

Client Alert

Current Issues Relevant to Our Clients

October 31, 2014

IRS Releases Guidance Expanding Management Contract Safe Harbors

On October 24, 2014, the IRS issued Notice 2014-67, Private Business Use of Tax-Exempt Bond Financed Facilities (the "Notice"). The Notice expands the management contract safe harbor guidelines of Revenue Procedure 97-13 ("Rev. Proc. 97-13") to permit certain productivity awards and liberalizes the requirements for certain types of 5-year contracts that will not result in private business use. The Notice also provides rules under which a governmental entity or a 501(c)(3) organization may participate in the Medicare Shared Savings Program through an accountable care organization (an "ACO") without causing private business use of its tax-exempt bond-financed facilities.

The Notice amplifies the permitted productivity awards and the types of permissible arrangements described in Rev. Proc. 97-13 that do not result in private business use. Rev. Proc. 97-13 sets forth the conditions under which a management contract between a governmental entity or 501(c)(3) organization and a service provider will not result in private business use of tax-exempt bond-financed facilities. Generally, Rev. Proc. 97-13 applies when, under a management contract, a service provider provides management or other services involving property financed with proceeds of qualified 501(c)(3) bonds or tax-exempt bonds that are not private activity bonds. Rev. Proc. 97-13 describes six types of management contract arrangements, based primarily on the method of compensation and the length of contract, that will not result in private business use. Rev. Proc. 97-13 further provides that in order to be a management contract that falls within the safe harbor contract arrangements described in Rev. Proc. 97-13, none of the compensation under the contract can be based on a share of net profits of the bond-financed facility.

The Notice provides that a productivity award for services in any annual period during the term of the contract will not cause the compensation under a management contract to be based on a share of net profits if (i) eligibility for the productivity award is based on the quality of services provided under the management contract (for example, the achievement of Shared Savings Program quality performance standards or meeting data reporting requirements), rather than increases in revenues or decreases in expenses of the facility and (ii) the amount of the productivity award is a stated dollar amount, a periodic fixed fee, or a tiered system of stated dollar amounts or periodic fixed fees based solely on the level of

performance achieved with respect to the applicable measure.

The Notice also supplements Rev. Proc. 97-13 to add a seventh type of management contract arrangement that will not result in private business use. The Notice provides that a contract with a term of no more than 5 years, including all renewal options, will not result in private business use so long as all of the compensation for services is based on a stated amount, periodic fixed fee, capitation fee, a per unit fee, or a combination of the preceding. In addition, the compensation for services also may include a percentage of gross revenues, adjusted gross revenues or expenses of the facility (but not both revenues and expenses). The contract does not need to be terminable by the 501(c)(3) organization/governmental entity prior to the end of the term, which is a requirement for certain types of other arrangements described in Rev. Proc. 97-13. Additionally, for purposes of this new safe harbor, a tiered productivity award as described above will be treated as a stated amount or a periodic fixed fee, as appropriate. As a result, this additional safe harbor for 5-year contracts significantly broadens the types of management contract arrangements that will not result in private business use.

The Notice further provides that the IRS expects to issue guidance concerning management contracts and requests public comments on the Notice. The management contract guidance applies to contracts entered into, materially modified, or extended (other than pursuant to a renewal option) on or after January 22, 2015, but may be applied to contracts entered into before January 22, 2015. As a result, certain previously executed contracts that may have been treated as creating private business use of tax-exempt bond-financed facilities or as creating

uncertainty because a safe harbor was not satisfied may satisfy the new 5-year contract safe harbor, providing a governmental entity or 501(c)(3) organization with assurance that the contract did not create private business use.

For More Information

A client alert discussing the ACO provisions of the Notice is available [here](#). For more information, including information on the Notice or Rev. Proc. 97-13, please contact your primary Chapman attorney or visit us at chapman.com.

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