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# IRS Releases New Safe Harbors for Management Contracts Involving Bond-Financed Hospitals

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Hospital leaders have long been vexed by IRS guidelines applicable to certain services arrangements involving bond-financed facilities, as most recently embodied in Rev. Proc. 97-13 (as expanded by IRS Notice 2014-67). As they say, all good things must come to an end. On August 22, 2016, the Internal Revenue Service (IRS) released Revenue Procedure (Rev. Proc.) 2016-44, which supersedes Rev. Proc. 97-13 and articulates new safe harbors pursuant to which management contracts involving bond-financed facilities will avoid private business use.

The full implications of the new Rev. Proc. (which presumably will eventually become known as simply "16-44") undoubtedly will be the subject of considerable discussion in the days and weeks ahead. In basic terms, Rev. Proc. 2016-44 permits any type of fixed or variable compensation that is reasonable compensation for services rendered under the contract, but retains (and clarifies) the prohibition on net profits arrangements.

More specifically, the Rev. Proc. blesses:

- An arrangement where the only compensation consists of reimbursement of actual and direct expenses paid by the service provider to unrelated parties and reasonable related administrative overhead expenses of the service provider; and
- An arrangement where all of the following criteria are met:
    - Payments (including expense reimbursements) reflect reasonable compensation for services rendered;
    - The arrangement does not give the service provider a share of net profits from the operation of the managed property (with some elaboration as to what might constitute a "net profits" arrangement);
    - The service provider does not share any net losses from the operation of the managed property;
    - The term of the contract is no greater than the lesser of (a) 30 years or (b) 80% of the weighted average reasonably expected economic life of the managed property;
    - The 501(c)(3) hospital exercises a significant degree of control over the use of the managed property, as demonstrated based on the right to approve annual budgets of the managed property, capital expenditures, disposition of property, rates charged for use of the property, and the general nature and type of use of the managed property;
    - The 501(c)(3) hospital bears the risk of loss damage or destruction of the managed property;
    - The service provider agrees that it will not take any tax position inconsistent with being a service provider as to the managed property (for example, it won't take any depreciation deductions);
    - No more than 20% of the governing board of the 501(c)(3) hospital is vested in the directors, officers, shareholders, partners, members and employees of the service provider;
    - The 501(c)(3) hospital's board does not include the CEO or board chair of the service provider; and
    - The CEO of the service provider is not the CEO of the 501(c)(3) hospital or any of its related parties.

The new safe harbors apply to contractual arrangements entered into on or after August 22, 2016, but hospitals may also elect to apply them to contracts entered into before that date. The more familiar safe harbors of Rev. Proc. 97-13 may continue to be applied to new contracts entered into before February 18, 2017.

Please contact one of the authors below with questions about Rev. Proc 2016-44 or if you need any assistance with evaluating the application of the new safe harbors to particular arrangements.

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