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Person to Contact:

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Refer Reply To:
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Date:
September 30, 2003

Legend

Authority	=
State	=
City X	=
City Y	=
Port X	=
Port Y	=
Railroads	=
Street	=
Date 1	=
Date 2	=
Date 3	=
Year 1	=
Year 2	=

a =

b =

c =

d =

e =

f =

g =

h =

Dear :

This is in response to your request for a supplemental ruling that the Authority may continue to rely on the following conclusions reached in the private letter ruling issued to the Authority on Date 1 (the Prior Ruling) despite the factual changes that have occurred since Date 1:

1. The Authority's allocation of 50% of the Trench Costs to the Street Improvements will not cause the Bonds or the New Bonds (as defined below) to be private activity bonds under section 141.

2. The facts and circumstances weigh against application of the anti-abuse rule of section 1.141-14 of the Income Tax Regulations to reallocate the proceeds of the Bonds or the New Bonds to other purposes.

FACTS AND REPRESENTATIONS:

The facts that form the basis for the Prior Ruling are incorporated herein by reference to the extent such facts have not been changed by the current ruling. Certain facts set forth in the Prior Ruling are repeated below for context. All terms used and not otherwise defined herein are as defined in the Prior Ruling.

Background

The Authority is a joint powers agency formed under the laws of the State and has been expressly delegated all powers possessed in common by its members, City X and City Y, necessary for the development and implementation of the Corridor Project (described in detail in the Prior Ruling and summarized below), including the power of eminent domain and the power to issue bonds.

Port X and Port Y (the “Ports”) are proprietary departments of City X and City Y, respectively, and are major seaports which provide public dock and wharf facilities to handle the shipment and transportation of international cargo. The Ports' revenues are derived mainly from dock and wharfage fees collected from their users, most of which are transporters using the Ports to import or export cargo. The Ports are served by the Railroads. Prior to the construction of the Corridor Project, the Railroads each transported Port-related freight between the Ports and City X's central staging areas and rail-yards on their own separate tracks.

In response to substantial highway and rail congestion caused by an increase in the volume of cargo shipped through the Ports, the Authority began major construction on the Corridor Project in Year 1. The Corridor Project is a grade-separated a-mile transportation corridor connecting the Ports to the national railroad and interstate highway systems that is designed to decrease congestion and traffic delays, reduce air and noise pollution, minimize energy consumption, improve vehicular and pedestrian safety in the area of the Ports and in the communities along and adjacent to the Corridor Project, and increase the efficiency and competitiveness of the Ports.

The Corridor Project was officially completed on Date 2. As fully described in the Prior Ruling, the Corridor Project consists of several components, including (1) the necessary railroad tracks, signals, rail overpasses and similar structures (the "Rail Facilities"), (2) numerous improvements to the Street, which runs parallel to the Rail Facilities, grade separation projects and related improvements (the “Public Improvements”), and (3) several rights-of-way and other property acquired by the Ports (the “Purchased Properties”) on which the Rail Facilities were built.[1]

For more than half the distance of the Corridor Project, the Rail Facilities are grade separated from adjacent and crossing road traffic by the Trench. The Trench is functionally and structurally related to both the Rail Facilities and the Street. The Railroads operate on components of the Rail Facilities laid at the bottom of the Trench while vehicular and pedestrian traffic operates at grade on the Street and other adjacent roadways. The construction of the Trench included the construction of retaining walls, embankments, and other structures that provide direct physical support for the Street and other Public Improvements.

[1] As in the Prior Ruling, the Authority represents that it will not allocate any proceeds of tax-exempt bonds to the Rail Facilities or to the Purchased Properties, two components of the Corridor Project that will be used by the Railroads in their businesses.

The Trench was selected over alternative designs because it satisfies the major objectives of (1) improving the efficiency of transport between the Ports and the staging hub in City X with the least disruption for surrounding communities; (2) reducing train and vehicular/pedestrian traffic conflicts along the Corridor Project; (3) improving public safety along the transport route by, among other things, providing the best containment for potential toxic spills and lessening motor carrier and railroad accidents; (4) reducing noise and vibration impact on local residents without the necessity of continuous and invasive soundwalls; and (5) enhancing economic development opportunities by eliminating grade crossings and improving traffic circulation.

The Memorandum of Understanding

At the time of the Prior Ruling, the operation and use of the Corridor Project, its expected financing, and the fees to be paid by the Railroads for using it were governed by the Memorandum of Understanding (the "MOU"), which was, by its terms, an interim agreement.

Under the MOU, the Railroads pay Maintenance Fees, Use Fees, and Container Charges for use of the Corridor Project. Maintenance Fees are a pro-rata portion of the annual cost of operating, maintaining and repairing the Rail Facilities, but do not cover the cost of developing the Corridor Project or maintaining any of the Public Improvements, including the Trench. Under the MOU, Use Fees were calculated on the basis of the number of railcars or container units of specified size with separate charges for certain specified cargo. At the time of the issuance of the Prior Ruling, Use Fees were expected to be adjusted over time. The Container Charges were assessed against the Railroads for each container unit that is loaded from a vessel at one of the Ports but is not transported by the Railroads on the Rail Facilities and, therefore, not subject to a Use Fee. The MOU set the Container Charge at the same rate as the Use Fee. The MOU does not require the Railroads to make any minimum payments to the Authority other than as a function of the amount of cargo transported to the Ports or on the Rail Facilities.

Under the MOU, the Ports were required to pay b of the annual debt service on all indebtedness incurred for the construction of the Corridor Project (the “Annual Amount”) from their general revenues. The Railroad’s obligation to pay annual Use Fees and Container Charges was capped at c of the Annual Amount (the “Fee Cap”).

Changes from Prior Ruling

In Year 2, the Authority received a cargo forecast projecting that the volume of cargo passing through the Ports and, as a result, on the Rail Facilities will grow substantially faster than anticipated at the time of the Prior Ruling. In addition to the projected increase in cargo moving through the Corridor Project, the volume of vehicular traffic using the improvements to the Street and other Public Improvements has increased and is projected to continue increasing substantially.

Also in Year 2, the Authority, the Ports, and the Railroads transformed the MOU into a final use and operating Agreement (the “Operating Agreement”). Under the Operating Agreement, the Railroads continue to pay annual Maintenance Fees, Use Fees and Container Charges at the same rates set forth in the MOU. However, due to the expected increase in the volume of cargo moving on the Rail Facilities, the Fee Cap under the MOU was removed. Unlike the MOU, the Operating Agreement also provides for a date certain when the Railroads’ obligation to pay annual Use Fees and Container Charges will cease (the “Termination Date”). Specifically, the Termination Date is the earlier of (1) the d anniversary date of the beginning of operations of the Rail Facilities, regardless of whether any indebtedness incurred for the Corridor Project is still outstanding on that date, or (2) the date on which the debt service on all indebtedness incurred to finance the Corridor Project is paid in full.

As in the MOU, the Railroads have no requirement to make any minimum payment of Use Fees and Container Charges to the Authority under the Operating Agreement. The annual fees paid are computed solely on the amount of cargo flowing through the Ports and on the Rail Facilities. As a result, there is a degree of uncertainty regarding the amount of the Railroads’ payments that will be available to pay any portion of the Annual Amount. If during a calendar year the Railroads’ fees are not sufficient, the Operating Agreement requires the Ports to make advance shortfall payments to the Authority of up to b of the Annual Amount (the “Port Advances”).

The Operating Agreement also amends the costs and expenses to which the Use Fees and Container Charges may be applied. For example, the Use Fees and Container Charges may be applied to repay up to e of the costs incurred by the Ports to acquire the Purchased Properties. The Use Fees and Container Charges may also be used to reimburse the Ports for prior-year Port Advances and other amounts specified in the Operating Agreement.

As at the time of the Prior Ruling, the Railroads do not have exclusive right to use the Rail Facilities and the Ports may unilaterally authorize the use of the Rail Facilities by other railroads, subject to certain conditions. Further, the Railroads are under no legal obligation to provide the Trench.

Financing of the Corridor Project

The Corridor Project was financed through various sources including, primarily: a Federal loan from the U.S. Government through the Department of Transportation (the "Federal Loan") in the amount of f ; g aggregate principal amount of tax-exempt bonds issued on Date 3 (the “Bonds”); and h aggregate principal amount of taxable bonds also issued on Date 3 (the “Taxable Bonds”).

The proceeds of the Bonds were used to finance certain portions of the Public Improvements, specifically, improvements to the Street, non-Trench grade separation, and bridge components of the Corridor Project (the "Street Improvements"). The Street Improvements involve improvements to streets and roads that are owned by governmental units and that will be available for use by the general public. Although the Prior Ruling permitted the Authority to allocate up to 50% of the costs of the Trench and the relocation of related utility lines ("Trench Costs") to the proceeds of tax-exempt bonds, the Authority did not use proceeds of the Bonds to finance any of the Trench Costs in light of the factual changes that occurred between the issuance of the Prior Ruling and the actual construction. The Authority currently requests a supplemental ruling that it may rely on the determination of the Prior Ruling to refinance up to 50% of the Trench Costs with one or more issues of new tax-exempt bonds (the "New Bonds").

LAW:

Generally, section 103(a) of the Internal Revenue Code (the "Code") provides that gross income does not include interest on any state or local bond. Section 103(b)(1) provides that this exclusion does not apply to any private activity bond unless it is a qualified bond under section 141.

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

Under section 141(b)(1), an issue generally meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Private business use is defined in section 141(b)(6) as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For this purpose, any activity carried on by a person other than a natural person is treated as a trade or business.

Section 141(b)(2) provides in general that an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of the issue is (under the terms of the issue or any underlying arrangement) directly or indirectly (A) secured by any interest in property used or to be used for a private business use, or payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 1.141-3 provides rules relating to the definition of private business use. Section 1.141-3(a)(1) provides, in part, that the use of financed property is treated as the direct use of proceeds. Under section 1.141-3(a)(2), in determining whether an issue meets the private business use test, it is necessary to look to both the indirect and direct uses of proceeds.

Under section 1.141-3(b)(1), both actual and beneficial use by a nongovernmental person may be treated as private business use. Section 1.141-3(b)(1) further provides that, in most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

Under section 1.141-3(b)(7)(i), any other arrangement that conveys special legal entitlements for beneficial use of bond proceeds or of financed property that are comparable to ownership, leases, management contracts, output contracts, or research agreements results in private business use. For example, an arrangement that conveys priority rights to the use or capacity of a facility generally results in private business use.

In the case of financed property that is not available for use by the general public, section 1.141-3(b)(7)(ii) provides that private business use may be established solely on the basis of a special economic benefit to one or more nongovernmental persons, even if those nongovernmental persons have no special legal entitlements to the use of the property. In determining whether special economic benefit gives rise to private business use it is necessary to consider all of the facts and circumstances, including one or more of the following factors: (A) Whether the financed property is functionally related or physically proximate to property used in the trade or business of a nongovernmental person; (B) Whether only a small number of nongovernmental persons receive the special economic benefit; and (C) Whether the cost of the financed property is treated as depreciable by any nongovernmental person.

Under section 1.141-3(c)(1), use of financed property by nongovernmental persons in their trades or businesses is treated as general public use only if the property is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade or business. An arrangement that conveys priority rights or other preferential benefits is not use on the same basis as the general public. Section 1.141-3(c)(3) further provides that an arrangement is not treated as general public use if the term of the arrangement is longer than 200 days.

Section 1.141-3(g) provides rules for the measurement of private business use. In general, the amount of private business use of property is determined according to the average percentage of private business use of that property during the measurement period. Section 1.141-3(g)(2)(i) provides that, in general, the measurement period of property financed by an issue begins on the later of the issue date of that issue or the date the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the issue financing the property (determined without regard to any optional redemption dates). In general, the period of reasonably expected economic life of the property for this purpose is based on reasonable expectations as of the issue date.

Section 1.141-3(g)(3) provides that the average percentage of private business use is the average of the percentages of private business use during the 1-year periods within the measurement period. Appropriate adjustments must be made for beginning and ending periods of less than 1 year.

Section 1.141-3(g)(4)(i) provides that the percentage of private business use of property for any 1-year period is the average private business use during that year. This average is determined by comparing the amount of private business use during the year to the total amount of private business use and use that is not private business use (government use) during that year. Section 1.141-3(g)(4)(ii) through (v) apply to determine the average amount of private business use for a 1-year period.

Section 1.141-3(g)(4)(iii) provides, in general, that for a facility in which government use and private business use occur simultaneously, the entire facility is treated as having private business use. For example, a governmentally owned facility that is leased or managed by a nongovernmental person in a manner that results in private business use is treated as entirely used for a private business use. If, however, there is also private business use and actual government use on the same basis, the average amount of private business use may be determined on a reasonable basis that properly reflects the proportionate benefit to be derived by the various users of the facility (*e.g.,* reasonably expected fair market value of use). For example, the average amount of private business use of a garage with unassigned spaces that is used for government use and private business use is generally based on the number of spaces used for private business use as a percentage of the total number of spaces.

Section 1.141-3(g)(4)(iv) provides that measurement of use of proceeds allocated to a discrete portion of a facility is determined by treating that discrete facility as a separate facility. Section 1.141-3(g)(5) also special provides rules for common areas. The amount of private business use of common areas within a facility is generally based on a reasonable method that properly reflects the proportionate benefit to be derived by the users of the facility. Section 1.141-1(b) defines "common areas" as portions of a facility that are equally available to all users of a facility on the same basis for uses that are incidental to the primary use of the facility. For example, hallways and elevators generally are treated as common areas if they are used by the different lessees of a facility in connection with the primary use of that facility.

Section 1.141-14 provides anti-abuse rules that broadly permit the Commissioner to reflect the substance of transactions. Section 1.141-14(a) provides that, if an issuer enters into a transaction or series of transactions with respect to one or more issues with a principal purpose of transferring to nongovernmental persons (other than as members of the general public) significant benefits of tax-exempt financing in a manner that is inconsistent with the purposes of section 141, the Commissioner may take any action to reflect the substance of the transaction or series of transactions including reallocating proceeds to expenditures, property, use, or bonds, and reallocating payments to use or proceeds.

ANALYSIS:

Issue One: Trench Costs

In the Prior Ruling, it was determined that the Railroads will be treated as users of the Rail Facilities and the Trench, but not the Street Improvements, which are governmentally-owned and used by the general public. It was also determined that the Trench is not properly treated solely as part of the Rail Facilities, but was functionally and structurally related to both the Street Improvements and the Rail Facilities. The factors cited to support this determination were that the Railroads are under no legal obligation to provide the Trench and the present value of payments by the Railroads for use of the Corridor Project, including the Trench, will not significantly exceed the costs of the Rail Facilities and the Purchased Properties used by the Railroads. Although it remains true that the Railroads are under no legal obligation to provide the Trench, the present value of the total Use Fees and Container Charges that the Railroads are expected to pay has increased as a result of the removal of the Fee Cap.

The removal of the Fee Cap does not impact the determination that the Trench is functionally and structurally related to both the Street Improvements and the Rail Facilities. Despite the modification to the Use Fees and Container Charges, the general public continues to use the Trench in the same manner as before, as a structural component of the Street Improvements. Also, the Trench continues to function as a wall separating two distinct uses: the use by the Railroads of the Rail Facilities and the use by the general public of the Street Improvements.

Moreover, the changed facts do not affect the determination of the Prior Ruling that the Trench benefits the Rail Facilities and the Street Improvements equally. A wall that separates two distinct uses benefits each use equally unless the facts and circumstances warrant a different conclusion. The relevant changed fact in this case, the removal of the Fee Cap, does not warrant a different conclusion with respect to the Trench. Any increase in fees paid by the Railroads because of the removal of the Fee Cap is not the result of the Railroad obtaining additional rights to the Trench or using the Trench in a different manner. Rather, any increase in fees reflects an increase in the volume of cargo transported on the Rail Facilities from that expected at the time of the Prior Ruling. The Railroads' increased use of the Trench will not affect the general public's use of the Trench; the public continues to use the Trench as a structural component of the Street and the other Street Improvements. In fact, the general public's use of the Trench has also increased through increased traffic on the Street.

While we are unable to quantify the increased use of the Trench by the general public vis-a`-vis the increased use by the Railroads, we nevertheless conclude, based on the facts and circumstances, that the benefits of the Trench to the Railroads are not sufficiently different from the benefits of the Trench to the general public to warrant a different allocation of the uses of the Trench than that approved in the Prior Ruling. Thus, the Authority may continue to rely on the conclusion of the Prior Ruling that 50 percent of the Trench Costs are properly allocable to the Street Improvements.

Issue 2: Anti-Abuse Rules

In the Prior Ruling, it was determined that the facts and circumstances that existed at the time weighed against application of the anti-abuse rule of section 1.141-14. This determination was based on an analysis of nine factors.

Only the first of the nine factors discussed in the Prior Ruling is impacted by the changed facts. By removing the Fee Cap, the Authority no longer expects that the portion of the Corridor Project financed with sources other than tax-exempt bonds to be substantially greater than the present value of the payments that the Railroads are expected to make. This modification to the Railroads' payment arrangement, however, is not sufficient to change the determination of the Prior Ruling.

The annual Use Fees and Container Charges are not structured to reflect the tax-exempt interest rate on either the Bonds or the New Bonds, but are based on the amount of cargo that moves through the Ports. The removal of the Fee Cap does not change the fact that the Railroads have no requirement to make any minimum payment of Use Fees and Container Charges and, as a result, there is no guarantee as to the amount of fees that will be available to pay debt service on either the Bonds or the New Bonds. The principal purpose for the removal of the Fee Cap is not to transfer the benefits of tax-exempt financing to the Railroads, but rather to more accurately reflect the amount of cargo transported by the Railroads through the Corridor Project.

Finally, the remaining factors discussed in the Prior Ruling continue to weigh against application of the anti-abuse rule. Thus, section 1.141-14 does not apply to the unique facts and circumstances of this case.

CONCLUSIONS:

Based on the information submitted and representations made, we conclude that:

1. The Authority's allocation of 50% of the Trench Costs to the Street Improvements will not cause the Bonds or the New Bonds to be private activity bonds under section 141.

2. The unique facts and circumstances weigh against application of the anti-abuse rule of section 1.141-14 of the Income Tax Regulations to reallocate the proceeds of the Bonds or the New Bonds to other purposes.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,
Assistant Chief Counsel (Exempt Organizations/Employment Tax/Government Entities)

By: ______________________________
Timothy L. Jones
Senior Counsel
Tax Exempt Bond Branch

cc: