

## Internal Revenue Service

## Department of the Treasury

Number: **200049022**  
Release Date: 12/8/2000  
Index Number: 147.06-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

**CC:TEGE:EOEG:TEB/PLR-109683-00**

Date:

August 6, 2000

### LEGEND:

Authority =  
State =  
City =  
System =  
Hospital =  
Hospital B =  
Bonds =  
Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
Date 5 =  
a =

This letter is in reply to your request for a ruling that the use of bond proceeds as described below will be an insubstantial deviation from the public notice and approval requirements of § 147(f) of the Internal Revenue Code and § 5f.103-2(f) of the Temporary Income Tax Regulations.

### **Facts and Representations**

You make the following factual representations. The Authority is a public body corporate and politic of the State, created to enable nonpublic, nonprofit hospitals to provide facilities and services for healthcare. To accomplish this purpose, the Authority is authorized to issue bonds to finance certain exempt activities of organizations described in § 501(c)(3).

The System is a § 501(c)(3) organization, and consists of a system of integrated healthcare facilities located within the State. The System is the sole member or shareholder, directly or indirectly, of each System subsidiary. Through its subsidiaries, the System currently owns and operates six acute care and specialty hospitals and a number of ambulatory care centers, nursing homes, and physician practices.

The Authority issued the Bonds as qualified § 501(c)(3) bonds for the benefit of Hospital on Date 1. As of Date 1, Hospital was not in any way related to or otherwise affiliated with the System. Hospital consists in part of a tertiary-care teaching hospital, located within the same geographic area served by the System.

The proceeds of the Bonds were loaned to Hospital to, in part, finance certain construction and renovation at Hospital (the “Hospital Project”).

Prior to issuance of the Bonds, the Authority published a notice of public hearing in a newspaper of general circulation in the City, which is the location of the geographic area served by the System. The notice proposed to issue the Bonds and, in part, use the proceeds of the Bonds for the Hospital Project, and also contained a general functional description of the Hospital Project. The notice provided the place, date, and time of the public hearing relating to the proposed issuance of the Bonds. The notice set forth the maximum aggregate principal amount of the Bonds. The notice identified the potential site location for the Hospital Project by street address and city. A public hearing was held, and the Governor of the State approved the issuance of the Bonds and the use of the Bond proceeds for the Hospital Project as that use was described in the public notice.

On Date 2, Hospital entered into an Affiliation Agreement (the “Agreement”) with the System. Under the terms of the Agreement, the System became the sole corporate member of Hospital, and became a member of the obligated group that guarantees repayment of the Bonds. On Date 3, the System announced a plan to integrate and consolidate the services previously provided at Hospital B, a wholly owned subsidiary of the System, and Hospital. The services would be consolidated at Hospital after the Hospital Project was completed, and Hospital B would be demolished. Hospital and Hospital B are located approximately one-half mile apart.

Subsequent to Date 3, the System began experiencing financial difficulties, including losses resulting from the acquisition of Hospital. On Date 4, the governing board of the System (the “Board”) determined to cease operations at Hospital and consolidate operations of the two hospitals at the site of Hospital B.

On Date 5, the Board approved a plan to, in part, use approximately \$a of the unspent proceeds of the Bonds to finance renovations at Hospital B to meet immediate health and safety requirements. The portions of Hospital B that will be renovated with the \$a of unspent proceeds generally serve the same function as portions of Hospital that would have been renovated as part of the Hospital Project. No new structures, additions, or changes to any building facades will be financed with the \$a of unspent Bond proceeds. All property provided by the \$a of unspent proceeds will be owned and used by the System, of which Hospital is now a part.

A ruling is requested that the proposed use of approximately \$a of the proceeds

of the Bonds to finance renovations at Hospital B constitutes an insubstantial deviation from the public notice and public approval requirements of §§ 147(f) and 5f.103-2(f).

### **Law and Analysis**

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any State or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond within the meaning of § 141.

Section 141(a) provides that the term “private activity bond” includes any bond issued as part of an issue that meets the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or meets the private loan financing test of § 141(c).

Section 141(e)(1)(G) provides that the term “qualified bond” means any private activity bond that is a qualified § 501(c)(3) bond.

Section 147(f) provides that a private activity bond is not a qualified bond unless it is part of an issue that has been approved by the governmental unit that issued the bond or by the governmental unit on whose behalf the bond was issued. Section 147(f)(2)(B) treats an issue as having been approved by a governmental unit if the issue is approved “by the applicable elected representative of the governmental unit after a public hearing following reasonable public notice.”

Section 5f.103-2(f) provides further guidance on meeting the public notice and approval requirements. Under § 5f.103-2(f)(2), a facility is within the scope of an approval if the notice of public hearing and the approval contain all of the following: (i) a general functional description of the type and use of the facility to be financed; (ii) the maximum aggregate face amount of obligations to be issued with respect to the facility; (iii) the initial owner, operator, or manager of the facility; and (iv) the prospective location of the facility by its street address or, if none, by a general description designed to inform readers of its specific location. The term “facility” is defined to include a tract or adjoining tracts of land, the improvements thereon and any personal property used in connection with such real property. Separate tracts of land (including improvements and connected personal property) may be treated as one facility only if they are used in an integrated operation.

An approval is valid under § 5f.103-2(f) for an issue, notwithstanding insubstantial deviations with respect to the maximum aggregate face amount of the bonds issued under the approval for the facility, the name of its initial owner, manager, or operator, or the type or location of the facility from that described in the approval. An approval or public notice is not adequate if any of the items in § 5f.103-2(f)(2)(i) through (iv), with respect to the facility to be financed, are unknown on the date of the approval

or the date of the public notice.

Section 5f.103-2(g)(2) states that a public hearing is a “forum providing a reasonable opportunity for interested individuals to express their views, both orally and in writing, on the proposed issue of bonds and the location and nature of a proposed facility to be financed.” In defining reasonable public notice, § 5f.103-2(g)(3) states that the public notice must be “reasonably designed to inform residents of the affected governmental units, including residents of the issuing unit and the governmental unit where a facility is to be located, of the proposed issue.” The notice must state the time and place for the hearing and must contain the information contained in § 5f.103-2(f)(2). Notice is presumed to be reasonable if it is published no fewer than 14 days before the scheduled hearing.

When § 215(a) of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) added former § 103(k) to the 1954 Code, the public approval requirement applied only to industrial development bonds and not to bonds issued for the benefit of § 501(c)(3) organizations. At that time, tax-exempt industrial development bonds were required to finance specific capital projects. Consequently, § 5f.103-2 states that a “facility” is within the scope of approval if the notice of hearing and the approval contain all of the items listed in §§ 5f.103-2(f)(2)(i) through (iv). Later, § 1301(b) of the Tax Reform Act of 1986 expanded the application of the public approval requirement to all private activity bonds. This expansion included qualified § 501(c)(3) bonds, even though § 145 does not require that qualified § 501(c)(3) bonds finance a facility as defined in § 5f.103-2(f)(4).

According to the Senate Committee on Finance, S. Rep. No. 494, 97<sup>th</sup> Cong., 2d Sess. 168 (1982), the public notice and approval requirements in TEFRA were enacted to help eliminate inappropriate uses of tax-exempt financing and to help restore the benefit of tax-exempt financing for traditional governmental purposes. While admitting that state and local governments were best suited to determine the appropriate uses of industrial development bonds, the committee believed that industrial development bonds would serve legitimate purposes only if (a) the affected public has an opportunity to comment on the use of tax-exempt financing for particular facilities, and (b) after that input, the elected representatives of the governmental unit determine that there will be substantial public benefit from issuing the bonds. The Conference Committee adopted the Senate amendment with some clarifications. H.R. Conf. Rep. No. 760, 97<sup>th</sup> Cong., 2d Sess. 518 (1982), 1982-2 C.B. 623-624.

The purpose of the public notice requirement is to ensure that the affected public will be notified of the pending bond issue and made aware of the intended use of proceeds to elicit comments that will ensure a substantial public benefit from issuing bonds. Because of the System’s decision to consolidate the operations of Hospital and Hospital B, the approximately \$a of unspent proceeds of the Bonds will be spent at the site of Hospital B, which is located approximately one-half mile from the location

described in the public notice for the Bonds (Hospital). Medical facilities have existed on the sites of Hospital and Hospital B for many years. The proposed use of the approximately \$a to finance renovations at Hospital B does not deviate from the nature of the original intended use of those unspent proceeds for the Hospital Project, as the portions of Hospital B that will be renovated with the \$a of unspent proceeds generally serve the same function as portions of Hospital that would have been renovated as part of the Hospital Project. Thus, the approximately \$a of unspent proceeds will be used in a nearby facility in essentially the same manner as originally approved. No new structures, additions, or changes to any building facades will be financed. The approximately \$a of unspent proceeds that the System proposes to use at Hospital B represents less than one-fifth of the original principal amount of the Bonds. The originally published notice therefore provided the general public in the affected locality with all of the pertinent information regarding the proposed project as required by §§ 147(f) and 5f.103-2(f).

### **Conclusion**

Based on the specific facts presented and representations made, we conclude that the proposed use of approximately \$a of the proceeds of the Bonds to finance renovations at Hospital B constitutes an insubstantial deviation from the public notice and public approval requirements of §§ 147(f) and 5f.103-2(f).

Except as specifically ruled above, no opinion is expressed concerning this transaction under any other provision of the Code or regulations thereunder. Specifically, no opinion is expressed concerning whether interest on the Bonds is excludable from gross income under § 103(a).

This ruling letter is addressed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent

Sincerely yours,  
Assistant Chief Counsel  
(Tax Exempt and Government Entities)  
By: Timothy L. Jones  
Assistant to the Chief  
Tax Exempt Bond Branch