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# **The New Rev. Proc. 2017-13 Safe Harbor and Management Agreements**

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## Revenue Procedure 2017-13 Safe Harbor and Management Contracts

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A management contract is defined by the Internal Revenue Service (“IRS”) as a management, service, or incentive payment contract under which a service provider provides services involving all, a portion of, or any function of, a facility<sup>1</sup>. Examples include the management of a childcare center, mailroom, dining hall, parking garage, bookstore or building (residential, commercial, retail, academic or administrative). In all of these cases, the outside company has an ongoing presence in or at the facility.

Yale sometimes enters management contracts with outside providers for services in Yale properties that are financed by tax-exempt bonds. Such contracts have the potential to constitute “private business use” of the managed property, endangering the tax exemption of Yale’s bonds.

IRS Revenue Procedure 2017-13 (“Rev. Proc. 17-13”) provides a “safe harbor,” or conditions under which a management contract between a governmental or Section 501(c)(3) property owner and a service provider will not result in private business use. This paper summarizes each of the safe harbor conditions set forth in Rev. Proc. 17-13, followed by a brief description of how Yale currently interprets or intends to comply with each condition. This paper presents Yale’s current practices for its staff, but they are a work-in-progress and have not yet been finalized.

All management contracts that do not either (1) clearly satisfy each of the safe harbor conditions (as outlined below), or (2) fall into one of the two exemptions discussed below, will be treated as if they create private business use, unless determined otherwise by the Yale’s Office of the General Counsel.

### *Exemptions:*

1. Rev. Proc. 17-13, Section 2.08. A contract exclusively for janitorial services, office equipment repair, billing, or similar services incidental to the primary function of the facility, is not considered to be a private business use management contract.

2. Rev. Proc. 17-13, Section 4.02 Eligible expense reimbursement arrangement. A contract under which the service provider’s only compensation will be reimbursement for actual and direct expenses paid by the provider to unrelated parties, along with reimbursement for reasonable administrative overhead expenses, is not considered to be a private business use management contract.

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<sup>1</sup> IRS Revenue Procedure 2017-13, Section 2.07.

Note that under Rev. Proc. 17-13, unrelated parties are defined to be other than either (1) related parties (as defined in Section 1.150-1(b)) or (2) a service provider's employees. Rev. Proc. 17-13's definition of "unrelated parties" excludes "related parties", as would be expected, but it also explicitly excludes employees of the service provider. The exclusion of employees from the definition of unrelated parties is a significant departure from Rev. Proc. 97-13 as modified by Rev. Proc. 2001-39 and amplified by Notice 2014-67 ("Rev. Proc. 97-13") and is discussed further below.

*Safe Harbor Conditions (each must be met):*

1. Rev. Proc. 17-13, Section 5.02(1) Reasonable compensation. The payments to the service provider, including reimbursements for expenses, must constitute reasonable compensation for the services rendered. To comply with this condition, Yale will document that the compensation is at or near the "going rate" for similar services, and/or that the contract was competitively bid.

2. Rev. Proc. 17-13, Sections 5.02(2) No net profits arrangement and 5.02(3) No bearing of net losses. The contract must not make the eligibility for, amount of, or timing of the service provider's compensation or the expenses to be paid by the service provider (without reimbursement) dependent on, or in any way related to, the managed property's net profit, net loss or both the managed property's revenues and expenses.

2.1 For purposes of these sections, reimbursement of direct and actual expenses paid by the service provider to unrelated parties is not considered to be a part of the service provider's compensation. That is, even though reimbursement of direct and actual expenses paid by the service provider to unrelated parties is based on expenses, it is disregarded when determining whether the compensation is based on net profits, net losses, or both revenues and expenses.<sup>2</sup>

NOTE: Rev. Proc. 97-13 also allowed reimbursements to be excluded from compensation for purposes of determining whether the compensation was a share of net profits or losses. Rev. Proc. 97-13 stated:

"Reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties is not by itself treated as compensation".

However, the definition of "unrelated" in Rev. Proc. 17-13 means that excluded reimbursements are much more limited under Rev. Proc. 17-13 than under Rev. Proc. 97-13. Because "unrelated" was not defined in Rev. Proc. 97-13, bond lawyers generally treated the service provider's employees as "unrelated parties"<sup>3</sup>. Consequently, Yale's management contracts often called for the reimbursement of the service provider's actual

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<sup>2</sup> Section 5.02(1) defines compensation to include such reimbursements, but they are ignored for purposes of the analysis under Section 5.02(2).

<sup>3</sup> However, employees may not be "unrelated" if the employees are officers or if the business is closely held and the "employee" effectively has an ownership interest in that business.

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