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MEMORANDUM FOR Charles M. Anderson
Manager, Tax-Exempt Bonds - Field Operations

FROM: Timothy L. Jones
Assistant Chief, Tax-Exempt Bond Branch

SUBJECT:

This written technical assistance is to inform you of our position regarding a lease arrangement at an airport that causes a bond financed parking lot to be privately used for purposes of § 141(b)(1) of the Internal Revenue Code. In accordance with § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE

Is the private business use test under § 141(b)(1) met if the amount of a lease payment to an airport authority for a terminal space takes into account the net profits generated by parking facility fees on a bond financed parking lot?

CONCLUSION

When an airport authority's lease with a private air carrier gives the carrier an interest in the net profits generated by the parking facility fees (in the form of reduced lease payments), such lease causes the private business use test under § 141(b)(1) to be met with respect to the parking facility because it is an arrangement that conveys special legal entitlements to the financed facility to the carrier.

FACTS

The Authority is a public entity that owns and operates an airport and is authorized to issue tax-exempt bonds. It plans to issue tax exempt bonds to build a parking facility adjacent to the airport (the "Bonds").

The Authority leases terminal space at the airport to a private air carrier under a lease arrangement whereby the carrier has exclusive use of the leased premises. The proposed parking facility is not part of this exclusive lease arrangement with the carrier. Instead, the parking facility will be used primarily by customers of the airlines at the airport including private air carriers, with incidental use by employees of the airlines. The fees generated by the parking facility are to be applied to debt service on the

Bonds. Any remaining net profits of the parking facility are part of the Authority's net revenues.

Under the lease with the carrier, rental charges are assessed to the carrier based primarily on square footage of area leased. However, these rental charges will be reduced under the terms of the lease by a portion of the Authority's net revenues, which include net profits of the parking facility, if the net revenues exceed a certain level, A. It is expected that the parking facility will generate a profit and that the net revenues of the Authority will exceed A. The carrier will have no other rights to the parking facility.

LAW AND ANALYSIS

Generally, under § 103(a), interest on a state or local bond is exempt from tax unless the bond is a private activity bond under § 103(b). Section 141 provides that a bond is a private activity bond if the bond satisfies the private business use test and the private security or payment test of § 141(b), or the private loan financing test of § 141(c).

Section 141(b)(1) provides that the private business use test is satisfied if more than 10 percent of the proceeds of the bonds are to be used for any private business use. Private business use is defined in § 141(b)(6) as use, directly or indirectly, in the trade or business of nongovernmental persons.

Under § 141(b)(2), the private security or payment test is satisfied if payment of the principal of, or the interest on, more than 10 percent of the proceeds of the issue is directly or indirectly (1) secured by any interest in property used or to be used for a private business use, or payments in respect of such property; or (2) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(c), the private loan financing test is satisfied if the amount of the proceeds of the issue which are to be used (directly or indirectly) to make or finance loans to persons other than governmental units exceeds the lesser of 5 percent of such proceeds, or \$5,000,000.

Section 1.141-3(a) sets forth that use of financed property is treated as the direct use of proceeds. In determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct use of proceeds.

Section 1.141-3(c)(1) provides that use as a member of the general public is not private business use. Use of financed property by nongovernmental persons in their trade or business is treated as general public use only if the property is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade or business. Section 1.141-3(c)(2) provides that in general, use under an arrangement that conveys priority rights or other preferential benefits is not use on the same basis as the general public. Section 1.141-3(c)(4) states that use of

financed property by the general public does not prevent the proceeds from being used for a private business use because of other use under this section.

Section 1.141-3(b)(1) provides that both actual and beneficial use by a nongovernmental person may be treated as private business use, and generally, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer.

Section 1.141-3(b)(7) provides that an arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to special legal entitlements described under §§ 1.141-3(b)(2), (3), (4), (5), or (6) results in private business use.

Section 1.141-3(f), Example 8(iii) illustrates the application of the private business use rules. City I issues bonds and uses all of the proceeds to finance construction of a runway at a new city-owned airport. The runway is available on a fee basis to the general public. Private air carriers lease terminal space from the airport. The lease payments under the leases with the private air carriers are determined on a residual basis by taking into account the net revenues generated by runway landing fees. These leases cause the private business use test to be met with respect to the runway because they are arrangements that convey special legal entitlements to the financed facility to nongovernmental persons.

In contrast, § 1.141-3(f), Example 9 illustrates a case where the private business use test is not met. City S issues bonds and uses all of the proceeds to finance construction of a city-owned parking garage at the city-owned airport. Even though it is reasonably expected that more than 10 percent of the actual use of the parking garage will be by employees of private air carriers in connection with their use of the airport terminals leased by those carriers, the use nevertheless is general public use because use of the garages by the air carrier will be on the same basis as passengers and other members of the general public using the airport. The leases for the use of the terminal space provide no priority rights to the air carriers for use of the parking garage, and the lease payments are determined without taking into account the revenues generated by the parking garage. Although the lessee air carriers receive a special economic benefit from the use of the parking garage, this economic benefit is not sufficient to cause the air carriers to be private business users because the parking garage is available for general public use. The issue does not meet the private business use test.

Here, the Authority's lease with the private air carrier causes the private business use test under § 141(b)(1) to be met with respect to the parking facility bonds. The lease provides the carrier with a special legal entitlement to the net profits of the parking facility when the Authority's net revenues exceed A. An interest in the net profits of a facility is the type of special legal entitlement that gives rise to private business use under § 1.141-3(b)(7). See § 1.141-3(f), Example 8(iii). Similar to Example 8(iii), the rental payments due under the Authority's lease with the carrier are determined on a residual basis by taking into account the net profits generated by the parking facility.

While there is no guarantee that the parking facility will generate net profits, the fact that there is an expectation that net revenues of the Authority will exceed A creates a special legal entitlement to use that bond financed facility, satisfying the private business use test under § 141(b)(1).

Therefore, under the facts described above, the Authority's lease with the private air carrier causes the private business use test under § 141(b)(1) to be met with respect to the parking facility.

This written technical assistance is advisory only and does not represent an expression of the views of the Service as to the application of law, regulations, and precedents to the facts of a specific case. If there are questions regarding whether the facts and circumstances in a particular case establish a residual lease arrangement, please seek the input of this office.

If you have any questions, please feel free to contact me at (202) 622-3980.