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Management Contracts Safe Harbors Revisited – IRS Releases Updated Guidance (Again)

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Demonstrating the "user-friendly" side of the IRS, on January 17, 2017, the IRS released Revenue Procedure 2017-13 ("Rev. Proc. 2017-13") (available ***here***) to address many (but not all) of the comments received on the rather short-lived Revenue Procedure 2016-44 ("Rev. Proc. 2016-44"). The IRS released Rev. Proc. 2016-44 last August (as Bracewell reported ***here***) to provide "a more flexible and less formulaic approach" for issuers and 501(c)(3) borrowers entering into long-term contracts with private entities for the management and operation of facilities financed with tax-exempt bonds, seemingly upending the longstanding guidance set forth in Revenue Procedure 97-13 ("Rev. Proc. 97-13").

Updated Guidance under Rev. Proc. 2017-13

Rev. Proc. 2017-13 generally restates the entirety of Rev. Proc. 2016-44, but includes the following revisions and/or clarifications:

- *Certain "97-13 Approved" Compensation Structures Live On :* Though capitation fees, periodic fixed fees, per-unit fees, and combinations thereof, as well as certain types of incentive compensation, arguably would have qualified under the more "flexible" (but less defined) provisions of Rev. Proc. 2016-44, issuers and 501(c)(3) borrowers (and their bond counsel) can rest easy now that the IRS has clarified that the safety enjoyed by these compensation structures continues. All other compensation arrangements will have to be tested under the general compensation rules set forth under Rev. Proc. 2016-44.

- *Ain't Got No Money - Deferred Compensation:* Rev. Proc. 2017-13 continues to provide that the timing of payment of compensation cannot be contingent upon net profits or losses from the operation of the managed property. However, it provides additional guidance by clarifying that, if there is a deferral of compensation due to insufficient cash flows of the managed property, compensation will not be considered contingent upon net profits or net losses so long as the contracts provides for annual payments, there are reasonable consequences for late payment, and the deferred compensation must be paid within five years of the original payment due date.

- *Life of Land Counts (Sometimes):* Like Rev. Proc. 2016-44, Rev. Proc. 2017-13 limits the term of a management contract to the lesser of 30 years or 80 percent of the weighted average reasonably expected economic life of the managed property. Unlike Rev. Proc.

2016-44, Rev. Proc. 2017-13 provides that land will be treated as having an economic life of 30 years if 25 percent or more of bonds that financed the managed property financed land. Under Rev. Proc. 2016-44, land was never taken into account, potentially reducing the permissible maximum duration of the management contract.

- *Stamp of Approval on Rates:* Under Rev. Proc. 2017-13, an issuer or 501(c)(3) borrower may satisfy the "approval of rates requirement" introduced by Rev. Proc. 2016-44 by approving a reasonable general description of the method used to set rates (e.g., hotel room rates set based on comparable properties) or by requiring that the service provider charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party (e.g. physician's services negotiated with a medical insurance company), which is helpful for circumstances in which it may not be feasible for a qualified user to approve each specific rate charged.

Effective Date

Rev. Proc. 2017-13 applies to any management contract that is entered into on or after January 17, 2017, and may be applied to any management contract that was entered into before such date. In addition, the safe harbors in Rev. Proc. 97-13, as modified by Revenue Procedure 2001-39 and amplified by Notice 2014-67, may be relied upon for any management contract that is entered into before August 18, 2017, and that is not materially modified or extended on or after such date (other than pursuant to a permissible renewal option).

Although Rev. Proc. 2017-13 could benefit from revisions and/or clarification of certain provisions (isn't that always the case?) that weren't addressed, it nevertheless provides welcome guidance for issuers and 501(c)(3) borrowers entering into management contracts.

For more information, please contact ***Brian Teaff***.