

Rev. Proc. 82-26, 1982-1 CB 476, January 1, 1982.

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth the circumstances under which the Service will ordinarily issue an advance ruling that obligations issued by a corporation organized under the general nonprofit corporation law of a state ("nonprofit corporation" or "corporation") will be considered obligations of a state or a political subdivision of a state under section 103(a)(1) of the Internal Revenue Code.

SEC. 2. BACKGROUND

Section 103 of the Code provides that, subject to the exceptions set forth in sections 103(b), 103(c), 103(f) and 103A, interest on the obligations of a state, a territory, or a possession of the United States, or any of their political subdivisions, or of the District of Columbia ("governmental units") are not includible in gross income. Section 1.103-1(b) of the Income Tax Regulations provides that obligations issued on behalf of any governmental unit by constituted authorities empowered to issue such obligations are the obligations of the unit.

The Service has issued three revenue rulings that hold that obligations issued by a nonprofit corporation will be considered obligations of a governmental unit under section 1.103-1(b) of the regulations if certain conditions are met.

Rev. Rul. 54-296, 1954-2 C.B. 59, holds that notes issued by a nonprofit corporation organized by a group of public-spirited citizens to make improvements to a city-owned building are considered obligations of the city if (1) the city owns all of the stock in the corporation, (2) the city will become absolute owner of the improvements upon retirement of the notes by the corporation at or prior to maturity or upon assumption or discharge of the notes by the city, whichever occurs first, and (3) all of the income earned from the rental of the building inures to the city.

Rev. Rul. 59-41, 1959-1 C.B. 13, holds that obligations issued by a nonprofit corporation organized at the request of a city to finance the acquisition of a system for the supply and distribution of water in and near the city are the obligations of the city if (1) none of the net earnings or assets of the corporation inures to any private person, (2) the city has the right to purchase the system at any time for the outstanding indebtedness of the corporation plus interest, (3) the city will receive, without demand or further action, fee ownership and immediate exclusive possession of the system when the corporation's debt is paid, (4) the city has stated its intention to take title at that time, and (5) the city has approved the issuance of the obligations and has the right to make recommendations to the corporation regarding operation of the system.

Rev. Rul. 63-20, 1963-1 C.B. 24, holds that obligations of a nonprofit corporation will be considered issued on behalf of a governmental unit if (1) the corporation engages in activities that are essentially public in nature, (2) the corporation is not organized for profit, except to the extent of retiring indebtedness, (3) the corporate income does not inure to any private person, (4) the governmental unit has a beneficial interest in the corporation while the indebtedness is outstanding, and it obtains full legal title to the property of the corporation with respect to which the indebtedness was incurred upon retirement of the indebtedness, and (5) the corporation and the specific obligations to be issued by the corporation have been approved by the governmental unit on whose behalf the obligations are issued.

The requirements enumerated in Rev. Rul. 63-20 apply to obligations issued by the nonprofit corporations described in Rev. Ruls. 54-296 and 59-41. Under this revenue procedure, the Service will ordinarily issue an advance ruling that obligations issued by a nonprofit corporation meet the requirements in Rev. Rul. 63-20, if the operating rules of sections 3 and 4 below are met.

Historically, the Service has required that certain conditions be met before it issued an advance ruling that obligations issued by a nonprofit corporation met the requirements of Rev. Rul. 63-20. This revenue procedure is intended only to state in one document the conditions that the Service has required to be met in prior years before such an advance ruling was issued. This revenue procedure is not intended to change or add to the conditions that the Service required to be met before it would issue such an advance ruling.

This revenue procedure is not intended to address the question of whether an entity is a political subdivision of a state within the meaning of section 103 of the Code. Further, this revenue procedure is not intended to address the issue of whether obligations issued by a corporation that is organized either under a special state statute or a statute providing that only governmental units may organize the corporation meet the requirements of Rev. Rul. 57-187, 1957-1 C.B. 65, or Rev. Rul. 60-248, 1960-2 C.B. 35. In addition, this revenue procedure is not intended to address the issue of whether trusts created under state laws to further certain public functions meet the requirements of Rev. Rul. 57-151, 1957-1 C.B. 64. Moreover, this revenue procedure does not apply to issues of qualified scholarship funding bonds defined in section 103(e), which are exempt from federal income tax under section 103(a)(2).

The operating rules of this revenue procedure are intended only to assist issuers of governmental obligations, and other parties with a material financial interest, in preparing ruling requests. The operating rules do not define, as a matter of law, the circumstances under which obligations to be issued by a nonprofit corporation will be considered issued on behalf of a governmental unit within the meaning of section 1.103-1(b) of the regulations. Thus, the operating rules are not to be used as tests for determining the taxability of bond interest.

The authority and general procedures of the National Office and the Offices of the District Directors of Internal Revenue for issuing advance rulings and determination letters are outlined in Rev. Proc. 80-20, 1980-1 C.B. 633, as modified, clarified, and amplified by Rev. Proc. 81-33, 1981-32 I.R.B. 19, and in section 601.201 of the Statement of Procedural Rules (26 C.F.R section 601.201 (1980)). Also see Rev. Proc. 79-4, 1979-1 C.B. 483; Rev. Proc. 79-12, 1979-1 C.B. 492, as amplified by Rev. Proc. 80-1, 1980-1 C.B. 579; and Rev. Proc. 82-22, page 469, this Bulletin. Careful attention to all of the requirements of these documents will help prevent delays in processing requests for rulings.

SEC. 3. GENERAL OPERATING RULES

The Service will ordinarily rule that obligations issued by a nonprofit corporation are issued on behalf of a governmental unit within the meaning of section 1.103-1(b) of the regulations if the following requirements are met:

.01 The nonprofit corporation must engage in activities that are essentially public in nature. This requirement will be met if:

1 The activities and purposes of the corporation are those permitted under the general nonprofit corporation law of the state; and

2 The property to be provided by the corporation's obligations is located within the geographical boundaries of or has a substantial connection with the governmental unit on whose behalf the obligations are issued.

.02 The corporation must not be organized for profit except to the extent of retiring indebtedness. This requirement will be met if:

1 The corporation is organized under the general nonprofit corporation law of the state in which is located the governmental unit on whose behalf the corporation will issue its obligations; and

2 The articles of incorporation of the corporation provide that the corporation is one that is not organized for profit.

.03 The corporate income may not inure to any private person. This requirement will be met if the articles of incorporation provide that the corporate income will not inure to any private person, and in fact, the corporate income does not inure to any private person.

.04 The governmental unit must have a beneficial interest in the corporation while the indebtedness remains outstanding. This requirement will be met if:

1 (a) The governmental unit has exclusive beneficial possession and use of a portion of the property financed by the obligations and additions to that property equivalent to 95 percent or more of its fair rental value for the life of the obligations (including any other obligations, such as those described in section 3.055 of this revenue procedure, issued by the nonprofit corporation either to make improvements to the property or to refund a prior issue of the corporation's obligations). For purposes of determining whether an obligation is an industrial development bond under section 103(b) of the Code, a nonprofit corporation in the circumstances described in this subparagraph will be considered an exempt person within the meaning of section 103(b)(3) even if the corporation is not an organization described in section 501(c)(3) that is exempt from federal taxation under section 501(a). Use by an instrumentality of a governmental unit will be considered use by the unit if the instrumentality is an instrumentality of only the governmental unit on whose behalf the obligations are issued and the requirements of Rev. Rul. 57-128, 1957-1 C.B. 311, are otherwise met; or

(b) (1) The nonprofit corporation has exclusive beneficial possession and use of a portion of the property financed by the obligations, and any additions to that property, equivalent to 95 percent or more of its fair rental value for the life of the obligations; and

(2) The governmental unit on whose behalf the nonprofit corporation is issuing the obligations (A) appoints or approves the appointment of at least 80 percent of the members of the governing board of the corporation, and (B) has the power to remove, for cause, either directly or through judicial proceedings, any member of the governing board and appoint a successor. If the articles of incorporation of the nonprofit corporation provide that ex-officio representatives of the governmental unit constitute all or a part of the membership of the governing board of the corporation, then the requirements of (A) and (B) shall not apply to the ex-officio members; or

(c) The government unit has the right at any time to obtain unencumbered fee title and exclusive possession of the property financed by the obligations, and any additions to that property, by (1) placing into escrow an amount that will be sufficient to defend the obligations, and (2) paying reasonable costs incident to the defeasance. However, the governmental unit, at any time before it defeases the obligations, may not agree or otherwise be obligated to convey any interest in the property to any person (including the United States of America or its agencies or instrumentalities) for any period extending beyond or beginning after the unit defeases the obligations. In addition, generally the unit may not agree or otherwise be obligated to convey a fee interest in the property to any person who was a user of the property, or a related person under section 103(b)(6)(C) of the Code, before the defeasance within 90 days after the unit defeases the obligations. If the governmental unit exercises its right under this subparagraph, the corporation must immediately cancel all encumbrances on the property, including leases and management contracts. Any lease, management contract, or other similar encumbrance on the property will be considered immediately cancelled if the lessee, management company, or other user vacates the property within a reasonable time, generally not to exceed 90 days, after the date the governmental unit exercises its right under this subparagraph. Encumbrances that do not significantly interfere with the enjoyment of the property, such as most easements granted to utility companies, are not considered encumbrances for purposes of this subparagraph; and

2 In the event the nonprofit corporation defaults in its payments under the obligations, the governmental unit has an exclusive option to purchase the property financed by the obligations and additions to that property for the amount of the outstanding indebtedness and accrued interest to the date of default. The governmental unit shall have (a) not less than 90 days from the date it is notified by the nonprofit corporation of the default in which to exercise the option, and (b) not less than 90 days from the date it exercises the option to purchase the property. This requirement does not apply if the governmental unit has the use of the property described in paragraph 1(a) above.

.05 The governmental unit must obtain full legal title to the property of the corporation with respect to which the indebtedness was incurred upon retirement of the indebtedness. This requirement will be met if:

1 The obligations of the nonprofit corporation are issued on behalf of no more than one governmental unit and unencumbered fee title to the property will vest solely in that governmental unit when the obligations are discharged. For purposes of this revenue procedure obligations are discharged when (a) cash is available at the place of payment on the date that the obligations are due (whether at maturity or upon prior call for redemption) and (b) interest ceases to accrue on the obligations; and

2 All of the original proceeds and investment proceeds of the obligations are used to provide tangible real or tangible personal property. Proceeds are considered to provide tangible property only if the proceeds are (a) used to finance costs that a taxpayer must charge to the property's capital account, may elect to charge to the property's capital account instead of deducting, or may elect to deduct instead of charging to the property's capital account, and (b) used to fund a reasonably required reserve fund within the meaning of section 103(c)(4) of the Code. The previous sentence does not apply to a de minimis amount, less than \$5,000, that is included in the bond issue solely for the purpose of rounding the dollar amount of the issue. If excess proceeds remain on hand after the acquisition or completion of construction or reconstruction of the property, the requirements of this subsection will be considered met if (a) the face amount of the obligations (taking into account estimated investment proceeds) was based on reasonable estimates of the cost of the property at the time the obligations were issued, and

(b) the excess proceeds are used and invested in the manner described in sections 3.04, 3.05, and 3.06 of Rev. Proc. 79-5, 1979-1 C.B. 485, as amplified by Rev. Proc. 81-22, 1981-1 C.B. 692.

Amounts used to provide a borrower with working capital are not used to provide tangible property. For example, if the proceeds of obligations issued by a nonprofit corporation are used to acquire property from a charitable organization and the corporation subsequently leases the property back to the charitable organization, the proceeds are not used to provide tangible property. Similarly, if the proceeds of obligations issued by a nonprofit corporation are used to acquire a portfolio of outstanding mortgages on tangible property, the proceeds are not used to provide tangible property.

For purposes of this revenue procedure, original proceeds are amounts (after payment of all expenses of issuing the obligations) received at any time as a result of the sale of an issue of obligations. For purposes of this revenue procedure investment proceeds are amounts (net of administrative costs) that result from the investment of any proceeds of an issue of obligations. However, for purposes of this subsection investment proceeds do not include amounts earned after the date that (1) the construction, reconstruction, or acquisition of the property is completed, or (2) all of the proceeds (less amounts used to fund a reasonably required reserve fund) have been spent on the construction, reconstruction, or acquisition of the property, whichever occurs later (for rules concerning refunding issues see section 4.01 of this revenue procedure); and

3 The governmental unit obtains upon discharge of the obligations unencumbered fee title and exclusive possession and use of the property financed by the obligations, including any additions to the property, without demand or further action on its part. Thus, for example, all leases, management contracts, and other similar encumbrances must terminate upon discharge of the obligations. Encumbrances that do not significantly interfere with the enjoyment of the property, such as most easements granted to utility companies, are not considered encumbrances for purposes of this paragraph. If a nonprofit corporation sells interim short-term obligations on behalf of a governmental unit in anticipation of selling permanent financing to provide tangible property, the requirements of this paragraph will be met if (a) the governmental unit obtains unencumbered fee title and exclusive possession and use of the property upon discharge of the permanent financing and (b) the last issue of interim short-term obligations used to provide the property is discharged not later than five years after the date of issue of the first issue of short-term obligations; and

4 Before the obligations are issued, the governmental unit adopts a resolution stating that it will accept title to the property financed by the obligations, including any additions to that property, when the obligations are discharged; and

5 The indenture or other documents under which the obligations used to originally provide the property provide that any other obligations issued by the nonprofit corporation either to make improvements to the property or to refund a prior issue of the nonprofit corporation's obligations will be discharged no later than the latest maturity date of the original obligations, regardless of whether the original obligations are callable at an earlier date. In addition, the maturity date of the original obligations or any other obligations issued by the nonprofit corporation with respect to the property may not be extended beyond the latest maturity date of the original obligations, regardless of whether the original obligations are callable at an earlier date. If the governmental unit has the beneficial interest described in section 3.041(a) of this revenue procedure, the obligations need not meet the requirements of this paragraph (for additional rules concerning refunding issues, see section 4.01 of this revenue procedure); and

6 The proceeds of fire or other casualty insurance policies received in connection with damage to or destruction of the property financed by the obligations, including any additions to the property, will, subject to the claims of the holders of the obligations, (a) be used to reconstruct the property, regardless of whether the insurance proceeds are sufficient to pay for the reconstruction, or (b) be remitted to the governmental unit; and

7 (a) A reasonable estimate of the fair market value of the property on the latest maturity date of the obligations, regardless of whether the obligations are callable at an earlier date, is equal to at least 20 percent of the original cost of the property financed by the obligations. The estimated fair market value of property shall be determined without including in the value any addition to the property or any increase or decrease for inflation or deflation during the term of the obligations; and

(b) A reasonable estimate of the remaining useful life of the property on the latest maturity date of the obligations, regardless of whether the obligations are callable at an earlier date, is the longer of one year or 20 percent of the originally estimated useful life of the property financed by the obligations.

If the property financed by the obligations does not itself meet the requirements of (a) and (b) of this paragraph, these requirements will be considered met if the nonprofit corporation is required to replace the property and the replacement property meets the requirements of (a) and (b) of this paragraph. If the governmental unit has the beneficial interest described in section 3.041(a) of this revenue procedure, the obligations need not meet the requirements of this paragraph.

.06 The governmental unit must approve both the nonprofit corporation and the specific obligations to be issued by the corporation. This requirement will be met if, within one year prior to the issuance of the obligations, the governmental unit adopts a resolution approving the purposes and activities of the corporation and the specific obligations to be issued by the corporation. If the corporation intends to issue obligations for a single project through a series of obligations to be issued over a period not to exceed five years, the governmental unit may meet the requirements of this subsection by adopting a single resolution, approving the purposes and activities of the corporation and all obligations to be issued in the series, within one year prior to the issuance of the first issue in the series.

SEC. 4. OPERATING RULES FOR REFUNDING ISSUES

.01 The Service will ordinarily issue an advance ruling that refunding obligations issued by a nonprofit corporation are issued on behalf of a governmental unit if:

1 All of the original and investment proceeds of the refunding issue are used (a) to pay principal, qualified interest, and any premium, on another issue ("the prior issue") of obligations issued on behalf of the governmental unit, and (b) to fund a reasonably required reserve fund for the refunding issue within the meaning of section 103(c)(4) of the Code. For purposes of this subsection, investment proceeds do not include amounts earned after the last obligation of the prior issue is discharged. Qualified interest means unpaid interest on the prior issue reduced by the amount of original proceeds and investment proceeds of the prior issue allocated to pay interest on the prior issue but unexpended therefor. However, unpaid interest on a prior issue shall not be treated as qualified interest if interest on the prior issue is payable less frequently than is reasonable and customary for issues of its type; and

2 The obligations are not advance refunding obligations. For purposes of this subsection advance refunding obligations are refunding obligations that are issued more than 180 days before the date on

which the prior obligations are discharged. However, the Service will ordinarily issue an advance ruling that advance refunding obligations issued by a nonprofit corporation are issued on behalf of a governmental unit if the obligations used to provide the tangible property meet the beneficial interest requirement of section 3.04 of this revenue procedure because the governmental unit has the interest described in section 3.041(a); and

3 The refunding obligations will be discharged no later than the latest maturity date of the obligations that were issued by the nonprofit corporation to originally provide the property, regardless of whether the original obligations are callable at an earlier date. If the governmental unit has the beneficial interest described in section 3.041(a) of this revenue procedure, the obligations need not meet the requirements of this paragraph.

4 The requirements set forth in section 3 of this revenue procedure are met, except that section 4.011 instead of section 3.052 shall apply to refunding issues.

SEC. 5. INQUIRIES

Inquiries about this revenue procedure should refer to its number and should be addressed to the Associate Chief Counsel (Technical), Attention: CC:IND:I, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224.