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# IRS Revenue Procedure. 97-13: Ignore The Rules (If They Don't Apply)

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We are rather fond (because you are rather fond) of discussing Rev. Proc. 97-13 and related authorities that address private business use from management contracts. Back in 2014, when the IRS amplified Rev. Proc. 97-13 in Notice 2014-67 (collectively, "97-13"), we even made a holiday present of it. Now more than ever, 97-13 is an essential tool that allows issuers and borrowers to use managers in their facilities and still stay within the private business use limitations. But 97-13 is not a panacea, nor do you always need it to avoid private business use. So, to mix things up, we'll now discuss when you can ignore 97-13, either because you don't need it, or because it can't help you anyway. Many people fall into the habit of thinking that the 97-13 rules apply to any arrangement in bond-financed facilities. However, that's not the case.

Let's start with a key definition from 97-13: a "management contract" is "a management, service, or incentive payment contract between a qualified user and a service provider under which the service provider provides services involving all, a portion of, or any function of, a facility."

From the definition alone, it is clear that some contracts are not "management contracts." Only contracts with "service providers" are included, which means that private parties that have more significant rights to the actual or beneficial use of the bond-financed property (such as lessees of the bond-financed property) will cause private business use of the bond-financed facilities even if the terms of the arrangement technically fall within a safe harbor. In other words, 97-13 cannot help you escape the private business use that may arise from a lease of bond-financed property. (Other exceptions may apply, though, including those in Reg. 1.141-3(d).)

In addition, not all service contracts rise to the level of a "management contract" that must be scrutinized under 97-13. These contracts fall outside of what the regulations and 97-13 say when they refer to a "management contract" that can give rise to private business use. Four notable exceptions from the definition of "management contract" are provided by the Treasury Regulations and referenced in the 97-13. We include these below, along with comments on each:

- Contracts for services that are solely incidental to the primary governmental function or functions of a financed facility (for example, contracts for janitorial, office equipment repair, hospital billing or similar services);

The “solely incidental” language allows certain minor contracts to be excluded. If the particular contract you are reviewing is one of those that is contained within the parenthesis, even better. However, those are only examples, which means that other contracts may also qualify.  To date, despite repeated requests from professionals to provide more guidance regarding the scope of “similar services,” we have not gotten any.

- The mere granting of admitting privileges by a hospital to a doctor, even if those privileges are conditioned on the provision of de minimis services, if those privileges are available to all qualified physicians in the area, consistent with the size and nature of its facilities;

Similarly, “mere” admitting privileges do not fall within 97-13. This exception, like the prior exception, focuses on the economically insignificant and incidental nature of such agreements. What about if you aren’t considering a contract with a hospital? Don’t forget that this exception may also help by analogy to establish an exception from 97-13 based on facts and circumstances, although one should tread lightly in doing so.

- A contract to provide for the operation of a facility or system of facilities that consists predominantly of public utility property (as defined in § 168(i)(10) of the 1986 Code), if the only compensation is the reimbursement of actual and direct expenses of the service provider and reasonable administrative overhead expenses of the service provider; and

- A contract to provide for services, if the only compensation is the reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties.

We lumped these two together because they are quite similar. The third and fourth exception each depend on reimbursement consisting only of “actual and direct expenses.” Like the prior exceptions, these two also focus on the economic insignificance of such agreements.

The fourth exception is particularly helpful because it is not tied to any particular type of services. An important limit to the exception is that it is limited to actual and direct expenses; therefore, if a contract involves a payment to compensate a service provider for projected expenses, it would not qualify for the fourth exception from being treated as a management contract.

Note that this fourth exception dovetails with the provision of 97-13 that reimbursement of actual and direct expenses is not treated as “compensation” that factors into 97-13’s list of safe harbors that link permitted compensation to permitted length. So, even if a contract doesn’t meet an exception from the definition of a “management contract,” to the extent that compensation involves reimbursement of actual and direct expenses, that compensation is ignored for purposes of the safe harbor. In sum, it may be tempting to treat 97-13 as a one-size-fits-all tool that either fixes (or doesn’t) every private business use issue. But remember that 97-13 applies only to “management contracts,” and that this term has a specific definition.



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