IRS Private Letter Ruling Provides New Guidance On Calculating Economic Life of Certain Bond-Financed Assets

Description

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The IRS has released a Private Letter Ruling that approves a simplified method of calculating the remaining economic life of property financed with exempt facility bonds. Section 142 of the Internal Revenue Code (the "Code") defines exempt facility bonds (which are tax-exempt under the Code) as bonds that are part of an issue 95 percent or more of the net proceeds of which are to be used to finance fifteen (15) enumerated types of facilities.

Bonds that finance certain of those facilities, such as airports, docks and wharves, have an additional requirement that all of the bond-financed property be owned by a governmental unit. Section 142 further provides a safe harbor for such property which is under a lease or management contract with private lessees. To fall within the safe harbor to continue to be treated as governmentally owned: (i) the lessee must make an irrevocable election not to claim depreciation or an investment credit with respect to the property; (ii) the lease term cannot be more than 80 percent of the reasonably expected economic life of the property; and (iii) the lessee can have no option to purchase the property other than at fair market value (as of the time such option is exercised).

With respect to the second requirement of this safe harbor rule, when bond proceeds only finance improvements to assets, as opposed to the construction or acquisition of the asset as a whole, it was unclear whether the entire improved asset, instead of only the financed improvements, could be taken into account when calculating the asset's economic life, where a lease for such assets was entered into or amended. The recent Private Letter Ruling addressed this uncertainty.

Under the facts presented in the Private Letter Ruling, the bond issuer controls, manages and operates a public port and has financed improvements and upgrades to the port assets with bond proceeds. The issuer has also entered into agreements with maritime businesses for preferential use of the port facilities, which it wished to extend for a term that was within the Section 142 safe harbor.

The issuer proposed a method of determining the economic life of the bond-financed property based on an engineering assessment of the life of each improved asset as a whole, instead of the life of each separate improvement to such asset. The IRS concluded that this approach was reasonable under the facts and circumstances. The IRS also confirmed that the remaining lives of bond-financed assets subject to leases are properly calculated as of the effective date of the leases (or, in this case, the amended leases). Therefore, it was reasonable to calculate the remaining life of each asset that was financed with bond proceeds without regard to the remaining life of the asset as measured from its original placed-in-service date.

Although the ruling is limited to the facts provided by the requesting issuer and may not be cited as precedent, it will help to provide comfort to bond counsel in calculating the remaining economic life of assets financed with exempt-facility bonds. The ruling also may have implications in an analogous context when calculating the remaining economic life of assets subject to management contracts under Revenue Procedure 2017-13, which provides a safe harbor with a similar limit to the term of such contracts.

Please contact Eugene G. Bernardo II or David M. DiSegna at Partridge Snow & Hahn LLP if you have questions about this Private Letter Ruling.

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