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USING NOT-FOR-PROFIT CORPORATIONS FOR TAX-EXEMPT FINANCING: REVENUE RULING 63-20 REVISITED

Jeffrey G. Liss*

Revenue Ruling 63-20 provides a mechanism whereby the interest on obligations issued by a not-for-profit corporation can be received tax-free. Both political subdivisions and private entrepreneurs have utilized this tax-exempt financing to construct, inter alia, schools, housing, hospitals, cable television facilities, and even public golf courses. The tax status of millions of dollars of financing currently is hinged on Revenue Ruling 63-20. Nevertheless, during the ruling's first nineteen years of existence, only private letter rulings issued by the Internal Revenue Service (I.R.S. or Service) discussed the circumstances under which a corporation's obligations meet the ruling's five conditions for tax-exempt status.

Although private letter rulings may not be cited as precedent, these private rulings provided the only insight into the Service's positions towards Revenue Ruling 63-20 financing. Regulations were proposed in 1976, but never adopted. Finally, in 1982, the Service promulgated Revenue Procedure 82-26 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 will be considered obligations of a state or political subdivision and thus tax-exempt under section 103(a)(1) of the Internal Revenue Code (Code). This Revenue Procedure incorporated some, but not all, of the principles expressed in the private letter rulings and in the proposed regulations, and added some new requirements.

After generally examining Revenue Ruling 63-20, this Article will analyze all the published private letter rulings in light of Revenue Ruling 63-20's five requirements and will attempt to distill general guidelines followed by the Service. The Article will consider the extent to which Revenue Pro-

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2. See infra notes 74-87 and accompanying text.
3. See infra notes 29-30 and accompanying text.
7. Id. Rev. Proc. 82-26 also applies to Rev. Rul. 54-296, 1954-2 C.B. 59, and Rev. Rul. 59-41, 1959-1 C.B. 13, both of which held that obligations issued by nonprofit corporations were considered those of the cities on whose behalf they were issued. In those rulings, the financings met standards akin to, but not the same as, those set forth in Rev. Rul. 63-20.
procedure 82-26 and the proposed regulations follow, depart from, or fail to consider these guidelines. Finally, the Article will assess the criticisms leveled at Revenue Ruling 63-20 and the appropriateness of the Service's responses to these criticisms.

**INTRODUCTION TO REVENUE RULING 63-20 FINANCING**

Revenue Ruling 63-20 was promulgated under section 103 of the Internal Revenue Code. Section 103 provides that gross income does not include interest on "the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia." The Service's regulations broadly interpret section 103 to include those obligations that have been issued by or "on behalf of" any state or local governmental unit by constituted authorities empowered to issue such obligations.

In Revenue Ruling 63-20, the Service took the position that obligations issued by a *corporation* will be deemed to have been issued "on behalf of" a state or political subdivision if five conditions are met:

1. the corporation must engage in activities which are essentially public in nature;
2. the corporation must be one which is not organized for profit (except to the extent of retiring indebtedness);
3. the corporate income must not inure to any private person;
4. the State or a political subdivision thereof must have a beneficial interest in the corporation while the indebtedness remains outstanding and it must obtain full legal title to the property of the corporation with respect to which the indebtedness was incurred upon the retirement of such indebtedness; and
5. the corporation must have been approved by the State or a political subdivision thereof, either of which must also have approved the specific obligations issued by the corporation.

If these five conditions are satisfied, a corporation, sometimes referred to as a 63-20 corporation, will be able to borrow money at lower interest rates through the issuance of such obligations because the interest it pays on those obligations will be tax-exempt to the holders of those obligations.

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11. For example, a taxpayer who is in a 50% tax bracket will receive an after-tax return of only 8% on a taxed bond carrying a 16% interest rate. A tax-exempt 11% bond, therefore, yields the investor a greater return than the 16% taxable bond. See generally R. LAMB & S. RAPPAPORT, THE COMPREHENSIVE REVIEW OF TAX-EXEMPT SECURITIES AND PUBLIC FINANCE 5-6 (1980) (chart illustrating the approximate yields taxable securities must earn in various income brackets to produce after tax yields equal to tax-exempt bonds) [hereinafter cited as LAMB & RAPPAPORT].
A typical 63-20 financing might be structured as follows. A 63-20 corporation is established under the state's not-for-profit corporation law and obtains an I.R.S. determination that it is an organization exempt from taxation under section 501(a) of the Internal Revenue Code. The political subdivision sponsoring a particular project enacts a formal resolution approving the corporation, the members and directors, the project, the issuance of bonds necessary to fund the project, and the legal documents necessary to effect the foregoing. The subdivision also agrees to accept title to the intended facility upon the retirement of the bonds.

Generally, an attempt will be made prior to the financing to obtain an I.R.S. private letter ruling confirming the tax-exempt status of the proposed bonds. Based upon the private rulings issued over the past two years, a ruling request generally takes about two to five months to be acted upon. If there is insufficient time to secure a private letter ruling, a corporation often relies upon an opinion of counsel.

After a confirmation by a letter ruling or a favorable opinion by counsel, the 63-20 corporation will issue its bonds. The proceeds from the bonds will be used to construct and equip the facility and perhaps to acquire the site. If the political subdivision previously owned the site, however, it would be leased to the 63-20 corporation for the duration of the bond issue for nominal consideration. Then the 63-20 corporation will lease both the site and the facility to another entity to operate it. This operating entity may be the sponsoring political subdivision, a public agency, a tax-exempt organization, or a private partnership or corporation. The lessee pays a sufficient sum of rent to cover the principal and interest payments that the

12. I.R.C. § 501(a) exempts from taxation an extensive list of organizations described in § 501(c)-(d) or § 401(a).

13. Although most 63-20 financings involve bonds, notes and other financial instruments also will qualify. See, e.g., Private Letter Ruling 8012112 (Dec. 31, 1979).

14. For a determination regarding tax exempt status under § 103, the request for a ruling is to be made in accordance with Rev. Proc. 79-4, 1979-1 C.B. 483, for issuers, and Rev. Proc. 79-12, 1979-1 C.B. 492, for non-issuers.

The following three rulings are sought and rendered most frequently by the I.R.S. in connection with Revenue Ruling 63-20:

(1) the Bonds that will be issued by the corporation will be issued on behalf of the District, a political subdivision of the State,

(2) interest on the Bonds will be excludable from gross income under section 103(a)(1) of the Code, and

(3) the Corporation will derive no taxable income from the financing, construction, and leasing of the [Project] to be constructed thereon.

A frequent fourth ruling is that the obligations do not constitute "Industrial Development Bonds" under Sec. 103(b).


17. See, e.g., Private Letter Ruling 7926093 (Mar. 29, 1979) (an exempt management corporation operating a housing facility for aged and indigent persons).

63-20 corporation must pay on the bonds it has issued. If the lessee is a private entity, any receipts in excess of the principal and interest due as rent constitute profit to the private entity. Thus, the lower the interest charged on tax-exempt bonds, the greater the potential for profit to the lessee.

During the financing, the 63-20 corporation pledges the leases and rentals to a trustee as security for its indebtedness. The real estate also may be mortgaged. Upon retirement of the bonds, the leases of both the site and facility terminate. The property then is transferred to the political subdivision free and clear of all encumbrances. Such 63-20 financing arrangements can be very advantageous both to political subdivisions and to private entrepreneurs.

USEFULNESS OF 63-20 FINANCING

Revenue Ruling 63-20 financing typically is used when normal financing alternatives are unavailable. The ruling, therefore, permits construction of projects a political subdivision otherwise might not be able to build. Generally, a political subdivision raises funds for a project by issuing its own debt instruments. These debt instruments may be either backed by the subdivision's own credit or repayable solely from the earnings of the project. These normal financing alternatives, however, are not always available. For example, the financing of a desired project may not be permitted by statute, or by the political subdivision's charter or budget. In

19. The subdivision has the right to acquire the project earlier upon payment to the corporation of the amount necessary to retire the indebtedness. See infra notes 216-19 and accompanying text. Until the indebtedness has been retired, however, the subdivision has no liability with respect to the project.

20. Such instruments are called general obligation bonds. General obligation bonds are secured by a pledge of the issuer's full faith and credit and supported by the taxing power of the issuing governmental entity. LAMB & RAPPAPORT, supra note 11, at 9. Thus, these bonds have been viewed as a relatively low-risk investment medium. In fact, the incidence of defaults by local governmental units has been rare. U.S. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, CITY FINANCIAL EMERGENCIES: THE INTERGOVERNMENTAL DIMENSION 10 (1976).

21. Such instruments generally are called revenue bonds. Revenue bonds, unlike general obligation bonds, are not considered obligations of the issuing governmental entity. LAMB & RAPPAPORT, supra note 11, at 251. Consequently, revenue bonds are redeemed with funds derived from the particular project that they originally funded. In this manner, the financing costs of a particular project are allocated to those who derive benefit from the project. Id. at 14. Revenue bonds typically are used to encourage industrial development by providing businesses with the low-cost financing derived from utilization of these tax-free bonds. C. AMMER & D. AMMER, DICTIONARY OF BUSINESS AND ECONOMICS 204 (1977). See generally U.S. ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, INDUSTRIAL DEVELOPMENT BOND FINANCING (1963) (examining bond financing of industrial development against the background of intergovernmental relations). State law, however, sometimes restricts the use of revenue bonds in favor of general obligation debts. LAMB & RAPPAPORT, supra note 11, at 283.


addition, there may be insufficient time to arrange for the normal methods of financing or the subdivision may not be equipped to supervise the construction or management of the project. In such instances, 63-20 financing may be available to enable the project to be built.

A private entrepreneur also may benefit from a political subdivision's decision to use 63-20 financing. The lessee of a project built by the 63-20 corporation, for example, enjoys two basic benefits. First, because the interest paid by a 63-20 corporation is tax-exempt to the recipient, the interest rate a 63-20 corporation must pay to borrow the construction money is less than the commercial rate. Consequently, a 63-20 corporation can charge a lessee a lower rent to cover these interest payments than would be charged in a strictly commercial lease. This difference in rent is profit to the private entrepreneur lessee. Second, although the political subdivision will receive full title, use and control of the project upon the retirement of the 63-20 financing, as a practical matter the subdivision may not want to manage the project and, therefore, will continue to lease it to the prior lessee. Thus, in many instances, the private entrepreneur will initiate and promote the project, and the political subdivision merely will provide the necessary endorsement and acquiescence.

Other tax benefits also may accrue in a 63-20 financing. In some jurisdictions, for example, the tangible personal property purchased for the project may be exempt from sales tax. Some jurisdictions also exempt the project from real estate taxes. In addition, there possibly may be exemptions from personal property taxes. Interest on the obligations, however, when received in a state other than the situs of the 63-20 corporation, is likely to be subject to state and local income taxes.

Revenue Ruling 63-20's obvious advantages created new opportunities for political subdivisions and private entrepreneurs. In effect, Revenue Ruling 63-20 might be described as "a kind of federal industrial revenue bond legislation." As such, the Revenue Ruling minimized the disparity between states.

24. See, e.g., Private Letter Ruling 8004043 (Oct. 30, 1979) (63-20 corporation used to acquire one water system while negotiations continued to purchase another system to avoid price increase); Private Letter Ruling 7930120 (Apr. 27, 1979) (interest from promissory notes issued for purchase of land excludable from gross income where school district had insufficient time to obtain bond-financed loan); Private Letter Ruling 7827030 (Apr. 6, 1978) (63-20 corporation used because state suit challenging the constitutionality of an agency's existence led to delays in issuing revenue bonds).


26. See, e.g., CAL. REV. & TAX CODE § 231 (West Supp. 1982); ILL. REV. STAT. ch. 120, § 500.6 (1981).


29. See Nelson, Tax Considerations of Municipal Industrial Incentive Financing, 45 TAXES 941, 944 (1967) [hereinafter cited as Nelson]. See also supra notes 20-21.
which had industrial development legislation and those states which did not. Liberal administration of the ruling resulted in the construction of multi-million dollar plants and generous renewal options at nominal rentals that assured the lessee of possession for the full normal life of the property. In addition, passage of title to the political subdivision was deferred through issuance of improvement bonds, with maturities beyond those of the original bonds. Such liberality in the administration of Revenue Ruling 63-20 was severely criticized by the former Chief Counsel of the Service, Hart H. Spiegel, as opening "loopholes" or "truckholes" in the tax law and as "unsound, legally and administratively."

LIMITATIONS ON 63-20 FINANCING

Since 1968, the 63-20 "truckhole" has been narrowed, and correspondingly, the usefulness of the ruling to the borrower has been reduced but certainly not eliminated. This narrowing occurred through additional Code provisions, the proposed regulations, the Service's own limiting glosses on Revenue Ruling 63-20, and Revenue Procedure 82-26.

The additional Code provisions now are contained: in section 103(b), removing certain defined "Industrial Development Bonds" (IDBs) from the scope of the exemption of section 103(a); in section 103(c), removing certain defined "arbitrage bonds" from the exemption; and in sections 103(j) through (l), imposing certain other restrictions on tax-exempt obligations.

Section 103(b)(1) provides that an IDB shall be treated as an obligation not described in section 103(a). Thus, interest on an IDB will be included in the gross income of the recipient. Section 103(b)(2) defines an IDB as an obligation of which: (A) all or a major portion (more than twenty-five percent) of the proceeds are to be used in the trade or business of any non-exempt person, and (B) the payment for the obligation is, in whole or major part, (i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or (ii) to be

30. Id.
31. Id.
32. Spiegel, Financing Private Ventures with Tax-Exempt Bonds: A Developing "Truckhole" in the Tax Law, 17 STAN. L. REV. 224, 228 (1965) [hereinafter cited as Spiegel]. Spiegel advanced three reasons for criticizing Revenue Ruling 63-20 as unsound. First, the issuance of tax exempt bonds by private nonprofit corporations is not sanctioned by statute, regulations, or court decision. Second, 63-20 financing permits private entities to serve as financing mechanisms with much of the benefit inuring to the private entity rather than to political subdivisions. Finally, the Service approves 63-20 financing in instances where the purpose furthers objectives of private entities rather than those of political subdivisions. Thus, Spiegel concludes that 63-20 financing decreases the country's tax base while private industry benefits. Id.
34. I.R.C. § 103(c)(1). See infra notes 46-49 and accompanying text.
35. Treas. Reg. § 1.103-7(b)(3)(iii).
36. The term "exempt person" is defined in I.R.C. § 103(b)(3).
derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.  

Section 103(b), however, excludes from the definition of an IDB any obligation issued to fund certain exempt facilities\(^3\) or industrial parks,\(^3\) or to advance refund certain qualified public facilities.\(^4\) Section 103(b)(6) also excludes from the definition of an IDB certain "small issues" aggregating less than $1,000,000 or, in certain instances, less than $10,000,000.\(^4\) As of January 1, 1983, this "small issue" exemption is not available if (i) more than twenty-five percent of the proceeds are used to provide a facility whose primary purpose is retail food and beverage services, automobile sales or service, or the provision of recreation or entertainment, or (ii) any portion of the proceeds is used to provide any private or commercial golf course, country club, massage parlor, tennis club, skating facility, racquet sports facility, hot tub facility, suntan facility, or racetrack.\(^2\) Since January 1, 1983, those four types of obligations excluded from the definition of an IDB are excluded only if the average maturity of the obligations which are part of the issue does not exceed 120% of the average reasonably expected economic life of the facilities being financed by the proceeds of such issue.\(^4\) In addition, obligations issued after January 1, 1983, which otherwise would

37. Id. § 103(b)(2)(B).
38. Id. § 103(b)(4). The facilities excluded include:
   (A) certain projects for residential rental property,
   (B) sports facilities,
   (C) convention or trade show facilities,
   (D) airports, docks, wharves, mass commuting facilities, parking facilities, or storage or training facilities directly related to any of the foregoing,
   (E) sewage or solid waste disposal facilities or facilities for the local furnishing of electric energy or gas,
   (F) air or water pollution control facilities,
   (G) certain water facilities,
   (H) qualified hydroelectric generating facilities,
   (I) qualified mass commuting vehicles, and
   (J) local district heating or cooling facilities.
39. Id. § 103(b)(5).
40. Id. § 103(b)(7). Qualified facilities include convention or trade show facilities, wharves, mass commuting facilities, parking facilities, or storage or training facilities directly relating to the foregoing which are generally available to the public. Id. § 103(b)(7)(B).
41. The Service has provided guidelines to determine whether an issue is an exempt "small issue." See id. § 103(b)(6); Treas. Reg. § 1.103-10. The conditions under which obligations can qualify for the "small issue" exemption were significantly limited by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, 96 Stat. 466, which added I.R.C. §§ 103(b)(6)(K) through 103(b)(6)(O) and § 103(b)(14). The entire "small issue" exemption now is scheduled for elimination with respect to obligations issued after December 31, 1986 (including any obligation issued to refund an obligation issued on or before such date). I.R.C. § 103(b)(6)(N).
43. I.R.C. § 103(b)(14) (enacted by TEFRA, § 219(a)).
be excluded from the definition of an IDB, will be exempt only if they meet certain new public approval requirements.44

The exact mechanics of the IDB limitations are beyond the scope of this Article. It should be noted, however, that Revenue Ruling 63-20 will not be useful to private parties unless the obligations issued fit within one of these section 103(b) exclusions and, thus, can avoid being labeled as IDBs. It further should be noted that the section 103(b) exclusions from the IDB label do not apply with respect to any obligation when the obligation is held by any person or a related person who is a substantial user of the facilities financed.45

An obligation otherwise qualifying for tax-exempt treatment under section 103(a) nonetheless will fail to qualify if it is an "arbitrage bond."46 An obligation will be deemed an arbitrage bond if a major portion of the proceeds is reasonably expected to be used directly or indirectly either to acquire securities or non-tax-exempt obligations that are reasonably expected to produce a yield materially higher than the yield on the arbitrage bond or to replace funds used to acquire such securities or non-tax-exempt obligations.47 An obligation, however, will not be an arbitrage bond solely because the proceeds may be invested temporarily in such securities or obligations until those proceeds are needed for the purpose for which the obligation was issued.48 Nor will an obligation necessarily be deemed an arbitrage bond solely because a small portion of the proceeds are invested in such securities or other obligations as part of a reasonably required reserve fund.49

Concomitantly, beginning shortly after Revenue Ruling 63-20 was promulgated, the Service began to develop a series of unpublished restrictions. Although the restrictions were applied first on an ad hoc basis, subsequent general application of the restrictions significantly reduced the number and dollar amount of 63-20 transactions.50 "Some of these restrictions probably went beyond the criteria of the ruling itself, but for the most part the Service attempted to cast them within the published framework."51 These restrictions will be discussed later.

44. I.R.C. § 103(k) (enacted by TEFRA, § 215(a)).
46. I.R.C. § 103(c)(1)). Extensive regulations clarify the circumstances under which an obligation will be deemed an arbitrage bond. See Treas. Reg. § 1.103-13 to -15.
In addition, some of the private letter rulings specifically dealing with Revenue Ruling 63-20 also consider arbitrage bonds. For example, some of the rulings state that officials of the corporation will execute a "no-arbitrage certificate," see, e.g., Private Letter Ruling 8015098 (Jan. 17, 1980), or explicitly do not rule on the question, see, e.g., Private Letter Ruling 8024114 (Mar. 18, 1980). In some instances, the Service rules that the obligations will not be arbitrage bonds, see, e.g., Private Letter Ruling 8046031 (Aug. 19, 1980), or rules on specific aspects of the arbitrage regulations, see, e.g., Private Letter Ruling 8051121 (Sept. 26, 1980).
47. I.R.C. § 103(c)(2).
48. Id. § 103(c)(4)(A).
49. Id. § 103(c)(4)(B). Generally, if no more than 15% of the proceeds are invested in securities, the obligation will not be considered an arbitrage bond. Treas. Reg. § 1.103-13(b)(1)(ii).
50. See Nelson, supra note 29, at 945.
51. Id.
In addition, the Service in 1976 issued its proposed regulations under section 103(a)(1), which would substantially modify and supersede Revenue Ruling 63-20. Although the proposed regulations have not been implemented, these regulations generally provide that only a "constituted authority" of a state or political subdivision may issue obligations "on behalf of" the subdivision. An issuer of obligations would be a "constituted authority" only if:

(i) it is specifically authorized by State law (creating it or authorizing the subdivision to create it), to accomplish a public purpose of the subdivision, which purpose must be specified in the authorization; such authorization would have to be specifically set forth in the constitution, charter or other organic act creating the subdivision and provide that the subdivision may utilize the constituted authority "to issue obligations" for such a purpose;
(ii) the subdivision controls the governing board of the authority;
(iii) the subdivision has either "organizational control" over the authority or "supervisory control" over the activities of the authority; and
(iv) other specified conditions are met.

To the extent that the proposed regulations, as in clause (i), would require changes in statutes or charters of political subdivisions, the proposed regulations would limit substantially the use of Revenue Ruling 63-20. To the extent the regulations merely would require changes in "control" of the 63-20 corporation or compliance with specified conditions, however, compliance does not appear unreasonably difficult. Some of the proposed regulations' requirements already appear to have been made additional, although hitherto unwritten, preconditions for favorable 63-20 rulings.

Finally, with the proposed regulations neither formally enacted nor withdrawn, the Service in Revenue Procedure 82-26 specified certain general operating rules under which, if complied with, it would ordinarily rule that obligations issued by a nonprofit corporation are those of a governmental

53. Id.
54. Id. (to be codified at Treas. Reg. § 1.103-1(c)(2)).
55. Recent Private Rulings have added the following cautionary note:
Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusions in the ruling. See Section 17.04 of Rev. Proc. 80-20, 1980-26 I.R.B. 7, 17. However, when the criteria in Section 17.05 of Rev. Proc. 80-20 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

unit.56 "The operating rules do not define, as a matter of law, the circumstances under which [such obligations] will be considered issued on behalf of a governmental unit," and thus "the operating rules are not to be used as tests for determining the taxability of bond interest."57 A later private letter ruling stated that, as a general rule, Revenue Procedure 82-26 "was not intended to change or add to the conditions that the Service requires to be met under Rev. Rul. 63-20."58

Given these limitations on 63-20 financing, this Article will now discuss the Service's positions. Because Revenue Ruling 63-20 has not been cited in any subsequent revenue rulings, the analysis necessarily must be based upon the 125 private letter rulings published through October 29, 1982, which have cited Revenue Ruling 63-20,1 the proposed regulations, and Revenue Procedure 82-26. Although, as stated, private letter rulings may not be cited as precedent,69 analysis of these materials should enable future transactions to be structured so as to qualify under Revenue Ruling 63-20's five conditions.

THE FIVE CONDITIONS

1. Public Nature of Activities

Revenue Ruling 63-20 requires, first, that "the corporation must engage in activities which are essentially public in nature"61. In determining whether the first requirement is met, the Service considers such factors as the corporate purposes and activities, and the location of the financed facility.

The Service focuses on whether the "activities" of the corporation, rather than the specific project, are public in nature. Consequently, the published private letter rulings usually recite the purposes set forth in the corporate charter and describe the project to be financed. The published rulings seem to equate "corporate purposes" with "activities." For example, in one private letter ruling,62 the Service concluded that because the foundation's purpose, as set forth in its articles, was to further the work of a state university, the activities were essentially public. Under Revenue Procedure 82-26, the public activities requirement will be deemed met if, inter alia,

56. Rev. Proc. 82-26, § 3, 1982-17 I.R.B. 16, 17. Section 3 states that the operating rules were intended only to assist issuers of governmental obligations and other parties in preparing ruling requests, and that the rules were "not to be used as tests for determining the taxability of bond interest." Id. at 17.
59. Private letter rulings are available in STAND. FED. TAX REP. (CCH), and on LEXIS, Fedtax library, CBPR file. See infra APPENDIX for a listing of private letter rulings.
60. Section 6110(j)(3) of the Internal Revenue Code provides that "[u]nless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent." I.R.C. § 6110(j)(3).
"the activities and purposes" of the corporation are those permitted under the general nonprofit corporation law of the State.\textsuperscript{63}

In most cases, the nature of the corporation's purposes will not differ from its activities. The published rulings note corporate purposes that are directly public in nature, such as building a hospital\textsuperscript{64} or providing low-income housing.\textsuperscript{65} Other published rulings recite corporate purposes that are indirectly public in nature in that the corporation assists another entity whose purposes are clearly public in nature. Assistance to a university\textsuperscript{66} or water district\textsuperscript{67} are examples of indirect public purposes. None of the published private letter rulings has involved a situation in which one or more of the corporate purposes, activities, or projects might be public in nature while another one or more of them might not be public. Nor have any of the rulings denied 63-20 qualification for failure to qualify under this first condition.

Thus, the public activities requirement has been liberally construed and permits the construction of a wide-range of projects. Illustrative of the broad scope of this first condition is Revenue Ruling 63-20 itself. The not-for-profit corporation considered in the ruling had been organized for the general purpose of stimulating industrial development within a county. Pursuant to its articles of incorporation, the corporation issued interest-bearing revenue bonds to acquire a site and to construct and equip a factory. It subsequently leased the property to an industrial firm. The ruling concluded that the bonds did not meet the fourth and fifth requirements set forth in the ruling and thus were not issued "on behalf of" a political subdivision.\textsuperscript{68} Consequently, the interest on the bonds was includable in the gross income of the bondholders. The clear implication, however, was that the construction of a factory for lease to a private party met the first requirement that the activity be essentially public in nature. Yet that activity—construction of a factory for lease to an industrial firm—seems to be as unpublic a public nature as possible. Moreover, in a recent private letter ruling, the financing qualified under 63-20 when the proceeds were to be used to build a retail shopping facility to be designated as a factory outlet center.\textsuperscript{69}

The subsequent published letter rulings do not aid in discerning the limits of the "public nature" requirement. Only two of these letter rulings involved construction\textsuperscript{70} or expansion\textsuperscript{71} of a factory, and in both instances, the projects were granted tax-exempt status. Similar private party involvement did

\textsuperscript{63.} Rev. Proc. 82-26, § 3.011, 1982-17 I.R.B. 16, 18 (emphasis added).
\textsuperscript{64.} See, e.g., Private Letter Ruling 8024114 (Mar. 18, 1980); Private Letter Ruling 8005031 (Nov. 7, 1979).
\textsuperscript{66.} See, e.g., Private Letter Ruling 8037107 (June 20, 1980).
\textsuperscript{67.} See, e.g., Private Letter Ruling 8104136 (Oct. 30, 1980).
\textsuperscript{69.} Private Letter Ruling 8247081 (Aug. 25, 1982).
not prevent the use of 63-20 financing to construct two buildings for private flight testing, research, and development. In this private letter ruling, the 63-20 corporation proposed to lease a site from the airport district, to issue bonds to construct two buildings on the site, and then to lease the site and the buildings back to the district. The district then would lease the buildings to the private corporations for their use. Although the Service ultimately ruled that the bonds would constitute IDBs, it expressly held that the transaction conformed with the requirements of Revenue Ruling 63-20. Thus, the public nature requirement had been met even in this situation. In fact, involvement by private persons in the corporation's activities has never prevented qualification of 63-20 financing in any of the published letter rulings.

Typical facilities that have received 63-20 financing include: low-income housing, housing for the elderly, school facilities, hospitals and medical facilities, nursing homes, combinations of the foregoing, courtrooms and jails, and water systems. More unusual was the use of 63-20 financing to construct tourist facilities, cable television transmitting and receiving facilities, and schools.
ing facilities,\textsuperscript{13} a public golf course,\textsuperscript{14} a restaurant on a public golf course,\textsuperscript{15} a university sports facility,\textsuperscript{16} and a public resort.\textsuperscript{17}

Although the Service has never used this first condition to deny 63-20 qualification, one factor, the location of the proposed facility, may influence the Service. In one private letter ruling,\textsuperscript{18} the Service hinted that, except in unusual circumstances, a project might fail to meet the public activities test of Revenue Ruling 63-20 if the proposed facilities were not constructed within the geographical boundaries of the political subdivision. In this ruling, a corporation proposed to construct, on behalf of \textit{City A}, a hospital in \textit{City B}. The facilities eventually were to be granted outright to \textit{City A}. \textit{City A}, approximately twenty-five air miles and forty-three road miles from \textit{City B}, was a trade center for the surrounding agricultural area and served as a residential community for the \textit{City B} area. Surplus hospital revenues would be used to pay for some health care services in \textit{City A}. Furthermore, residents of \textit{City A} using the hospital would receive discounts. Based on these factors, the Service found a "substantial nexus between City A and the Hospital" to grant the project tax-exempt status.

This concern for a substantial nexus also would seem applicable if, for example, a political subdivision sought to construct water facilities or power generation facilities outside its boundaries. None of the published letter rulings, however, discusses this issue concerning the extent of the required nexus. Nonetheless, analogy may be found in Revenue Ruling 77-281,\textsuperscript{19} in which the Service ruled that the IDBs a city had issued to finance railroad rolling stock would not qualify as an exempt small issue. The Service based its decision on two factors. First, the rolling stock would not "be established within [one] incorporated municipality or . . . county," but rather would be used in several. Second, the rolling stock would not be "located within the boundaries of the issuer" (or within the boundaries of the political subdivision in which the issuer is located) and, therefore, would not have "a substantial connection" with the issuing city.\textsuperscript{20} This principle is echoed in Revenue Procedure 82-26, which requires that the property financed be located within the geographical boundaries of or have a substantial connection with the governmental unit on whose behalf the obligations are issued.\textsuperscript{21}

\textsuperscript{13} See, e.g., Private Letter Ruling 8015079 (Jan. 16, 1980).
\textsuperscript{14} See, e.g., Private Letter Ruling 8015098 (Jan. 17, 1980).
\textsuperscript{15} See, e.g., Private Letter Ruling 7911097 (Dec. 18, 1978).
\textsuperscript{16} See, e.g., Private Letter Ruling 8029026 (Apr. 22, 1980).
\textsuperscript{17} See, e.g., Private Letter Ruling 7926052 (Mar. 28, 1979).
\textsuperscript{20} Rev. Proc. 82-26, § 3.012, 1982-17 I.R.B. 16, 18. Compare id. with I.R.C. § 103(b)(6)(K) (enacted by TEFRA § 215(a)). In Private Letter Ruling 8305018 (Oct. 29, 1982), the financing of a cable television facility two miles outside a city, but on land owned by the city, qualified under Rev. Rul. 63-20 as obligations issued by the city. See also Private Letter Ruling 7837041 (June 15, 1978) (a trust proposing to issue obligations on behalf of eight political subdivisions, instead of just one, was denied a 63-20 exemption). See Rev. Proc. 82-26, § 3.041(a).
Under the proposed regulations, additional limiting factors would be placed on this first requirement. These regulations would require that the issuer of the obligations be expressly authorized by law to accomplish a public purpose or purposes of the political subdivision and that these purposes be specified. In addition, the issuer must be created and operated solely to accomplish those purposes. Presumably, therefore, the more limited the purposes of a 63-20 corporation, the more favorably the Service will look upon a ruling request.

2. Corporation Not Organized For Profit

Second, Revenue Ruling 63-20 requires that "the corporation must be one which is not organized for profit (except to the extent of retiring indebtedness)." Under this second requirement, both the law under which the corporation is organized and the tax status of the corporation are considered.

Although the second condition initially was not phrased as narrowly, Revenue Ruling 63-20 later in its text stated that "not organized for profit" refers to corporations organized under a state's general nonprofit corporation law. Virtually all the corporations in the published private letter rulings were organized under such a state statute. Even where the entity issuing the obligations was denominated a foundation, an authority, or a trust, it had been organized under a state's general nonprofit corporation statute and qualified under Revenue Ruling 63-20. However, a foundation incorporated under a state law for the formation of foundations and holding companies also qualified under Revenue Ruling 63-20. In another ruling, a trust (which was not a nonprofit corporation) created under a state's common law rather than a nonprofit statute failed to qualify for several reasons but the trust status was not discussed. An inference could be drawn that under other circumstances such a trust might qualify for 63-20 financing.

93. Id. (to be codified at Treas. Reg. § 1.103-1(c)(2)(vi)). Cf. Private Letter Ruling 8204180 (Oct. 30, 1981) ("sole purpose" of the corporation was constructing or acquiring the facilities); Private Letter Ruling 8133057 (May 20, 1981) ("only business" of the 63-20 corporation was the project financed).
95. Id.
96. See Private Letter Ruling 8037107 (June 20, 1980); Private Letter Ruling 8029026 (Apr. 22, 1980).
98. See Private Letter Ruling 7949054 (Sept. 6, 1979) (although trust was a nonprofit corporation, tax-exempt status denied for failure to fulfill other Revenue Ruling 63-20 conditions).
100. See Private Letter Ruling 7837041 (June 15, 1978).
In contrast, in one ruling in which a stock corporation was involved, the Service denied qualification under Revenue Ruling 63-20 "in part because the Corporation [was] not a non-profit Corporation." 102

Under the proposed regulations' "organizational control" requirement, a subdivision would have "organizational control" only if, inter alia, the issuer was specially created and "not [created] under a statute providing generally for the organization of entities, such as a statute providing for the organization of nonprofit corporations." 103 Such special creation obviously would be more difficult to obtain, thus limiting opportunities for 63-20 financing.

A second factor to consider when analyzing whether a project will meet the second condition is the tax-exempt status of the 63-20 corporation. Although Revenue Ruling 63-20 does not explicitly require a corporation to be an organization described in section 501(c) exempt from taxation under section 501(a) of the Internal Revenue Code, 104 such a status is useful. Tax-exempt status was mentioned in only about one-fourth of the published letter rulings. In the majority of those rulings, however, the Service also considered whether the obligations were IDBs 105 for which a section 501(c)(3) tax-exempt status determination was relevant. 106

3. Corporate Income Not Inuring to Private Persons

Revenue Ruling 63-20 requires, third, that "the corporate income must not inure to any private person." 107 In determining whether this third requirement is met, the Service considers such factors as the language in the corporate charter, the disposition of corporate income, the disposition of

102. Private Letter Ruling 8047096 (Aug. 28, 1980). The corporation was organized under a special statute with a corporate purpose to acquire, construct, and operate municipally-aided housing and received certain tax exemptions from the municipality.


104. I.R.C. § 501(c) describes organizations that are exempt from taxation under § 501(a). See supra note 12. In all cases except two, the private letter rulings referred to § 501(c)(3). These two rulings concerned § 501(c)(4). See Private Letter Ruling 7737009 (June 14, 1977) (corporation established to promote fire protection services of District was civic association within meaning of § 501(c)(4)); Private Letter Ruling 7409240390A (Sept. 24, 1974) (corporation organized to promote educational services qualified as § 501(c)(4) organization).


106. See supra note 73 and accompanying text. Section 3.041(a) of Revenue Procedure 82-26 provides that for purposes of determining whether an obligation is an IDB, a nonprofit corporation that meets the other requirements of that subparagraph will be considered an exempt person (for § 103(b)(3) purposes, see supra text accompanying notes 35-36) even if it is not exempt under § 501(c)(3). See I.R.C. § 103(b)(3)(B).

corporate assets (other than the facilities financed) upon dissolution, and perhaps the receipt of benefits other than directly through the corporation.

In considering whether this third requirement is fulfilled, the Service examines the corporation's charter. Most of the published private letter rulings recite corporate charter provisions to the effect that no corporate earnings, net earnings, income, net income, funds, assets, property, gains, profits, dividends, or the like shall inure to, or be received by, any person, any private person, or any member, director or officer, or the like, or various combinations of the foregoing. Apparently no special wording is required, and provisions meeting state not-for-profit statutory standards seem acceptable. Variations in charter provisions seem attributable to variations in state not-for-profit corporation statutes and to I.R.S. paraphrasing. Revenue Procedure 82-26 adds the requirement that "in fact" the corporate income not inure to private persons, but does not discuss when inurement should be considered.

Two exceptions to this general rule against inurement of income to private persons exist. In more than a quarter of the rulings, the cited language indicates an exception that permits inurement of net earnings to the political subdivision that had sponsored the 63-20 corporation. The proposed regulations would confirm this exception for political subdivisions. In several other rulings in which corporations qualified for 63-20 status, an additional exception allowed inurement as "reasonable compensation for services rendered." Such inurement does not seem inconsistent with either Revenue Ruling 63-20 or the proposed regulations.

In addition to these exceptions, several other special problems have arisen with regard to distribution of corporate assets and receipt of non-income benefits from 63-20 transactions. Revenue Ruling 63-20 only considers disposition of the title to the financed property. It does not mandate any particular disposition of other corporate assets upon liquidation or disso-

108. See, e.g., Private Letter Ruling 8046031 (Aug. 19, 1980) ("no part of the assets, income or profit of Corp. X shall inure to the benefit of any member, director or officer of the Corporation"); Private Letter Ruling 8015098 (Jan. 17, 1980) ("[n]o gains, profits, or dividends shall be distributed to any of the members of the Corporation, and no part of the net earnings shall inure to the benefit of any person, except the District"); Private Letter Ruling 8004043 (Oct. 30, 1979) ("no part of the net earnings of the corporation shall ever inure to the benefit of any person other than the city"); Private Letter Ruling 7827030 (Apr. 6, 1978) ("nor will any of its income ever inure to any private person").


111. See 41 Fed. Reg. 4829 (1976) (to be codified at Treas. Reg. § 1.103-1(c)(iv) (proposed Feb. 2, 1976) ("[a]ny net earnings . . . may not inure to the benefit of any person other than the [subdivision]").

112. See, e.g., Private Letter Ruling 8042050 (July 23, 1980); Private Letter Ruling 7930120 (Apr. 27, 1979); Private Letter Ruling 7817130 (Jan. 30, 1978); Private Letter Ruling 7726066 (Apr. 5, 1977) But see Private Letter Ruling 8004053 (Oct. 30, 1979) (corporate bylaws provided that directors would not be paid for services as officers "or in any other capacity or pursuant to any other contractual arrangement whatever").
tion either to the sponsoring political subdivision or to a recipient permitted under a state's not-for-profit corporation act. In more than a dozen of the published private letter rulings, however, the articles of incorporation provided for distribution to the political subdivision. In at least two rulings, distributions were permitted to certain other public entities or charitable organizations.

In contrast, in one private letter ruling, which denied 63-20 status on other grounds, the Service added, "Furthermore, if the Corporation is dissolved there is no guarantee that its assets would pass to the State or any political subdivision in the State." In addition, "capital stockholders" could realize limited gains when they sold their "shares." Thus, it would be advisable to include a provision in the charter of a 63-20 corporation directing that upon dissolution of the corporation all property owned by the issuer be vested in the political subdivision. The proposed regulations' requirement for such a provision lends support to this advice.

The timing of this transfer of assets may vary. Some of the letter rulings recite that the corporation will dissolve when its obligations have been paid. Others state that all property of the corporation will become the property of the political subdivision upon the earlier of the expiration of the lease or the retirement of the 63-20 indebtedness. An immediate transfer, however, does not seem to be required.

Another area of concern under the third condition for 63-20 qualification is the inurement of benefits to private persons from 63-20 projects. Although Revenue Ruling 63-20 prohibits a private person from receiving corporate income, it does not prohibit private persons from benefiting from a 63-20 financing provided that their benefit is not through the corporation and the obligations issued do not constitute IDBs.

Thus, the Service frequently has qualified financings under Revenue Ruling 63-20 even though private persons would lease or operate the facilities


114. See Private Letter Ruling 7947037 (Aug. 22, 1979) ("the property will not inure to the benefit of any private person except a foundation or corporation organized and operated for charitable purposes"); Private Letter Ruling 7605210220A (May 21, 1976) (distribution permitted "to the United States, the State . . . or any political subdivision thereof, or to any organization that has been declared exempt under Section 501(c)(3) of the Code").


117. See, e.g., Private Letter Ruling 7835075 (June 1, 1978).


119. See supra note 73 and accompanying text.

120. See supra notes 35-45 and accompanying text.
involved. For example, the Service permitted the leasing of a 63-20 financed silver and silica concentrate mill to a non-exempt corporation, the leasing of nursing homes to private operators, and the contracting out of management rights by a private partnership to a private operator. The Service also has permitted portions of the premises that involved a specified portion of the 63-20 financing proceeds to be leased to private persons. Moreover, 63-20 financing has been approved when management fees owed to private persons were fixed, a percentage of the gross revenue, a combination of both of these, or when the fees included a cost-of-living adjustment. In some instances, however, the fee merely was represented to be "reasonable."

The majority of the rulings that permitted leasing or operation by private persons recite the specific and fairly short time limits of these management contracts, viz., one, three, or five years. The political subdivisions also had the right to approve the renewals or to terminate prematurely these short-term contracts. The recitation of such arrangements with private persons, however, is consistent with an inquiry into the IDB aspects of a proposed financing. In fact, in almost all of those rulings considering such contractual arrangements, the Service specifically considered whether the arrangements would render the financings to be IDBs rather than qualified 63-20 financings. Although such private involvement might render an obligation an IDB, it does not prohibit qualification under Revenue Ruling 63-20.

Nevertheless, if private persons are significantly involved with the project as, for example, a lessee, operator or manager, prudence would dictate that they also not be involved as members, directors or officers of the 63-20 corporation. In one recent private letter ruling, the Service stated that the prohibition against inurement "includes indirect inurement." The ruling

130. Cf. Private Letter Ruling 8004043 (Oct. 30, 1979) (Service specifically ruling that the bonds were not IDBs); Private Letter Ruling 7947037 (Aug. 22, 1979) (ruling did not refer to IDBs).
said, as an example, that if an officer or director of the corporation is also an employee or director of a bank, "care must be taken by the [corpora-
tion] to insure that all its transactions with the bank are at arms length." 132

4. Political Subdivision's Beneficial Interest

Revenue Ruling 63-20 requires, fourth, that the state or political subdivi-
sion "have a beneficial interest in the corporation while the indebtedness re-
mains outstanding" and "obtain full legal title to the property of the corpora-
tion with respect to which the indebtedness was incurred upon the retirement
of such indebtedness." 133 The Service has imposed an array of stringent con-
ditions that must be met before this requirement will be fulfilled.

a. Restrictions on the Project

First, the use of the proceeds from the 63-20 financing is restricted. These
restrictions appear to apply to all of the proceeds rather than to a "major
portion" or "substantially all" of the proceeds as with IDBs. 134 When
determining whether all of the proceeds of a 63-20 financing are being used
properly, the Service apparently means "net proceeds." Neutral costs, such
as the expenses related to the financing, do not seem to be considered as be-
ing part of the net proceeds. 135 Such neutral costs also might include the
underwriter's discount 136 or issuing expenses or fees. 137 The rulings do not
indicate, however, whether net proceeds must be any minimum percentage
of gross proceeds or whether such finance-related expenses can be so
disproportional as to warrant denying 63-20 qualification.

Although proceeds may be used for the administrative expenses of the
financing, the Service specifically has indicated that the proceeds would not
be used for the legal or organizational expenses of the corporation. 138 In

132. Id.
134. See supra notes 35-45 and accompanying text. Compare I.R.C. § 103(b)(2)(A) ("all or
a major portion" or proceeds to be used by non-exempt person) with id. § 103(b)(4)-(7)
("substantially all" of proceeds to be used for various, specified purposes). See also Private
135. See, e.g., Private Letter Ruling 8029033 (Apr. 22, 1980). The term "good or neutral
costs" is specifically referred to in Private Letter Ruling 8136055 (June 11, 1981). See also
Rev. Proc. 82-26, § 3.052, 1982-17 I.R.B. 16, 19, which considers "original proceeds" to be
calculated "after payment of all expenses of issuing the obligations."
137. See, e.g., Private Letter Ruling 8046031 (Aug. 19, 1980); Private Letter Ruling 8004053
(Oct. 30, 1979). Treas. Reg. § 103-8(a)(6) issuing expenses and fees include bond election costs,
costs of publishing notices, attorneys' fees, printing costs, trustees' fees for fiscal agents and
similar expenses. See also Rev. Rul. 79-332, 1979-2 C.B. 38 ("if a portion of cost labeled as
issuance costs is in fact used for another purpose, such portion may not be deducted as issuance
costs in arriving at bond issue proceeds"). In addition, these expenses may include engineering
and auditing costs. See Private Letter Ruling 7906053 (Nov. 9, 1978).
one private letter ruling, the applicant satisfied this distinction by amending its request to specify that the financing proceeds would not be used for "reasonably required insurance reserves." 139

The most important of the restrictions on the use of these net proceeds requires that the proceeds be used to acquire or construct tangible property. 140 This insures that the state or political subdivision receives property. For example, a series of eight substantially identical rulings 141 denied 63-20 qualification to bond issues for the acquisition of mortgage notes secured by first mortgage liens on owner-occupied homes purchased by low and moderate income families within the geographic boundaries of the sponsoring political subdivisions. The Service observed that "when the bonds are redeemed, little or no property will remain for Corporation X to turn over to City Y." 142

Other rulings have echoed this theme. Some 63-20 financings were conditioned upon the use of the financing proceeds for "capitalizable assets" 143 or for assets "capitalizable under Sec. 266 of the Code." 144 The Service also has precluded the use of proceeds for administrative expenses unless the expenditures constituted capital expenditures under sections 263 or 266 of the Internal Revenue Code. 145 Such particular restrictions appear to be merely exemplary rather than mandatory. Other rulings have recited more generally that the proceeds may not be used for "nondepreciable" assets. 146

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140. See Private Letter Ruling 7829133 (Apr. 24, 1978); Private Letter Ruling 7824059 (Mar. 20, 1978). See also Private Letter Ruling 8028016 (Apr. 15, 1980) (backup loan failed to qualify because the indebtedness to be incurred was not tangible property, but a vehicle for facilitating financing); Private Letter Ruling 7605210220A (May 21, 1976) ("intangible property, including contracts, notes receivables, good will and other similar items" could not be financed by bond proceeds). Cf. Private Letter Ruling 8004043 (Oct. 30, 1979) (Revenue Ruling 63-20's requirements met when bond proceeds reimburse a political subdivision for temporary advances of funds used to acquire tangible property).
144. Private Letter Ruling 8004053 (Oct. 30, 1979). In Private Letter Ruling 8149037 (July 10, 1981), in which the 63-20 conditions were met, the Service declared that any excess bond proceeds were to be "expended for costs that are chargeable to the capital account of the corporation."
146. See, e.g., Private Letter Ruling 7842013 (July 18, 1978). See also Private Letter Ruling 8125027 (Mar. 24, 1981) (interest due during construction period that was financed with bond proceeds is chargeable to corporation's capital account under § 266 of the Internal Revenue Code). To qualify for the IDB small issue exemption, the property must be depreciable. I.R.C. § 103(b)(6)(A)(i).
Nor may the proceeds from a 63-20 financing be used "to provide for the [corporation's] working capital in its daily operations."\textsuperscript{147} This principle was specifically stated in Revenue Procedure 82-26.\textsuperscript{148}

Revenue Procedure 82-26 also states that all of the original proceeds and investment proceeds must be used to provide tangible real or tangible personal property.\textsuperscript{149} Proceeds are considered to provide tangible property only if the proceeds are (a) used to finance costs that a taxpayer must (i) charge to the property's capital account or (ii) elect to charge to the capital account or (iii) elect to deduct instead of charging to the capital account, and (b) used to fund a reasonably required reserve fund within the meaning of section 103(c)(4) of the Code.\textsuperscript{150}

None of the published rulings specifically discussed use of the proceeds for site acquisition. Nonetheless, numerous rulings qualify under Revenue Ruling 63-20 where real estate is so acquired\textsuperscript{151} and such use is clearly encompassed within the spirit of Revenue Ruling 63-20. Moreover, the proposed regulations, in discussing a subdivision's "supervisory control" over an issuer, specifically refer to the acquisition of real estate financed by the proceeds.\textsuperscript{152}

The Service also apparently requires that the financed facility be new. Thus, the Service denied financing when the political subdivisions already had the use of the facility. In so doing, the Service stated that "Revenue Ruling 63-20 contemplates the issuance of bonds on behalf of a political subdivision to provide facilities for use within such political subdivision rather than to provide working capital."\textsuperscript{153} Revenue Ruling 63-20 financing was denied in this instance because the issuance of bonds would not provide the county with new or different facilities. Rather, the county would continue to use the same property that it had used under long term leases. The proposed 63-20 financing would only free up any capital not needed to purchase the facility. Such use of the proceeds is not the intended purpose of 63-20 financing.


\textsuperscript{148} Rev. Proc. 82-26, § 3.052, 1982-17 I.R.B. 16, 19.

\textsuperscript{149} Id. The terms "original proceeds" and "investment proceeds" are defined in that section.

\textsuperscript{150} Id. The Procedure provides further for a $5,000 de minimis amount and for maintaining the exemption if excess proceeds were based on reasonable estimates and then are invested in a prescribed manner.


The purchase of equipment, inventory, and supplies also has been subject to restrictions by the Service. The use of proceeds to purchase equipment has been denied because of the unlikelihood that equipment would exist at the time the obligations were to be paid and the property was to be given to the political subdivision. In recent years, however, the Service has taken a more realistic and flexible position. It has recognized that many projects are useless unless the buildings are equipped. Accordingly, a number of the published letter rulings have permitted 63-20 financings that involved the purchase of equipment with the proceeds and that obligated the corporation to repair, maintain, and replace such equipment. Thus, there would be assurance that equipment would exist to be given to the subdivision upon payment of the indebtedness. In some situations, a portion of the proceeds were earmarked for a "Renewal and Replacement Fund." The rationale that permits expenditures for equipment seem to apply to expenditures for supplies and inventories. The few published rulings referring to such items, however, recite that 63-20 proceeds will not be used for supplies and inventories. In contrast, several rulings indicate that furnishings would be financed. Perhaps, if there is adequate assurance of replacement, the Service may be persuaded to permit expenditures of 63-20 proceeds for supplies and inventories.

Another area of restriction is the use of proceeds for prior, interim, and additional issues. A financing apparently will qualify under Revenue Ruling 63-20 under some circumstances even if a portion of the proceeds may be used to retire outstanding obligations (assuming those obligations also are

155. See Private Letter Ruling 8034067 (May 29, 1980) (stated to be limited to eight percent of proceeds); Private Letter Ruling 8005031 (Nov. 7, 1979) (project's equipment, purchased from bond proceeds, required to be maintained, replaced where necessary, and conveyed to County in good working condition); Private Letter Ruling 8115095 (Jan. 19, 1981) (hospital would maintain and replace obsolete equipment acquired with the notes), amended by Private Letter Ruling 8116088 (Jan. 23, 1981). See also Private Letter Ruling 8133057 (May 20, 1981) (Service authorized subdivision's plan in which the corporation "reasonably expects to maintain and replace any obsoleted property" and further authorized a fund for the replacement of the project or equipment); Private Letter Ruling 8304011 (Oct. 15, 1982) (hospital corporation required to repair or replace obsolete or worn equipment).
158. See, e.g., Private Letter Ruling 8124074 (Mar. 18, 1981); Private Letter Ruling 7947065 (Aug. 22, 1979); Private Letter Ruling 7726066 (Apr. 15, 1977). Cf. Private Letter Ruling 7926093 (Mar. 29, 1979) (since county would receive full title to facilities, including furnishings and equipment, when bonds were redeemed and county could exercise option to purchase facilities at any time, Revenue Ruling 63-20's requirements were met).
If the outstanding obligations are not tax-exempt, refinancing will not qualify under Revenue Ruling 63-20. The Service reasoned that otherwise, the obligations would not be "issued for the purpose intended by Rev. Rul. 63-20, the providing of new or different facilities for the benefit of [the] County. Instead, the purpose of the issuance will be to retire and refinance [the] Hospital's previously issued Notes, obligations that were incurred without the contemplation of eventual tax-exempt bond financing."  

Interim financing may qualify under Revenue Ruling 63-20 if it is part of a unified financing arrangement clearly contemplating permanent financing. Thus, permissible interim financing would include instances in which the political subdivisions cannot act quickly enough to arrange permanent financing or the financing only is necessary for the construction period. Furthermore, if bond proceeds are used to reimburse a political subdivision for temporary advances of funds that were used to acquire tangible property, the Service has ruled that the proceeds would be considered necessary for acquisition of tangible property rather than as providing working capital.

It should be noted that the Service has issued proposed regulations revising section 1.103-7, the existing regulations relating to the advance refunding of IDBs. The new regulations would prohibit most refundings because, in part, they do not finance the acquisition, construction, or reconstruction of property, but rather refinance an existing debt. Although the proposed regulations do not apply specifically to "on behalf of" issuances or 63-20 financings, the Service stated in one 1978 private letter ruling that "we are studying whether the underlying rationale applicable to the proposed regulations should apply to advance refunding of '63-20' obligations." The Service then proceeded to apply the standards in the proposed regulations to the 63-20 financing under consideration.

Refinancing appears permissible only if the maturity of the new financing will not postpone the date on which the political subdivision is to receive the property involved as set forth in the terms of the original 63-20 financ-

162. See, e.g., Private Letter Ruling 7930120 (Apr. 27, 1979) (because insufficient time to secure bond-financed loan for purchase of school property, Service approved plans whereby not-for-profit foundation would purchase land for resale to school district).
163. See, e.g., Private Letter Ruling 8145078 (undated) (Service approved 63-20 qualification of Bond Anticipation Notes for interim construction financing of courthouse project).
This principle is consistent with the Service’s requirement prohibiting the extension of lease renewal options beyond the time the political subdivision will receive the title to the property.

Similarly, additional financings that are secured by the same property that secured the original financing are permitted only if the original maturity dates are not extended. Thus, in one revenue ruling, a hospital that financed an addition by issuing bonds that qualified under Revenue Ruling 63-20 could refund these bonds in advance with 63-20 bonds because title to the facilities would not vest in the sponsoring city later than the original vested date under the first bond issue. The hospital, however, could not later finance an addition with 63-20 bonds if it would have been unable to amortize such bonds on or before the original maturity date. The hospital accordingly proposed an arrangement, which the Service approved, whereby a state Authority would issue its own tax-exempt bonds “on behalf of” the city in which the hospital was located. Part of the proceeds were to be escrowed during the construction and used to pay off the 63-20 bonds. Upon such payoff, the hospital, which was the 63-20 corporation, would deed all the original 63-20 financed property to the city, free and clear of all encumbrances. The city then would lease all the property to the state Authority under a ground lease for the duration of the Authority’s bond issue. The Authority, in turn, would lease the facilities to the hospital.

In Revenue Procedure 82-26, the Service now has stated that it ordinarily will issue an advance ruling that refunding obligations are issued by a non-profit corporation on behalf of a governmental unit, if four conditions are met:

1. That all of the original and investment proceeds (subject to certain exceptions) are used to pay the principal, qualified

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168. See infra text accompanying notes 255-63.

169. Nelson, supra note 29, at 945. See, e.g., Private Letter Ruling 8051121 (Sept. 26, 1980) (series B Bonds issued to construct, equip, and acquire addition to nursing home facility co-terminous with outstanding series A Bonds); Private Letter Ruling 8037107 (June 20, 1980) (foundation increased amount of loan without increasing term of the note); Private Letter Ruling 8015098 (Jan. 17, 1980) (if corporation issues additional bonds, final maturity of additional bonds cannot be later than final maturity date of outstanding bonds); Private Letter Ruling 8007054 (Nov. 23, 1979) (repayment of additional funds borrowed for additional facility will terminate on same date that the indebtedness incurred in connection with the original facility matures).

Parity bonds for future expansion have been authorized, see Private Letter Ruling 8133057 (May 20, 1981); Private Letter Ruling 7907072 (Nov. 16, 1978); Private Letter Ruling 7906053 (Nov. 9, 1978), but such bonds may not extend the original maturity date, see Private Letter Ruling 8004043 (Oct. 30, 1979). Cf. Private Letter Ruling 8145078 (undated) (there is no mention of maturity dates of possible parity bonds). But see Private Letter Ruling 7605210220A (May 21, 1976) (parity bonds authorized on condition that title to bonded facility not be encumbered while bonds remain outstanding).


interest and any premium on the prior issue, and to fund a reasonably re-
quired reserve fund; 172 (2) that the obligations are not “advance refunding
obligations,” which means obligations issued more than 180 days before the
date the prior obligations are discharged; 173 however, the Service will give a
favorable ruling to “advance refunding obligations” if the governmental
unit has exclusive possession and use of a portion of the financed property
equal to ninety-five percent of the fair rental value for the life of the
obligations; 174 (3) that the refunding obligations will be discharged no later
than the latest maturity date of the original obligations, 173 except that this
requirement is waived if the governmental unit has the beneficial interest in
the corporation specified by section 3.041(a) of the Revenue Procedure; 176
and (4) most of the general operating rules of section 3 of Revenue Pro-
cedure 82-26 are met. 177

b. Beneficial Interest While Indebtedness Outstanding

In addition to restricting the use of 63-20 proceeds, Revenue Ruling 63-20
requires that the political subdivision have a beneficial interest in the cor-
poration while the indebtedness remains outstanding. This requirement has
been reflected in the private letter rulings in many ways, and certain of
those conditions are now contained in Revenue Procedure 82-26.

Under section 3.04 of Revenue Procedure 82-26, this beneficial interest
requirement is met if any of the following three conditions exist:

(a) the governmental unit has “exclusive beneficial possession and use of
the portion of the property financed by the obligations and additions to
that property equivalent to [ninety-five] percent or more of its fair rental
value for the life of the obligations” (including other obligations issued by
the corporation in connection with the property to make improvements or
to refund a prior issue of obligations). 178 This condition appears for the
first time in Revenue Procedure 82-26 and is not mentioned in any of the
prior private letter rulings.

(b)(1) the corporation has that amount of “exclusive beneficial possession
and use,” 179 and (2) the governmental unit on whose behalf the nonprofit
corporation is issuing the obligations (A) appoints or approves the appoint-
ment of at least eighty percent of the members of the corporation’s govern-
ring board and (B) has the power to remove for cause, either directly or
through judicial proceedings any member of that board and appoint a suc-
cessor. 180 However, if the corporation’s articles of incorporation provide

\[172. \textit{Id.} \textsection 4.011.\]
\[173. \textit{Id.} \textsection 4.012.\]
\[174. \textit{Id.} \textsection 4.012 (referring to \textsection 3.041(a) of the Procedure).\]
\[175. \textit{Id.} \textsection 4.013.\]
\[176. \textit{Id.}\]
\[177. \textit{Id.} \textsection 4.014.\]
\[178. \text{Rev. Proc. 82-26, \textsection 3.041(a), 1982-17 I.R.B. 16, 18.}\]
\[179. \textit{Id.} \textsection 3.041(b)(1).\]
\[180. \textit{Id.} \textsection 3.041(b)(2).\]
that ex officio representatives of the governmental unit constitute all or a part of the membership of the board, then the requirements of (A) and (B) do not apply to the ex officio members.\textsuperscript{181} This condition, while perhaps hinted at in prior published private letter rulings, also imposes requirements far beyond those enunciated in the prior rulings.\textsuperscript{182}

(c) The governmental 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 the property, by (1) placing into escrow an amount sufficient to defease the obligations, and (2) paying reasonable costs incident to the defeasance.\textsuperscript{183} To preserve the governmental unit's right to obtain title, the unit generally is prohibited from contracting in advance to convey any interest in the property for periods after the defeasance of the obligations. The governmental unit specifically is prohibited from contracting to convey a fee interest to any user of the property (as defined in § 103(b)(6)(C) of the Code) before the defeasance within ninety days after the unit defeases the obligations.\textsuperscript{184} This condition builds on principles clearly reflected in the prior private letter rulings. If the governmental unit exercises its right at any time to obtain unencumbered title, the property must be conveyed as unencumbered as is necessary in the ordinary discharge of the obligations.\textsuperscript{185}

If the first condition\textsuperscript{186} has not been met, then, in addition to meeting one of the other two conditions, the financing also must provide that if 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 any additions to that property) for the amount of the outstanding indebtedness and accrued interest to the date of default.\textsuperscript{187}

The conditions imposed in Revenue Procedure 82-26 are ambiguous to some extent. As with Revenue Ruling 63-20, the prior private letter rulings may be helpful in understanding the Service's views.

The meaning in Revenue Procedure 82-26 of the term "exclusive beneficial possession and use"\textsuperscript{188} is not clear. The prior private letter rulingss

\begin{footnotesize}
\begin{enumerate}
\item[181.] \textit{Id.}
\item[182.] See infra notes 196-203 and accompanying text.
\item[183.] Rev. Proc. 82-26, § 3.041(c), 1982-17 I.R.B. 16, 18.
\item[184.] \textit{Id.} The reference to the 90-day period is ambiguous, and thus fosters confusion. If it means merely that the transfer must be delayed at least 90 days from defeasance, it would contradict the principle that there should be no contracting in advance. Similarly, if the reference means that the conveyee could not have been a user within 90 days before the defeasance, it contradicts the same principle, because the governmental unit, immediately after defeasance, should be free to contract with anyone.
\item[185.] \textit{Id.} Compare id. § 3.053 with infra notes 227-35 & 253-65 and accompanying text.
\item[186.] See supra text accompanying note 178.
\item[187.] Rev. Proc. 82-26, § 3.042, 1982-17 I.R.B. 16, 18.
\item[188.] E.g., id. §§ 3.041(a), 3041(b)(1). Compare id. with § 3.053 (exclusive possession and use).
\end{enumerate}
\end{footnotesize}
erally implied that either the corporation or political subdivision would have exclusive possession and use, but did not specifically state that. As discussed above, under Revenue Ruling 63-20 private parties always have been permitted to be lessees, managers, and operators of 63-20 financed facilities, and they could make profits out of these arrangements. Thus, where the corporation or political subdivision initially had full control and then chose to enter into such arrangements, the language in Revenue Procedure 82-26 does not seem to be an attempt to prohibit these arrangements. If the Service had desired that result, it probably would have stated so more clearly. Rather, the language seems an effort to insure that the corporation or political subdivision does have full control initially.

Under Revenue Procedure 82-26, "use" by an instrumentality of a governmental unit will be considered "use" by that unit if that instrumentality is an instrumentality of only the governmental unit on whose behalf the obligations are issued and the requirements of Revenue Ruling 57-128 are otherwise met. This language is unclear. If to be an instrumentality of a governmental unit means to be chartered by the governmental unit, then very few instrumentalities will qualify. If to be an instrumentality means to have limiting charter provisions, then most nonprofit corporations could be structured to qualify.

In one private letter ruling exemplifying the Service's concern that the subdivision have the use of the property, the city sponsoring the 63-20 bonds and using the facility only had a one-year lease of the property. Although the city had the option to terminate the rental at the end of the lease, it automatically renewed the lease each year. The Service, however, seemed unsure that the city maintained a sufficient beneficial interest through such an arrangement. Thus, the Service required a representation that "[t]he City fully intends to renew each year its lease with the Authority (the 63-20 corporation) relative to the facility involved herein."

The requirement of section 3.041(b)(2) that the political subdivision control the board is much more specific and restrictive than the requirements previously expressed in the published private letter rulings. While some degree of control always seemed to be recited, rulings generally do not specify that the political subdivision must possess any particular control over the 63-20 corporation. For example, in those rulings the subdivision's governing body might either elect or approve the corporations' members.
directors, articles of incorporation, bylaws, expenditures, or budget. In some instances, officials of the political subdivision also may serve as officials of the 63-20 corporation. Such control by the political subdivision might occur only at the creation of the corporation, or this control of the corporation might continue.

The proposed regulations are even more restrictive than Revenue Procedure 82-26 in requiring the political subdivision to generally control the governing board of the corporation. Under those regulations, the board must be composed entirely of: (i) subdivision public officials who serve ex-officio, but for no longer than their term in public office; or (ii) persons elected by the voters for a specified term; or (iii) persons appointed by other members of the board who are in the first two categories. Board members in the third category would have to be removable at will with no appointment exceeding six years. However, if the subdivision does not trust for the political subdivision. See, e.g., Private Letter Ruling 8032046 (May 13, 1980); Private Letter Ruling 8008034 (Nov. 27, 1979); Private Letter Ruling 7944046 (Aug. 1, 1979); Private Letter Ruling 7835075 (June 1, 1978); Private Letter Ruling 7827027 (Apr. 6, 1978).

197. See, e.g., Private Letter Ruling 8245073 (Aug. 13, 1982); Private Letter Ruling 8226058 (Mar. 30, 1982); Private Letter Ruling 8211028 (Dec. 15, 1981). See infra notes 213-15 and accompanying text. Unpublished Private Letter Ruling 701203001 (Dec. 3, 1979) has been cited by some attorneys as requiring the subdivision to have control over the appointment of directors. "Members" or "Directors" may be used synonymously in different rulings because of the variations in corporate structures under different states' not-for-profit corporation laws. Generally, reference to either probably should be construed as references to the controlling persons.


202. Prior to the issuance of the bonds, a municipality may exercise control by approving the development of the project, approving the articles of incorporation, and confirming the appointment of the initial board of directors. See, e.g., Private Letter Ruling 8152124 (Oct. 5, 1981); Private Letter Ruling 8124149 (Mar. 23, 1981). See also Private Letter Ruling 7836023 (June 7, 1978) (municipality exercises control through approving initial board of directors and approving initial funding of the corporation).


205. Id.
have "organizational control," a majority of the members of the corporation's governing body must be in the first two categories.

As previously stated, the proposed regulations also require that the subdivision have "organizational control" or "supervisory control" over the corporation.\textsuperscript{206} Organizational control would include the right to "at its sole discretion, and at any time, alter or change the structure, organization, programs or activities" of the issuing corporation.\textsuperscript{207} Such control also would include the power to terminate the corporation.\textsuperscript{208} Supervisory control of the issuer would ordinarily include approval of, and power to amend, the issuer's governing instrument and bylaws,\textsuperscript{209} annual approval and post-review of the issuer's programs and expenditures,\textsuperscript{210} annual review of its financial statements,\textsuperscript{211} and access at any time to its books and records.\textsuperscript{212}

An early unpublished private letter ruling has been cited for the proposition that the political subdivision is required to have control over the appointment of directors.\textsuperscript{213} In a more recent ruling, the Service relied upon the proposed regulations to determine that the issuer, a state university, was neither a political subdivision nor an issuer "on behalf of" a subdivision.\textsuperscript{214} In discussing the "on behalf of" requirement, the Service stated that an "on behalf of" entity acts as an agent or alter ego of the political subdivision in the issuance of obligations. The Service observed that "[t]his relationship, or nexus, exists when the state or political subdivision possesses organizational or supervisory control over the activities of the issuing entity."\textsuperscript{215} Concluding that the proposed regulations merely codified requirements of prior revenue rulings, control was determined on the basis of whether a state or political subdivision had the right to select the members of the governing body of the issuing entity. Thus, in seeking qualification under Revenue Ruling 63-20, it would appear useful to give the sponsoring political subdivision as many as possible of the elements of control enumerated in Revenue Procedure 82-26 and in the proposed regulations.

As is now reflected in section 3.041(c) of Revenue Procedure 82-26, the Service has long insisted on a provision granting the political subdivision the option to purchase the financed property at any time at a price suffi-
cient to retire the indebtedness.216 Almost all of the published rulings cite the existence of such a provision.217 Such a provision helps ensure that the subdivision ultimately will receive full legal title. The principle has been so embedded in the private letter rulings that the occasional omission of such a recitation or variation seems insignificant. However, the specification in Revenue Procedure 82-26 of the escrow arrangement218 is new and may be less restrictive than arrangements recited in the prior private letter rulings. Many such arrangements implied that the obtaining of possession and the defeasing of the obligations should occur promptly.

The option expressed in section 3.042 of Revenue Procedure 82-26 permitting the political subdivision to purchase the property upon default is consistent with the Service's prior position. The political subdivision was granted a similar right in prior private letter rulings "in the event of a default under the [bond] Indenture" to fully pay the bonds and acquire ownership of the project.221 Sometimes this was an exclusive right.222 In a number of the rulings qualifying under Revenue Ruling 63-20, the time in which the subdivision may exercise that right was limited. For example, the subdivision might have thirty days in which to exercise its option and sixty days within which to perfect its purchase.223 Revenue Procedure 82-26 now

217. See, e.g., Private Letter Ruling 8104136 (Oct. 30, 1980); Private Letter Ruling 8034067 (Mar. 29, 1980); Private Letter Ruling 7944086 (July 31, 1979); Private Letter Ruling 7827030 (Apr. 6, 1978); Private Letter Ruling 7741037 (July 18, 1977); Private Letter Ruling 7608139210A (Aug. 13, 1976); Private Letter Ruling 7409240390A (Sept. 24, 1974). Sometimes a ruling will recite a price sufficient "to retire any notes, bonds, or other obligations of the corporation then outstanding." See Private Letter Ruling 7907072 (Nov. 16, 1978). One ruling recognized that it was permissible for the state to have the right to purchase the financed property when it took title "for the use and benefit" of the subdivision. Private Letter Ruling 8007054 (Nov. 23, 1979).
218. See Private Letter Ruling 7827030 (Apr. 6, 1978) (on maturity political subdivision was "obligated" to purchase acquired assets at value of loans plus interest).
219. See Private Letter Ruling 8116088 (June 23, 1981) (subdivision "can purchase the project at anytime by assuming the outstanding indebtedness"); Private Letter Ruling 8007054 (Nov. 23, 1979) (subdivision can purchase the facility on "any rental payment date"); Private Letter Ruling 7807076 (Nov. 21, 1977) (subdivision "has a continuous right to acquire the property . . . through either discharging or assuming the corporate indebtedness").

In one ruling the subdivision could purchase "any part" of the project. Private Letter Ruling 8121170 (Mar. 2, 1981). The option price was "equal to the aggregate amount for the entire remaining term of the facility lease of the part of the total rent attributable to such part of the project," which seems to equate the rent to the indebtedness. Id. (emphasis added). In another ruling, the subdivision could purchase the project "subject to the lease." Private Letter Ruling 7409240390A (Sept. 24, 1974).
220. See supra note 183 and accompanying text.
specifies a permissible time limit. The governmental unit shall have not less than ninety days from the date it is notified by the nonprofit corporation of the default in which to exercise the option, and not less than ninety days from the date it exercises the option to purchase the property. 224

The proposed regulations, as an element of "supervisory control" by the political subdivision, provide that "in the event of default with respect to obligations issued to finance the acquisition of property, the [subdivision] has the exclusive option to purchase such property for the amount required to discharge such obligations and is provided a reasonable time to exercise such option." 225 Both Revenue Procedure 82-26's and the proposed regulations' imposition of a time limit within which to exercise such an option seem to back off from the Service's apparent general position that an option to purchase be exercisable "at any time." 226

A number of the private letter rulings also recite that while the indebtedness is outstanding there will be no liens or encumbrances 227 on the property other than mortgages and security interests needed to secure 63-20 financing. 228 It is not clear whether this is part of the Service's beneficial interest requirement or simply a reflection of the boilerplate language in financing instruments.

Alternatively, the further requirement that the property be free of encumbrances when given to the subdivision 229 implies that liens would be permissible until such time. In one ruling, for example, the Service relied upon a representation that the term "permitted encumbrances," as defined in the trust agreement, would "have no application to the full, unincumbered [sic] title to the project which will be transferred to the City upon its option to purchase, or upon the complete discharge or payment of the bonds." 230 In other rulings, liens were prohibited "excepting sewer assessments" 231 or "any necessary easements for public convenience." 232 Yet, if the subdivision has the right to acquire the property at any time and if its ultimate acquisition must be lien-free, it is arguable that the property must be kept lien-free at all times. Presumably a reasonable time to clear newly-incurred liens would be allowed.

Many of the published private letter rulings also recite that title

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226. See supra note 216 and accompanying text.
229. See infra notes 254-63 and accompanying text.
documents would be placed with an escrowee or trustee for the benefit of the subdivision while the indebtedness was outstanding.\textsuperscript{233} This procedure can both secure the property to the holders of the indebtedness and ensure ultimate conveyance to the subdivision. Again, it is unclear whether the procedure is merely sound commercial practice or whether it is a Service requirement. In other rulings, the corporation's membership certificates also were held by a trustee or escrowee for the benefit of the subdivision while the obligations were outstanding.\textsuperscript{234} As another element of "supervisory control" by the political subdivision, the proposed regulations would require that such an escrow be established to convey title upon retirement of the indebtedness.\textsuperscript{235}

c. Title Upon Retirement of the Indebtedness

In addition to project restrictions and the beneficial interest requirement, Revenue Ruling 63-20 requires that the political subdivision obtain full legal title to the financed property upon the retirement of the indebtedness. The published private letter rulings indicate that the mode of transfer to the subdivision may vary. For example, transfer may be effected through the corporation's articles of incorporation,\textsuperscript{236} by gift\textsuperscript{237} or deed,\textsuperscript{238} through the bond indenture\textsuperscript{239} or the lease,\textsuperscript{240} or by unspecified means.\textsuperscript{241} Many rulings talk of the property as being "tendered." Regardless of the mode of transfer, the subdivision must obtain control of the property upon retirement of the indebtedness.\textsuperscript{242}

Thus, the Service has denied 63-20 qualification, in part, because legal title

\textsuperscript{233} See Private Letter Ruling 7836023 (June 7, 1978); Private Letter Ruling 7835075 (June 1, 1978).
\textsuperscript{238} See Private Letter Ruling 7836023 (June 7, 1978).
\textsuperscript{240} See Private Letter Ruling 8038131 (June 27, 1980).
\textsuperscript{241} See Private Letter Ruling 8038131 (June 14, 1977).
\textsuperscript{242} See, e.g., Private Letter Ruling 8102048 (Oct. 16, 1980); Private Letter Ruling 7944046 (Aug. 1, 1979). It is interesting to note that early 63-20 transactions provided that a lessee would have an automatic purchase option over the property (in an amount sufficient to retire the bonds) if the interest was ruled to be not tax-exempt. This was prohibited by the I.R.S., however, in part on the theory that the right of the political subdivision to take full legal title to the property should not be jeopardized by any changes in federal tax law. See Nelson, supra note 29, at 946.
would vest in another nonprofit corporation rather than in the subdivision. In one ruling, the requirement was not met because the corporation was authorized to sell its property to private industry. In a later ruling, however, where state law permitted a city to donate property to a nonprofit corporation for public purposes, the 63-20 corporation could have required the subdivision to deed the facilities to a nonprofit corporation. In this situation, Revenue Ruling 63-20 financing was approved because the nonprofit corporation was obligated to keep the facilities available to the public. In contrast, the Service in a more recent ruling denied 63-20 qualification for a university's obligations even though the university's board of trustees held title to the university's property in trust for the people of the state. Although the university urged that the state thereby had a beneficial interest in the university, the Service stated that the "holding of property 'in trust' by [the university] is not equivalent to full legal title vesting in [the state]."

The proposed regulations, as an element of supervisory control, and Revenue Procedure 82-26 also require full legal title to vest in the political subdivision.

Under Revenue Procedure 82-26, seven conditions must be met to fulfill the requirement that the political subdivision obtain full legal title to the property upon the retirement of the indebtedness:

1. The obligations of the nonprofit corporation must be issued on behalf of no more than one governmental unit and unencumbered fee title must be vested solely in that unit when the obligations are discharged. This condition is consistent with the Service's prior positions when multiple governmental units were involved.

2. All of the original proceeds and investment proceeds must be used to provide tangible property.

3. The governmental unit must obtain unencumbered fee title and ex-

245. See Private Letter Ruling 8038183 (June 30, 1980).
247. Id.
249. Rev. Proc. 82-26, § 3.05, 1982-17 I.R.B. 16, 20. Compare id. with I.R.C. § 103(b)(6)(K) (implying that financed facilities located in more than one state can qualify for an IDB "small issue" exemption).
250. Rev. Proc. 82-26, § 3.051, 1982-17 I.R.B. 16, 20. This paragraph also states that 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.
clusive possession and use of the property financed, including any additions, without demand or further action on its part.\textsuperscript{253}

The absence of liens and encumbrances always has been a requirement.\textsuperscript{254} The Revenue Procedure states that, for example, all leases, management contracts, and other encumbrances must terminate upon discharge of the obligations.\textsuperscript{255} The published private letter rulings also have made it clear that all leases,\textsuperscript{256} subleases,\textsuperscript{257} and management contracts\textsuperscript{258} affecting the property must terminate upon retirement of the indebtedness. Although not explicitly stated in any of the published private letter rulings, it appears that the lease must be cancelled at the time title passes rather than merely be terminable. For example, 63-20 qualification was denied when the tenant sought a post-retirement non-disturbance agreement.\textsuperscript{259} Under the proposed regulations, lease renewals and lease extensions exercisable by any person other than the political subdivision are cited as examples of title encumbrances that are prohibited beyond the date of the retirement of the indebtedness.\textsuperscript{260} Some of the private letter rulings, however, recite that the subdivision may receive title at the earlier of the expiration of the original lease or the retirement of the indebtedness\textsuperscript{261} or the expiration of the site lease from the subdivision.\textsuperscript{262} If title vests upon the expiration of the lease or site lease but before the retirement of the indebtedness, it would seem permissible for mortgages and security interests to remain attached until the indebtedness is retired. This proposition, however, is not stated in the private letter rulings. The proposed regulations, as one element of supervisory control, require that title be transferred "free of encumbrances created subsequent to the acquisition of the property" by the corporation.\textsuperscript{263}

\begin{enumerate}
\item \textsuperscript{253} Rev. Proc. 82-26, § 3.053, 1982-17 I.R.B. 16, 19.
\item \textsuperscript{255} Rev. Proc. 82-26, § 3.053, 1982-17 I.R.B. 16, 19.
\item \textsuperscript{256} See Private Letter Ruling 8152124 (Oct. 5, 1981); Private Letter Ruling 8142041 (July 21, 1981); Private Letter Ruling 8038131 (June 27, 1980); Private Letter Ruling 8038117 (June 27, 1980); Private Letter Ruling 8029033 (Apr. 22, 1980). See also infra note 293 (options).
\item \textsuperscript{257} See Private Letter Ruling 7911097 (Dec. 18, 1978).
\item \textsuperscript{259} See Private Letter Ruling 8047033 (Aug. 27, 1980) (repealing Private Letter Ruling 8029033 (Apr. 22, 1980)).
\item \textsuperscript{262} See, e.g., Private Letter Ruling 8226058 (Mar. 30, 1982); Private Letter Ruling 7928013 (Apr. 10, 1979).
\end{enumerate}
Under Revenue Procedure 82-26, 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 the purposes of the condition that full legal title vest in the political subdivision.\textsuperscript{264} The Procedure further prescribes that if the 63-20 corporation sells interim financing in anticipation of selling permanent financing for the governmental unit, the condition is met if (a) the unit receives the requisite title and possession upon discharge of the permanent financing and (b) the last short-term issue is discharged within five years after the date the first short-term issue is issued.\textsuperscript{265}

(4) Before the obligations are issued, the governmental unit must adopt 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.\textsuperscript{266} This condition reflects numerous private letter rulings that also have recited (but did not specifically require) that the political subdivision, prior to the financing, agreed to accept the property upon the retirement of the indebtedness.\textsuperscript{267} In at least one ruling, the Service conditioned 63-20 qualification upon such a prior agreement.\textsuperscript{268} Acceptance in advance is consistent with the requirement that the subdivision receive the property upon retirement of the indebtedness. The proposed regulations also require acceptance in advance as another element of supervisory control.\textsuperscript{269}

(5) As indicated in the published private letter rulings,\textsuperscript{270} subsequent obligations issued to make improvements or to refund prior obligations must be discharged no later than the maturity date of the original obligations.\textsuperscript{271} The Revenue Procedure now states that this restriction must be contained in the indenture or other financing documents of the original obligations.\textsuperscript{272} Similarly, the maturity date of the original obligations may not be extended beyond the latest original maturity date of those obligations.\textsuperscript{273} However, this condition is waived if the governmental unit (not the corporation) has exclusive beneficial possession and use of a portion of the property equivalent to ninety-five percent of its fair rental value during the life of the obligations.\textsuperscript{274}

\textsuperscript{264} Rev. Proc. 82-26, § 3.053, 1982-17 I.R.B. 16, 19. Cf. § 3.041(c).

\textsuperscript{265} Id.

\textsuperscript{266} Id. § 3.054.

\textsuperscript{267} See e.g., Private Letter Ruling 8124149 (Mar. 23, 1981); Private Letter Ruling 8032046 (May 13, 1980); Private Letter Ruling 7921058 (Feb. 26, 1979); Private Letter Ruling 7829123 (Apr. 24, 1978); Private Letter Ruling 7741037 (July 18, 1977). One ruling asserted that the political subdivision "unequivocally" agreed to accept the project when the bonds were retired. Private Letter Ruling 8133057 (May 20, 1981).

\textsuperscript{268} See Private Letter Ruling 8051121 (Sept. 26, 1980).


\textsuperscript{270} See supra notes 167-70 and accompanying text.

\textsuperscript{271} Rev. Proc. 82-26, § 3.055, 1982-17 I.R.B. 16, 19.

\textsuperscript{272} Id.

\textsuperscript{273} Id.

\textsuperscript{274} Id. See id. § 3.041(a); supra text accompanying note 178.
Just slightly prior to its issuance of Revenue Procedure 82-26 on April 26, 1982, the Service issued a private letter ruling dated March 30, 1982, refusing to express an opinion on the issuance of an additional series of bonds after those that were the subject of the ruling. The Service stated that it "is presently studying the tax consequences of an extension of the date on which full legal title to the facility vests in the governmental unit as a result of a subsequent bond issue." Whether Revenue Procedure 82-26 stated the conclusion of that study or whether the study is continuing is not certain.

(6) The proceeds of fire or other casualty insurance received in connection with damage or destruction to the property financed must, 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. Until Revenue Procedure 82-26, the question of damage or insurance was mentioned only in two published private letter rulings. The first ruling merely recited the fact that "[i]n the event of damage or destruction to the facilities, the lessee (63-20 corporation) is required to reconstruct them with the insurance proceeds, even if the proceeds are not sufficient." One more recent ruling, issued after Revenue Procedure 82-26, recited that any insurance proceeds would be used to reconstruct the project or would be remitted to the sponsoring city. The reference in the Revenue Procedure to insufficient insurance proceeds implies answers to several hitherto unresolved questions. Apparently, a favorable 63-20 ruling will not be jeopardized by the failure to have adequate insurance or by the failure to rebuild. Thus, due to a lack of insurance, the governmental unit, in effect, may not have a beneficial interest in the project. Lack of insurance also could leave the governmental unit with either bare land or land with ruins which the unit might be forced to clear. Similarly, if the governmental unit receives insurance proceeds rather than a rebuilt project, the unit, in effect, receives only working capital which otherwise would disqualify the financing under Revenue Ruling 63-20.

Other questions remain unresolved. Is the choice that is permitted in Revenue Procedure 82-26—to rebuild or to remit the proceeds—to be made by the 63-20 corporation or by the governmental unit? Is that choice an

276. Id.
278. Private Letter Ruling 8145078 (undated); Private Letter Ruling 8142041 (July 2, 1981). After Rev. Proc. 82-26, Private Letter Ruling 8305018 (Oct. 29, 1982) recited that insurance proceeds would be used, subject to claims of the bondholders, to make repairs and that if the corporation did not commence repairs "within a set period," the bond trustee could make repairs.
281. See supra notes 147-48 and text accompanying.
either/or proposition; for example, can the corporation use some proceeds to clear the land of ruins and remit the balance? If the insurance proceeds are sufficient to build only a lesser facility, and such a lesser facility is in fact built, will a favorable 63-20 ruling be nullified? How much time may elapse before a decision to rebuild or to remit must be made? If the property is not rebuilt, must the underlying land or the damaged property be conveyed to the governmental unit? If so, must it be conveyed immediately, or only upon the discharge of the obligations? If there are excess insurance proceeds after rebuilding, do the principles underlying Revenue Ruling 63-20 mandate that the excess proceeds be remitted to the governmental unit instead of being retained by the corporation, as all other income of the corporation is retained?

(7) At the latest maturity date of the obligations, the financed property reasonably must be estimated to have (a) a fair market value equal to at least twenty percent of its original cost\textsuperscript{282} and (b) a remaining useful life which is the longer of one year\textsuperscript{283} or twenty percent of its originally estimated useful life.\textsuperscript{284} Prior published private letter rulings also had imposed these quantitative restrictions on original cost and useful life.\textsuperscript{285} Fair market value does not include any additions to the property,\textsuperscript{286} any increase for inflation, or any decrease for deflation during the term of the obligations.\textsuperscript{287} It also may not include any costs incurred for the removal and delivery of possession of the project to the governmental unit.\textsuperscript{288}

This condition is waived if the governmental unit (not the corporation) has exclusive beneficial possession and use of a portion of the property equivalent to ninety-five percent of its fair rental value during the life of the obligations.\textsuperscript{289} Also, the twin "twenty percent" tests in (a) and (b) will be deemed met if the nonprofit corporation is required to replace the property and the replacement property meets those tests.\textsuperscript{290}

\textsuperscript{282} Rev. Proc. 82-26, § 3.057(a), 1982-17 I.R.B. 16, 19.
\textsuperscript{283} See also Private Letter Ruling 8004043 (Oct. 30, 1979).
\textsuperscript{284} Rev. Proc. 82-26, § 3.057(b), 1982-17 I.R.B. 16, 19-20.
\textsuperscript{285} See Private Letter Ruling 8142041 (July 21, 1981); Private Letter Ruling 8133057 (May 20, 1981); Private Letter Ruling 8115095 (Jan. 19, 1981); Private Letter Ruling 8034150 (May 30, 1980); Private Letter Ruling 8015098 (Jan. 17, 1980); Private Letter Ruling 8012112 (Dec. 30, 1979); Private Letter Ruling 7605210220A (May 21, 1976). In Private Letter Ruling 8149037 (July 10, 1981), the Service even applied this two-part test to an aircraft carrier being converted into a museum. Cf. Private Letter Ruling 8015079 (Jan. 16, 1981) (Service observed that facilities would have "substantial value and useful life" if the test was met). A similar requirement of 20% useful life and 20% remaining fair market value has been promulgated by the I.R.S. in Revenue Rulings 75-21 and 75-28, relating to "leveraged lease" transactions.

\textsuperscript{286} Rev. Proc. 82-26, § 3.057(a), 1982-17 I.R.B. 16, 19.
\textsuperscript{287} Id. Accord Private Letter Ruling 8004043 (Oct. 30, 1979).
\textsuperscript{288} Private Letter Ruling 8004043 (Oct. 30, 1979).
\textsuperscript{289} Rev. Proc. 82-26, § 3.057(b), 1982-17 I.R.B. 16, 20 See also id. § 3.041(a).
\textsuperscript{290} Rev. Proc. 82-26, § 3.057(b), 1982-17 I.R.B. 16, 20 See also supra text accompanying note 178.
These "twenty percent" conditions are implicit in the requirement that the political subdivision obtain full legal title upon defeasance of the obligations. If defeasance is remote, the value of the property could be minimal when it passes to the political subdivision. In the published private letter rulings approving 63-20 financing, forty years was the longest cited period before defeasance of the obligations.\(^{291}\) The proposed regulations are more general, requiring as an element of supervisory control only that the property "have significant value" at the time it is conveyed to the subdivision.\(^{292}\)

One question not resolved by Revenue Procedure 82-26 involves a lease terminating or a bond maturing when property has more than the required twenty percent of the useful life and twenty percent fair market value remaining. In such circumstances, extension of the lease to the date when only twenty percent of the useful life and fair market value would remain would not seem to violate 63-20 principles. Such a situation, however, has not arisen in any of the published private letter rulings and probably should not be planned without prior consultation with the Service.

Some concerns of the Service with respect to Revenue Ruling 63-20's "beneficial interest" requirement are not fully articulated in Revenue Procedure 82-26. For example, the position of the I.R.S. as to options to purchase and options to renew a lease beyond retirement, was summarized:

The Service does not permit purchase options running to the lessee because it takes the position that a purchase option is such a qualitative encumbrance upon the property as to be violative of the provision that requires full, unencumbered legal title to the property to pass to the associated municipality when the bonds are paid. The suggestion has been made that such an option is permitted if the option price is at the fair market value determined at the time of exercise. This was rejected by the Service on the grounds that freedom from encumbrances ought to include freedom not to sell the property of the municipality.\(^{293}\)

Although the Service requires the property to pass unconditionally to the political subdivision, a number of rulings qualified this requirement by reciting that the transfer would be for some unstated, "nominal" considera-

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293. Nelson, supra note 29, at 945. Nelson further noted:

On a parity of reasoning, the Service at one time proposed the elimination of all renewal options. It appeared however, that this would be commercially unrealistic and so it allows renewal options which will result in occupancy of up to 45 years (including the primary term) provided that the renewal rentals are at fair rental value based upon the fair market value of the property at the time the options are exercised. It was felt that this would give the political subdivisions a valuable residual within the framework of a commercially feasible transaction.

Id. Nothing in the unpublished rulings, Revenue Procedure 82-26, or the Proposed regulations indicates that the policy described in the foregoing quotation still is in effect. But see Private Letter Ruling 8302104 (Oct. 15, 1982) (under certain conditions, lessee had options to lease the facilities after the bonds were retired).
In some cases, a nominal consideration of one dollar was recited. Any consideration that would jeopardize the passing of title to the political subdivision, however, would seem clearly unacceptable.

The requisite transfer of unencumbered legal title is a major difference between 63-20 financing and conventional IDB financing. In the latter, the user of the facilities may continue to use the facility after the indebtedness is paid. In contrast, the private user in a 63-20 financing must derive full benefit from the project during the term of the indebtedness. The sponsoring political subdivision, however, might not be interested in either managing the facilities thereafter or negotiating with other potential users once the indebtedness is retired. Thus, as a practical matter, the original user may continue to lease the facilities from the political subdivision under new and market terms.

Finally, the acquisition of property for which tax exemption rulings are sought must be acquired without the use of coercion. The Service expressed this concern, in one ruling, by conditioning approval of 63-20 financing upon the representation that the seller "has not been forced to sell the site under the threat of inverse condemnation." The seller further had to represent that "no portion of the bond issue is consideration for the settlement of the suit."

5. Approval

Revenue Ruling 63-20 requires, fifth, that the state or political subdivision approve both the corporation and the specific obligations the corporation will issue. Revenue Procedure 82-26 states that this requirement is met if, within one year prior to the issuance of the obligations, the governmental unit adopts a resolution approving both the specific purposes and activities of the corporation and the specific obligations to be issued by the corporation.

Previously, there was no such time limit and no express requirement of a formal resolution, although the previous published private letter rulings strongly implied some formal action. Those rulings do not cite any particular language to be used in this approval. Generally, they recite that the subdivision approved the corporation or the articles of incorporation.

296. See supra text accompanying notes 19 & 24-25.
297. Private Letter Ruling 7835075 (June 1, 1978).
298. Id.
and that the subdivision also approved the indebtedness or the transac-
tion. The only ruling touching upon this aspect merely made it a condi-
tion that "[a] bond resolution or similar official action (such as prescribed in [Regulation 1.103-8(a)(5)(v)]) is adopted by the [subdivision] prior to ac-
quision and construction of the project." Regulation 1.103-8(a)(5)(v), however, is not detailed. The subdivisions frequently also approved either the 63-20 financing documents or the execution of those documents. Revenue Procedure 82-26 is sketchy on this subject and, accordingly, it would seem advisable for the governmental unit's approvals to be as com-
prehensive as possible.

This approval requirement might be compared with the "public approval requirement" imposed by Congress in 1982, which must be met if obliga-
tions are to avoid taxable IDB status. An obligation satisfies the require-
ment if, in general, it is approved by the sponsoring governmental unit and by each governmental unit having jurisdiction over the area in which the facility is located. Approval must be by the applicable elected representa-
tive of the unit after a public hearing following reasonable public notice or by voter referendum. In general, the representative is an elected legislative body of such unit or the chief elected executive. This proviso represents an effort by Congress to increase scrutiny of obligations that would be tax-exempt.

Revenue Procedure 82-26 also provides that if the corporation intends to issue a series of obligations for a single project, all of which are to be issued within five years, the governmental unit can approve the entire series of obligations in one resolution adopted within one year prior to the is-
suance of the first issue. In such circumstances prudence would suggest obtaining both overall approval initially, and then separate approvals of each separate issue.

Another crucial issue, frequently discussed in the private letter rulings, is what constitutes a political subdivision capable of approving 63-20 trans-
actions. The description used most often is substantially in accordance with the existing regulations interpreting section 103 of the Internal Revenue Code. The regulations define a political subdivision to be "any division of a State or local governmental unit that is a municipal corporation or that has

304. See Private Letter Ruling 8024114 (Mar. 18, 1980).
308. I.R.C. § 103(k) (enacted by TEFRA, § 215(a)).
309. Id. § 103(k)(2)(A).
310. Id. § 103(k)(2)(B).
311. Id. § 103(k)(2)(E)(i).
313. See infra note 325, for the cases most frequently cited in the private letter rulings.
been delegated the right to exercise part of the sovereign power of the State or governmental unit." 314 The Tax Court has identified certain generally acknowledged sovereign powers of states. The power to tax, the power of eminent domain, and the police power are the most significant sovereign powers. 315 Although possession of all three of these powers is not necessary to determine that a political subdivision exists, "more than merely an insubstantial amount of any or all of these powers must be present before a political subdivision can be found to exist." 316 Thus, an entity that is a division of a state or local government or that possesses one of these three attributes of sovereignty will be considered a political subdivision. 317

Even if an entity meets the definition of a political subdivision, only the appropriate subdivision can give the approval. If the approving entity is not the entity that will receive the property, the Service will not qualify the financing under Revenue Ruling 63-20. 318

It should be noted that other Revenue Rulings, such as those cited 319 in Revenue Ruling 63-20 itself and which have slight factual distinctions, nonetheless may be of relevance by parity of reasoning in interpreting Revenue Ruling 63-20. There are also published private letter rulings that reach similar conclusions without citing either Revenue Ruling 63-20 or other Revenue Rulings.

In summary, Revenue Ruling 63-20 has expanded the financing options available to political subdivisions. Although its requirements are technical, they are not onerous. Most importantly, however, compliance with these requirements provides a useful and beneficial financing vehicle. 320

Revenue Ruling 63-20 created a new kind of financing, but the ruling was neither an inevitable development under the Internal Revenue Code nor was it without substantial criticism. The ruling was not inevitable because section 103 of the Internal Revenue Code provided tax-exempt status only for obligations of a state or political subdivision. Regulations issued in 1921 expanded this to include obligations issued "on behalf of" such entities by constituted authorities empowered to issue these obligations. 321 As Hart H.

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314. Treas. Reg. 1.103-1(b).
316. Id.
318. See Private Letter Ruling 8037107 (June 20, 1980).
320. One final caveat: Because some state laws might deem 63-20 financing to be an "unlawful lending of credit" by a political subdivision, it should not automatically be assumed that 63-20 financing is feasible in every jurisdiction.
Spiegel noted in his leading article criticizing Revenue Ruling 63-20, it is “assumed that, in view of the history of this regulation, it has the force of law.” Nevertheless, “there [was] no impelling reason to stretch the language of section 103.”

Spiegel argued that the term “constituted authorities” connoted some sort of governmental entity and need not have been deemed to apply to officers of a private corporation organized under a state’s general not-for-profit corporation law. In addition, the “on behalf of” concept need not have been extended to situations involving private corporations serving merely as a financing medium and only indirectly benefiting the state and political subdivision. According to Spiegel, the concept could have been limited to entities, perhaps including corporations, which the state or subdivision specifically created to carry out a specific public purpose but without using the subdivision’s credit.

Spiegel and others especially objected to the exemption for obligations “issued by a private corporation . . . in carrying out a project which a private entity desires to foster with the acquiescence or approval of a city or other political subdivision.” Spiegel suggested that a subdivision “has all to gain and nothing to lose” in approving a project. This latter criticism, however, may be more theoretical than real. Experience probably shows that political subdivisions examine projects very carefully before approving them. It is doubtful that the prospect of acquiring a project without cost will lure approval unless the project accords with the subdivision’s long-term goals.

Current Applicability of the Criticisms

Although some of the foregoing criticisms of Revenue Ruling 63-20 may be inherently valid, the Service has not reversed the ruling and instead has reaffirmed it over the years. Therefore, in considering the applicability of these criticisms today, several points should be kept in mind.

322. Spiegel, supra note 32, at 229.
323. Id. at 232.
324. Id. at 230-31.
325. Id. at 231-32 (citing Commissioner v. Shamberg’s Estate, 144 F.2d 998 (2nd Cir. 1944), cert. denied, 323 U.S. 792 (1945) and Commissioner v. White’s Estate, 144 F.2d 1019 (2d Cir. 1944), cert. denied, 323 U.S. 792 (1945)).

If a political subdivision is sufficiently interested in a project to enact special legislation creating a development authority, port authority, or other agency vested with a sufficient quantum of political power to be considered an arm of the state, acting as manager or operator of a project, the “on behalf” language of the Treasury regulations may be interpreted to permit such an agency to issue revenue bonds which qualify for the exemption. But it is quite another thing to allow exemptions for bonds issued by private nonprofit corporations which are created by private interests and which serve only as a financing medium for such interests.

327. Id. at 227.
While a twenty-year old Revenue Ruling does not have the "force of law," Revenue Ruling 63-20 has developed substantial precedential value in construing the Code. The ruling, therefore, should not be repudiated or severely curtailed without great thought, especially because of its use in defining the tax status of millions of dollars of financings.

It also should be noted that many of the criticisms aimed at Revenue Ruling 63-20 are criticisms of industrial development bonds in general. The pros, cons, and the tax status of such bonds have been debated for decades, and still are debated. In 1968, however, five years after Revenue Ruling 63-20 was issued and three years after the Spiegel article, Congress attempted to strike a balance in the area of IDBs. It reaffirmed the exemption for governmental obligations, withdrew the exemption from the IDBs, and excluded certain small issues from the definition of IDBs. In 1978, Congress increased the amount of the small issue exemption and added additional exemptions for obligations issued to finance certain specified facilities. In 1982, Congress further restricted IDBs and other tax-exempt obligations, and, for obligations issued after December 31, 1986, made the small issue exemption inapplicable.

Revenue Ruling 63-20 does not determine whether a financing is a non-exempt IDB or whether the financing is tax-exempt because it is not an IDB or is an IDB subject to the small issue exemption. Rather, Revenue Ruling 63-20 relates only to whether, if the financing otherwise would be tax-exempt, the obligations will be tax-exempt if issued by a not-for-profit corporation instead of directly by a state or political subdivision.

A political subdivision, under the "small issue" exemption, could issue tax-free obligations to construct, for example, "aluminum mills, bowling alleys, department stores, motels and other business projects." Absent the small issue exemption, these obligations might have constituted IDBs benefiting private parties. Accordingly, the issuance by a not-for-profit corporation of these tax-free obligations under all the existing restrictions of Revenue Ruling 63-20 should not seriously, if at all, violate the policy determinations made by Congress. The policy quarrel is not with Revenue Ruling 63-20's definition of an "on behalf of" issuer; rather, it is with Congress' definition of an IDB. Thus, criticisms or proposed changes of Revenue Ruling 63-20 should be disregarded as inapplicable to the extent that they are directed to the broader concept of IDBs. Congress has addressed the issue.

328. See supra note 322.
329. See supra text accompanying notes 35-45.
332. See id. § 103(b)(6)(K), (L), (M) and (O) (enacted by TEFRA, §§ 214(a), (b) and (e)); id. §§ 103(j), (k) and (l) (enacted by TEFRA, §§ 215(a), (b), and 310(b)(1)).
333. Id. § 103(b)(6)(N) (enacted by TEFRA, § 214(e)).
335. See supra notes 331-33 and accompanying text.
Even if Revenue Ruling 63-20, theoretically, could be faulted for allowing the tax-exempt financing of private projects, the ruling does not appear to have been abused in practice in recent years. Analysis of all of the published private letter rulings reveals only two projects involving factories and a handful of others that might be described as business projects.336 The large majority of projects described in the rulings clearly were "public" in nature.337 The remaining projects, in which some private involvement might be questionable, usually involved nursing or residential facilities for the indigent or elderly. Whether the public benefit derived from such projects is outweighed by the potential private gain involves the same policy question which underlies the IDB debate. In instances where private involvement may be found, the private benefit would not be substantial enough, by statutory definition, to characterize the financing as a non-exempt IDB.338 Furthermore, analysis of the published rulings show that private parties were involved as lessees, managers, or operators in less than fifteen percent of the rulings in which the exemption was recognized.

Thus, although private entities are able to take advantage of Revenue Ruling 63-20, political subdivisions have in fact been the principal beneficiaries. The subdivisions have used not-for-profit corporations as a financing vehicle primarily to circumvent restrictions in local law and to meet the subdivision's perceived needs. The propriety of such techniques seems more a question of local law than of federal tax policy.

A major caveat to the foregoing analysis is that many projects financed on the basis of Revenue Ruling 63-20 rely upon an opinion of counsel rather than upon a private letter ruling. The number of such unpublished projects is indeterminable. A higher percentage of projects relying on counsel's opinion, therefore, may involve private interests.

Revenue Procedure 82-26

Revenue Procedure 82-26 is a welcome codification of many of the hitherto unwritten rules that apply to Revenue Ruling 63-20 financings. The Procedure should help Revenue Ruling 63-20 make the transition from the arcane to the comprehensive and, therefore, should make the Ruling a more useful tool for political subdivisions.

A revised Procedure would be even more welcome, (a) incorporating even more of the principles applicable to 63-20 financings, and (b) clarifying some of the ambiguities in the Procedure. In particular, the term "exclusive possession and use" should be defined to clarify the role of private parties in connection with the property financed.339 Consideration should be given to reconciling the requirement in the Procedure that at least "twenty per-

336. See supra notes 68-73 and accompanying text.
337. See supra notes 74-87 and accompanying text.
338. See supra notes 35-45 and accompanying text.
339. See supra notes 188-89 and accompanying text.
cent useful life" of the property remain at the maturity of a financing with the more liberal principle embodied in Code Section 103(b)(14) added in 1982 permitting exemption for certain obligations with an average maturity of up to 120% of the property's average reasonably expected economic life. Consideration also should be given to permitting extensions of the date on which the property financed must be turned over to the political subdivisions, in cases of lease renewals, refinancings, or the financing of additions or improvements, where there would be at least twenty percent of useful life and twenty percent of fair market value remaining at the extended maturity date. The provision in Revenue Procedure 82-26 referring to a governing unit's power to remove a member of a corporation's governing board may inappropriately encroach upon state general corporation laws. Finally, the Revenue Procedure in many instances distinguishes between exclusive beneficial possession and use by the sponsoring governmental unit and such possession and use by the nonprofit corporation. Revenue Procedure 82-26 is substantially more restrictive in the latter case. Such unequal treatment contradicts the broad applicability of Revenue Ruling 63-20 over nineteen years and unnecessarily curtails the flexibility of local governmental uses. To that extent, the Procedure is as overreaching as the proposed regulations and should be modified.

The Proposed Regulations

Regulations defining "constituted authorities" empowered to issue tax-exempt obligations "on behalf of" a political subdivision were not proposed until 1976. To the extent that the 1976 proposed regulations codify the unwritten glosses on Revenue Ruling 63-20, the regulations are logical and useful. To the extent, however, they seek to dictate customary matters of state law, the proposed regulations are overreaching. These regulations, for example, prescribe what must be in the charter of the political subdivision. In addition, the regulations provide that only specifically created entities may issue qualified obligations. Entities created under a general or not-for-profit corporation statute may not issue 63-20 obligations. Furthermore, the proposed regulations prescribe the membership requirements for the issuing entity's governing boards, including the terms of members. The regulations also mandate that the subdivision have the

340. Rev. Proc. 82-26, § 3.07.
343. Id. § 3.041(a).
344. Id. § 3.041(b).
345. See id. §§ 3.042, 3.055, 3.057(b), 4.012, 4.013.
346. See supra notes 52-58 and accompanying text.
348. Id. (to be codified at Treas. Reg. § 1.103-1(c)(2)(ii)(B)(2)).
349. Id. (to be codified at Treas. Reg. § 1.103-1(c)(2)(ii)).
ability or duty to become involved in the actual operations of the issuing entity. 350

These types of detailed requirements are perhaps suitable for determining the tax status of purely private arrangements such as partnerships. They are, however, inappropriate for dealing with the governmental structure. Political subdivisions always have had and have utilized flexibility in creating corporate entities. After creating these entities with specific charter powers and limitations, political subdivisions have not been involved further in the entities' operations. The proposed regulations attack this ingrained practice.

As a practical political matter, many states and political subdivisions currently utilizing Revenue Ruling 63-20 could not comply with the requirements of the proposed regulations. Thus, rather than merely clarifying Revenue Ruling 63-20, the proposed regulations substantially would curtail its application. Although regulations codifying the glosses on Revenue Ruling 63-20 would be appropriate and useful, the proposed regulations do not comport with well established practices and, therefore, are both too late and too broad. Nor do they comport with the subsequent and more realistic Revenue Procedure 82-26.

The Future

The Service's delay in financing the 1976 proposed regulations has been a mixed blessing. While the delay has caused uncertainty, it avoided making the undesirable provisions final. The issuance of Revenue Procedure 82-26 has made the need for regulations elucidating Revenue Ruling 63-20 less urgent. The 1982 Revenue Procedure also seems to have receded from some of the drastic requirements of the 1976 proposed regulations. The continued existence of the proposed regulations can only confuse the situation. For all of the reasons stated, the proposed regulations should be substantially modified or withdrawn.

Until final regulations are issued or section 103 is further amended, those desiring to utilize Revenue Ruling 63-20 must proceed primarily on the basis of past private letter rulings and Revenue Procedure 82-26. Because of the many rulings which have been issued, the ground rules for most intended 63-20 financings now are much clearer.

350. Id. (to be codified at Treas. Reg. § 1.103-1(c)(2)(iii)(C)).
## APPENDIX

### LEXIS LISTING OF PRIVATE LETTER RULINGS CITING REVENUE RULING 63-20

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