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CREATING AN EFFECTIVE POST-BOND ISSUANCE TAX COMPLIANCE PROGRAM

A Web Conference Series hosted by
Foley & Lardner LLP

Welcome & Introductions

Michael G. Bailey

Heidi H. Jeffery

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REMINDER: Upcoming Sessions

- Mark your calendar and plan to join us for the final session of the Creating an Effective Post-Bond Issuance Tax Compliance Program Web conference series.
  - **Thursday, June 7, 2007**
    Session III: Conducting an Internal Audit of Tax-Exempt Bond Compliance

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Web Conference Details

- Call **866.493.2825** for technology assistance
- Dial ***0** (star/zero) for audio assistance
- Ample time for live Q & A will be allotted at the end of the formal presentation
- To print the PowerPoint, click on File and then Print to PDF.
- We encourage you to Maximize the PowerPoint to Full Screen Usage:
  – Hit F5 on your keyboard; or
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SESSION II: SELECTING ASSETS TO FINANCE WITH TAX-EXEMPT BONDS AND OTHER COMPLIANCE STRATEGIES

Michael G. Bailey
Heidi H. Jeffery
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Presentation Overview

- Forward-looking compliance review considerations
- Tax compliance considerations are a factor in any financing, but may be outweighed by business considerations
- Tax compliance considerations are best taken into account in the framework of an overall tax compliance policy
- Spending time on asset selection can save time on tax compliance
- Financing assets with a mix of bonds and equity can ease tax compliance

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Financing Different Types of Assets: Assessing the Tax Compliance Burden

- Most burden: equipment
- Least burden: buildings and additions
- Middle case: renovations

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Financing Equipment

- Need to list, identify use and assign useful life
- Need to track use of a large number of movable assets
- Related use not always clear (e.g., tables, chairs, computers in general use)
- Short useful life – so private use has a disproportionate effect
- Equity allocation ("mixed use") rules may not be helpful
- Equipment pool financings may be an option

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Financing Buildings and Additions

- Equity allocation ("mixed use") rules can greatly simplify compliance
- Fewer assets to track
- Long useful life provides flexibility for application of private-use measurement rule
- Need to carve out for future flexibility (e.g., joint venture space)

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Financing Renovations

- Equity allocation ("mixed use") rule not as helpful as for buildings and additions

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Rules for Equity Allocations: Final Regulations Soon

- Require timely identification of equity and tax allocations
- Permit "undivided portion" method and "discrete portion" method
- Limit "equity" to cash contributions and proceeds of taxable bonds
- Unlike private-use measurement rule, equity-allocation rule does not permit averaging over useful life

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Rules for Equity Allocations: Definition of "Project"

- The definition of a "project" is key
- Proposed definition permits buildings and equipment to be treated as a single "project"
- 12-month placed-in-service time limit
- Final regulations may limit "project" to buildings and renovations

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Plan to Maximize Benefit of Equity Contributions

- Identify and document all equity contributions
  - date of issuance tax certificate
  - project completion certificate
- Generally use "undivided portion" method
- Also identify the discrete portion that is initially treated as equity-financed
- Consider the right amount of "equity buffer" to simplify tax compliance

Financing Working Capital

- 5 percent "directly related" working capital permitted
- Other working capital financing is restricted by "proceeds-spent-last" rule
- Examples: salaries, utilities and other operating expenses for a financed project

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Financing Working Capital: Disadvantages

- May result in loss of exemption from $150 million cap on nonhospital bonds
- May be difficult to document, particularly for the “directly related” requirement
- Some state laws do not permit financing working capital
- May lose some “margin for error” for rebate spending exceptions

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Financing Working Capital: Advantages

- No need for continued tracing of an asset
- No financed asset may mean no private use, depending on facts
- No reduction in useful life
- May enable a greater equity contribution to financed projects
- Quick expenditures may help to meet rebate spending exceptions

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The $150 Million Cap on Nonhospital Bonds: "Living with the Zombie"

- Partial repeal, but only if 95 percent or more of net proceeds finance capital expenditures incurred after August 5, 1997
- Can be very complex and difficult to track (e.g., rules for 3-year "test periods" and for organizations under "common control" are difficult to apply)
- Nonhospital bond taint can continue after disaffiliation

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Financing Working Capital: General Assessment

- An option worth considering if $150 million cap is not a concern
- Standard procedure reduces "directly related" requirement
- Compliance burden of "living with the zombie" may outweigh the benefits

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Financing Additional Interest

- Tax rules generally permit funding interest for up to 3 years for new money
- In general, funded interest is a "capital expenditure" only up to placed-in-service date

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Financing Additional Interest: Disadvantages

- May result in loss of exemption from $150 million cap on nonhospital bonds
- Some state laws are more restrictive
- May prevent meeting rebate spending exceptions

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Financing Additional Interest: Advantages

- No reduction in useful life
- May enable a greater equity contribution to financed projects
- Easy to document use of proceeds

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Financing Additional Interest: General Assessment

- An option worth considering if no concern meeting rebate spending exceptions and $150 million cap
- Compliance burden of “living with the zombie” may outweigh the benefits

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Financing Assets at Risk for Unrelated Trade or Business Use

- Unrelated trade or business activity results in private use, regardless of contractual rights
- For that reason, private use resulting from unrelated trade or business use is particularly difficult to monitor
- Examples: parking garages, pharmacies, labs
- Consider a policy to disfavor, or require a conservative “equity buffer”

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Financing Assets Used in Common

- Often raise difficult private use measurement questions
- Examples: power plant serving a campus; computer hardware and software serving many purposes
- Consider a policy to disfavor, or require a conservative “equity buffer”

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Financing Assets at Multiple Sites

- Financing for multiple sites increases monitoring burden (e.g., multiple hospital facilities, satellite facilities and outpatient clinics)
- Smaller facilities may be more at risk for change of use (e.g., sale or lease) requiring remedial action
- Monitoring of private use may be more difficult

Financing Costs of Issuance

- Costs of issuance are treated as private use for qualified 501(c)(3) bonds
- Financing costs of issuance reduces private use limit
- In some cases, an equity contribution to the project has a similar result
- In any event, a margin for error should be considered

Example for Discussion

- Hospital has the following capital project: $75 million patient tower; $30 million parking garage; $25 million equipment
- Parking garage is reasonably expected to be used 1/6 by general public in an unrelated trade or business use
- Hospital desires to finance $110 million

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Common Reasons to Structure Separate "Issues" in the Same Financing Plan

- Keep variable-yield bonds separate from fixed-yield bonds to permit advance refunding
- Keep issues separate to be certain that one qualifies for a rebate spending exception
- For large bond issues subject to the $15 million limit on private use, permit more private use

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Restricted Donations: Planning Considerations

- A donation restricted to a particular project may restrict tax-exempt financing of that project
- An up-front procedure to review the wording of restrictions can be helpful
- The desired amount of “equity buffer” for a particular project is also a consideration

Preserving Eligibility of Costs for Tax-Exempt Financing

- Recommend at least annual review of need for a reimbursement “declaration of intent”
- Interim taxable financing can preserve eligibility for tax-exempt financing
- Interim taxable financing must meet requirements for declaration of intent and cost documentation

Presentation Takeaways

- Financing equipment may present compliance issues; think about business considerations
- Plan to maximize the benefits from any equity contributions; involve counsel in donations planning
- Financing working capital is permissible under federal tax rules; think about $150 million limitation
- Consider tax compliance burden of financing multiple sites
- Selecting assets is a fundamental; make sure to build in appropriate time to fully vet assets

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Questions & Answers

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Thank you for your participation.

- A copy of the PowerPoint presentation, including the audio for this session, will be available tomorrow on our website at: www.foley.com/taxwebconference2

- We welcome your feedback. Please take a few moments before you leave the web conference today to provide us with your feedback.

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