FIN-029

Use of Buildings Financed with Tax-Exempt Debt

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Policy Type University

Contact Office Controller (Office of the University)

Oversight Executive
Executive Vice President and Chief Operating Officer

Applies To Academic Division, Medical Center, and the College at Wise.

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Reason for Policy

Where tax-exempt debt is used to finance the construction or acquisition of facilities and capital equipment, the University must comply with IRS laws and regulations applicable to Private Business Use. Pursuant to the Private Business Use test set forth at 26 USC §141, the tax-exempt status of a bond issuance is jeopardized if more than 10% of the proceeds are used for Private Business Use (the applicable limit is 5% for bonds issued for the benefit of University-Associated Organizations and other 501(c)3 affiliates).

Because of the decentralized management of space assignment, unit managers must have a working knowledge of “private business use” restrictions applicable to tax-exempt financed facilities. This policy formalizes the responsibility of managers in enabling the University to comply with Internal Revenue Service (IRS) laws and regulations on Private Business Use.

Definition of Terms

Basic Research

Description

Any original investigation not having a specific commercial objective for the advancement of scientific knowledge (see IRS Rev. Proc. 2007-47).

Non–Governmental Person

Description

Any person, firm, corporation, partnership, or entity (including the federal government and its agencies) that is not a state or local governmental unit. University-Associated Organizations (UAOs) are considered Non-Governmental Persons except where tax-exempt bonds have been issued by the University specifically for the benefit of the UAO (such bonds commonly referred to as “501(c)(3) bonds” or “qualified private activity bonds”).

Private Business Use

Description

Use in a Trade or Business carried on by or for the benefit of any Non-Governmental Person. Private Business Use does not include use of a facility by a member of the general public where the facility is open to the public and the user has no special legal entitlement to use of the facility.

Trade or Business

Description

Any activity carried on by a Non-Governmental Person other than an individual acting as a member of the general public.

Safe Harbor

Description

A provision that shields a party from liability under the law provided that certain conditions are met. IRS revenue procedures contain several Safe Harbors relating to activities which could generate Private Business Use, the most important of which pertain to management contracts and research contracts.

Policy Statement

The University (and University-Associated Organizations to the extent participating in the University’s debt-financing program) will comply with all IRS laws and regulations applicable to Private Business Use in tax-exempt financed facilities. The University’s director of financial operations and the applicable unit managers are responsible for ensuring that any space in debt-financed buildings allocated to Private Business Use does not exceed the legal limits.

1. **Responsibilities of Managers:**
   The University’s director of financial operations and Academic Division, Medical Center, College at Wise, and applicable University-Associated Organization managers are responsible for ensuring compliance with IRS laws and regulations concerning Private Business Use.

   For new capital projects, if debt financing is a component of the business plan, the unit manager of the planned facility should submit a request for approval of debt capacity and financing to the University Treasurer. This request should be made as soon as possible during the development of the project business

plan. Treasury Management will ask the director of financial operations to perform a private use analysis and the unit manager will be required to provide information about the planned use and financing of the facility. If the director of financial operations determines that reasonably expected Private Business Use will exceed the applicable legal limit, Treasury Management will not be permitted to finance the facility with tax-exempt debt and may require the facility to be financed with taxable debt which carries a higher borrowing cost.

After completion of the capital project, the unit manager is responsible for ensuring that Private Business Use in the facility remains below the applicable limit for as long as the debt (including any refundings) remains outstanding. If the director of financial operations determines that actual Private Business Use of the facility has exceeded the applicable legal limits, corrective action will be required.

The unit manager must consult with the University's director of financial operations before finalizing any of the five types of arrangements discussed in Section 2.

To assess and monitor compliance, the director of financial operations will distribute the University's Private Use Questionnaire to the responsible business managers prior to debt issuance and thereafter as necessary for compliance. The business managers must complete and return the Private Use Questionnaires in a timely manner and include all necessary information for identifying and quantifying potential sources of Private Business Use. The director of financial operations will analyze questionnaire responses to: (i) provide the University Treasurer with timely and accurate information for determining whether taxable financing is appropriate for a particular capital project; (ii) identify impermissible Private Business Use in existing facilities so that corrective action can be taken; and (iii) collect information necessary for complete reporting to the IRS and the Commonwealth of Virginia.

2. **Types of Private Business Use:**
   Most Private Business Use in a tax-exempt financed facility arises from five types of arrangements:
   a. **Ownership:** A sale or transfer of ownership to a Non-Governmental Person of tax-exempt financed property. Ownership is determined under federal income tax principles.
   b. **Leases:** Any arrangement that is properly characterized for federal income tax purposes as a lease to a Non-Governmental Person.
   c. **Management Contracts:** A management contract is any arrangement whereby a Non-Governmental Person actively manages the operations of a facility. Management contracts include, for example, contracts for dining services, facility management, or vivarium services (management of an animal facility). However, there are exceptions for certain contracts meeting the Safe Harbors set forth in Rev. Proc. 97-13. To meet the Safe Harbors, the contract must provide for reasonable compensation to the Non-Governmental Person for services rendered with no compensation based in whole or in part on a share of net profits. Arrangements that generally are not treated as net profit arrangements and therefore satisfy the Safe Harbor requirements include contracts for a percentage of gross revenues or expenses (but not both), or a per person or per unit fee. Management contracts must be analyzed in advance by the Director of Financial Operations for their impact on tax-exempt financed facilities.
   d. **Research Agreements:** Sponsored research by a Non-Governmental Person (including the federal government and its agencies) may result in Private Business Use unless the terms of the sponsorship agreement meet the Safe Harbors set forth in Rev. Proc. 2007-47. In general, sponsored research will not result in Private Business Use if: (i) the research in question is properly characterized as Basic Research; (ii) the University's licensing of the resulting technology to the sponsor is on terms no more favorable than those the University would extend to an unrelated, non-sponsoring party; and (iii) the price paid for that license is determined at the time the resulting technology is available for use. Additional exceptions (as described in Rev. Proc. 2007-47) apply for federally sponsored

research and industry-sponsored cooperative research agreements.

e. **Other Actual or Beneficial Use:** Any other arrangement that conveys special legal entitlements to a Non-Governmental Person for beneficial use of tax-exempt financed property, such as an arrangement that conveys priority rights to use a tax-exempt financed facility, will result in Private Business Use. Examples of such "special legal entitlements" include summer camps having the exclusive right to use an athletic facility, specially designed courses open only to one company, or use of a parking garage for a private event.

3. **Compliance with Policy:**
   Failure to comply with the requirements of this policy may result in disciplinary action up to an including termination or expulsion in accordance with relevant University policies.

   Direct questions about this policy to the Office of the University Controller.

Related Information

US Code: Title 26, Section 141
IRS Revenue Procedure 2007-13 (management contracts)
IRS Revenue Procedure 2007-47 (research agreements)
BOV-015: University of Virginia Debt Policy
FIN-024: Internal Borrowing Program
VPFI-001: Tax-Exempt Debt Compliance
University's Capital Project Approval Process

Major Category Finance and Business Operations

Next Scheduled Review Thursday, April 22, 2027

Revision History

Confirmed 4/22/24; Updated 2/1/21; 4/17/18.

Approved By Executive Vice President and Chief Operating Officer

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