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Client Alert: New Revenue Procedure 2017-13 Provides Clarification of Safe Harbors for Management Contracts of Tax-Exempt Financed Facilities

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The Internal Revenue Service has issued Revenue Procedure 2017-13 that clarifies certain provisions of Revenue Procedure 2016-44. For a full explanation of the provisions of Rev. Proc. 2016-44, see our client alert of August 24, 2016, as updated September 6, 2016.

Rev. Proc. 2016-44 is modified, amplified and superseded by Rev. Proc. 2017-13.

Effective Date. Rev. Proc. 2017-13 applies to any management contract entered into on or after January 17, 2017. An issuer may apply Rev. Proc. 2017-13 to any management contract entered into before January 17, 2017. In addition, an issuer *may* apply the safe harbors of Rec. Proc. 97-13, as modified by Rev. Proc. 2001-39 and amplified by Notice 2014-67, to a management contract entered into before August 18, 2017 that is not materially modified or extended on or after August 18, 2017 (other than pursuant to a renewal option, defined as a provision under which either party has a legally enforceable right to renew the contact. An automatic renewal for 1-year periods absent a notice of cancellation is not a renewal option).

Permissible Payment Arrangements. Rev. Proc. 2017-13 provides that certain types of compensation that were safe harbors in Rev. Proc. 97-13 – the capitation fee, periodic fixed fee and per-unit fee – will continue to be safe harbors. Specifically, without regard to whether the service provider pays expenses with respect to the operation of the managed property without reimbursement by the qualified user, compensation described in the following clauses will not be treated as providing a share of net profits or requiring the service provider to bear a share of the net losses: (1) compensation based solely on a capitation fee, a periodic fixed fee or a per-unit fee, (2) incentive compensation if the eligibility for the incentive is determined by the service provider's performance in meeting one or more standards that measure quality of service, performance or productivity and the amount and timing of such incentive compensation meets the requirements of Rev. Proc. 2017-13, or (3) a combination of the compensation arrangements described in (1)

and (2).

Timing of Compensation Payments. The timing of payment provisions of Rev. Proc. 2016-44 that prohibits compensation payments contingent upon net profits or net losses is addressed in Rev. Proc. 2017-13 and clarified to provide that compensation subject to an annual payment requirement and reasonable consequences for late payments will not be treated as being contingent upon the net profits or net losses if the contract includes a requirement that the qualified user will pay the deferred compensation within 5 years of the original due date of the payment.

Specifically, Rev. Proc. 2017-13 states that deferral of compensation (that otherwise qualifies under one of the safe harbors of Rev. Proc. 2017-13) due to insufficient net cash flows from the operation of the managed property will not cause the compensation to be treated as contingent upon the net profits or net losses if the contract provided that (1) compensation is payable at least annually, (2) the qualified user is subject to reasonable consequences for late payment, such as reasonable interest charges or late payment fees, and (3) the qualified user will pay such deferred compensation (with interest or late payment fees) no later than 5 years from the original due date.

Term of the Contract and Calculation of the Weighted Average Reasonably Expected Economic Life of the Property. As in Rev. Proc. 2016-44, the term of a contract, including all renewal options, may not exceed the lesser of 30 years or 80% of the weighted average reasonably expected economic life of the managed property.

Rev. Proc. 2017-13 adheres to the accepted calculation of economic life provided by Section 147(b) of the Internal Revenue Code of 1986, as amended (the "Code"), reinstating the provision that was specifically excluded from Rev. Proc. 2016-44 for land the cost of which is at least 25% of the net proceeds of the bonds that financed the property. Such land is assigned an economic life of 30 years. Rev. Proc. 2017-13 retains the requirement of Rev. Proc. 2016-44 that a contract that is materially modified be retested for economic life as a new contract as of the date of the material modification.

Approval of Rates Charged. To exhibit control over the managed property, Rev. Proc. 2016-44 states that the qualified user must approve rates charged either by expressly approving such rates, or approving the methodology for setting such rates, or by including in the contract a requirement that the service provider charge rates that are reasonable and customary, as specifically determined by an independent third party.

Rev. Pro. 2017-13 loosens the approval process to permit a qualified user to exhibit approval by, in addition to expressly approving such rates, expressly approving a general description of the methodology used to set the rates (such as a method that establishes hotel room rates using specified revenue goals based on comparable properties), or by requiring the service provider to charge rates that are reasonable and customary as specifically determined by or negotiated with an independent third party (such as a medical insurance company).

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