

**STATE OF NEW JERSEY
GENERAL OBLIGATION BONDS
POST ISSUANCE COMPLIANCE PROCEDURES**

**OFFICE OF THE SECRETARY OF HIGHER EDUCATION
USE OF TAX-EXEMPT BOND FINANCED PROPERTY AND PROCEEDS
RELATING TO
SECURING OUR CHILDREN’S FUTURE BOND ACT, P.L. 2018, C. 119**

October 29, 2021

BACKGROUND

The State of New Jersey (the “State”) has issued and intends to issue in the future its tax-exempt General Obligation Bonds to finance various purposes authorized under various State general obligation bond acts (the “Bond Acts”). The New Jersey Secretary of Higher Education Secretary (the “Secretary”) administers or participates in the administration of the program described on Appendix A hereto (the “Bond Financed Program”), which program is financed, in whole or in part, pursuant to the Securing Our Children’s Future Bond Act, P.L. 2018, c. 119 (the “Bond Act”) with proceeds of tax-exempt State of New Jersey General Obligation Bonds (the “Tax-Exempt Bonds”) issued by the State. Under the Bond Act, the State has issued its Tax-Exempt Bonds for the purposes of providing for State capital project grants, on an up to 75% matching basis, for the purpose of providing funds to increase the career and technical education program capacity at county colleges.

In connection with each issuance of new money Tax-Exempt Bonds (“New Money Tax-Exempt Bonds”), representatives of the Office of the Secretary of Higher Education, including the Secretary, and representatives of the New Jersey Educational Facilities Authority (“EFA”) were interviewed by bond counsel and provided information relating to the Secretary’s reasonable expectations as to the use of such New Money Tax-Exempt Bond proceeds and the projects and properties to be financed thereby. In addition, the Secretary and bond counsel review a Due Diligence Request and Tax Questionnaire (a “Questionnaire”) and a Grant Agreement (a “Grant Agreement”) that is submitted by each applicant for grant proceeds (each, a “Grantee”). In some instances, bond counsel or the Secretary or staff of the EFA will conduct follow-up conference calls or exchange follow-up emails with the applicable Grantee to clarify information submitted on the Questionnaire. In connection with the issuance of Tax-Exempt Bonds to refund prior issuances of Tax-Exempt Bonds (“Refunding Tax-Exempt Bonds”), the Secretary or her/his representatives shall provide the State and its bond counsel with information relating to the issuances of prior Tax-Exempt Bonds (whether issued to fund new or on-going capital projects or issued to refund prior issues of Tax-Exempt Bonds) (collectively, “Prior Tax-Exempt Bonds”), including the actual expenditure of the proceeds of the Prior Tax-Exempt Bonds and the use of the projects and properties financed by such Prior Tax-Exempt Bonds. The processes described in this paragraph are herein referred to as the “Due Diligence Process”).

In addition, each Grantee makes certain tax covenants and representations in its Grant Agreement and agrees to cooperate with the State Librarian’s periodic requests for information with respect to the use and financing of the project and to maintain records in accordance with these written post-issuance compliance procedures.

Based, among other things, on the Due Diligence Process, the State represents in the tax certificate delivered in connection with the issuance and delivery of each series of Tax-Exempt Bonds (the “Tax Certificate”), that the State expects and intends to be able to comply with, and will, to the extent permitted by law, comply with the provisions and procedures set forth in the Tax Certificate and do and perform all acts and things necessary or desirable in order to assure that, under the Internal Revenue Code of 1986, as amended (the “Code”) as then in effect, interest on the Tax-Exempt Bonds be and remain excluded from gross income for federal income tax purposes. Based on the representations of the State in the Tax Certificate, bond counsel is able to deliver its tax opinion which provides, in part, that “under existing statutes, regulations, rulings and court decisions, interest on the Tax-Exempt Bonds, including interest in the form of original issue discount, will not be includible in gross income of the holders thereof for federal income tax purposes, assuming continuing compliance by the State with the requirements of the Code.”

PURPOSE

Section 141 of the Code contains limitations on the extent to which proceeds of the Tax-Exempt Bonds can benefit persons other than a state or local governmental unit. In addition, Section 148 of the Code imposes limitations on the investment of proceeds of the Tax-Exempt Bonds and required rebate of excess earnings to the federal government. The Secretary is implementing the procedures set forth herein as part of the State’s overall and ongoing effort to preserve the tax-exempt status of the State’s outstanding Tax-Exempt Bonds. These procedures, together with the Due Diligence Process and the Tax Certificates establish procedures for: (1) identifying uses that may constitute private use; (2) managing and tracking changes in use, (3) accomplishing remedial action when necessary; and (4) assuring compliance with the arbitrage requirements of the Code.

RESPONSIBILITY

In order to facilitate continuing compliance with the federal income tax requirements relating to the tax-exempt status of the outstanding Tax-Exempt Bonds (the “Tax Requirements”), the Secretary will act as the Tax Compliance Officer (the “Tax Compliance Officer”) and will have the primary responsibility to monitor compliance with the Tax Requirements set forth herein for the Tax-Exempt Bonds. The Tax Requirements include limitations on the private use of bond-financed facilities under the Code. The general responsibilities of the Tax Compliance Officer with respect to tax compliance shall include, but not be limited to, (1) communicating monitoring procedures (as outlined herein) and the results of such monitoring to the State Treasurer’s Office (the “Treasurer’s Office”) through personnel of the State Department of the Treasury’s Office of Public Finance (“OPF”) responsible for confirming consistent application of these procedures, (2) monitoring the completeness of documentation required by these procedures, and (3) communicating with OPF regarding any potential issues so that OPF can request that the Attorney General’s Office engage nationally recognized bond counsel (“Bond Counsel”) as necessary. The procedures that will be undertaken are set forth below and are intended to supplement the Due Diligence Process and the Tax Certificates. The State and the Secretary, in consultation with Bond Counsel engaged by the Attorney General’s Office and representatives of the Treasurer’s Office and OPF, will supplement and update these procedures as appropriate to provide a continuing source of guidance on these requirements.

Pursuant to separate written procedures previously adopted by the State, the Director of OPF (the “Director”) is responsible for monitoring compliance with the arbitrage and rebate requirements of the Code.

PRIVATE ACTIVITY LIMITATIONS

Bond-Financed Property

As part of the Due Diligence Process, the Secretary’s representatives and representatives of each Grantee are queried regarding the use of bond-financed property and projects. Private use of bond-financed properties and projects and private payments received in connection with such use, if any, is documented as part of the Due Diligence Process and taken into account in structuring the allocation of bond proceeds to grant proceeds. In connection with each issuance of New Money Tax-Exempt Bonds and any expenditure of the proceeds of Prior Tax-Exempt Bonds after the implementation of these procedures, the Tax Compliance Officer will oversee the establishment and maintenance of books and records reflecting the actual expenditure of proceeds of such Tax-Exempt Bonds during the expenditure period (the “Bond-Financed Property”) for Fiscal Year 2021 and future fiscal years and will coordinate with the responsible persons within the Office of the Secretary of Higher Education as described below under “Secretary’s Procedures.”

Private Activity Review

It is the intention of these Procedures that the private activity review described in this section be conducted in connection with the issuance of Tax-Exempt Bonds. In addition, as discussed below under Secretary’s Procedures - *Change in Use and Remediation*, it will be necessary for the Tax Compliance Officer to conduct a periodic review to confirm that no change in use has occurred which could potentially affect the tax-exempt status of any Tax-Exempt Bonds. Reference should be made to the Private Activity Restrictions on Private Business Use and accompanying attachments, attached as Appendix B, for further guidance on the Private Activity Limitations of Section 141 of the Code (the “Private Activity Limitations”). A form of Private Business Use Questionnaire that can be utilized to conduct private activity review is attached as Appendix C.

Federal tax law limits the permitted amount of private business use of bond-financed facilities by reference to a percentage of the total amount of proceeds. In the case of private uses that are related to the governmental use of the facility, the limit is 10% of bond proceeds. In the case of private use that is unrelated to the governmental use or related but disproportionate to the governmental use, the limit is 5% of bond proceeds. Federal tax law also limits the amount of private loans to the lesser of 5% of bond proceeds or \$5,000,000.

As discussed above, as part of the Due Diligence Process, private activity review is undertaken prior to the issuance of each series of Tax-Exempt Bonds and during the Due Diligence Process conducted with the Grantees. Thus, in connection with Prior Tax-Exempt Bonds, any private activity that was contemplated at the time of and disclosed during the Due Diligence Process has already been taken into consideration in the structuring of such issue(s) of Prior Tax-Exempt Bonds. With regard to Prior Tax-Exempt Bonds, the responsibility of the Tax Compliance Officer continues to be to identify any deviation or change from what was contemplated at the time of such Due Diligence Process and disclosed to bond counsel at that time. To assist the Tax Compliance Officer in this regard, Appendix A attached hereto and

made a part hereof details any private use associated with the Bond Financed Program that has already been disclosed to and contemplated by bond counsel in connection with the issuance of Prior Tax-Exempt Bonds that remain outstanding at the time of the implementation of these procedures. With regard to New Money Tax-Exempt Bonds, the State and its bond counsel will again undertake the Due Diligence Process. In connection with such Due Diligence Process, the Tax Compliance Officer or other representatives responsible for responding to due diligence inquiries will be interviewed regarding any known or contemplated private activity at properties or projects to be financed with the proceeds of such New Money Tax-Exempt Bonds and a Due Diligence Process will be conducted with each Grantee as described above. With regard to New Money Tax-Exempt Bonds, the Tax Compliance Officer will continue to be responsible for identifying any deviation or change from what was contemplated at the time of the Due Diligence Process and disclosed to bond counsel at that time. It is the responsibility of the Tax Compliance Officer to maintain records detailing the information provided to bond counsel during the Due Diligence Process in connection with the issuance of such New Money Tax-Exempt Bonds.

In order to demonstrate continuing compliance with the Private Activity Limitations, the Tax Compliance Officer will oversee the procedures described below under “Procedures.” These procedures are designed to assist the Tax Compliance Officer in identifying the potential occurrence of any of the events set forth below if and to the extent such event (i) was not disclosed to bond counsel during the Due Diligence Process or (ii) is inconsistent or not in compliance with the Bond Financed Program as described to bond counsel (each a “Tax Event”) with respect to any Bond-Financed Property:

Change in use of Bond-Financed Property – the ownership of any portion of the Bond-Financed Property is transferred to anyone other than a State or local governmental unit, prior to the earlier of the end of the expected economic life of the property, or the latest maturity date of any bond of the issue financing (or refinancing) the property.

Change of ownership of Bond-Financed Property – the ownership of any portion of the Bond-Financed Property is transferred to anyone other than a State or local governmental unit prior to the earlier of the end of the expected economic life of the property, or the latest maturity date of any bond of the issue financing (or refinancing) the property.

Private business use of the Bond-Financed Property – any portion of the Bond-Financed Property will be used by anyone other than a State or local governmental unit or members of the general public who are not using the property in the conduct of a trade or business and such use was not contemplated at the time of and disclosed during the Due Diligence Process. Examples of uses that can give rise to private business use include use by a person as an owner, lessee, purchaser of the output of facilities under a “take” or “take or pay” contract, purchaser or licensee of research, a manager or independent contractor under certain management or professional service contracts or any other arrangement that conveys special legal entitlements (*e.g.*, arrangement that conveys priority rights to the use or capacity of the financed property) for beneficial use of the property financed with proceeds of tax-exempt debt or special economic benefit.

Leases of the Bond Financed Property – any portion of the Bond-Financed Property is to be leased, or otherwise subject to an agreement which gives possession of any portion of the Bond-Financed Property to anyone other than a State or local governmental unit and such lease or agreement was not contemplated at the time of and disclosed during the Due Diligence Process.

Management agreement or service agreement -- any portion of the Bond-Financed Property is to be used under a management contract or professional service contract (*e.g.*, medical

group), other than a contract for services that are solely incidental to the primary function of Bond-Financed Property, such as janitorial services or office equipment repair and such contract was not in place or contemplated at the time of and disclosed during the Due Diligence Process.

Sale of Output from Bond-Financed Property – any output of the Bond-Financed Facility is to be sold under a long-term contract to any person other than a state or local governmental unit and such sale was not contemplated at the time of and disclosed during the Due Diligence Process.

Naming rights agreements for the Bond-Financed Property – any portion of the Bond-Financed Property will become subject to a naming rights or sponsorship agreement, other than a “brass plaque” dedication and such naming rights or sponsorship agreement was not contemplated at the time of and disclosed during the Due Diligence Process.

Research using the Bond-Financed Property – any portion of the Bond-Financed Property will be used for the conduct of research under the sponsorship, or for the benefit of, any organization other than a state or local governmental unit and such use was not contemplated at the time of and disclosed during the Due Diligence Process.

Private Loan of Bond Proceeds – any portion of the proceeds of the Tax-Exempt Bonds (including any investment earnings thereon) is to be loaned by the to any person other than a State or local governmental unit and such loan was not contemplated at the time of and disclosed during the Due Diligence Process.

The Tax Compliance Officer shall notify in writing each Grantee of the publication of these Written Post-Issuance Compliance Procedures and that each Grantee has the obligation to notify the Tax Compliance Officer immediately upon the occurrence of any Tax Event affecting its grant and their respective responsibilities under the Section titled “Ongoing Contract Review”. Immediately following the Tax Compliance Officer obtaining knowledge of the occurrence of any Tax Event, the Tax Compliance Officer will contact the Director who shall request that the Attorney General’s Office engage Bond Counsel to provide advice on and to ascertain what effect, if any, a contemplated Tax Event may have on the tax-exempt status of interest on the Tax-Exempt Bonds. In certain circumstances, it may be necessary for the State to take a remedial action under Treasury Regulation Section 1.141-12 to preserve the tax-exempt status of interest on the Tax-Exempt Bonds. See Appendix D regarding available remedial actions. Timely identification of a Tax Event is necessary to take a remedial action. In certain cases, remedial action may not be available and the State may need to consider a voluntary closing agreement with the IRS.

Secretary's Procedures

Responsible Persons

The Tax Compliance Officer will designate such person or persons within the Office of the Secretary of Higher Education to be responsible for monitoring tax compliance with regard to each Bond Financed Program (each a "Tax Compliance Designee" and, collectively, the "Tax Compliance Designees"). The Tax Compliance Officer will notify the Director of the name and title of each Tax Compliance Designee and the Bond Financed Program for which such the Tax Compliance Designee is responsible. Any change in a Tax Compliance Designee or the responsibilities thereof shall be communicated promptly to the Secretary.

The Tax Compliance Officer will review the list of Tax Events with the Tax Compliance Designees.

Allocation of Expenditures

In connection with each issuance of New Money Tax-Exempt Bonds and any expenditure of the proceeds of Prior Tax-Exempt Bonds after the implementation of these procedures, the Tax Compliance Officer or the Tax Compliance Designees, as applicable, shall create and maintain the following records:

a. The Tax Compliance Officer and each Tax Compliance Designee shall maintain an accessible, comprehensive file(s) which allocates expenditures to projects under each Bond Financed Program, such file being sufficient to demonstrate the allocation of expenditures to specific projects, the date and amount of such expenditure and the specific bond fund from which such expenditure was made;

b. The Tax Compliance Designees shall maintain a single file for each project within a Bond Financed Program for which there has been an expenditure, each such file to include the following:

- a copy of each Grant Agreement;

- a copy of each Questionnaire; and

- a copy of any other documents identifying or detecting possible changes of use or other private-use issues, such as signage or advertising agreements, license agreements, rental agreements, operating agreements, concession agreements or other facility use agreements.

The Tax Compliance Officer will contact the Director who shall request that the Attorney General's Office engage Bond Counsel to provide advice on questions relating to the determination or measurement of private use, safe harbors for management contracts and service contracts with private entities and the appropriate course of action to take for any particular Tax Event.

Ongoing Contract Review

Each Grantee will oversee the establishment of a procedure for the review on an on-going basis of all existing and prospective contracts between the Grantee and a non-governmental person, including the federal government or a non-profit organization, that involve use at, management of, provision of services with respect to, or sale of any grant-financed property. Excluded from this review of contracts will be (i) contracts that existed at the time of and were disclosed during the Due Diligence Process and (ii)

construction contracts, engineering or similar contracts, and purchase contracts. Based upon such review of contracts, the Grantee shall identify and record in writing the type of use by the contracting party, the term of the contract and the compensation arrangement and provide such information to the Tax Compliance Officer.

For all such contracts, the Tax Compliance Officer will contact the Director who shall request that the Attorney General's Office engage bond counsel to provide advice on whether the contract meets, or will meet, the requirements for a safe harbor management contract under Rev. Proc. 2016-44 or another exception to private use or can be revised to meet a safe harbor or exception. For those contracts that cannot meet a safe harbor or exception from private use, including all leases and sale contracts, the Tax Compliance Officer will identify the affected property and will contact the Director who shall request that the Attorney General's Office engage bond counsel to provide advice as to any further steps to be taken, including remedial action.

In addition, the Tax Compliance Office shall cause a Private Business Use Questionnaire in the form set forth in Appendix B hereto (or in such other form as Bond Counsel to the State may advise) to be sent to each Grantee annually and each Grantee shall complete and return such Private Business Use Questionnaire within one hundred eighty (180) days of the end of Grantee's Fiscal Year, commencing with the Fiscal Year beginning in calendar year 2021.

Change in Use and Remediation

Should the information collected by the Tax Compliance Officer indicate that there may be a change in private use from what was contemplated at the time of and disclosed during the Due Diligence Process, the Tax Compliance Officer will contact the Director who shall request that the Attorney General's Office engage Bond Counsel to provide advice as to any further steps to be taken, including remedial action. To the extent that any such potential change in private use comes to the attention of the Tax Compliance Officer prior to the next scheduled periodic review, the Tax Compliance Officer shall promptly contact the Director, who shall request that the Attorney General's Office engage Bond Counsel to provide advice on and to ascertain what effect, if any, such potential change may have on the tax-exempt status of interest on the Tax-Exempt Bonds.

Recordkeeping

The Internal Revenue Service has advised issuers of tax-exempt obligations that they have post-issuance recordkeeping responsibilities that are necessary to satisfy the Internal Revenue Service in the event of any future audit of the Tax-Exempt Bonds. All files must be maintained for the life of the Tax-Exempt Bonds plus three years. See IRS FAQs on Record Retention, attached as Appendix E. The records to be maintained by the Tax Compliance Officer and each Grantee, as applicable, are to include:

1. Information and records regarding any use of proceeds of Tax-Exempt Bonds; (State Librarian Tax Compliance Officer);
2. Records reflecting actual expenditures of the proceeds of Tax-Exempt Bonds (each Grantee);
3. Information and records regarding the continued use and ownership of the Bond-Financed Property (each Grantee and Tax Compliance Officer);

4. Any use arrangements affecting the Bond-Financed Property, which result in private business use of any portion of the Bond-Financed Property (each Grantee and Tax Compliance Officer); and

5. Copies of any leases, management contracts, service contracts or other written arrangements with persons other than a state or local governmental unit relating to Bond-Financed Property (each Grantee and Tax Compliance Officer).

Miscellaneous

Training Requirements

The State will provide training for the Tax Compliance Officer and each Tax Compliance Designee and any successor(s) thereto regarding the requirements of these procedures and will periodically provide training for each of such individuals concerning their respective duties under these procedures.

Attachments

Appendix A Bond Financed Programs

Appendix B Private Activity Restrictions on Private Business Use

Appendix C Private Business Use Questionnaire

Appendix D Remedial Actions

Appendix E IRS FAQs on Record Retention

Appendix A

Private Business Use

[bond counsel due diligence chart to be inserted here]

Appendix B

Private Activity Restrictions on Private Business Use

TAB I

PRIVATE ACTIVITY RESTRICTIONS ON PRIVATE BUSINESS USE

GOVERNMENTAL BONDS

Introduction

The Internal Revenue Code of 1986, as amended (the “Code”) limits the amount of proceeds of tax-exempt governmental bonds (including short term obligations such as notes) that can be used for the benefit of private businesses. Section 141 of the Code treats as a taxable private activity bond a bond issued as part of an issue that meets the private business use test and the private security or payment test, or the private loan test. The private business use test is met if the amount of proceeds of bonds that are used in a private business use is more than ten percent of total proceeds. The private security or payment test is met if the payment of debt service on more than 10 percent of the issue is directly or indirectly (i) secured by any interest in property used for a private business use or payments in respect of such property or (ii) derived from payments in respect of property or borrowed money used for a private business use. A five percent limit is used in lieu of a ten percent limit if the private use is unrelated to a governmental use or related but disproportionate to a governmental use. For purposes of Section 141, the term private business includes nonprofit, 501(c)(3) organizations as well as the federal government.

Private Business Use Generally

Private business use can arise from almost any use of tax-exempt bond-financed property by anyone other than a state or local governmental unit (“Governmental Unit”) or members of the general public who are not using the property in the conduct of a trade or business. Examples of uses which can give rise to private business use include use (a) by a person as (i) an owner, (ii) a lessee, (iii) a purchaser of the output of facilities under a “take and pay” or “take or pay” contract, (iv) a purchaser, sponsor or licensee of research and (v) a manager or independent contractor under certain management or professional service contracts, (b) pursuant to an arrangement that conveys (i) special legal entitlements (e.g., an arrangement that conveys priority rights to the use or capacity of the financed property) for beneficial use of the property financed with proceeds of tax exempt debt or (ii) other special economic benefits, (c) use by the United States government and its agencies and instrumentalities and (d) use by nonprofit corporations.

The purpose of this Summary is to assist employees of a Governmental Unit in recognizing uses, actions or other arrangements with respect to tax-exempt bond-financed property which may not comply with the requirements of the Internal Revenue Code of 1986, as amended, and which could jeopardize the tax exempt status of bonds issued to finance such property. It is not exhaustive and may not be relied upon

as legal advice. Before any use, action or other arrangement described herein is commenced, such use, action or other arrangement should be reviewed by bond counsel to the Governmental Unit.

Leases of the Financed Property. Leases and certain other agreements which transfer possession of tax exempt financed property will result in a private business use if the party to whom the property is leased is not a Governmental Unit. Examples include leases of space for book stores and cafeterias.

Priority Rights. Arrangements that convey special legal entitlements (e.g., arrangements that convey priority rights to the use or capacity of the financed property) for control or beneficial use of property financed with proceeds of tax exempt debt are treated as private business uses. Examples of such arrangements are contracts with research companies to set aside space for the testing of new products or arrangements pursuant to which a person which is not an Governmental Unit is entitled to limit, or control charges for, access to all or a portion of tax-exempt bond financed property.

Naming Rights and Sponsorship Payments. Agreements which permit a private company or organization to make payments for the right to have its name or logo used in connection with property financed with tax exempt debt may result in private business use. The rules in this area continue to evolve but “qualified sponsorship payments” should not give rise to a private business use. A qualified sponsorship payment means any payment made by any person engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgement of the sponsor’s name or logo in connection with the activities of the Governmental Unit. Such use or acknowledgement may not include advertising such person’s products or services. The qualified sponsorship payment would not include (a) any payment that is contingent upon attendance at events or (b) any payment that entitles the payor to the use or acknowledgement of the payor’s name or logo in regularly scheduled and printed material published by or on behalf of the Governmental Unit. This would allow donations in exchange for the usual “brass plaque” but call into question arrangements such as the right to name a facility of the Governmental Unit and control how that facility is referred to in publications and press releases.

Research Arrangements. Research conducted under the sponsorship or for the benefit of organizations other than Governmental Units, including research sponsored by any branch of the Federal government, can result in the private business use of any property financed with tax exempt debt which is used in the conduct of the research. The Internal Revenue Service has published guidance on the circumstances under which a research agreement does not result in private business use. The guidance for safe harbor research arrangements is set forth in Rev. Proc. 2007-47 (2007 IRB LEXIS 570; 2007-29 I.R.B. 108) attached hereto as Exhibit 1.

Management and Service Contracts. Both contracts for the management of property financed with tax exempt debt and certain contracts for the provision of services in connection with property financed with tax exempt debt can result in private business use. Contracts which may result in a private business use include management, service, or incentive payment contracts between the Governmental Unit and a service provider under which the service provider provides services involving all, a portion of, or any function of, a facility financed with tax exempt debt. For example, a contract for the provision of management services for an entire facility, and a contract for management services for a specific portion of a facility, such as a cafeteria are each treated as a management contract. However, contracts for services that are solely incidental to the primary function of the property financed with tax exempt debt, such as janitorial services or office equipment repair, are not regarded as management or service contracts for this

purpose. The Internal Revenue Service has published safe harbor guidance on the circumstances under which a management or service agreement does not result in private business use. The guidance is set forth in Rev. Proc. 2016-44 attached hereto as Exhibit 2.

Output Facilities. Occasionally a Governmental Unit will acquire facilities such as co-generation facilities. The sale of output (as distinguished from consumption of the output by the Governmental Unit) from an output type facility can result in a private business use.

Joint Ventures. Joint venture arrangements between a Governmental Unit and persons other than a Governmental Unit may result in private business use. These arrangements need to be examined to see if they are viewed as partnerships for federal tax purposes.

Exclusions from Private Business Use

Incidental Uses. A very limited spectrum of incidental uses are not treated as private business uses if certain conditions are met. Those conditions are: (a) except for vending machines, pay telephones, kiosks and similar uses, the use must not involve the transfer to the private user of possession and control of space that is separated from the other areas of the facility by a physical barrier; (b) the use must not be functionally related to another use of the facility by the same private user; and (c) such incidental uses may not, in the aggregate involve more than 2.5 percent of the facility. Examples of incidental uses include pay telephones, vending machines and advertising displays.

General Public Use. Use of facilities intended for general public use is not considered “use” by nongovernmental persons in a trade or business if such persons use the facilities in their trade or business on the same basis as other members of the public. Use of the financed facilities by organizations such as school groups, church groups, and fraternal organizations and numerous commercial organizations for a short period of time on a rate scale basis will not be considered use by nongovernmental persons in a trade or business if the rights of such a user are only those of a transient occupant rather than the full legal possessory interests of a lessee. Any arrangement that conveys priority rights to the use or capacity of the financed property will be treated as a private business use.

Short Term Uses. Certain short term uses will not be treated as private use. Use by a nongovernmental person is not private use if either:

(i) (A) the term of the use under the arrangement, including all renewal options is not longer than 200 days, and (B) the use of the financed property under the same or similar arrangements is predominantly by natural persons who are not engaged in a trade or business; or

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

(iii) (A) the term of the use under the arrangement, including all renewal options, is not longer than 50 days; and (B) the arrangement is a negotiated arm’s-length arrangement, and compensation under the arrangement is at fair market value.

In addition, in each case the property must not be financed for the principal purpose of providing that property for use by that non-Governmental Unit.

Qualified Improvements. Proceeds of tax exempt bonds that provide a governmentally owned improvement to a governmentally owned building (including its structural components and land functionally related and subordinate to the building) are not used for a private business use if

- (i) The building was placed in service more than 1 year before the construction or acquisition of the improvement is begun;
- (ii) The improvement is not an enlargement of the building or an improvement of interior space occupied exclusively for any private business use;
- (iii) No portion of the improved building or any payments in respect of the improved building secures payment of the tax exempt bonds; and
- (iv) No more than 15 percent of the improved building is used for a private business use.

Measurement of Private Business Use

All private business uses of property financed by a bond issue are aggregated to determine if the limitations have been exceeded. Private business use of property is measured on an average basis over a measurement period that runs from the later of the issue date of the bonds or the date property is placed in service, through the earlier of the last date of the expected economic life of the property or the maturity date of the bonds or refunding bonds. The average percentage of private business use is the average of the percentages of private business during one-year periods within the measurement period. The percentage of private business use for any one-year period is the average private business use for that year, determined by comparing the amount of private business use during that year to the total amount of private business use and governmental use.

EXHIBIT 1

RESEARCH CONTRACT GUIDELINES

Rev. Proc. 2007-47—Operating Guidelines for Research Agreements

(Also Part I, § § 103, 141, 145; 1.141-3, 1.145-2.)

June 26, 2007

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth conditions under which a research agreement does not result in private business use under § 141(b) of the Internal Revenue Code of 1986 (the Code). This revenue procedure also addresses whether a research agreement causes the modified private business use test in § 145(a)(2)(B) of the Code to be met for qualified 501(c)(3) bonds. This revenue procedure modifies and supersedes Rev. Proc. 97-14, 1997-1 C.B. 634.

SECTION 2. BACKGROUND

.01 Private Business Use.

(1) Under § 103(a) of the Code, gross income does not include interest on any State or local bond. Under § 103(b)(1), however, § 103(a) does not apply to a private activity bond, unless it is a qualified bond under § 141(e). Section 141(a)(1) defines “private activity bond” as any bond issued as part of an issue that meets both the private business use and the private security or payment tests. Under § 141(b)(1), an issue generally 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. Under § 141(b)(6)(A), private business use means direct or indirect use in a trade or business carried on by any person other than a governmental unit. Section 150(a)(2) provides that the term “governmental unit” does not include the United States or any agency or instrumentality thereof. Section 145(a) also applies the private business use test of § 141(b)(1) to qualified 501(c)(3) bonds, with certain modifications.

(2) Section 1.141-3(b)(1) of the Income Tax Regulations 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 of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

(3) Section 1.141-3(b)(6)(i) provides generally that an agreement by a nongovernmental person to sponsor research performed by a governmental person may result in private business use of the property used for the research, based on all the facts and circumstances.

(4) Section 1.141-3(b)(6)(ii) provides generally that a research agreement with respect to financed property results in private business use of that property if the sponsor is treated as the lessee or owner of financed property for Federal income tax purposes.

(5) Section 1.141-1(b) provides that the term “governmental person” means a State or local governmental unit as defined in § 1.103-1 or any instrumentality thereof. Section 1.141-1(b) further provides that governmental person does not include the United States or any agency or instrumentality thereof. Section 1.141-1(b) further provides that “nongovernmental person” means a person other than a governmental person.

(6) Section 1.145-2 provides that §§ 1.141-0 through 1.141-15 apply to qualified 501(c)(3) bonds under § 145(a) of the Code with certain modifications and exceptions. (7) Section 1.145-2(b)(1) provides that, in applying §§ 1.141-0 through 1.141-15 to § 145(a) of the Code, references to governmental persons include § 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under § 513(a).

.02 Federal Government rights under the Bayh-Dole Act.

(1) The Patent and Trademark Law Amendments Act of 1980, as amended, 35 U.S.C. § 200 et seq. (2006) (the “Bayh-Dole Act”), generally applies to any contract, grant, or cooperative agreement with any Federal agency for the performance of research funded by the Federal Government.

(2) The policies and objectives of the Bayh-Dole Act include promoting the utilization of inventions arising from federally supported research and development programs, encouraging maximum participation of small business firms in federally supported research and development efforts, promoting collaboration between commercial concerns and nonprofit organizations, ensuring that inventions made by nonprofit organizations and small business firms are used in a manner to promote free competition and enterprise, and promoting the commercialization and public availability of inventions made in the United States by United States industry and labor.

(3) Under the Bayh-Dole Act, the Federal Government and sponsoring Federal agencies receive certain rights to inventions that result from federally funded research activities performed by non-sponsoring parties pursuant to contracts, grants, or cooperative research agreements with the sponsoring Federal agencies. The rights granted to the Federal Government and its agencies under the Bayh-Dole Act generally include, among others, nonexclusive, nontransferable, irrevocable, paid-up licenses to use the products of federally sponsored research and certain so-called “march-in rights” over licensing under limited circumstances. Here, the term “march-in rights” refers to certain rights granted to the sponsoring Federal agencies under the Bayh-Dole Act, 35 U.S.C. § 203 (2006), to take certain actions, including granting licenses to third parties to ensure public benefits from the dissemination and use of the results of federally sponsored research in circumstances in which the original contractor or assignee has not taken, or is not expected to take within a reasonable time, effective steps to achieve practical application of the product of that research. The general purpose of these rights is to ensure the expenditure of Federal research funds in accordance with the policies and objectives of the Bayh-Dole Act.

SECTION 3. DEFINITIONS

.01 Basic research, for purposes of § 141 of the Code, 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.

.02 *Qualified user* means any State or local governmental unit as defined in § 1.1031 or any instrumentality thereof. The term also includes a § 501(c)(3) organization if the financed property is not used in an unrelated trade or business under § 513(a) of the Code. The term does not include the United States or any agency or instrumentality thereof.

.03 *Sponsor* means any person, other than a qualified user, that supports or sponsors research under a contract.

SECTION 4. CHANGES

This revenue procedure modifies and supersedes Rev. Proc. 97-14 by making changes that are described generally as follows:

.01 Section 6.03 of this revenue procedure modifies the operating guidelines on cooperative research agreements to include agreements regarding industry or federally sponsored research with either a single sponsor or multiple sponsors.

.02 Section 6.04 of this revenue procedure provides special rules for applying the revised operating guidelines under section 6.03 of this revenue procedure to federally sponsored research. These special rules provide that the rights of the Federal Government and its agencies mandated by the Bayh-Dole Act will not cause research agreements to fail to meet the requirements of section 6.03, upon satisfaction of the requirements of section 6.04 of this revenue procedure. Thus, under the stated conditions, such rights themselves will not result in private business use by the Federal Government or its agencies of property used in research performed under research agreements. These special rules do not address the use by third parties that actually receive more than non-exclusive, royalty-free licenses as the result of the exercise by a sponsoring Federal agency of its rights under the Bayh-Dole Act, such as its march-in rights.

SECTION 5. SCOPE

This revenue procedure applies when, under a research agreement, a sponsor uses property financed with proceeds of an issue of State or local bonds subject to § 141 or § 145(a)(2)(B) of the Code

SECTION 6. OPERATING GUIDELINES FOR RESEARCH AGREEMENTS

.01 *In general.* If a research agreement is described in either section 6.02 or 6.03 of this revenue procedure, the research agreement itself does not result in private business use. In applying the operating guidelines under section 6.03 of this revenue procedure to federally sponsored research, the special rules under section 6.04 of this revenue procedure (regarding the effect of the rights of the Federal Government and its agencies under the Bayh-Dole Act) apply.

.02 *Corporate-sponsored research.* A research agreement relating to property used for basic research supported or sponsored by a sponsor is described in this section 6.02 if any license or

other use of resulting technology by the sponsor is permitted only on the same terms as the recipient would permit that use by any unrelated, non-sponsoring party (that is, the sponsor must pay a competitive price for its use), and the price paid for that use must be determined at the time the license or other resulting technology is available for use. Although the recipient 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.

.03 Industry or federally-sponsored research agreements. A research agreement relating to property used pursuant to an industry or federally-sponsored research arrangement is described in this section 6.03 if the following requirements are met, taking into account the special rules set forth in section 6.04 of this revenue procedure in the case of federally sponsored research —

- (1) A single sponsor agrees, or multiple sponsors agree, to fund governmentally performed basic research;
- (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) Title to any patent or other product incidentally resulting from the basic research lies exclusively with the qualified user; and
- (4) The sponsor or sponsors are entitled to no more than a nonexclusive, royalty-free license to use the product of any of that research.

.04 Federal Government rights under the Bayh-Dole Act. In applying the operating guidelines on industry and federally-sponsored research agreements under section 6.03 of this revenue procedure to federally sponsored research, the rights of the Federal Government and its agencies mandated by the Bayh-Dole Act will not cause a research agreement to fail to meet the requirements of section 6.03, provided that the requirements of sections 6.03(2), and (3) are met, and the license granted to any party other than the qualified user to use the product of the research is no more than a nonexclusive, royalty-free license. Thus, to illustrate, the existence of march-in rights or other special rights of the Federal Government or the sponsoring Federal agency mandated by the Bayh-Dole Act will not cause a research agreement to fail to meet the requirements of section 6.03 of this revenue procedure, provided that the qualified user determines the subject and manner of the research in accordance with section 6.03(2), the qualified user retains exclusive title to any patent or other product of the research in accordance with section 6.03(3), and the nature of any license granted to the Federal Government or the sponsoring Federal agency (or to any third party nongovernmental person) to use the product of the research is no more than a nonexclusive, royalty-free license.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97-14 is modified and superseded.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for any research agreement entered into, materially modified, or extended on or after June 26, 2007. In addition, an issuer may apply this revenue procedure to any research agreement entered into prior to June 26, 2007.

SECTION 9. DRAFTING INFORMATION

The principal authors of this revenue procedure are Vicky Tsilas and Johanna Som de Cerff of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact Johanna Som de Cerff at (202) 622-3980 (not a toll-free call).

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EXHIBIT 2

MANAGEMENT CONTRACT GUIDELINES

Rev. Proc. 2016-44

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.

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 section 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 use.

.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 the 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. 97-13, 1997-1 C.B. 632, modified by Rev. Proc. 2001-39, 2001-2 C.B. 38, and amplified by Notice 2014-67, 2014-46 I.R.B. 822, sets forth conditions under which a management contract does not result in private business use under § 141 or cause the modified private business use test under § 145(a)(2)(B) to be met. These conditions include constraints on net profits arrangements, the permitted term of the management contract, the types of compensation, and the relationship between the parties.

.11 Rev. Proc. 97–13 as originally issued (the original safe harbors) specifies various permitted terms of contracts that depend on the extent to which the compensation is a fixed amount (that is, the greater the percentage of fixed compensation, the longer the permitted term of the management contract). For example, the original safe harbors permit (i) contracts of up to 15 years if at least 95 percent of the compensation consists of a periodic fixed fee, and (ii) contracts of two to five years if greater percentages of the compensation consist of variable fees, depending on the particular type of variable fee. Subsequently, in Notice 2014–67, the Treasury Department and the Internal Revenue Service expanded these safe harbors to address certain developments involving accountable care organizations after the enactment of the Patient Protection and Affordable Care Act, Pub. L. 111–148, 124 Stat. 119 (Affordable Care Act), and also to allow a broader range of variable compensation arrangements for shorter-term management contracts of up to five years. This revenue procedure builds upon the amplifications in Notice 2014–67 by taking a more flexible and less formulaic approach toward variable compensation for longer-term management contracts of up to 30 years. The safe harbor under this revenue procedure generally permits any type of fixed or variable compensation that is reasonable compensation for services rendered under the contract. This revenue procedure includes constraints on net profits arrangements and the relationship between the parties (as under the original safe harbors), but applies a more principles-based approach focusing on governmental control over projects, governmental bearing of risk of loss, economic lives of managed projects, and consistency of tax positions taken by the service provider.

SECTION 3. SCOPE

This revenue procedure applies to a management contract (as defined in section 4.02 of this revenue procedure) involving managed property (as defined in section 4.03 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 under § 145.

SECTION 4. DEFINITIONS

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

.01 *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.

.02 *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).

.03 *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.

.04 *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 501(c)(3) organization with respect to its activities which do not constitute an unrelated trade or business, determined by applying § 513(a).

.05 *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.

.06 *Unrelated parties* means persons other than a related party (as defined in § 1.150-1(b)) or 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 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. Further, solely for purposes of determining whether the amount of the compensation meets the requirements of this section 5.02(2), any reimbursements of actual and direct expenses paid by the service provider to unrelated parties are disregarded as 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 substance, 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.

.03 Term of the contract and revisions. The term of the contract, including all renewal options (as defined in § 1.141-1(b)), is 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, 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 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, 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 the service provider charge rates that are reasonable and customary as specifically determined by an independent third party.

.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, upon 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 take any depreciation or amortization, 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.* As a 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 in the aggregate is vested in the directors, officers, shareholders, partners, members, and employees of the service provider;

(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 defined in § 1.150-1(b)).

(3) For purposes of section 5.07(2) of this revenue procedure, the phrase "service provider" includes 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 consists of all or a portion of that project and that meets the requirements of this section 5 does not result in private business use (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. 97-13 and Rev. Proc. 2001-39 are modified and superseded. Section 3.02 of Notice 2014-67 is modified and superseded. All other sections of Notice 2014-67 remain in effect.

SECTION 7. DATE OF APPLICABILITY

The safe harbors in this revenue procedure apply to any management contract that is entered into on or after August 22, 2016, and an issuer may apply these safe harbors to any management contract that was entered into before August 22, 2016. 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).

Appendix C

**PRIVATE BUSINESS USE QUESTIONNAIRE
STATE OF NEW JERSEY GENERAL OBLIGATION BONDS**

TO: [NAME]
[TITLE]

FROM: .

DATE: [CURRENT DATE]

RE: Use of Tax-Exempt Bond-Financed Property

In order to maintain the tax exempt status of certain General Obligation Bonds of the State of New Jersey which have been issued to finance career and technical education program capacity at county colleges for the benefit certain county colleges (each, a “Grantee”), the ownership and certain uses of the Bond-Financed Property must be monitored and recorded. In general, the ownership and use of the Bond-Financed Property must be monitored and recorded from the date of issue of the bonds until the earlier of the end of the expected life of the property, or the final maturity date of any bonds issued to finance the property. Because it is the Internal Revenue Service’s position that records be maintained until 3 years after the final maturity date of any bonds issued to finance (or refinance) the property, staff will be asked to update these records for changes in the use or ownership of the property.

Attached is a schedule with a brief description of property financed with proceeds of tax exempt bonds. Please review your records and respond to each of the questions for the Bond-Financed Property listed, including both the present use of the property and any past uses of it. Please do not skip questions. If you are uncertain how to respond to a particular question please provide a brief explanation in the space immediately following the question. If necessary, one of my staff members will contact you for clarification. Reference can be made to Appendix A, Private Activity Restrictions on Private Business Use – Governmental Bonds of the Post-Issuance Compliance Guide, for a brief description of types of private use.

We recognize that some of the requested information and records may not be available. However, your cooperation is necessary in order to collect as much of this information as possible.

SCHEDULE

USE OF TAX EXEMPT BOND BOND-FINANCED PROPERTY

Description of property: [Description] (the “Bond-Financed Property”)

Location: [facility name]

Bond Issue: [name of bonds]

Survey Date: [current date]

I. Familiarity with Uses

1.1 My familiarity with, and/or the records with respect to, the uses made of the Bond-Financed Property, dates back to _____ [insert date]

1.2 For information on uses of the Bond-Financed Property prior to the date set forth in Section 1.1, I suggest contacting _____.

II. Ownership and Use of the Bond-Financed Property.

2.1 When was the Bond-Financed Property placed in service? _____

2.2 Is the Bond-Financed Property still owned by the Grantee? Yes No

2.3 If, no, on what day was the Bond-Financed Property disposed of? _____.
What were the terms of the disposition?

2.4 Is the Bond-Financed Property still in use? Yes No If No, please explain when it stopped being used and what its current state is.

2.5 Is the Bond-Financed Property still being used for its original purpose? Yes
No If No, please explain how it is being used.

III. Leases of the Bond-Financed Property.

3.1 Has any portion of the Bond-Financed Property been leased to or been the subject of a possessory interest, such as a license in, any person? YES NO

3.2 If the answer to the preceding question is yes, describe the nature and the extent of all such interests, including the lease payments, and identify the persons or organizations to whom such interests have been given.

IV. Priority Rights

4.1 Has any portion of the Bond-Financed Property been the subject of an arrangement with a person other than a Governmental Unit for priority use or for use of certain capacity of the Bond-Financed Property? YES NO

4.2 If the answer to the preceding question is Yes, describe the nature and the extent of all such interests, including any payments, and identify the persons or organizations to whom such interests have been given.

4.3 Has any portion of the Bond-Financed Property been used in the testing of products under a contract with a person other than a Governmental Unit? YES NO

4.4 If the answer to the preceding question is Yes, describe the nature and the extent of all such arrangements, and identify the persons or organizations with whom such arrangements have been entered into.

V. Naming Rights or Sponsorship Agreements.

5.1 Has any portion of the Bond-Financed Property been the subject of a contract or other arrangement with anyone pursuant to which the that person will make a payment to the Grantee in return for the right to have its name or logo used in connection with the Bond-Financed Property or any portion of it? YES NO If Yes, please provide details of the arrangement.

VI. Research.

6.1 Has any portion of the Bond-Financed Property been used in research sponsored by anyone other than a Governmental Unit? (Note that the federal government is not a Governmental Unit.) YES NO

6.2 If Yes, please describe the nature and the extent of all such arrangements, and identify the persons or organizations with whom such arrangements have been entered into. Please attach a copy of any contract or arrangement relating to such research.

VII. Management Agreements and Service Agreements.

7.1 Has any portion of the Bond-Financed Property been used in connection with any type of service contract or management contract described below?

(a) A contract with a non-employee group, other than a Governmental Unit, to provide services to, or manage any function of, the Grantee? YES NO. If Yes, identify the person or organization that is a party to the contract.

(b) A contract with an employee to provide services to, or manage any function of, the Grantee, where such contract contains an incentive compensation

arrangement? YES NO If Yes, identify the person or organization that is a party to the contract.

(c) A contract with a person other than a Governmental Unit to provide services, such as food services to the Grantee? YES NO If Yes, identify the person or organization that is a party to the contract.

7.2 For each contract identified in Section 7.1 answer the following questions, which track the safe harbor requirements of Rev. Proc. 2016-44. Identify the answer by the name of the contracting party. Attach a copy of the contract to this questionnaire response.

(a) What is or was the term of the contract/agreement, including all renewal options?

(b) Is or was any of the compensation of the manager/service provider based on a share of net profits? YES NO Does the contract impose upon the service provider the burden of bearing any share of net losses from the operation of the managed property? YES NO

(c) What is or was the annual compensation arrangement for the manager/service provider?

(d) Does the Grantee exercise a significant degree of control over the use of the managed property? YES NO 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, 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 the service provider charge rates that are reasonable and customary as specifically determined by an independent third party.

(e) Does the governing body of the Grantee include the manager/service provider or any of its directors, officers, shareholders, or employees? YES NO

(f) Does the governing body of the manager/service provider include any of the Grantee's governing body, officers, or employees? YES NO

(g) Is the chief executive officer of either the Grantee or the manager/service provider a member of the governing body of the other? YES NO

(h) Does the manager/service provider have any role or relationship with the Grantee that might limit the Grantee's ability to exercise its rights (including cancellation rights) under the contract? YES NO This would include a limitation on the Grantee's right to compete with the service provider; a requirement that the Grantee purchase equipment, goods, or services from the service provider; or a requirement that the Grantee pay liquidated damages for cancellation of the contract.

(i) Will the members of the governing body of the Grantee own any interest in the management company? YES NO

IX Joint Ventures.

9.1 Has any portion of the Bond-Financed Property been used in any joint venture arrangement with any person other than a Governmental Unit? YES NO If Yes, please provide details of the arrangement.

Date: _____

By: _____
Name:
Title:

Appendix D

Remedial Actions

REMEDIAL ACTIONS GOVERNMENTAL BONDS

Introduction

The Internal Revenue Code of 1986, as amended (the “Code”) limits the amount of proceeds of tax-exempt governmental bonds that can be used for the benefit of private businesses. Section 141 of the Code treats as a taxable private activity bond a bond issued as part of an issue that meets the private business use test and the private security or payment test, or the private loan test. The private business use test is met if the amount of proceeds of bonds that are used in a private business use is more than ten percent of total proceeds. The private security or payment test is met if the payment of debt service on more than 10 percent of the issue is directly or indirectly (i) secured by any interest in property used for a private business use or payments in respect of such property or (ii) derived from payments in respect of property or borrowed money used for a private business use. A five percent limit is used in lieu of a ten percent limit if the private use is unrelated to a governmental use or related but disproportionate to a governmental use. For purposes of Section 141, the term private business includes nonprofit, 501(c)(3) organizations as well as the federal government.

Deliberate Action

The Regulations promulgated by the Internal Revenue Service (“IRS”) under Section 141 of the Code, specifically provide that bonds will be treated as private activity bonds if the issuer takes a deliberate action subsequent to the issue date that causes the tests for a private activity bond to be met. An issuer cannot rely merely on its expectations on the date of issuance to avoid jeopardizing the status of its bonds as governmental bonds. A deliberate action is any action taken by an issuer, but not including an action, such as a condemnation, that would be treated as an involuntary or compulsory conversion under Section 1033 of the Code, or an action that is taken in response to a regulatory directive made by the federal government. A deliberate action is deemed to occur when the issuer enters into a binding contract with a nongovernmental person for use of the financed property that is not subject to any material contingencies. In most cases, material conditions to closing a transaction will be treated as material contingencies so that the date of deliberate action will be the date disposition proceeds are received.

Conditions to Remedial Action

Under the Regulations, in order to take a remedial action to preserve the tax-exempt status of interest on bonds, the following conditions must be met:

- (1) *Reasonable expectations test.* The issuer must reasonably have expected on the issue date that neither the private business test nor the private loan test would be met. The period of time that has elapsed since the bonds were issued will be a factor in evaluating the reasonableness of expectations. Under certain conditions an expectation on the issue date to take a deliberate action that would cause one of the tests to be met (e.g., a sale of the project) will be disregarded if the issuer expected on the issue date that the financed property would be used for a qualified purpose for a substantial period before such action, the issuer is required to redeem all nonqualifying bonds (without regard to the amount of disposition proceeds) within 6 months of the action, the redemption meets all the remedial action conditions (described below) and there was no arrangement on the date of issue with a nongovernmental person or a non-501 (c)(3) organization with respect to the activity;
- (2) *Maturity not unreasonably long.* The term of the bond *issue* must not be longer than is reasonably necessary for the governmental purpose of the issue. This requirement is met under a safe harbor if the weighted average maturity of the bonds is not greater than 120 percent of the average reasonably expected economic life of the financed property as of the issue date.
- (3) *Fair market value consideration.* The terms of any change in use or loan arrangement are bona fide and arms-length and the new user pays fair market value for the use of the financed property. For this purpose fair market value may take into account restrictions on the use of the financed property that serve a bona fide governmental purpose.
- (4) *Disposition proceeds treated as gross proceeds for arbitrage purposes.* Any disposition proceeds must be treated as gross proceeds for arbitrage purposes. This will require that the issuer meet yield restriction or rebate requirements with respect to these funds. The issuer may treat the date of receipt of the proceeds as an issue date for purposes of eligibility for temporary periods and exemptions from rebate.
- (5) *Proceeds expended on a governmental purpose.* Except where a redemption or defeasance remedial action is taken, the proceeds must have been expended on a governmental purpose before the date of the deliberate action.

Effect of Remedial Action

A remedial action is treated as curing a change in ownership or a private use or private loan of proceeds, thereby preserving the tax-exempt status of existing bonds. It does not cure a failure to meet the private payment or security interest limitation. In the case of advance refunding bonds, remedial action taken with respect to the refunding bonds proportionally reduces the amount of proceeds of the refunded bonds that is taken into account under the private business use or loan test. In other words, the remedial action taken with respect to the refunding bonds proportionally “cures” the refunded bonds.

Disposition Proceeds and Nonqualified Bonds

Generally, in order to take one of the remedial actions it is necessary to know what the disposition proceeds are and how much of the disposition proceeds are allocated to particular issues. Disposition proceeds arise in a sale, exchange or other disposition of bond-financed property. Disposition proceeds do not arise, however, in an installment sale arrangement and the bond

proceeds remain allocated to the transferred property in that case. This distinction becomes important when determining what remedial action is appropriate.

In the case of property financed from different sources of funding, the disposition proceeds are first allocated to the outstanding bonds (both taxable and tax-exempt) that financed the property in proportion to the principal amount of the outstanding bonds. Disposition proceeds may not be allocated to bonds that are no longer outstanding or to revenues if the disposition proceeds are not greater than the total principal amount of the outstanding bonds allocable to that property. Only amounts in excess of that total may be allocated to another source.

Under the Regulations, the amount of nonqualified bonds that arise from a deliberate action is a percentage of the outstanding bonds equal to the highest percentage of private business use in any one-year period commencing with the deliberate action. Allocations to nonqualified bonds must be made on a pro-rata basis except that for purposes of the redemption or defeasance remedial action the issuer may treat bonds with longer maturities as the nonqualified bonds. This treatment would be necessary, for example, where the bonds are required to be called in inverse order of maturity rather than pro rata.

Permitted Remedial Actions

Redemptions or Defeasance

The first remedial action is redemption or defeasance which is available in the case of a deliberate action taking the form of a sale, lease or nonqualified management contract or other action. This remedial action probably will be the most frequently used remedial action in sale transactions. Under this remedial action, other than in the case of an exclusively cash disposition, all nonqualified bonds must be redeemed within 90 days of the deliberate action. Proceeds of tax-exempt bonds may not be used to effect the redemption unless they are proceeds of qualified private activity bonds (e.g., exempt facility bonds) taking into account the purchaser's use. If the bonds are not currently redeemable, a defeasance escrow must be established for all nonqualified bonds within 90 days of the deliberate action and notice of defeasance must be furnished to the Commissioner of Internal Revenue within 90 days of the escrow establishment. Defeasance is only available as a remedial action, however, if the period between the issue date and the first call date is not more than 10½ years. Thus, for example, if a bond-financed building is leased to a private for-profit entity, all tax-exempt bonds that financed that building would have to be redeemed or defeased within 90 days.

In the case of a disposition, a sale, exclusively for cash, if the disposition proceeds are less than the amount of the nonqualified bonds, only an amount equal to the disposition proceeds must be used to redeem or defease a pro rata portion of the nonqualified bonds.

Alternative Use of Disposition Proceeds

In the case of a disposition exclusively for cash, the issuer may, in lieu of redeeming or defeasing bonds, expend the disposition proceeds on other qualifying facilities. The issuer must reasonably expect to expend the disposition proceeds within two years of the deliberate action and must treat the disposition proceeds as bond proceeds for purposes of Section 141. The issuer must not use such proceeds in a manner that would cause the private business tests or the private loan test to be met. Furthermore the issuer must not take any action subsequent to the date of deliberate action to

cause either of these tests to be met. This requirement precludes the issuer from repeatedly taking advantage of the remedial action provisions with respect to the same bond issue. If the issuer does not use all of the disposition proceeds for an alternative use it must use the remaining proceeds to redeem or defease bonds as described above.

If the disposition proceeds are to be used by a 501(c)(3) organization, the nonqualified bonds must, in addition, be treated as reissued and must, beginning on the date of the deliberate action, meet all the requirements for qualified 501(c)(3) bonds. For example, this requires that a TEFRA hearing be held and approval obtained with respect to the new uses of proceeds before the date of the deliberate action.

Alternative Use of Facility

The third remedial action, alternative use of a facility, permits the bonds to remain outstanding if the facility is now used for a qualifying purpose and the nonqualified bonds are treated as reissued as of the date of deliberate action as qualified bonds, e.g., qualified 501(c)(3) bonds or qualified exempt facility bonds. The nonqualified bonds must satisfy all the requirements for that particular type of issue from the date of deliberate action, including the volume cap limitation of Section 146 of the Code, if applicable. The Regulations specifically provide, however, that the used property limitation of Section 147 will not apply. In the case of exempt facility bonds, and other non-501(c)(3) qualified bonds, the interest will be treated as a preference item for alternative minimum tax (“AMT”) purposes (see discussion below). This remedial action is not available if the deliberate action involves a disposition to a purchaser who finances the purchase with tax-exempt bonds.

The Regulations provide that any disposition proceeds, including proceeds from an installment sale, must be used to pay debt service on the bonds on the next available payment date or within 90 days of receipt, be deposited into a defeasance escrow, yield restricted and used to pay debt service on the bonds on the next available payment date. The Regulations do not address under this remedial action alternative how to deal with the change in status of interest from non-AMT to AMT. This is addressed, however, in *Rev. Proc. 97-15*, discussed below.

Rev. Proc. 97-15

Rev. Proc. 97-15 provides a program under which an issuer may request a closing agreement as a remedial action to prevent interest on outstanding bonds from being included in gross income or to prevent interest from being treated as an item of tax preference for AMT purposes as a result of a subsequent action. Closing agreements under this program will not resolve any other issue, nor will they preclude an examination by the IRS of any matters not addressed in the closing agreement. These closing agreements are not available with respect to an issue of outstanding bonds that is under examination by the IRS.

Closing Agreement as to Exclusion from Gross Income

A number of procedural and substantive conditions to obtaining a closing agreement are set forth in Rev. Proc. 97-15. In addition, in the case of a closing agreement that provides that interest will not be included in gross income, the issuer must agree to redeem the outstanding bonds at the next redemption date. The issuer also must pay a closing agreement amount equal to the sum of the present value amounts determined by multiplying the amount of interest accruing on the

nonqualified bonds in each year by .29 and present valuing each such number from April 15 of the year after the interest accrues to the date on which the payment is sent to the IRS, using as the discount rate the taxable applicable federal rate for a term equal to the period from the subsequent action to the redemption date.

Alternative Minimum Tax Closing Agreement

In the case of a closing agreement that provides that the interest will not be treated as an item of tax preference, among other conditions, the issuer must pay an amount equal to the sum of certain present value amounts. These amounts are determined by multiplying the principal amount of the nonqualified bonds that will be outstanding on January 1 in each calendar year beginning in the year of the subsequent action and ending the first calendar year in which the bonds will no longer be outstanding, by .0014 and present valuing each such number from April 15 of the year following each such calendar year to the date of payment to the IRS, using the applicable federal rate for the period specified in the closing agreement as the discount rate.

VCAP

The IRS has adopted procedures for its Voluntary Closing Agreement Program (“VCAP”) under which issuers of tax exempt bonds can voluntarily resolve violations of the Code or Regulations on behalf of their bondholders or themselves through closing agreements with the IRS. These procedures are set forth in Internal Revenue Manual 7.2.3.1. If a deliberate action has occurred that cannot be remedied with a remedial action, a VCAP should be considered.

Appendix E

IRS FAQ's

Tax Exempt Bond FAQs Regarding Record Retention Requirements

- During the course of an examination, IRS Tax Exempt Bonds (TEB) agents will request all material records and information necessary to support a municipal bond issue's compliance with section 103 of the Internal Revenue Code. The following information is intended solely to answer frequently asked questions concerning how the broad record retention requirements under section 6001 of the Code apply to tax-exempt bond transactions. Although this document provides information with respect to many of the concerns raised by members of the municipal finance industry about record retention, it is not to be cited as an authoritative source on these requirements. TEB recommends that issuers and other parties to tax-exempt bond transactions review section 6001 of the Code and the corresponding Income Tax Regulations in consultation with their counsel.

- These frequently asked questions and answers are provided for general information only and should not be cited as any type of legal authority. They are designed to provide the user with information required to respond to general inquiries. Due to the uniqueness and complexities of Federal tax law, it is imperative to ensure a full understanding of the specific question presented, and to perform the requisite research to ensure a correct response is provided.

- The freely available [Adobe Acrobat Reader](#) software is required to view, print, and search the questions and answers listed below.

Why keep records with respect to tax-exempt bond transactions?

- Section 6001 of the Internal Revenue Code provides the general rule for the proper retention of records for federal tax purposes. Under this provision, every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Section 1.6001-1(a) of the Income Tax Regulations amplifies this general rule by providing that any person subject to income tax, or any person required to file a return of information with respect to income, must keep such books and records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by that person in any return of such tax or information.

- The IRS regularly advises *taxpayers* to maintain sufficient records to support their tax deductions, credits and exclusions. In the case of a tax-exempt bond transaction, the primary taxpayers are the beneficial holders of the bonds. However, in most cases, the beneficial holders of tax-exempt bonds will not have any records to support their exclusion of the interest paid on those bonds. Instead, these

records will generally be found in the bond transcript and the books and records of the issuer, the conduit borrower, and other participants to the transaction. Therefore, in order to ensure the continued exclusion of interest by the beneficial holders, it is important that the issuer, the conduit borrower and other participants retain sufficient records to support the continued exclusion being taken by the beneficial holders of the bonds. Pursuant to this statutory regime, IRS agents conducting examinations of tax-exempt bond transactions will look to these parties to provide books, records, and other information documents supporting the bonds continued compliance with federal tax requirements.

- Additionally, in the case of many private activity bonds, the conduit borrowers are also primary taxpayers. For instance, the conduit borrower will generally deduct the interest indirectly paid on the bond issue through the loan documents. Conduit borrowers are also often entitled to claim depreciation deductions for bond-financed property. Consequently, conduit borrowers should maintain sufficient records to support their interest deductions, depreciation deductions or other tax deductions, exclusions or credits related to the tax-exempt bond issue.
- Moreover, issuers and conduit borrowers should retain sufficient records to show that all tax-exempt bond related returns submitted to the IRS are correct. Such returns include, for example, IRS Forms 8038, 8038-G, 8038-GC, 8038-T, and 8038-R.
- In addition to the general rules under section 6001, issuers and conduit borrowers are subject to specific recordkeeping requirements imposed by various other Code sections and regulations. For example, section 1.148-5(d)(6)(iii)(E) of the arbitrage regulations requires that an issuer retain certain records necessary to qualify for the safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.

Who may maintain records?

- Read together, section 6001 of the Code and section 1.6001-1(a) of the Regulations apply to taxpayers and persons filing tax returns, including returns related to tax-exempt bond transactions (i.e., Forms 8038, 8038-G, 8038-GC, 8038-T, 8038-R, 8328, 8703). This encompasses several parties to the bond transaction including:
 1. issuers as the party responsible for satisfying the filing requirements under section 149(e) of the Code;
 2. conduit borrowers for deductions taken for payment of interest on outstanding bonds or depreciation of bond-financed facilities; and
 3. bondholders, lenders, and lessors as recipients of exempt income from the interest paid on the bonds.
- Since many of the same records may be examined to verify, for example, both the tax-exempt status of the bonds and the interest deductions of the conduit borrower, it is advisable for the bond documents to specify which party will bear the responsibility for maintaining the basic records relating to a bond transaction. Additional parties may also be responsible for maintaining records

under contract with any of the parties named above. For example, a trustee may agree to maintain certain records pursuant to the trust indenture.

What are the basic records that should be retained?

• Although the required records to be retained depend on the transaction and the requirements imposed by the Code and the regulations, 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).

Are these the only records that need to be maintained?

• No, the list above is very general and only highlights the basic records that are typically material to many types of tax-exempt bond financings. Each transaction is unique and may, accordingly, have other records that are material to the requirements applicable to that financing. The decision as to whether any particular record is material must be made on a case-by-case basis and could take into account a number of factors, including, for instance, the various expenditure exceptions. Moreover, certain records may be necessary to support information related to certain requirements applicable to specific types of qualified private activity bonds. With respect to single and multifamily housing bonds as well as small issue industrial development bonds, examples of such additional material records include:

•

Single Family Housing Bonds	<ul style="list-style-type: none"> • Documents evidencing that at least 20% of proceeds were available for owner financing
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	<p>of targeted area residences.</p> <ul style="list-style-type: none"> • Documentation evidencing proper notification of each mortgagor of potential liability of the mortgage subsidy recapture tax.
Multi-Family Housing Bonds	<ul style="list-style-type: none"> • Documentation evidencing that the facility is not used on a transient basis. • Documentation evidencing compliance with the income set-aside requirements. • Documentation evidencing timely correction, if any, of noncompliance with the income set-aside requirements.
Small Issue Industrial Development Bonds	<ul style="list-style-type: none"> • Documentation evidencing compliance with the \$10,000,000 limitation on the aggregate face amount of the issue. • Documentation evidencing that no test-period beneficiary has been allocated more than \$40,000,000 in bond proceeds.

In what format must the records be kept?

- All records should be kept in a manner that ensures their complete access to the IRS for so long as they are material. While this is typically accomplished through the maintenance of hard copies, taxpayers may keep their records in an electronic format if certain requirements are satisfied.
- Rev. Proc. 97-22, 1997-1 C.B. 652 provides guidance to taxpayers that maintain books and records by using an electronic storage system that either images their hardcopy (paper) books and records, or transfers their computerized books and records, to an electronic storage media. Such a system may also include reasonable data compression or formatting technologies so long as the requirements of the revenue procedure are satisfied. The general requirements for an electronic storage system of

taxpayer records are provided in section 4.01 of Rev. Proc. 97-22. A summary of these requirements is as follows:

1. The system must ensure an accurate and complete transfer of the hardcopy books and records to the electronic storage system and contain a retrieval system that indexes, stores, preserves, retrieves, and reproduces all transferred information.
2. The system must include reasonable controls and quality assurance programs that (a) ensure the integrity, accuracy, and reliability of the system; (b) prevent and detect the unauthorized creation of, addition to, alteration of, deletion of, or deterioration of electronically stored books and records; (c) institute regular inspections and evaluations; and (d) reproduce hardcopies of electronically stored books and records that exhibit a high degree of legibility and readability.
3. The information maintained in the system must be cross-referenced with the taxpayer's books and records in a manner that provides an audit trail to the source document(s).
4. The taxpayer must maintain, and provide to the Service upon request, a complete description of the electronic storage system including all procedures relating to its use and the indexing system.
5. During an examination, the taxpayer must retrieve and reproduce hardcopies of all electronically stored books and records requested by the Service and provide the Service with the resources necessary to locate, retrieve, read and reproduce any electronically stored books and records.
6. The system must not be subject, in whole or in part, to any agreement that would limit the Service's access to and use of the system.
7. The taxpayer must retain electronically stored books and records so long as their contents may become material in the administration of federal tax law.

How long should records be kept?

- Section 1.6001-1(e) of the Regulations provides that records should be retained for so long as the contents thereof are material in the administration of any internal revenue law. With respect to a tax-exempt bond transaction, the information contained in certain records support the exclusion from gross income taken at the bondholder level for both past and future tax years. Therefore, as long as the bondholders are excluding from gross income the interest received on account of their ownership of the tax-exempt bonds, certain bond records will be material. Similarly, in a conduit financing, the information contained in the bond records is necessary to support the interest deduction taken by the conduit borrower for both past and future tax years for its payment of interest on the bonds.
- To support these tax positions, material records should *generally* be kept for as long as the bonds are outstanding, plus 3 years after the final redemption date of the bonds. This rule is consistent with the specific record retention requirements under section 1.148-5(d)(6)(iii)(E) of the arbitrage regulations.
- Certain federal, state, or local record retention requirements may also apply.

How does this general rule apply to refundings?

- For certain federal tax purposes, a refunding bond issue is treated as replacing the original new money issue. To this end, the tax-exempt status of a refunding issue is dependent upon the tax-exempt status of the refunded bonds. Thus, certain material records relating to the original new money issue and all material records relating to the refunding issue should be maintained until 3 years after the final redemption of both bond issues.

What happens if records aren't maintained?

- During the course of an examination, TEB agents will request material records and information in order to determine whether a tax-exempt bond transaction meets the requirements of the Code and regulations. If these records have not been maintained, then the issuer, conduit borrower or other party may have difficulty demonstrating compliance with all federal tax law requirements applicable to that transaction. A determination of noncompliance by the IRS with respect to a bond issue can have various outcomes, including a determination that the interest paid on the bonds should be treated as taxable, that additional arbitrage rebate may be owed, or that the conduit borrower is not entitled to certain deductions.
- Additionally, a conduit borrower who fails to keep adequate records may also be subject to an accuracy-related penalty under section 6662 of the Code on the underpayment of tax attributable to any denied deductions. Section 6662 of the Code imposes a penalty on any portion of an underpayment of tax required to be shown on a return that is attributable to one of several factors, including negligence or disregard of rules or regulations. Section 1.6662-3(b)(1) of the Regulations provides that negligence includes any failure by the taxpayer to keep adequate books and records or to substantiate items properly. Under section 6662(a) of the Code, the penalty is equal to 20 percent of the portion of the underpayment of tax attributable to the negligence. Section 6664(c)(1) provides an exception to the imposition of accuracy-related penalties if the taxpayer shows that there was reasonable cause for the underpayment and that the taxpayer acted in good faith.

Can a failure to properly maintain records be corrected?

- Yes, a failure to properly maintain records can be corrected through the Tax Exempt Bonds Voluntary Closing Agreement Program (TEB VCAP). This program provides an opportunity for state and local government issuers, conduit borrowers, and other parties to a tax-exempt bond transaction to voluntarily come forward to resolve specific matters through closing agreements with the IRS. For example, TEB Compliance and Program Management has resolved arbitrage rebate concerns in cases where issuers have approached the IRS and reported a failure to retain sufficient records to determine, precisely, the correct amount of arbitrage rebate due on a bond issue. [More information](#) on VCAP is available.

Are there exceptions to the general rule regarding record retention for certain types of records?

- No, but TEB encourages members of the municipal finance industry to submit comments and suggestions for developing record retention limitation programs for specific types of bond records, for specific classes of tax-exempt bond issues, or for specific segments of the bond industry. Comments can be submitted in writing to TEB and sent by e-mail to [TEGE TEB Questions](#).

CERTIFICATE OF ADOPTION
OF
WRITTEN POST-ISSUANCE COMPLIANCE PROCEDURES
STATE OF NEW JERSEY
GENERAL OBLIGATION BONDS

I, **Brian Bridges, Ph.D.**, New Jersey Secretary of Higher Education (“Secretary”), DO HEREBY CERTIFY as follows:


1. This Certification is made in connection with the State of New Jersey General Obligation Bonds issued by the State of New Jersey on a tax-exempt basis (the “Bonds”) to finance State capital project grants, on an up to 75% matching basis, for providing funds to increase the career and technical education program capacity at county colleges authorized under the Securing Our Children’s Future Bond Act, P.L. 2018, c. 119. Capitalized terms used but not defined herein shall have the meanings given to them in the resolution adopted by the Issuing Officials on October 29, 2021 (the “Resolution”) adopting post-issuance tax compliance procedures in connection with the State’s \$325,000,000 Securing Our Children’s Future Bonds (2018) (Series B) (Various Purposes) issued in 2021 (the “Bonds”) pursuant to the State’s Securing Our Children’s Future Bond Act.

2. The Resolution delegated to the State Treasurer the power to develop, in consultation with Bond Counsel and the State Attorney General, and adopt on behalf of the Issuing Officials and amend from time to time post-issuance tax compliance procedures as required by the Code and the regulations promulgated thereunder with respect to the Bonds previously issued by the State and all future Bonds to be issued by the State and delegated to the State Treasurer authority to take any additional actions which are necessary or desirable to implement such procedures.

3. In consultation with Bond Counsel, the State Attorney General and the Department of the Treasury, Office of Public Finance (the “Office of Public Finance”), and in furtherance of the State Treasurer’s delegated authority as described above, the State Treasurer has developed the procedures attached hereto (the “Procedures”).

4. Accordingly, I hereby adopt the Procedures attached hereto, and I hereby appoint the Secretary as the Tax Compliance Officer (as such term is defined in the Procedures).

IN WITNESS WHEREOF, I have signed this Certificate of Adoption this 9th
day of March, 2022.



Brian Bridges, Ph.D.,
Secretary, Higher Education