

HB

102

HFIN

FILE

Alaska State Legislature

House Finance Committee

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SPONSOR STATEMENT

HB's: 102, 103, 104, 105, 106, 107, 108

The proposed package of seven bills enacts a major cleanup of nearly 30 inactive accounts from State Statutes. The legislation clearly reflects the mission of bringing about a "smaller, smarter" government through careful scrutiny of inefficient and unnecessary administrative functions.

During the past year, investigation by Representative Martin, the past Chairman of the Legislative Budget and Audit Committee, revealed that a large number of special accounts, established through the legislative process over the last thirty years, have been completely inactive since their creation.

Prior to introducing these bills, Co-Chair Therriault and Representative Martin contacted agencies responsible for the funds to insure their deletion would not be problematic. Without exception, the departments supported the elimination of the inactive accounts contained in these bills. In fact, it was discovered that in some cases, the departments were unaware of the accounts' existence.

A cooperative effort continued with the Administration, specifically the Office of Management and Budget, to develop a package of bills to repeal the non-operative statutes from the accounting process. In some cases, legislation does not actually repeal statutes, but rather changes the language to read "Program" rather than "Fund", in order to retain the integrity of a program without maintaining a separate account.

This package of bills does not impede the intent of or appropriation to any existing program, but rather is a series of housekeeping measures designed to save the State from unnecessary administrative expense.

Alaska State Legislature
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BILL SUMMARIES
HB's 102, 103, 104, 105, 106, 107, 108

HB 102

"An Act abolishing the Alaska Medical Facility Authority . . ."

This legislation follows up with last year's SB136, which transferred the balance remaining in the Alaska Medical Facilities Authority Fund to the State General fund, thus closing out all accounts pertaining to the Authority. Since that time, neither the Fund nor the Authority have been used. By repealing AS 18.26, the obsolete Alaska Medical Facility Authority would be cleared from the Statutes.

HB 103

"An Act repealing certain state funds and accounts and boards and programs related to those funds and accounts. . ."

Simple repeals of the following inactive accounts: Alaska Amateur Sports Fund; Cooperative arrangement grant fund; Bilingual-Bicultural Education Fund; Alaska Student Leadership Development Fund; Alaska School Counseling Program Grant Fund; University Risk Management Fund; Community College Fund; Community Health Aide Grant Account; Veterans Service Fund; Alaska Municipal Land Account; Federal Transitional Grants Accounts; Mineral Resource Revolving Fund; Outdoor Recreational, Open Space, and Historic Properties Development Fund; Neighborhood Revitalization and Development Fund; Legal Assistance and Juvenile Justice Grant Fund; Fisheries Product Revolving Loan Guarantee Fund; Forest Products Business Loan Guarantee Fund; Community Action Against Substance Abuse Grant Fund; Alaska Longevity Bonus Fund; Self-Sufficiency Trust Fund; Alaska Pioneers' Home Trust Fund; Older Alaskans Service Programs Account; Community Schools Grant Fund; and Handicap & Mental Illness Charitable Account.

HB 104

"An Act repealing the search and rescue fund, relating to expenditures for search and rescue activities . . ."

Search and rescue activities are appropriated directly from the General Fund and not through the search and rescue fund, which has remained empty and

inactive. This legislation removes the fund from statutes, as well as reference to the fund.

HB 105

" An Act relating to the unorganized borough national forest receipts program . . . "

There is no present or anticipated use for the unorganized borough national forest receipts fund. Federal appropriations for the program go directly into the General Fund, leaving this special account inactive and empty. The legislation would clear the unused account from Statutes, by changing the reference from "fund" to "program".

HB 106

"An Act relating to the municipal assistance program and organization grant program..."

Although these programs remain operative, the municipal assistance and organization grant funds are inactive and empty. Legislation would clear the "fund"(s) from statutes, and refer only to the "program"(s).

HB 107

"An Act relating to water quality enhancement and water supply, waste water, and solid waste systems grants . . . "

This legislation removes from Statutes the Water Quality Enhancement and Water Supply, Wastewater, and Solid Waste Systems Fund. The fund is empty and is not used in making appropriations to the program.

HB 108

"An Act relating to the crime victim compensation program. . ."

The crime victim compensation program does not receive allocations from the fund established by statute. The inactive account is cleared by changing reference from "fund" to "program".

HB's 102 - 108
Inactive Funds and Accounts
 (Listed by Department)

DIII #	Agency	Fund/Account	Cite	Balance	Notes
HB 103	DCED	Alaska Amateur Sports Fund	05.35.150	\$0	
HB 103	DCED	Neighborhood Revitalization and Development Fund	44.33.436	\$0	
HB 103	DCRA	Legal Assistance and Juvenile Justice Grant Fund	44.47.200	\$0	
HB 105	DCRA	Unorganized Borough National Forest Receipts Fund	41.15.180(b)	\$0	
HB 106	DCRA	Organization Grant Fund	29.05.200(a)	\$0	
HB 106	DCRA	Municipal Assistance Fund	29.60.350	\$0	
HB 107	DEC	Water Supply, Wastewater, and Solid Waste Systems Fund	46.03.030(c)	\$0	
HB 103	DHSS	Community Health Aide Grant Account	18.28.030	\$0	
HB 103	DHSS	Self-Sufficiency Trust Fund	47.80.200	\$0	
HB 103	DHSS	Handicap & Mental Illness Charitable Account	47.80.240(a)	\$0	
HB 103	DMVA	Veterans Service Fund	26.10.020	\$0	
HB 103	DNR	Alaska Municipal Land Account	29.65.080	\$0	
HB 103	DNR	Mineral Resource Revolving Fund	41.98.015	\$0	
HB 103	DNR	Outdoor Recreation, Open Space, and Historic Properties Dev. Fund	41.98.170	\$0	
HB 103	DOA	Federal Transitional Grants Account	37.20.020	\$0	
HB 103	DOA	Alaska Longevity Bonus Fund	47.45.090	\$0	
HB 103	DOA	Alaska Pioneers' Home Trust Fund	47.55.060	\$0	
HB 103	DOA	Older Alaskans Service Programs Account	47.65.010	\$0	
HB 103	DOE	Cooperative Arrangement Grant Fund	14.14.115(b)	\$0	
HB 103	DOE	Bilingual-Bicultural Education Fund	14.30.410(a)	\$0	
HB 103	DOE	Alaska Student Leadership Development Fund	14.30.510	\$0	
HB 103	DOE	Alaska School Counseling Program Grant Fund	14.30.750	\$0	
HB 103	DOE	Community Schools Grant Fund	14.36.020	\$0	
HB 102	DOR	Medical Facilities Special Bond Guarantee Account	18.26.260(a)	\$0	
HB 103	DOR	Fishery Product Revolving Loan Guarantee Fund	45.92.010	\$0	
HB 103	DOR	Forest Products Business Loan Guarantee Fund	45.94.010	\$0	
HB 104	DPS	Search and Rescue Fund	18.00.145	\$0	
HB 108	DPS	Crime Victims Compensation Fund	43.23.028(b)	\$0	
HB 103	HSS	Community Action Against Substance Abuse Grant Fund	47.37.045	\$0	
HB 103	UA	University Risk Management Fund	14.40.455	\$0	
HB 103	UA	Community College Fund	14.40.610(a)	\$0	

HB's 102 - 108
Inactive Funds and Accounts
 (Listed by Bill #)

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February 8, 1997

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VIA FACSIMILE--ORIGINAL TO FOLLOW

Mr. Garrey M. Peska
Alaska State Hospital & Nursing Home Association
P. O. Box 240185
Douglas, Alaska 99824

Re: Proposed Legislation
Repeal of Medical Facility Authority Statute
Our File No. 4566-10

Dear Garrey:

You have asked me to review Representative Therriault's proposed legislation repealing AS 18.26, which establishes the Alaska Medical Facility Authority. I understand from the telephone message that I received from you late yesterday afternoon that such a bill now has been introduced and that a hearing is scheduled at 1:30 on Monday afternoon, February 10.

My understanding of the supposed purpose of this legislation is based on comments that were made in the meetings of ASHNSHA's Legislative Committee and the Executive Committee on Thursday, February 6. Specifically, it was explained that, originally, the Authority had been established to take advantage of a financing mechanism that had been authorized by federal law and that in 1986 federal law had been changed so that such financing was no longer possible. Before adopting a position on the proposed repeal, ASHNSHA wanted to determine definitely whether that background information was accurate. The specific concern was to

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Mr. Garrey Peska
Alaska State Hospital & Nursing Home
Association
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Re: Proposed Legislation
Repeal of Medical Facility Authority Statute
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confirm that the repeal would not eliminate a possible means of financing the construction of health care facilities that might not otherwise be available.

Reading between the lines, I believe the 1986 change in federal law that was mentioned must have been the adoption of the Tax Reform Act of 1986. That law placed certain limitations on the tax exemptions that are available for interest earned on state and local bonds. Among other things, the Alaska Medical Facility Authority is authorized to issue revenue bonds for the purpose of establishing and equipping health care facilities. Those bonds are exempt from state taxes. Clearly, however, if the bonds were exempt from state taxes but not exempt from federal taxes, they would not be as attractive. I have researched the current status of the availability of a federal tax exemption for state and local government bonds used to finance construction of health care facilities, and I have determined that, with some restrictions, the tax exemption is still available. Specifically, the federal tax exemption continues to be available without limitation for non-profit hospital bonds and is available for other non-profit purposes, with some limitations.

Under sections 145 and 501(c)(3) of the Internal Revenue Code, if 95 percent of a state or local bond issue is for the use of a "hospital" that is otherwise exempt from federal income tax under section 501(c)(3), then the interest on those bonds is exempt and there is no limit on the amount of such bonds that can be issued. Other so-called "501(c)(3) bonds" also are tax exempt, but, except for "hospital bonds," there is a \$150 million limit on the amount of bonds that may be outstanding at any one time.

As back-up documentation, enclosed I am sending you copies of the following:

1. Section 145 of the Internal Revenue Code, "Qualified 501(c)(3) Bond";
2. Internal Revenue Service Private Letter Ruling 9226062 (March 3, 1992) (discussing standards for identifying a "hospital" not subject to the \$150 million limit on tax exempt bonds); and

Mr. Garrey Peska
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3. F. Ballard, "Tax Exempt Financing and Charities,"
ALI-ABA Course of Study (Dec. 2, 1993) (in outline format,
summarizes mechanism and standards for tax-exempt bonds).

Given the continuing availability of a federal tax exemption for "hospital bonds," it may well be advisable to attempt to retain the Alaska Medical Facility Authority as a vehicle for issuing such bonds. There appears to be no requirement that such bonds be issued by an Authority, and presumably they also could be issued directly by the state or local government. That might require a public vote, however. (The outline listed as Item 3 above states, in paragraph 1(a), "City or state, or authority formed by city or state . . . issues bonds that are exempt from Federal income tax")

As you know, bond financing and the related tax exemptions are a very complex area, and I certainly am not a bond specialist. It is clear, however, that the federal tax exemption is still available for non-profit "hospital bonds." With this additional background information, it may be possible to determine if the proposed repeal in fact is based on a mistaken understanding that the federal tax exemption for such bonds was repealed in 1986. At the very least, demonstrating the invalidity of that reason may help bring to light some other reason the repeal is being proposed.

I hope this information is helpful to you in formulating ASHNHA's position on this legislation. I will be glad to discuss this with you at your convenience.

Sincerely,

KEESAL, YOUNG & LOGAN


Susan Wright Mason

SWM:klc
Enclosures
cc: Ms. Laraine Derr

(SWM\LTR\1939)

Citation
26 USCA s 145
26 U.S.C.A. s 145

FOUND DOCUMENT

Database
USCA

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UNITED STATES CODE ANNOTATED
TITLE 26. INTERNAL REVENUE CODE
SUBTITLE A--INCOME TAXES
CHAPTER 1--NORMAL TAXES AND SURTAXES
SUBCHAPTER B--COMPUTATION OF TAXABLE INCOME
PART IV--TAX EXEMPTION REQUIREMENTS FOR STATE AND LOCAL BONDS
SUBPART A--PRIVATE ACTIVITY BONDS
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Current through P.L. 104-333, approved 11-12-96

s 145. Qualified 501(c)(3) bond

(a) In general.--For purposes of this part, except as otherwise provided in this section, the term "qualified 501(c)(3) bond" means any private activity bond issued as part of an issue if--

(1) all property which is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and

(2) such bond would not be a private activity bond if--

(A) 501(c)(3) organizations were treated as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying section 513(a), and

(B) paragraphs (1) and (2) of section 141(b) were applied by substituting "5 percent" for "10 percent" each place it appears and by substituting "net proceeds" for "proceeds" each place it appears.

(b) \$150,000,000 limitation on bonds other than hospital bonds.--

(1) In general.--A bond (other than a qualified hospital bond) shall not be treated as a qualified 501(c)(3) bond if the aggregate authorized face amount of the issue (of which such bond is a part) allocated to any 501(c)(3) organization which is a test-period beneficiary (when increased by the outstanding tax-exempt nonhospital bonds of such organization) exceeds \$150,000,000.

(2) Outstanding tax-exempt nonhospital bonds.--

(A) In general.--For purposes of applying paragraph (1) with respect to any issue, the outstanding tax-exempt nonhospital bonds of any organization which is a test-period beneficiary with respect to such issue is the aggregate amount of tax-exempt bonds referred to in subparagraph (B)--

(1) which are allocated to such organization, and

(ii) which are outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

(B) Bonds taken into account.--For purposes of subparagraph (A), the bonds referred to in this subparagraph are--

(i) any qualified 501(c)(3) bond other than a qualified hospital bond, and

(ii) any bond to which section 141(a) does not apply if--

(I) such bond would have been an industrial development bond (as defined in section 103(b)(2), as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) if 501(c)(3) organizations were not exempt persons, and

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26 USCA s 145

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TEXT (b) (2) (B) (ii) (II)

(II) such bond was not described in paragraph (4), (5), or (6) of such section 103(b) (as in effect on the date such bond was issued).

(C) Only nonhospital portion of bonds taken into account.--

(i) In general.--A bond shall be taken into account under subparagraph (B) only to the extent that the proceeds of the issue of which such bond is a part are not used with respect to a hospital.

(ii) Special rule.--If 90 percent or more of the net proceeds of an issue are used with respect to a hospital, no bond which is part of such issue shall be taken into account under subparagraph (B)(ii).

(3) Aggregation rule.--For purposes of this subsection, 2 or more organizations under common management or control shall be treated as 1 organization.

(4) Allocation of face amount of issue; test-period beneficiary.--Rules similar to the rules of subparagraphs (C), (D) and (E) of section 144(a)(10) shall apply for purposes of this subsection.

(c) Qualified hospital bond.--For purposes of this section, the term "qualified hospital bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used with respect to a hospital.

(d) Restrictions on bonds used to provide residential rental housing for family units.--

(1) In general.--Except as otherwise provided in this subsection, a bond which is part of an issue shall not be a qualified 501(c)(3) bond if any portion of the net proceeds of the issue are to be used directly or indirectly to provide residential rental property for family units.

(2) Exception for bonds used to provide qualified residential rental projects.--Paragraph (1) shall not apply to any bond issued as part of an issue if the portion of such issue which is to be used as described in paragraph (1) is to be used to provide--

(A) a residential rental property for family units if the first use of such property is pursuant to such issue,

(B) qualified residential rental projects (as defined in section 142(d)), or

(C) property which is to be substantially rehabilitated in a rehabilitation beginning within the 2-year period ending 1 year after the date of the acquisition of such property.

(3) Certain property treated as new property.--Solely for purposes of determining under paragraph (2)(A) whether the 1st use of property is pursuant to tax-exempt financing--

(A) In general.--If--

(i) the 1st use of property is pursuant to taxable financing,

(ii) there was a reasonable expectation (at the time such taxable financing was provided) that such financing would be replaced by tax-exempt financing, and

(iii) the taxable financing is in fact so replaced within a reasonable period after the taxable financing was provided,

then the 1st use of such property shall be treated as being pursuant to the tax-exempt financing.

(B) Special rule where no operating state or local program for tax-exempt financing.--If, at the time of the 1st use of property, there was no

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26 USCA s 145
TEXT (d) (3) (B)

PAGE 3

operating State or local program for tax-exempt financing of the property, the 1st use of the property shall be treated as pursuant to the 1st tax-exempt financing of the property.

(C) Definitions.--For purposes of this paragraph--

(i) Tax-exempt financing.--The term "tax-exempt financing" means financing provided by tax-exempt bonds.

(ii) Taxable financing.--The term "taxable financing" means financing which is not tax-exempt financing.

(4) Substantial rehabilitation.--

(A) In general.--Except as provided in subparagraph (B), rules similar to the rules of section 47(c)(1)(C) shall apply in determining for purposes of paragraph (2)(C) whether property is substantially rehabilitated.

(B) Exception.--For purposes of subparagraph (A), clause (ii) of section 47(c)(1)(C)(i) shall not apply, but the Secretary may extend the 24-month period in section 47(c)(1)(C)(i) where appropriate due to circumstances not within the control of the owner.

(e) Election out.--This section shall not apply to an issue if--

(1) the issuer elects not to have this section apply to such issue, and

(2) such issue is an issue of exempt facility bonds, or qualified redevelopment bonds, to which section 146 applies.

~~CREDIT(S)~~

1997 Electronic Pocket Part Update

(Added Pub.L. 99-514, Title XIII, s 1301(b), Oct. 22, 1986, 100 Stat. 2629, and amended Pub.L. 100-647, Title I, s 1013(a)(6)-(8), Title V, s 5053(a), Nov. 10, 1988, 102 Stat. 3538, 3677; Pub.L. 101-239, Title VII, s 7815(f), Dec. 19, 1989, 103 Stat. 2419; Pub.L. 101-508, Title XI, s 11813(b)(7), Nov. 5, 1990, 104 Stat. 1388-551.)

< General Materials (GM) - References, Annotations, or Tables >

HISTORICAL AND STATUTORY NOTES

Revision Notes and Legislative Reports

1986 Act. House Conference Report No. 99-841, and Statement by President, see 1986 U.S.Code Cong. and Adm.News, p. 4075.

1988 Act. Senate Report No. 100-445 and House Conference Report No. 100-1104, see 1988 U.S.Code Cong. and Adm.News, p. 4515.

1989 Act. House Report No. 101-247 and House Conference Report No. 101-386, see 1989 U.S.Code Cong. and Adm.News, p. 1906.

1990 Act. House Report No. 101-881 and House Conference Report No. 101-964, see 1990 U.S.Code Cong. and Adm.News, p. 2017.

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Citation	Rank(R)	Database	Mode
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(Publication page references are not available for this document.)

Section 145 -- Qualified Sec. 501(c)(3) Bonds

Publication Date: June 26, 1992

0103.00-00
 Interest on Certain Governmental Obligations (Excluded V.
 Notexcluded)
 0145.02-01
 0145.03-00
 CC:FI&P:Br.5/TR-31-2207-90

March 31, 1992

LEGEND:

X = * * *
 Complex Y = * * *
 Z = * * *
 Project = * * *
 Issuer = * * *
 Old Bonds = * * *
 a = * * *
 b = * * *
 c = * * *
 Dear * * *

This letter is our reply to a request for rulings on the application of section 145 of the Internal Revenue Code to a proposed issue of bonds (New Bonds). The request was submitted by the authorized representatives of X.

FACTS

X represents that it is an organization described in section 501(c)(3) of the Code. Z is licensed by a state agency as a hospital and is accredited as a hospital by the Joint Commission on Accreditation of Health Care Organizations. Z has been continuously certified as a hospital provider for purposes of receiving Medicare reimbursement by the United States Department of Health and Human Services.

Z requires every patient to be under the care and supervision of a physician. It provides 24-hour nursing services, rendered or supervised by registered professional nurses, and has licensed practical nurses or registered nurses on duty at all times. Z is licensed for and operates c beds.

Z is part of Complex Y, which consists of other hospitals accredited by the state agency, a teaching facility, an ambulatory care facility, and non-health care facilities. Approximately 80 percent of Z's gross patient revenues are currently from inpatients. However, X expects that changes in Medicare reimbursement, other economic pressures, and advances in technology will force Z to increase its relative amount of outpatient services, making it likely that a majority of services will eventually be rendered to outpatients.

In 1990, Issuer issued a dollars of Old Bonds and loaned the proceeds to X.

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(Publication page references are not available for this document.)

Of the proceeds of the Old Bonds, b dollars are being used for the construction of Project, which is an addition to Z. The remainder of the proceeds were or are being used for other purposes. When the Old Bonds were issued, X already exceeded the \$150 million limitation set forth in section 145(b)(1) of the Code. Therefore, the interest on the Old Bonds was not excludable from gross income under section 103(a).

Project is currently under construction. When completed, it will be part of Z. X expects Project to be licensed by the state agency as part of Z. Because Project will expand outpatient services, X expects that a majority of Z's revenues will be from outpatient services and that a majority of Z's space will be used for outpatient services.

X now proposes to direct Issuer, in accordance with provisions of the Old Bonds indenture, to issue New Bonds in an amount equal to the b dollars of proceeds from the Old Bonds used for Project. The proceeds of the New Bonds will be used to redeem part of the outstanding Old Bonds.

LAW AND ANALYSIS

Under section 103(b)(1) of the Code, the exclusion from gross income granted to interest on a state or local bond does not apply to private activity bonds. However, the exclusion does apply to private activity bonds that are qualified bonds. Among the qualified bonds listed in section 141(e)(1) is a qualified 501(c)(3) bond. A qualified 501(c)(3) bond is defined in section 145.

To be a qualified 501(c)(3) bond, a bond must satisfy a number of conditions, including \$150 million volume limitation set forth in section 145(b)(1) of the Code. Under this limitation, a bond is not treated as a qualified 501(c)(3) bond if it is part of an issue of bonds whose aggregate authorized face amount allocated to any 501(c)(3) organization, plus the amount of that organization's outstanding tax-exempt nonhospital bonds, exceeds \$150 million. A 501(c)(3) organization must be a test-period beneficiary under section 145(b)(4).

Under section 145(b)(1) of the Code, the \$150 million limitation does not apply to qualified hospital bonds. Section 145(c) defines a qualified hospital bond as any bond that is part of an issue if 95 percent or more of the issue's net proceeds are to be used for a hospital. Thus, unless Project is a hospital, the New Bonds must be tested under the \$150 million limitation.

The term "hospital" is not defined in Part IV, Subchapter B of the Code. However, the Conference Report for the Tax Reform Act of 1986, 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-725-727 (1986), 1986-3 C.B. (Vol. 4) 725-727, indicates that a hospital is a facility that (1) is accredited by the Joint Commission on Accreditation of Hospitals (which has been succeeded by the Joint Commission on Accreditation of Health Care Organizations); (2) is primarily used to provide diagnostic services and therapeutic services for medical diagnosis, treatment, and care of injured, disabled or sick persons as hospital inpatients under the supervision of physicians; (3) has a requirement that every patient be under the care and supervision of a physician; and (4) provides 24-hour nursing services rendered or supervised by a registered professional nurse and has a licensed practical nurse or registered nurse on duty at all times. The Report makes clear that the term "hospital" does not include rest or nursing homes, day care centers, medical school facilities, research laboratories or ambulatory surgicenters.

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Based on the information submitted, Z satisfies the tests of accreditation, physician supervision, and nursing services. The remaining question is whether it provides services primarily to inpatients.

The legislative history provides no test for determining whether a facility is primarily used to provide services to inpatients. However, we believe Z is primarily used to provide services to persons as hospital inpatients because (1) it has a principal, rather than an incidental, purpose to serve inpatients; (2) it has a substantial portion of its revenues derived from and a substantial portion of its area devoted to inpatients; (3) it has well-established facilities to accommodate on-site scheduled inpatients; and (4) it has well-established facilities to accommodate on-site a recipient of outpatient services who is immediately converted to an inpatient either when complications result from any outpatient services rendered or when a qualified health-care professional considers it medically prudent. Thus, at the present time, Z is primarily used to provide services to inpatients.

CONCLUSION

We conclude that Z is presently a hospital within the meaning of sections 145(b) and (c) of the Code. However, we express no opinion on the following questions: (1) whether Z and Project will continue to meet the definition of a hospital if there are changes in any of the four specified characteristics; (2) whether the proposed allocation of New Bonds' proceeds for purposes of section 145 is reasonable; and (3) whether the New Bonds would cause the \$150 million limitation of section 145(b)(1) to be exceeded. In addition, we express no opinion on the proposed transaction under any other provisions of the Code.

This ruling letter is directed only to the person that requested it. Section 6110(j)(3) of the Code states that the letter may not be used or cited as precedent. No temporary or final regulations pertaining to the ruling addressed in this letter have been adopted. Therefore, as stated in section 11.04 of Rev. Proc. 92-1, 1992-1 I.R.B. 7, 30, this letter will be modified or revoked when temporary or final regulations are adopted, to the extent the regulations are inconsistent with any of this letter's ruling. However, if the criteria set forth in section 11.05 of Rev. Proc. 92-1 are satisfied, the ruling in this letter will not be modified retroactively, except in rare or unusual circumstances.

In accordance with the power of attorney filed with this office, a copy of this letter has been mailed to your authorized representative.
Sincerely yours,

Assistant Chief Counsel
(Financial Institutions &
Products)

By: Lon B. Smith
Chief, Branch 5

Enclosure:

Copy for section 6110 purposes

Internal Revenue Service

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Citation	Rank(R)	Database	Mode
C875 ALI-ABA 179	R 14 OF 48	TP-ALL	Page
(Cite as: C875 ALI-ABA 179)			

ALI-ABA Course of Study
Tax Exempt Charitable Organizations
Cosponsored by the ABA Section of Taxation

***179 TAX EXEMPT FINANCING AND CHARITIES**

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December 2, 1993

Frederic L. Ballard, Jr.
Ballard, Spahr, Andrews & Ingersoll
Washington, D.C.

***181 1.** Basic transaction uses proceeds of municipal bonds to finance facilities for 501(c)(3) organization.

(a) City or state, or authority formed by city or state (collectively, the "issuer"), issues bonds that are exempt from Federal income tax and alternative minimum tax.

(b) Issuer lends proceeds to hospital or other 501(c)(3) organization ("borrower") for application to costs of facility.

(1) In some states, transaction may in form other than loan, such as lease, sublease, or installment sale.

(2) Non-loan formats originated historically out of concern over legality of government making loan to private parties.

(c) Payments by borrower to issuer provide issuer with funds to pay debt service on bonds plus expenses; reflect interest rate savings due to tax exemption of bond interest.

(d) Tax-exempt bonds for 501(c)(3) organizations ("qualified 501(c)(3) bonds") are subject to various limits under Internal Revenue Code -

(1) The 501(c)(3) organization must in fact be exempt under section 501(c)(3) and must not use the financed project in an unrelated trade or business.

(A) Substantive questions in some areas, such as low-income housing (75% of tenants below 60% of area median income, under Rev. Proc. 93-1).

(B) Management contracts must meet 5-year overall limit, pricing requirements, and other conditions of Rev. Proc. 93-19.

(C) Allocations sometimes permitted between cost of qualifying uses and nonqualifying uses -

***182 -** Allocation permitted on basis of space. LTR 8827065

(parking facility physically segregated between exempt and non-exempt use of parking spaces).

- Allocation permitted on basis of revenues. LTR 9125050 (research foundation may finance portion of cost of facility determined by prorating qualified revenues against private sponsored revenues).

(2) The 501(c)(3) organization cannot have more than \$150,000,000 of tax-exempt financing for "nonhospital" facilities; no limit on qualified 501(c)(3) bonds for hospital facilities (IRC s 145).

(A) Bonds issued before 1986 legislation count as well as bonds issued
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afterwards.

(B) "Hospital" is defined as facility that --

- is accredited,
- is "primarily" used to provide inpatient diagnostic or therapeutic services under supervision of a physician,
- requires that every patient be under supervision of a physician, and

- provides 24-hour nursing services. General Explanation of Tax Reform Act of 1986, Joint Committee on Taxation (1987) ["Joint Committee Explanation"] at 1188.

(C) Questionable whether rehabilitation hospitals are considered hospitals for purposes of this definition. Compare Joint Committee Explanation language with 42 U.S.C. s 1395x(e).

(D) If 95% of net proceeds (90% for pre-8/16/86 bonds) are used to provide a hospital, entire issue is treated as hospital bonds. Joint Committee Explanation at 1188.

(E) Non-hospital financings of 501(c)(3) organizations under common management or *183 control ("related organizations") are aggregated.

(F) Mixed use as between hospital and nonhospital facilities.

- Treat issue as exempt from \$150,000,000 limit to extent of proportional hospital services.
- Treasury may prescribe other allocation methods. Joint Committee Explanation at 1188.

- See also LTR 9822100 (facilities located in hospital but used both by inpatients and by outpatients are hospital facilities).

(3) Elected official must approve bond issuance after public hearing (IRC s 147(f)).

(4) Average maturity of bonds cannot exceed 120% of average economic life of financed facilities (IRC s 147(b)).

(5) Proceeds cannot be used for internal reimbursement of pre-bond expenditures unless -

(A) Issuer or borrower adopted a qualifying "declaration of official intent" not later than 60 days after the expenditure (exception for "preliminary expenditures" such as architects fees), and

(B) Bond issuance and reimbursement transfer occur within 18 months after expenditure or completion of project, but not later than 3 years after expenditure.

(6) Issuer and borrower must comply with arbitrage bond requirements -

(A) Must make "rebate" payments to Federal government equal to arbitrage (investment income at yield above bond yield) from -

(i) Reserve fund,

*184 (ii) Project fund, unless 6-month, 18-month, or 3-year "spending exception" applies.

(B) If bonds are "advance refunding bonds" (issued to pay off a prior issue at redemption date more than 90 days in future), cannot invest proceeds at yield more than .001% over the bond yield; project bonds issued after 1985 may be advance refunded once.

(7) Change in use of facility, such as sale to business, may be possible under Rev. Proc. 93-17 if -

(A) Not expected when bonds were issued,

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- (B) 5 years have passed.
- (C) Price is fair,
- (D) Bonds are redeemed.

2. Potentially abusive transactions under IR-90-60.

(a) 501(c)(3) organization acquires nursing home or hospital with proceeds of tax-exempt bonds, for example with "manage-back" agreement to developer.

(b) Facilities financed with tax-exempt bonds are sold or leased by a 501(c)(3) organization to partnership or other entities of medical staff.

(c) Private health care facility sells an unprofitable facility to a 501(c)(3) organization, for example newly formed by the private corporation and using bond financing.

(d) See also: Announcement 93-2, Proposed Examination Guidelines Regarding Colleges and Universities, s 342.7 (e.g. "determine whether the board of directors of the university have met a prudent man fiduciary standard in incurring the debt").

3. Particular problems in financing "working capital."

(a) "Working capital" expenditures are defined as expenditures not properly chargeable to capital account under general tax principles - that is, operating expenses. Reg. s 1.150-1(b).

*185 (b) Arbitrage bond regulations prevent an issuer from "allocating" proceeds to expenditures for working capital unless there are no other funds available.

(1) Exceptions for "de minimis" allocations (e.g., 5% of issue may be allocated to working capital expenditures, such as initial operating expenses, that are directly related to capital costs financed by the issue).

(2) Funds held in a "reasonable working capital reserve" (equal to 5% of prior year's expenses) can be treated as unavailable, unless the reserve represents an accumulation of funds replaced by the bond proceeds.

4. Emerging techniques with "derivative" securities.

(a) Fixed-rate bonds can be "fractionated" by parties into derivative products to meet particular markets.

(b) Example: first half of issue bears interest at conventional floating rate, second half jets difference between first half's rate and a fixed rate ("inverse floaters" or "residual interest bonds").

(c) Another example: bondholders receive floating rate; issuer enters an interest rate exchange contract ("swap contract") with a financial institution to hedge its rate risk.

(d) Desired result in both cases is tax treatment: as a fixed-rate issue of debt.

5. Emerging problems under Health Security Plan.

(a) How to finance working capital requirements of a health alliance.

(b) How to finance a state guarantee fund for failing hospitals.

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ALASKA STATE

HOSPITAL & NURSING HOME

ASSOCIATION

Testimony on House Bill 102

February 10, 1997

Mr. Chairman & Members of the House Finance Committee:

For the record, my name is Garrey Peska and I'm here representing the Alaska State Hospital and Nursing Home Association.

The Association members respectfully request that House Bill 102 not be passed from this committee and that the Alaska Medical Facilities Authority not be abolished.

This Authority was set up in 1978 for the purpose of selling tax exempt revenue bonds with the proceeds being used for medical facility construction and improvements.

In the past the Authority provided financing for two projects through bond sales. One was for the purchase of Careage North and the other was for remodeling Fairbanks Memorial Hospital. The Careage North bonds were retired on June 16, 1989 and the Fairbanks Memorial bonds were retired in March of 1990.

Since then there has been no activity in the Authority. That 's at least in part due to the fact that Alaska had enough money for a while to provide direct funding for hospital projects through the Capital Budget. That hasn't been happening lately and we don't expect to see it happen again in the near future.

Leaving the Authority on the books will provide a mechanism for selling tax exempt revenue bonds to finance medical facility construction and improvements in the future. Some facilities are municipally owned and they can sell revenue bonds through the municipalities and the State Municipal Bond Bank. Other non profit facilities that are not municipally owned could use this Authority for that purpose. We know of no other mechanism that would allow medical facilities to sell tax exempt revenue bonds for construction and improvement financing.

The Hospital & Nursing Home Association's lawyer has reviewed the State and Federal laws related to the Authority. In her report she verifies that the Authority may still sell these bonds under current Federal law. There is no compelling reason to abolish the Authority and I think the subject came up mostly because of the lack of activity in the Authority since 1990.

The Department of Revenue says that if bonds are sold by the Authority they are not general or moral obligations of the State. They are secured by lease payments on medical facilities mortgaged to the Authority and there would be no impact on the State's bond rating.

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FAX Transmission Sheet

Date: February 8, 1997
To: Garrey Peska
1-907-364-2950
From: Susan Wright Mason
Our File: ASHNHA/Proposed Legislation Care
Our File No. 4566-10
Message: Please see the attached.

You should receive 13 page(s) including this cover sheet. If there is a problem receiving this transmission, please call (907) 279-9696. Our fax number is (907) 279-4239.

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February 8, 1997

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VIA FACSIMILE--ORIGINAL TO FOLLOW

Mr. Garrey M. Peska
Alaska State Hospital & Nursing Home Association
P. O. Box 240185
Douglas, Alaska 99824

Re: Proposed Legislation
Repeal of Medical Facility Authority Statute
Our File No. 4566-10

Dear Garrey:

You have asked me to review Representative Therriault's proposed legislation repealing AS 18.26, which establishes the Alaska Medical Facility Authority. I understand from the telephone message that I received from you late yesterday afternoon that such a bill now has been introduced and that a hearing is scheduled at 1:30 on Monday afternoon, February 10.

My understanding of the supposed purpose of this legislation is based on comments that were made in the meetings of ASHNHA's Legislative Committee and the Executive Committee on Thursday, February 6. Specifically, it was explained that, originally, the Authority had been established to take advantage of a financing mechanism that had been authorized by federal law and that in 1986 federal law had been changed so that such financing was no longer possible. Before adopting a position on the proposed repeal, ASHNHA wanted to determine definitely whether that background information was accurate. The specific concern was to

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Mr. Garrey Peska
Alaska State Hospital & Nursing Home
Association
February 8, 1997
Page 2

Re: Proposed Legislation
Repeal of Medical Facility Authority Statute
Our File No. 4566-10

confirm that the repeal would not eliminate a possible means of financing the construction of health care facilities that might not otherwise be available.

Reading between the lines, I believe the 1986 change in federal law that was mentioned must have been the adoption of the Tax Reform Act of 1986. That law placed certain limitations on the tax exemptions that are available for interest earned on state and local bonds. Among other things, the Alaska Medical Facility Authority is authorized to issue revenue bonds for the purpose of establishing and equipping health care facilities. Those bonds are exempt from state taxes. Clearly, however, if the bonds were exempt from state taxes but not exempt from federal taxes, they would not be as attractive. I have researched the current status of the availability of a federal tax exemption for state and local government bonds used to finance construction of health care facilities, and I have determined that, with some restrictions, the tax exemption is still available. Specifically, the federal tax exemption continues to be available without limitation for non-profit hospital bonds and is available for other non-profit purposes, with some limitations.

Under sections 145 and 501(c)(3) of the Internal Revenue Code, if 95 percent of a state or local bond issue is for the use of a "hospital" that is otherwise exempt from federal income tax under section 501(c)(3), then the interest on those bonds is exempt and there is no limit on the amount of such bonds that can be issued. Other so-called "501(c)(3) bonds" also are tax exempt, but, except for "hospital bonds," there is a \$150 million limit on the amount of bonds that may be outstanding at any one time.

As back-up documentation, enclosed I am sending you copies of the following:

1. Section 145 of the Internal Revenue Code, "Qualified 501(c)(3) Bond";
2. Internal Revenue Service Private Letter Ruling 9226062 (March 3, 1992) (discussing standards for identifying a "hospital" not subject to the \$150 million limit on tax exempt bonds); and

Mr. Garrey Peska
Alaska State Hospital & Nursing Home
Association
February 8, 1997
Page 3

Re: Proposed Legislation
Repeal of Medical Facility Authority Statute
Our File No. 4566-10

3. F. Ballard, "Tax Exempt Financing and Charities,"
ALI-ABA Course of Study (Dec. 2, 1993) (in outline format,
summarizes mechanism and standards for tax-exempt bonds).

Given the continuing availability of a federal tax exemption for "hospital bonds," it may well be advisable to attempt to retain the Alaska Medical Facility Authority as a vehicle for issuing such bonds. There appears to be no requirement that such bonds be issued by an Authority, and presumably they also could be issued directly by the state or local government. That might require a public vote, however. (The outline listed as Item 3 above states, in paragraph 1(a), "City or state, or authority formed by city or state . . . issues bonds that are exempt from Federal income tax")

As you know, bond financing and the related tax exemptions are a very complex area, and I certainly am not a bond specialist. It is clear, however, that the federal tax exemption is still available for non-profit "hospital bonds." With this additional background information, it may be possible to determine if the proposed repeal in fact is based on a mistaken understanding that the federal tax exemption for such bonds was repealed in 1986. At the very least, demonstrating the invalidity of that reason may help bring to light some other reason the repeal is being proposed.

I hope this information is helpful to you in formulating ASHNHA's position on this legislation. I will be glad to discuss this with you at your convenience.

Sincerely,

KEESAL, YOUNG & LOGAN


Susan Wright Mason

SWM:klo
Enclosures
cc: Ms. Laraine Derr

(SAM\LTR\1939)

Citation
26 USCA s 145
26 U.S.C.A. s 145

FOUND DOCUMENT

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USCA

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UNITED STATES CODE ANNOTATED
TITLE 26. INTERNAL REVENUE CODE
SUBTITLE A--INCOME TAXES
CHAPTER 1--NORMAL TAXES AND SURTAXES
SUBCHAPTER B--COMPUTATION OF TAXABLE INCOME
PART IV--TAX EXEMPTION REQUIREMENTS FOR STATE AND LOCAL BONDS
SUBPART A--PRIVATE ACTIVITY BONDS
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Current through P.L. 104-333, approved 11-12-96

s 145. Qualified 501(c)(3) bond

(a) In general.--For purposes of this part, except as otherwise provided in this section, the term "qualified 501(c)(3) bond" means any private activity bond issued as part of an issue if--

(1) all property which is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and
(2) such bond would not be a private activity bond if--

(A) 501(c)(3) organizations were treated as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying section 513(a), and

(B) paragraphs (1) and (2) of section 141(b) were applied by substituting "5 percent" for "10 percent" each place it appears and by substituting "net proceeds" for "proceeds" each place it appears.

(b) \$150,000,000 limitation on bonds other than hospital bonds.--

(1) In general.--A bond (other than a qualified hospital bond) shall not be treated as a qualified 501(c)(3) bond if the aggregate authorized face amount of the issue (of which such bond is a part) allocated to any 501(c)(3) organization which is a test-period beneficiary (when increased by the outstanding tax-exempt nonhospital bonds of such organization) exceeds \$150,000,000.

(2) Outstanding tax-exempt nonhospital bonds.--

(A) In general.--For purposes of applying paragraph (1) with respect to any issue, the outstanding tax-exempt nonhospital bonds of any organization which is a test-period beneficiary with respect to such issue is the aggregate amount of tax-exempt bonds referred to in subparagraph (B)--

(i) which are allocated to such organization, and

(ii) which are outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

(B) Bonds taken into account.--For purposes of subparagraph (A), the bonds referred to in this subparagraph are--

(i) any qualified 501(c)(3) bond other than a qualified hospital bond, and
(ii) any bond to which section 141(a) does not apply if--

(I) such bond would have been an industrial development bond (as defined in section 103(b)(2), as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) if 501(c)(3) organizations were not exempt persons, and

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26 USCA § 145

PAGE 2

TEXT (b) (2) (B) (ii) (II)

(II) such bond was not described in paragraph (4), (5), or (6) of such section 103(b) (as in effect on the date such bond was issued).

(C) Only nonhospital portion of bonds taken into account.--

(i) In general.--A bond shall be taken into account under subparagraph (B) only to the extent that the proceeds of the issue of which such bond is a part are not used with respect to a hospital.

(ii) Special rule.--If 90 percent or more of the net proceeds of an issue are used with respect to a hospital, no bond which is part of such issue shall be taken into account under subparagraph (B)(ii).

(3) Aggregation rule.--For purposes of this subsection, 2 or more organizations under common management or control shall be treated as 1 organization.

(4) Allocation of face amount of issue; test-period beneficiary.--Rules similar to the rules of subparagraphs (C), (D) and (E) of section 144(a)(10) shall apply for purposes of this subsection.

(c) Qualified hospital bond.--For purposes of this section, the term "qualified hospital bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used with respect to a hospital.

(d) Restrictions on bonds used to provide residential rental housing for family units.--

(1) In general.--Except as otherwise provided in this subsection, a bond which is part of an issue shall not be a qualified 501(c)(3) bond if any portion of the net proceeds of the issue are to be used directly or indirectly to provide residential rental property for family units.

(2) Exception for bonds used to provide qualified residential rental projects.--Paragraph (1) shall not apply to any bond issued as part of an issue if the portion of such issue which is to be used as described in paragraph (1) is to be used to provide--

(A) a residential rental property for family units if the first use of such property is pursuant to such issue,

(B) qualified residential rental projects (as defined in section 142(d)), or

(C) property which is to be substantially rehabilitated in a rehabilitation beginning within the 2-year period ending 1 year after the date of the acquisition of such property.

(3) Certain property treated as new property.--Solely for purposes of determining under paragraph (2)(A) whether the 1st use of property is pursuant to tax-exempt financing--

(A) In general.--If--

(i) the 1st use of property is pursuant to taxable financing,

(ii) there was a reasonable expectation (at the time such taxable financing was provided) that such financing would be replaced by tax-exempt financing, and

(iii) the taxable financing is in fact so replaced within a reasonable period after the taxable financing was provided,

then the 1st use of such property shall be treated as being pursuant to the tax-exempt financing.

(B) Special rule where no operating state or local program for tax-exempt financing.--If, at the time of the 1st use of property, there was no

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26 USCA s 145
TEXT (d) (3) (B)

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operating State or local program for tax-exempt financing of the property, the 1st use of the property shall be treated as pursuant to the 1st tax-exempt financing of the property.

(C) Definitions.--For purposes of this paragraph--

(i) Tax-exempt financing.--The term "tax-exempt financing" means financing provided by tax-exempt bonds.

(ii) Taxable financing.--The term "taxable financing" means financing which is not tax-exempt financing.

(4) Substantial rehabilitation.--

(A) In general.--Except as provided in subparagraph (B), rules similar to the rules of section 47(c)(1)(C) shall apply in determining for purposes of paragraph (2)(C) whether property is substantially rehabilitated.

(B) Exception.--For purposes of subparagraph (A), clause (ii) of section 47(c)(1)(C)(i) shall not apply, but the Secretary may extend the 24-month period in section 47(c)(1)(C)(i) where appropriate due to circumstances not within the control of the owner.

(e) Election out.--This section shall not apply to an issue if--

(1) the issuer elects not to have this section apply to such issue, and

(2) such issue is an issue of exempt facility bonds, or qualified redevelopment bonds, to which section 146 applies.

~~CREDIT(S)~~

1997 Electronic Pocket Part Update

(Added Pub.L. 99-514, Title XIII, s 1301(b), Oct. 22, 1986, 100 Stat. 2629, and amended Pub.L. 100-647, Title I, s 1013(a)(6)-(8), Title V, s 5053(a), Nov. 10, 1988, 102 Stat. 3538, 3677; Pub.L. 101-239, Title VII, s 7815(f), Dec. 19, 1989, 103 Stat. 2419; Pub.L. 101-508, Title XI, s 11813(b)(7), Nov. 5, 1990, 104 Stat. 1388-551.)

< General Materials (GM) - References, Annotations, or Tables >

HISTORICAL AND STATUTORY NOTES

Revision Notes and Legislative Reports

1986 Act. House Conference Report No. 99-641, and Statement by President, see 1986 U.S.Code Cong. and Adm.News, p. 4075.

1988 Act. Senate Report No. 100-445 and House Conference Report No. 100-1104, see 1988 U.S.Code Cong. and Adm.News, p. 4515.

1989 Act. House Report No. 101-247 and House Conference Report No. 101-386, see 1989 U.S.Code Cong. and Adm.News, p. 1906.

1990 Act. House Report No. 101-881 and House Conference Report No. 101-964, see 1990 U.S.Code Cong. and Adm.News, p. 2017.

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(Publication page references are not available for this document.)

Section 145 -- Qualified Sec. 501(c)(3) Bonds

Publication Date: June 26, 1992

0103.00-00

Interest on Certain Governmental Obligations (Excluded V. Notexcluded)

0145.02-01

0145.03-00

CC:FI&P:Br.5/TR-31-2207-90

March 31, 1992

LEGEND:

X = * * *

Complex Y = * * *

Z = * * *

Project = * * *

Issuer = * * *

Old Bonds = * * *

a = * * *

b = * * *

c = * * *

Dear * * *

This letter is our reply to a request for rulings on the application of section 145 of the Internal Revenue Code to a proposed issue of bonds (New Bonds). The request was submitted by the authorized representatives of X.

FACTS

X represents that it is an organization described in section 501(c)(3) of the Code. Z is licensed by a state agency as a hospital and is accredited as a hospital by the Joint Commission on Accreditation of Health Care Organizations. Z has been continuously certified as a hospital provider for purposes of receiving Medicare reimbursement by the United States Department of Health and Human Services.

Z requires every patient to be under the care and supervision of a physician. It provides 24-hour nursing services, rendered or supervised by registered professional nurses, and has licensed practical nurses or registered nurses on duty at all times. Z is licensed for and operates c beds.

Z is part of Complex Y, which consists of other hospitals accredited by the state agency, a teaching facility, an ambulatory care facility, and non-health care facilities. Approximately 80 percent of Z's gross patient revenues are currently from inpatients. However, X expects that changes in Medicare reimbursement, other economic pressures, and advances in technology will force Z to increase its relative amount of outpatient services, making it likely that a majority of services will eventually be rendered to outpatients.

In 1990, Issuer issued a dollars of Old Bonds and loaned the proceeds to X.

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(Publication page references are not available for this document.)

Of the proceeds of the Old Bonds, b dollars are being used for the construction of Project, which is an addition to Z. The remainder of the proceeds were or are being used for other purposes. When the Old Bonds were issued, X already exceeded the \$150 million limitation set forth in section 145(b)(1) of the Code. Therefore, the interest on the Old Bonds was not excludable from gross income under section 103(a).

Project is currently under construction. When completed, it will be part of Z. X expects Project to be licensed by the state agency as part of Z. Because Project will expand outpatient services, X expects that a majority of Z's revenues will be from outpatient services and that a majority of Z's space will be used for outpatient services.

X now proposes to direct Issuer, in accordance with provisions of the Old Bonds indenture, to issue New Bonds in an amount equal to the b dollars of proceeds from the Old Bonds used for Project. The proceeds of the New Bonds will be used to redeem part of the outstanding Old Bonds.

LAW AND ANALYSIS

Under section 103(b)(1) of the Code, the exclusion from gross income granted to interest on a state or local bond does not apply to private activity bonds. However, the exclusion does apply to private activity bonds that are qualified bonds. Among the qualified bonds listed in section 141(e)(1) is a qualified 501(c)(3) bond. A qualified 501(c)(3) bond is defined in section 145.

To be a qualified 501(c)(3) bond, a bond must satisfy a number of conditions, including \$150 million volume limitation set forth in section 145(b)(1) of the Code. Under this limitation, a bond is not treated as a qualified 501(c)(3) bond if it is part of an issue of bonds whose aggregate authorized face amount allocated to any 501(c)(3) organization, plus the amount of that organization's outstanding tax-exempt nonhospital bonds, exceeds \$150 million. A 501(c)(3) organization must be a test-period beneficiary under section 145(b)(4).

Under section 145(b)(1) of the Code, the \$150 million limitation does not apply to qualified hospital bonds. Section 145(c) defines a qualified hospital bond as any bond that is part of an issue if 95 percent or more of the issue's net proceeds are to be used for a hospital. Thus, unless Project is a hospital, the New Bonds must be tested under the \$150 million limitation.

The term "hospital" is not defined in Part IV, Subchapter B of the Code. However, the Conference Report for the Tax Reform Act of 1986, 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-725-727 (1986), 1986-3 C.B. (Vol. 4) 725-727, indicates that a hospital is a facility that (1) is accredited by the Joint Commission on Accreditation of Hospitals (which has been succeeded by the Joint Commission on Accreditation of Health Care Organizations); (2) is primarily used to provide diagnostic services and therapeutic services for medical diagnosis, treatment, and care of injured, disabled or sick persons as hospital inpatients under the supervision of physicians; (3) has a requirement that every patient be under the care and supervision of a physician; and (4) provides 24-hour nursing services rendered or supervised by a registered professional nurse and has a licensed practical nurse or registered nurse on duty at all times. The Report makes clear that the term "hospital" does not include rest or nursing homes, day care centers, medical school facilities, research laboratories or ambulatory surgicenters.

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(Publication page references are not available for this document.)

Based on the information submitted, Z satisfies the tests of accreditation, physician supervision, and nursing services. The remaining question is whether it provides services primarily to inpatients.

The legislative history provides no test for determining whether a facility is primarily used to provide services to inpatients. However, we believe Z is primarily used to provide services to persons as hospital inpatients because (1) it has a principal, rather than an incidental, purpose to serve inpatients, (2) it has a substantial portion of its revenues derived from and a substantial portion of its area devoted to inpatients; (3) it has well-established facilities to accommodate on-site scheduled inpatients; and (4) it has well-established facilities to accommodate on-site a recipient of outpatient services who is immediately converted to an inpatient either when complications result from any outpatient services rendered or when a qualified health-care professional considers it medically prudent. Thus, at the present time, Z is primarily used to provide services to inpatients.

CONCLUSION

We conclude that Z is presently a hospital within the meaning of sections 145(b) and (c) of the Code. However, we express no opinion on the following questions: (1) whether Z and Project will continue to meet the definition of a hospital if there are changes in any of the four specified characteristics; (2) whether the proposed allocation of New Bonds' proceeds for purposes of section 145 is reasonable; and (3) whether the New Bonds would cause the \$150 million limitation of section 145(b)(1) to be exceeded. In addition, we express no opinion on the proposed transaction under any other provisions of the Code.

This ruling letter is directed only to the person that requested it. Section 6110(j)(3) of the Code states that the letter may not be used or cited as precedent. No temporary or final regulations pertaining to the ruling addressed in this letter have been adopted. Therefore, as stated in section 11.04 of Rev. Proc. 92-1, 1992-1 I.R.B. 7, 30, this letter will be modified or revoked when temporary or final regulations are adopted, to the extent the regulations are inconsistent with any of this letter's ruling. However, if the criteria set forth in section 11.05 of Rev. Proc. 92-1 are satisfied, the ruling in this letter will not be modified retroactively, except in rare or unusual circumstances.

In accordance with the power of attorney filed with this office, a copy of this letter has been mailed to your authorized representative.
Sincerely yours,

Assistant Chief Counsel
(Financial Institutions &
Products)
By: Lon B. Smith
Chief, Branch 5
Enclosure:
Copy for section 6110 purposes

Internal Revenue Service

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ALI-ABA Course of Study
Tax Exempt Charitable Organizations
Cosponsored by the ABA Section of Taxation

***179 TAX EXEMPT FINANCING AND CHARITIES**

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December 2, 1993

Frederic L. Ballard, Jr.
Ballard, Spahr, Andrews & Ingersoll
Washington, D.C.

***181** 1. Basic transaction uses proceeds of municipal bonds to finance facilities for 501(c)(3) organization.

(a) City or state, or authority formed by city or state (collectively, the "issuer"), issues bonds that are exempt from Federal income tax and alternative minimum tax.

(b) Issuer lends proceeds to hospital or other 501(c)(3) organization ("borrower") for application to costs of facility.

(1) In some states, transaction may in form other than loan, such as lease, sublease, or installment sale.

(2) Non-loan formats originated historically out of concern over legality of government making loan to private parties.

(c) Payments by borrower to issuer provide issuer with funds to pay debt service on bonds plus expenses; reflect interest rate savings due to tax exemption of bond interest.

(d) Tax-exempt bonds for 501(c)(3) organizations ("qualified 501(c)(3) bonds") are subject to various limits under Internal Revenue Code -

(1) The 501(c)(3) organization must in fact be exempt under section 501(c)(3) and must not use the financed project in an unrelated trade or business.

(A) Substantive questions in some areas, such as low-income housing (75% of tenants below 60% of area median income, under Rev. Proc. 93-1).

(B) Management contracts must meet 5-year overall limit, pricing requirements, and other conditions of Rev. Proc. 93-19.

(C) Allocations sometimes permitted between cost of qualifying uses and nonqualifying uses -

***182** - Allocation permitted on basis of space. LTR 8827065

(parking facility physically segregated between exempt and non-exempt use of parking spaces).

- Allocation permitted on basis of revenues. LTR 9125050 (research foundation may finance portion of cost of facility determined by prorating qualified revenues against private sponsored revenues).

(2) The 501(c)(3) organization cannot have more than \$150,000,000 of tax-exempt financing for "nonhospital" facilities; no limit on qualified 501(c)(3) bonds for hospital facilities (IRC s 145).

(A) Bonds issued before 1986 legislation count as well as bonds issued Copr. (C) West 1997 No claim to orig. U.S. govt. works

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afterwards.

(B) "Hospital" is defined as facility that --

- is accredited,
- is "primarily" used to provide inpatient diagnostic or therapeutic services under supervision of a physician,
- requires that every patient be under supervision of a physician,

and

- provides 24-hour nursing services. General Explanation of Tax Reform Act of 1986, Joint Committee on Taxation (1987) ["Joint Committee Explanation"] at 1188.

(C) Questionable whether rehabilitation hospitals are considered hospitals for purposes of this definition. Compare Joint Committee Explanation language with 42 U.S.C. s 1395x(e).

(D) If 95% of net proceeds (90% for pre-8/16/86 bonds) are used to provide a hospital, entire issue is treated as hospital bonds. Joint Committee Explanation at 1188.

(E) Non-hospital financings of 501(c)(3) organizations under common management or *183 control ("related organizations") are aggregated.

(F) Mixed use as between hospital and nonhospital facilities.

- Treat issue as exempt from \$150,000,000 limit to extent of proportional hospital services.

- Treasury may prescribe other allocation methods. Joint Committee Explanation at 1188.

- See also LTR 8822100 (facilities located in hospital but used both by inpatients and by outpatients are hospital facilities).

(3) Elected official must approve bond issuance after public hearing (IRC s 147(f)).

(4) Average maturity of bonds cannot exceed 120% of average economic life of financed facilities (IRC s 147(b)).

(5) Proceeds cannot be used for internal reimbursement of pre-bond expenditures unless -

(A) Issuer or borrower adopted a qualifying "declaration of official intent" not later than 60 days after the expenditure (exception for "preliminary expenditures" such as architects fees), and

(B) Bond issuance and reimbursement transfer occur within 18 months after expenditure or completion of project, but not later than 3 years after expenditure.

(6) Issuer and borrower must comply with arbitrage bond requirements -

(A) Must make "rebate" payments to Federal government equal to arbitrage (investment income at yield above bond yield) from -

(i) Reserve fund,

*184 (ii) Project fund, unless 6-month, 18-month, or 2-year "spending exception" applies.

(B) If bonds are "advance refunding bonds" (issued to pay off a prior issue at redemption date more than 90 days in future), cannot invest proceeds at yield more than .001% over the bond yield; project bonds issued after 1985 may be advance refunded once.

(7) Change in use of facility, such as sale to business, may be possible under Rev. Proc. 93-17 if -

(A) Not expected when bonds were issued,

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- (B) 5 years have passed,
- (C) Price is fair,
- (D) Bonds are redeemed.

2. Potentially abusive transactions under IR-90-60.

(a) 501(c)(3) organization acquires nursing home or hospital with proceeds of tax-exempt bonds, for example with "manage-back" agreement to developer.

(b) Facilities financed with tax-exempt bonds are sold or leased by a 501(c)(3) organization to partnership or other entities of medical staff.

(c) Private health care facility sells an unprofitable facility to a 501(c)(3) organization, for example newly formed by the private corporation and using bond financing.

(d) See also: Announcement 93-2, Proposed Examination Guidelines Regarding Colleges and Universities, s 342.7 (e.g "determine whether the board of directors of the university have met a prudent man fiduciary standard in incurring the debt").

3. Particular problems in financing "working capital."

(a) "Working capital" expenditures are defined as expenditures not properly chargeable to capital account under general tax principles - that is, operating expenses. Reg. s 1.150-1(b).

*185 (b) Arbitrage bond regulations prevent an issuer from "allocating" proceeds to expenditures for working capital unless there are no other funds available.

(1) Exceptions for "de minimis" allocations (e.g., 5% of issue may be allocated to working capital expenditures, such as initial operating expenses, that are directly related to capital costs financed by the issue).

(2) Funds held in a "reasonable working capital reserve" (equal to 5% of prior year's expenses) can be treated as unavailable, unless the reserve represents an accumulation of funds replaced by the bond proceeds.

4. Emerging techniques with "derivative" securities.

(a) Fixed-rate bonds can be "fractionated" by parties into derivative products to meet particular markets.

(b) Example: first half of issue bears interest at conventional floating rate, second half gets difference between first half's rate and a fixed rate ("inverse floaters" or "residual interest bonds").

(c) Another example: bondholders receive floating rate; issuer enters an interest rate exchange contract ("swap contract") with a financial institution to hedge its rate risk.

(d) Desired result in both cases is tax treatment as a fixed-rate issue of debt.

5. Emerging problems under Health Security Plan.

(a) How to finance working capital requirements of a health alliance.

(b) How to finance a state guarantee fund for failing hospitals.

C875 ALI-ABA 179

END OF DOCUMENT

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Revision Date: _____ Dept. Affected: Revenue
 Title: Abolish Alaska Medical Facility Authority BRU: Revenue Operations
 Component: Treasury Division
 Sponsor: (H) FIN
 Requestor: (H) FIN COMPONENT SERIAL NO. 121

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
----------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	0.0	0.0	0.0	0.0	0.0	0.0
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY97) cost \$ 0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

The Department of Revenue supports the abolishment of the Authority. There is no fiscal impact.

Prepared by: Laurie Perkins, Director Phone: 465-2312
 Division: Administrative Services Division Date: January 7, 1997
 Approved by Commissioner: Deborah Vogt Date: January 7, 1997
 Agency: Revenue

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