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Date:

November 06, 2024

Legend

Bonds =

Dates =

Service Provider =

Issuer =

Hotel =

a =

b =

c =

d =

e =

f =

Dear _____ :

This letter is in response to a request for a ruling and subsequent correspondence, submitted on behalf of Issuer, that the management fees described below (Management Fees) will not cause the Hotel to be used for private business use within the meaning of § 141(b)(6) of the Internal Revenue Code (Code) and § 1.141-3(b)(4)(i) of the Income Tax Regulations.

Facts and Representations

Issuer owns the Hotel. Issuer issued the Bonds on Dates, respectively, the proceeds of which were used in part to refund prior bonds that financed the Hotel. The Hotel is operated and managed by Service Provider.

Under the agreement between Issuer and Service Provider with respect to the management of the Hotel (Agreement), the Management Fees, which constitute part of Service Provider's compensation, include a base fee (the Base Fee) and an incentive fee (the Incentive Fee). The Base Fee is equal to a percent of the gross receipts of the Hotel in each fiscal year during the term of the Agreement payable on a monthly basis in arrears. The Incentive Fee is equal to b percent of the gross revenue of the Hotel in any year in which both the revenue per available room and the gross operating profit reach certain benchmarks (the RevPAR Test and GOP Margin Test, respectively) and, if payable, is payable annually. The RevPAR Test is met in any year in which the revenue per available room for the Hotel exceeds c percent of the average revenue per available room for a pre-determined group of hotels that are comparable to the Hotel. The GOP Margin Test is met in any year in which the gross operating profit of the Hotel meets or exceeds d percent. Gross operating profit is the excess (if any) of gross receipts for such year over operating expenses for such year. Operating expenses include the entire cost and expense of maintaining, operating, and supervising the operation of the Hotel. The gross receipts and operating expenses included in determining gross operating profit only include revenue and expense items that fall within the control of Service Provider. The expense items are each defined by the Uniform Systems of Accounts for the Lodging Industry, 11th Revised Edition, a publication of the Hospitality Financial and Technology Professionals. Issuer is required to fund an operating account (Operating Account) solely out of the gross receipts of the Hotel for use to timely pay all current liabilities of the Hotel, including the Service Provider's Management Fees. The bi-weekly balance in the Operating Account must be no less than \$e (subject to consumer price index adjustment), but need not be greater than \$f (subject to adjustment by Issuer and Service Provider in connection with the annual budget review process). Service Provider does not have any liability with respect to net operating losses of the Hotel.

Law and Analysis

Section 103(a) of the Code provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond.

Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) provides that the term “private activity bond” means any bond issued as part of an issue which meets (1) the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or (2) the private loan financing test of § 141(c).

Section 141(b)(1) provides that, except as otherwise provided, 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)(A) generally provides that the term “private business use” for purposes of § 141(b) means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For purposes of § 141(b)(6)(A), use as a member of the general public shall not be taken into account. Section 141(b)(6)(B) provides that, for purposes of § 141(b)(6)(A), any activity carried on by a person other than a natural person shall be treated as a trade or business.

Section 1.141-3(a)(1) provides generally that the private business use test relates to the use of the proceeds of an issue. 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 to both the direct and indirect uses of proceeds. Section 1.141-3(b)(1) provides generally 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.

Section 1.141-3(b)(4)(i) provides that, subject to exceptions in § 1.141-3(d), 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 operation of the facility.

Section 1.141-3(b)(4)(ii) defines a 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 of, 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.

Revenue Procedure 2017-13, 2017-6 I.R.B. 787, provides safe harbor conditions under which a management contract does not result in private business use under § 141(b). If a management contract meets all of the applicable conditions of sections 5.02 through 5.07 of Rev. Proc. 2017-13, the management contract does not result in private business use under § 141(b). See Rev. Proc. 2017-13, Section 5.01.

Section 5.02 of Rev. Proc. 2017-13 provides in part that 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. Further, 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 (other than any reimbursements of direct and actual expenses paid by the service provider to unrelated third parties) 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. 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 section 5.02. In addition, 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.

In the instant case, the Base Fee under the Agreement is equal to a percentage of the annual gross revenue of the Hotel, payable monthly from the Operating Account, which must be sufficiently and regularly funded by Issuer from gross receipts of the Hotel to pay all of the liabilities of the Hotel, including the Management Fees. Because the eligibility for, the amount of, and timing of the payment of the Base Fee do not take into account net profits, or both revenues and expenses of the Hotel, the Base Fee does not provide the Service Provider a share of net profits.

The Incentive Fee under the Agreement is similarly equal to a percentage of the gross revenue of the Hotel. The Incentive Fee differs from the Base Fee in that payment is contingent on satisfaction of two metrics, one of which is a variant of net profits. Given that, under both § 1.141-3(b)(4)(i) and § 5.02(2) of Rev. Proc. 2017-13, compensation may not provide the Service Provider with a share of net profits from the operation of the Hotel, we must determine whether the Incentive Fee, provides a share of net profits within the meaning of those provisions. In making this determination, we look to the facts and circumstances.

Here, the Incentive Fee is equal to a predetermined, fixed percentage of gross revenue. Despite the eligibility for receiving the Incentive Fee being partly triggered by a variant of net profits (that is, the GOP Margin Test), the amount of the Incentive Fee is not structured in such a way that it rises in proportion to increases in the Hotel's net profits or falls in proportion to decreases in the Hotel's net profits. The Incentive Fee is further distanced from net profits because the payment of the Incentive Fee depends on meeting the RevPAR Test, the other of the two metrics triggering payment of the Incentive Fee, which is based solely on revenues. Thus, in years when the Hotel fails to satisfy the RevPAR Test because of insufficient revenues, the amount of the Incentive Fee will be zero dollars even if the Hotel satisfies the GOP Margin Test with strong net profits. The Incentive Fee, if the Service Provider is eligible, is payable annually from the Operating Account. Therefore, the timing of its payment does not take into account net profits, or both revenues and expenses, of the Hotel. Based on these facts and circumstances, we conclude that the Incentive Fee does not provide the Service Provider a share of net profits.

Conclusion

Accordingly, we conclude that, the Management Fees do not cause the Hotel to be used for private business use under § 141(b)(6) and § 1.141-3(b)(4)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter, including whether the interest on the Bonds is excludable from gross income under § 103(a).

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. Because this office has not verified any of the material submitted in support of the request for rulings, such material is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Associate Chief Counsel
(Financial Institutions & Products)

By: _____
Zoran Stojanovic
Assistant to the Branch Chief
Branch 5
Office of Associate Chief
Counsel(Financial Institutions &
Products)

Enclosure

Copy for § 6110 purposes

cc: