with the applicable tax law relating to the retention of records with respect to tax-exempt debt. Current IRS policy requires that all records relating to tax-exempt debt shall be maintained for the life of the debt (or, in the event the debt issue is refunded by a subsequent issue, for the life of the subsequent issue) plus three years. This includes, but is not limited to all investment records, requisitions, information concerning private business use such as commercial sponsored research agreements, leases, and management agreements.

Records common to most tax-exempt bond transactions include:

- Basic records relating to the bond transaction (including the trust indenture, loan agreements, and bond counsel opinion);
- Documentation evidencing expenditure of bond proceeds;
- Documentation evidencing use of bond-financed property by public and private sources (i.e., copies of management contracts and research agreements);
- Documentation evidencing all sources of payment or security for the bonds; and
- Documentation pertaining to any investment of bond proceeds (including the purchase and sale of securities, SLGs subscriptions, yield calculations for each class of investments, actual investment income received the investment of proceeds, guaranteed investment contracts, and rebate calculations).

The University has contracted with Digital Assurance Certification, LLC (DAC) to store all basic records relating to the bond transactions (trust indentures, loan agreements and bond counsel opinions) and documentation pertaining to the investments of bond proceeds including rebate calculations contained in bond arbitrage reports.

Documentation evidencing use of bond financed property by public and private sources will also be stored with DAC. Copies of other management contracts, research agreements and leases of bond financed property not producing private use will be stored in other University imaging systems (currently WebOptix). Purchase orders created electronically remain in electronic format in the Emory Express purchasing system. Documents not transitioned to the imaging systems are stored in paper format in the appropriate departmental areas.

Annual Private Use Calculation

As required by the IRS, the University will perform an annual cumulative private use calculation for each outstanding tax-exempt bond issue. The calculations will be conducted by the DAC system.

Each year the University Tax Manager will collect required data to update the private use calculation for each outstanding bond issue to include:

- Confirmation of management contracts associated with each tax-exempt bond financed building. This process is completed via an annual survey of Business Officers responsible for the management of each University building.
• List of new management contract additions since the previous annual calculation obtained from the Business Officer survey.
• List of expired management contracts since the previous annual calculation obtained from the Business Officer survey.
• Confirmation of leases of tax-exempt bond financed buildings and equipment. This process is completed via the annual Business Officer survey.
• List of new leases of tax-exempt bond financed buildings and equipment since the previous annual calculation.
• List of expired leases of tax-exempt bond financed buildings and equipment since the previous annual calculation.
• List of new research agreements not meeting one of the IRS private business use safe harbors.

The University Tax Manager will provide the aforementioned updates to DAC for inclusion in the annual private use calculation for each outstanding bond issue.