

# **PRIVATE BUSINESS USE WORKSHOP**

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**April 27, 2017**

# Development Team

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- > Planning for this workshop involved a large team and a wide variety of departments across campus
  - Capital and Space Management
  - College of Engineering
  - CoMotion
  - F2 Administration
  - Management Accounting and Analysis
  - Office of Research Information Services
  - Office of Sponsored Programs
  - Pacifica Law Group
  - School of Medicine
  - Tax Office
  - Treasury

# Agenda

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8:30 am – 9:00 am

Registration

9:00 am – 9:05 am

Introduction & Welcome

9:05 am – 9:45 am

**Private Business Use (“PBU”):**

- > Overview of Guidelines
- > How is it measured?
- > Consequences – exceeding IRS limit

9:45 am – 10:15 am

**Overview of the Process**

- > <http://f2.washington.edu/treasury/pbu>

10:15 am – 10:40 am

**GeoSIMS Overview**

- > <http://maps.uw.edu/geosims/geosims.html>

10:40 am – 11:00 am

**Q&A**

11:00 am

**Conclusion**

# **PRIVATE BUSINESS USE (“PBU”)**

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**Stacey Lewis, Pacifica Law Group**  
**Josephine Ennis, Pacifica Law Group**

# Overview

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- > Overview of University Private Business Use Guidelines
  - What is private business use?
  - What are the exceptions under the IRS rules?
- > How is private business use measured?
- > What are the consequences for exceeding the private business use limit?

# Overview of Guidelines

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- > Guide to Identifying and Measuring Private Business Use in Tax-Exempt Bond-Financed Facilities
  - Resource available at: <http://f2.washington.edu/treasury/pbu>
- > Provides an overview of the federal law and guidance regarding private business use
- > Helps the University track private business use in its financed facilities
  - Note that the guide is not comprehensive, and the examples given are simplified for ease of presentation

# Applies to Bond Financed University Facilities

<u>Borrowing Unit</u>	<u>Examples</u>
Housing and Dining	Commodore Duchess, Lander Hall, Maple and Terry Hall, Mercer Hall
Medical	UWMC Roosevelt, Montlake Tower
Research	Ben Hall, Brotman, Mol-E, Foege
Academic	Joy Building, PACCAR Business School
Student	Husky Union Building, Hall Health, Suzzallo
Athletic	Hec Edmunson Pavilion, IMA, Husky Ballpark, Husky Stadium, UW Bothell Sportsfield
Technology and Equipment	HR Payroll
Parking Facilities	Portage Bay Garage



# **Overview of Guidelines – What is private business use?**

# What is Private Business Use?

Generally, “Private Business Use” means:

- > Use (directly or indirectly)
- > Of a financed facility
- > In a “trade or business”
- > Carried on by any person
  - Including the federal government and nonprofit organizations
  - Other than a state or local governmental unit

# General Public Use

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- > Use by a member of the general public is not private use
- > Can ignore for these purposes:
  - Use by natural persons not engage in a trade or business; or
  - Use by an entity in its trade or business
    - > If the financed facility is reasonably available for use on the same basis by natural persons not engaged in trade or business
    - > See Guidelines

# What Are the Limits on Private Use?

## Private Business Use Limits:

- > No more than 10% of the proceeds of a bond issue for Governmental Bonds
  - (and no more than \$15 million for bond issues over \$150 million)
- > No more than 5% for 501(c)(3) bonds

# Types of Private Business Use

- > Leases
- > Management Contracts
- > Research Agreements
- > Other “special legal entitlements” or “beneficial use arrangements”

# Leases

- > A lease or similar arrangement for a financed facility that doesn't meet an exception for general use is considered private use
- > Example: A Pagliacci Pizza restaurant (leased to Pagliacci) on the first floor of a financed facility

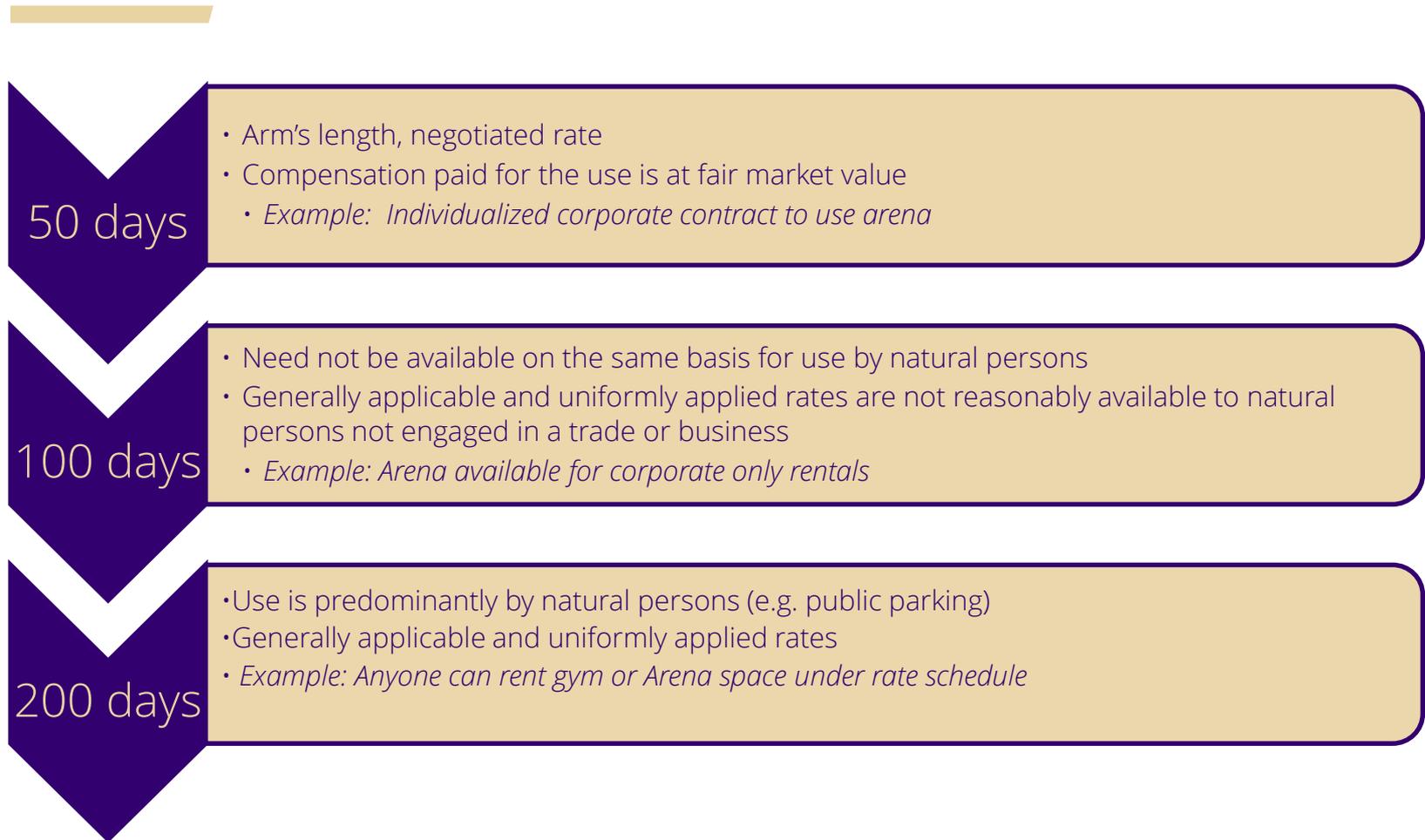


# Leases

- > Example: Husky Grind Coffee Shop
- > Is this private business use? Why or why not?



# General Public Use – Timing



# Incidental Use Arrangements

- > The financed facility may be used by any person or entity where use is incidental if the use is non-possessory and the non-possessory uses do not exceed 2.5% of the financed facility
- > Possessory use permitted for vending machines, pay telephones, kiosks and similar uses



# Management Contracts

A private management or service contract may result in private business use. Generally:

- > Compensation must be reasonable and
- > Must not give the service provider a share of net profits or impose on the service provider the burden of sharing net losses
  - Rev. Proc. 2017-13 specifically addresses the treatment of capitation fees, periodic fixed fees, and per-unit fees, as well as the payment of certain expenses
  - The safe harbors also include limitations on the deferral of compensation, the term of the contract, risk of loss, control over rates and other provisions
  - See Guidelines

# Management Contracts

- > Example: Sysco food service contract based on net profits



# Management Contracts – Exceptions

- > “Incidental Contracts” such as janitorial services, office equipment repair, hospital billing or similar services
- > Hospital admitting privileges
- > Reimbursement Contracts
- > Eligible Expense Reimbursement Arrangement

# Research Agreements



## Overview:

- > Research agreements with corporations, the federal government, or other entities may give rise to private business use
- > Facts and circumstances test
- > Three Safe Harbors

# Research Agreements – Safe Harbor 1

## Research agreements with a corporate sponsor

- > A research agreement relating to facilities used for research sponsored by a corporate sponsor will not create private business use so long as:
  - The activity is **basic research**;
  - Transfer of any license or other use of resulting technology to the sponsor is priced at **fair market value**; *and*
  - Fair market value is determined at the **time** the technology is available for use, not earlier
  
- > For example, an agreement giving the sponsor an option to acquire an exclusive license to any resulting technology in exchange for a price specified in the contract would not satisfy the safe harbor requirements

# Research Agreements – Safe Harbor 2

## Research agreements with an industry sponsor

- > A research agreement relating to facilities used pursuant to an industry research agreement will not create private business use so long as:
  - The activity is **basic research**;
  - The University **controls** the design and performance of the study; *and*
  - The University **retains title** to any patent or product incidentally resulting from the basic research; *and*
  - The sponsor receives no more than a nonexclusive royalty-free license (**NERF**)
- > Note on Corporate vs. Industry Sponsors: The distinction between “corporate” and “industry” sponsors is inconsequential as a practical matter as sponsored research agreements generally can qualify under either Safe Harbor 1 or Safe Harbor 2

# Research Agreements – Safe Harbor 3

## Research agreements with federal sponsors

- > A research agreement relating to facilities used pursuant to federally-sponsored research agreements will not create private business use so long as:
  - The University **controls** the design and performance of the study;
  - The University **retains exclusive title** to any patent or product incidentally resulting from the basic research; *and*
  - Any non-University party receives no more than a nonexclusive royalty-free license (**NERF**)

# Special Legal Entitlements

## Other Arrangements

- > Other arrangements that convey “special legal entitlements” to a non-governmental person for beneficial use of a financed facility may result in private business use
- > Example: naming rights
  - Private letter rulings provide some guidance





# Measuring Private Use

# How is Private Business Use Measured?

## Time & Space Analysis

- > Measure private business use by determining:
  - How much space in a financed facility is used for private use and
  - For what percentage of total time
  
- > Space: What is the total assignable square footage (ASF) or rentable square footage (RSF) of the facility and the square footage used for activities that generate private use
  
- > Time: What is the length of the lease, contract, or agreement and what is the “measurement period” for the bonds?

# How is Private Business Use Measured?

## Time & Space Analysis

### > Example:

- University finances building with 200,000 rentable square feet (RSF) with \$100,000,000 in tax-exempt bonds. The bonds have a 20-year maturity (and 20 year measurement period)
- 40,000 RSF leased to a private entity (20% of the facility)
- Term of lease is 5 years (25% of the measurement period)

Use	% of Facility	% of Time	% Private Use	Bond Proceeds
Lease	20%	25%	= 5%	\$5,000,000 (\$100,000,000 * 5%)

# How is Private Business Use Measured?

## Revenue Analysis

- > Alternatively, private business use may be measured based on the percentage of revenue generated by the financed facility
- > Example:
  - University finances building with \$100,000,000 in tax-exempt bonds. The bonds have a 20-year maturity (and 20 year measurement period).
  - The entire facility is used for research purposes and the building has \$4,000,000 in research expenditures per year
  - \$400,000 in annual research expenditures do not satisfy the safe harbors for research agreements and are treated as private business use
  - **10% of the financed facility, or \$10,000,000** of the bond proceeds are treated as private business use
    - >  $\$400,000 / \$4,000,000 = 0.10$
    - >  $0.10 * \$100,000,000 = \$10,000,000$

# How is Private Business Use Measured?

## Revenue Analysis

Use	Revenues	% of Revenues	Bond Proceeds
Ks with Private Use	\$400,000	<b>10%</b> (Private Use)	\$10,000,000 (\$100,000,000 * 10%)
Other Revenues	\$3,600,000	90%	\$90,000,000
<i>Total</i>	<i>\$4,000,000</i>	<i>100%</i>	<i>\$100,000,000</i>

# How is Private Business Use Measured?

## Combined Approach

- > Example: The University finances a building with \$100,000,000 in tax-exempt bonds. The bonds have a 20-year measurement period. The building has 200,000 total RSF with the following uses:
  - > Research:
    - 100,000 RSF is used for research activities
    - The building has \$4,000,000 in annual research expenditures and \$400,000 per year is private business use (10% of the research space)
  - > Classroom and Administration:
    - 80,000 RSF is used for classroom instruction and administrative purposes (no private business use)
  - > Retail Lease:
    - 20,000 RSF is leased to a private retail tenant for 5 years (25% of the measurement period)

# How is Private Business Use Measured?

## Combined Approach

Use	Rentable Square Footage	Proceeds (\$) (allocated by SF)	% PBU	% of Time	PBU (\$)
Research	100,000 SF	\$50,000,000	10%	100%	\$5,000,000
Administrative & Classroom	80,000 SF	\$40,000,000	-	-	\$0
Retail	20,000 SF	\$10,000,000	100%	25%	\$2,500,000
<b>Total</b>	<b>200,000 SF</b>	<b>\$100,000,000</b>			<b>\$7,500,000</b>
			<b>% Total PBU:</b>		<b>7.5%</b> <i>(\$7,500,000 / \$100,000,000)</i>

# How is Private Business Use Measured?

## “Qualified Equity”

- > Other funds (cash, taxable bonds, etc.) contributed by the University to help pay for a bond-financed facility can offset private business use
  - Needs to meet definition of Qualified Entity (type, timing)
- > Private business use in the project is allocated first to qualified equity and then to bond proceeds
- > Example:
  - Same facts as last slide, but University contributes \$5,000,000 to the project and tax-exempt bonds finance \$95,000,000 of the project
  - 5% of the project will be financed with Qualified Equity

# How is Private Business Use Measured?

## Qualified Equity

Use	RSF	Proceeds (\$) (allocated by SF)	% PBU	% of Time	PBU (\$)
Research	100,000 SF	\$50,000,000	10%	100%	\$5,000,000
Administrative & Classroom	80,000 SF	\$40,000,000	-	-	\$0
Retail	20,000 SF	\$10,000,000	100%	25%	\$2,500,000
<b>Total</b>	<b>200,000 SF</b>	<b>\$100,000,000</b>			<b>\$7,500,000</b>
			<b>% Total PBU:</b>		<b>7.5%</b>
			<b>Qualified Equity</b>		<b>5.0%</b>
			<b>PBU Allocable to Bonds</b>		<b>2.5%</b>



# Consequences

# What happens if we exceed the private business use limit?

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- > If the University takes an action that would cause the bonds to become nonqualified “private activity bonds”
  - Example: Sale of more than 10% of the facility to a private business
- > First and best option:
  - Take “remedial action” under the IRS change in use regulations
  - Meet the requirements of the regulations, which include specific timelines
- > Second and less desirable option:
  - IRS Voluntary Closing Agreement Program
- > Third and even less desirable option:
  - Pay a settlement following an IRS audit determination
- > Worst option:
  - Bonds are taxable to their date of issuance
    - > Harms bond owners and University access to bond markets

# Managing Consequences

- > To position the University to respond to a private business use issue through a timely remedial action
- > Monitor private business use with sufficient frequency for the University to avail itself of these options

# **OVERVIEW OF THE PROCESS**

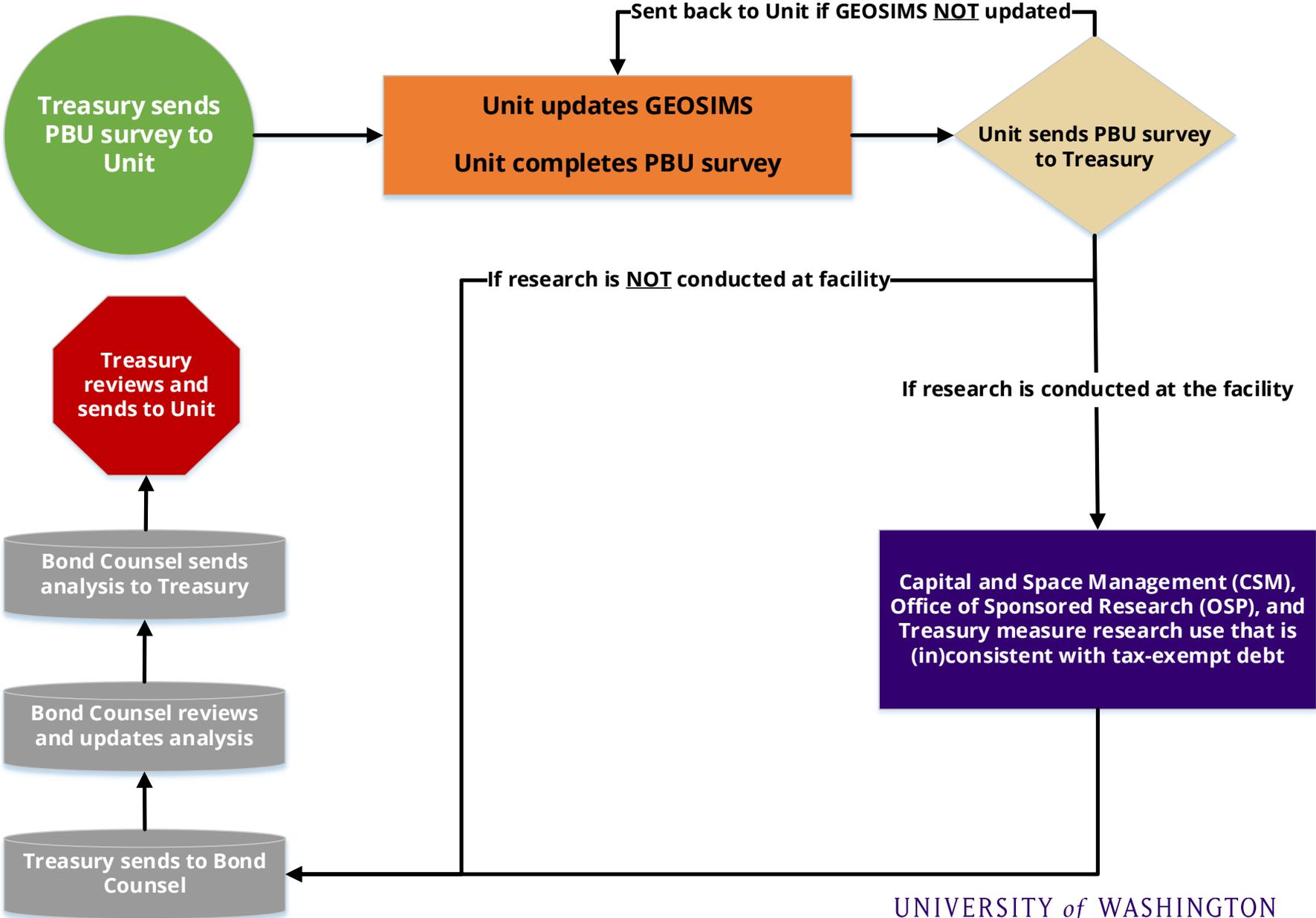
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**Bill Starkey, Treasury**

**Stacey Lewis, Pacifica Law Group**

**Josephine Ennis, Pacifica Law Group**

# Measuring Private Business Use



# What are we asking from you?

- > Survey circulated in early July
- > By September 15<sup>th</sup>
  - Complete GEOSIMS update
  - Return completed Survey to Treasury
  - Help us if we have any questions!
- > The financial consequences of a negative IRS audit finding could be significant and would likely be paid by your department!

# Additional Resources

- > UW Treasury Private Business Use webpage
  - <http://f2.washington.edu/treasury/pbu>
    - > Guidelines
    - > Tracking spreadsheet example
    - > Campus maps showing buildings with outstanding tax-exempt debt
    - > Conference materials
  - Links to Related Resources:
    - > Tax Office – Unrelated Business Tax Income
    - > UW Comotion
    - > Office of Sponsored Programs
    - > Management Accounting and Analysis
    - > Office of Planning & Budgeting

# Survey

## University of Washington Survey Regarding Use of Bond-Financed Projects

**PLEASE UPDATE GEOSIMS AND RETURN SURVEY TO [ASOMMER@UW.EDU](mailto:ASOMMER@UW.EDU) NO LATER THAN SEPTEMBER 15th**

Name & Title of Person Completing Survey: \_\_\_\_\_

Name of Project/Facility & Facility Number: [Field to be populated by ALM]

1. Has space inventory been updated in <u>GeoSIMS</u> ?	<input type="checkbox"/> No (complete no later than September 15, 2017) <input type="checkbox"/> Yes	Please contact Eric Darst in Capital and Space Management for assistance with <u>GeoSIMS</u> : <a href="mailto:ejdarst@uw.edu">ejdarst@uw.edu</a> (206) 616-4910
2. Have budget numbers been updated and linked to room number in <u>GeoSIMS</u> ?	<input type="checkbox"/> No (complete no later than September 15, 2017) <input type="checkbox"/> Yes	
3. Use of Project/Facility  Please select <u>all</u> uses occurring in the facility	<input type="checkbox"/> Undergraduate academic (instructional space, faculty offices) <input type="checkbox"/> Graduate academic (instructional space, faculty offices) <input type="checkbox"/> Research <input type="checkbox"/> Student housing and/or dining <input type="checkbox"/> Intercollegiate athletics	<input type="checkbox"/> Medical clinic/hospital <input type="checkbox"/> Student recreational <input type="checkbox"/> Parking <input type="checkbox"/> Infrastructure and support facility <input type="checkbox"/> Recharge/cost center

# Survey



4. Is any portion of the Project/Facility privately managed or serviced?	<input type="checkbox"/> No <input type="checkbox"/> Yes, but only contracts for services solely incidental to the primary function of the project <sup>1</sup> . <input type="checkbox"/> Yes, private management, service or incentive payment contract <sup>2</sup> . <b>Attach agreement.</b>
5. Is any portion of the Project/Facility leased by a private or federal party <sup>3</sup> ?	<input type="checkbox"/> No <input type="checkbox"/> Yes <sup>4</sup> . Describe ( <b>and attach any rental fee schedule or use agreement</b> ):
6. Is any portion of the Project/Facility subject to a naming rights or corporate donor recognition contract?	<input type="checkbox"/> No <input type="checkbox"/> Yes. Describe:

# Survey



7. Any other use by a private business, 501(c)(3) organization, a federal entity or a public-private joint venture?	<input type="checkbox"/> No <input type="checkbox"/> Yes. Describe:
8. Does the Project/Facility include space used for research?	<input type="checkbox"/> No <input type="checkbox"/> Yes. If yes, please describe any possible significant modifications over the next 12 months to research locations:

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<sup>1</sup> Such as janitorial, equipment repair, hospital billing or similar services.

<sup>2</sup> Such as a contract with a private property management company, a physician services group, concessionaires, parking manager, or food service provider.

<sup>3</sup> Disregard agreements that provide for use by University students, employees, visitors and patients.

<sup>4</sup> Includes long or short-term rentals, assigned parking spaces, and preferential use arrangements.

# **GEOSIMS OVERVIEW**

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**Eric Darst, UW Capital and Space Management**

# Introduction to GEOSIMS



[maps.uw.edu/geosims/geosims.html](http://maps.uw.edu/geosims/geosims.html)

# QUESTIONS & ANSWERS

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**Josephine Ennis, Pacifica Law Group**

# Conclusion

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- > Please respond to our Workshop event survey
- > Materials are available online on the Treasury website
- > The next PBU survey will be distributed in July:
  - Update GeoSIMS
  - Return PBU survey no later than September 15th
- > Questions? Contact Annette Sommer at [asommer@uw.edu](mailto:asommer@uw.edu) or (206) 221-8982

**THANK YOU!**