The University of Vermont

Tax Exempt Bond Post-Issuance Compliance Requirements:
A Primer on Private Business Use

Under federal law, institutions that are instrumentalities of the state, are eligible to benefit from the issuance of tax exempt governmental bonds. The issuance of tax-exempt debt is advantageous to the borrower given the lower interest rate assessed. However, as a result, tax-exempt debt also has many restrictions placed on its use and administration. These restrictions are generically referred to as post-issuance compliance requirements. This primer will address only one such compliance requirement – Private Business Use (PBU) for governmental bonds.

To maintain a bond issue's tax-exempt status following the issue date, the borrower must comply with the rules relating to PBU provided by the Internal Revenue Code and Treasury Regulations.

What is Private Business Use?

- Use of bond-financed property in a trade or business by a "nongovernmental person", such as:
    - For profit business entities;
    - Federal or foreign governments (note that state and local governments are considered "governmental persons" and do not generate PBU); and
    - Nonprofit organizations.

What are some examples of a trade or business triggering PBU?

- Transfer of Ownership. A transfer of ownership in bond-financed property to a private business user results in PBU, and may also violate the requirement that bond-financed property of a given issue be 100% owned by a state or local government.

- Leases and Rentals. A lease or rental of bond-financed property by a private business user constitutes PBU, unless an exception is satisfied.
    - *Common Exceptions:*
        - The term of use does not exceed 100 days and the property is made generally available to third parties.
        - Rental of the property is negotiated at fair market value and the term of use does not exceed 50 days.

- Management or Service Contracts. Agreements with a private user under which the user provides services to UVM with respect to the bond financed property are considered "management or service contracts" and give rise to PBU **unless**:
    - The services provided are incidental to the exempt uses of the facility; or
    - The agreement qualifies for "safe harbor" under applicable IRS revenue procedures (Rev. Proc. 2017-13 (or 97-13 for older contracts).

- Sponsored Research. An agreement to perform basic research in bond-financed space on behalf of a third party may give rise to PBU depending on the nature of the agreement and the parties involved, unless

- Naming Rights. Should UVM agree to name a bond-financed facility, or a portion thereof, for a for-profit business, PBU may arise.

- Substantial Economic Benefit or Special Legal Entitlement Catch-All. PBU may arise to the extent bond-financed property provides a "substantial economic benefit" to a private business user, or a private business user has a "special legal entitlement" to the property.

How much is too much?

- 10% Limit … Unless. As a governmental user, the limit on private business use for UVM is 10% of net proceeds. However, a 5% limit applies to use that is considered unrelated to any government use of bond proceeds, and use that is considered disproportionate to governmental use of bond proceeds.
- In addition, aggregate private business use cannot exceed the "lesser of" the percentages set forth above or $15 million. This concept is important to consider for larger bond issues (over $150M).
    - "Net proceeds means the total sale proceeds of the issue, plus any investment earnings on proceeds allocable to the projects (including earnings on proceeds for capitalized interest and costs of issuance), minus sale proceeds of the issue held in a "reasonably required" reserve fund.

How do you measure it?

- Bond Issue Specific Calculation. The amount of private business use is determined on a bond-issue-by-bond-issue basis. That is, the amount of private business use is calculated separately with respect to each bond issue, even if multiple bond issues financed different portions of the same project, and even if a single bond issue financed many different projects. The proceeds of a particular issue are traced to the specific projects they financed or refinanced.

- Square Footage Standard. The most common way to measure PBU of a facility is to compare the square footage of the facility used for PBU, including allocable common area, against the square footage of the entire facility.
    - Alternative measurement methods for instances where a square footage comparison is not appropriate may include relative time of use, relative revenues derived from such uses, or relative fair market rental values of the space used for each use.

- Life of Bond or Property. Overall PBU for an issue is calculated by determining the average PBU per year from the date of issuance or date the property is placed in service, whichever is later, until the earlier of the end of the property's expected useful life or the retirement of the issue, and then averaging those percentages.

- Combination Financing. If a project financed by a tax-exempt bond issue is also partly financed by equity contributions or taxable debt, it may be possible to allocate the equity or taxable debt to the portion of the project used for PBU, thereby minimizing the PBU of the bonds.