General Rule: Partnership Treated as Aggregate. Treasury Regulations Section 1.141-1(e) provides that a partnership is treated as an aggregate of its partners rather than as an entity for Section 141 purposes.\(^1\) This is a generally applicable rule that literally applies for all purposes of Section 141. It essentially means that the partnership is ignored as an entity or person, and only the partners are looked at for Section 141 purposes. What does that mean in practice?\(^2\)

Evolution of General Rule. The aggregate approach to partnerships under Section 141 traces back to some private letter rulings relating to joint operating agreements between health care nonprofits.\(^3\) In those rulings, the IRS focused on whether the partnership created through the joint operating relationship (the partnership being a person that otherwise would be a private business user) could be ignored for private business use purposes. There was much debate about whether the analysis in these rulings also applied for purposes of the ownership requirement under Section 145(a)(1), which the rulings explicitly did not address.

Through the rulemaking process, the IRS thinking evolved significantly. Regulations proposed in 2006\(^4\) allowed for partnerships to be ignored if all the partners were governmental entities or 501(c)(3) entities. Further, those proposed regulations provided that other partnerships would be treated as private entities and would not be disregarded (i.e., would not be treated as an aggregate of the partners). The preamble to those proposed regulations discussed the treatment of partnerships with for-profit partners and requested comments on partnerships with for-profit partners but only for “straight up” partnerships.\(^5\) The preamble stated various concerns with respect to other partnerships. The final regulations then adopted the rules we have today.

Special Operating Rules. Thus, the preamble to the 2006 proposed regulations signaled acceptance of straight up partnerships and a concern for how more complicated partnership allocations should be treated. The final rules fully embraced the aggregate treatment approach and rather than requiring straight up partnership allocations, provided a special rule in Treasury Regulations Section 1.141-3(g)(2) to deal with private business use measurement (and through Treasury Regulations Section 1.145-2(b)(2), private ownership) for all partnerships. However,
there are no special rules dealing with the private loan limitation.\textsuperscript{6} The application of the private loan test to partnerships will be discussed in a future Tax Section meeting.

In addition to the private business use measurement rule in Treasury Regulations Section 1.141-3(g)(2), Treasury Regulations Section 1.141-6(b)(2), in defining an eligible mixed-use project, requires such a project to be wholly-owned by one or more governmental persons or by a partnership in which at least one governmental (or 501(c)(3)) person is a partner. This is the only other rule in the regulations under Section 141 that specifically references partnerships in this context. Unfortunately, this rule, together with the definition of a “project” under Treasury Regulations Section 1.141-6(a)(3) creates a difficult construct in which to apply the basic aggregate approach.\textsuperscript{7}

\textbf{Services Contracts for Partnership-Owned Projects.} Although the bulk of the discussion in this document focuses on some fundamental or conceptual issues, one important and more practical aspect to consider is how the rules in Revenue Procedure 2017-13 apply to assets owned by a partnership among governmental and for-profit partners. Can a for-profit partner be the manager of the project? If there is a third-party manager, can the for-profit partner control that management relationship?

One observation is that if the services contract is an “eligible expense reimbursement arrangement”, as defined in Revenue Procedure 2017-13, then the contract does not cause any private business use. Thus, the for-profit partner could be the manager of the partnership project without any limitation on term or control by the other partner(s), so long as the for-profit partner/manager is only compensated by way of “reimbursements of actual and direct expenses paid … to unrelated parties and reasonable related administrative overhead expenses.” Note, however, that establishing a contract that strictly satisfies this requirement will be difficult if the individuals actually performing services are the partner/manager’s, because employees are treated as related parties. If all partner/manager employees are paid an industry standard wage, is the arrangement one that is outside the safe harbor but still does not cause private business use? What other limitations should be added to get comfortable with this sort of arrangement?

\textsuperscript{6} There is no direct preamble discussion of the application of the partnership rule to the private loan test. The one “reference” is found in the following passage: “Commenters recommended applying aggregate treatment to partnerships for purposes of the ownership test, seeing no reason to distinguish between ownership for purposes of the ownership test and for purposes of the \textit{private activity bond tests}, which also look to ownership of the financed property. The Final Regulations adopt this comment.” (Emphasis added.) The reference to the private activity bond tests is a reference that directly includes the private loan test. Thus, the preamble reinforces the conclusion that the general rule in Treasury Regulations Section 1.141-1(e) is intended to apply to the private loan test.

\textsuperscript{7} It is relevant to observe that the regulations implicitly included a special rule for partnerships since 1972. Treasury Regulations Section 1.103-7(c), Example 13 allowed for a city to finance its tenancy in common interest in an electric generating facility, stating that the tenancy in common interest “shall be treated as a separate property interest.” A tenancy in common arrangement like the one described in the example is in fact a partnership (albeit a straight up partnership) for federal tax purposes even if the partners can elect to not be treated as a partnership under Section 761. There is no language in Treasury Regulations Section 1.103-7(c), Example 13 that explicitly limits to output facilities the treatment of a tenancy in common interest as a separate property interest. Treasury Regulations Section 1.141-6(a)(3)(ii) is the current embodiment of this concept, but it only applies to output facilities.
The alternative is for the services contract to satisfy the regular requirements of the Revenue Procedure. Whether the manager is the for-profit partner or a third-party, the main concern in this context seems to be concluding that the governmental partner has enough control over the operations of the project and the termination of the contract to satisfy the requirements of the Revenue Procedure. Either in the services contract or in the partnership agreement, the governmental partner will need to have enough independent authority over the manager and the contract. In practice, this may be tricky when the for-profit partner has a more than 50% interest in the partnership.

**Problems with the Project Definition.** To focus on the project definition under Treasury Regulations Section 1.141-6(a)(3) and how it applies in the partnership context, consider a single office building financed in part with governmental bonds. Treasury Regulations Section 1.141-6(a)(3)(i) says “project means one or more facilities or capital projects, including land, buildings, equipment, or other property, financed in whole or in part with proceeds of the issue.” The “one or more … buildings” language seems to say that the entire office building always is a single project.

Further supporting the conclusion that a single building is always a project, as opposed to a portion of a building being a project, consider the special rule for output facilities in Treasury Regulations Section 1.141-6(a)(3)(ii). That rule describes a tenancy in common or straight up partnership and by negative implication suggests that the overall output facility would be a single project absent the rule.

**Office Building Hypothetical.** Assume that the office building is owned in part by City and in part by Developer on some sort of ratable basis. It appears the entire office building is still a single project because ownership is not a factor in the definition. If the office building was financed by City (with governmental bonds) and Developer (with cash) under the same plan of financing, then the office building is an eligible mixed-use project, and the private business use from Developer’s ownership would seem to be offset by Developer’s cash, which is qualified equity.

What if Developer constructed the building and a few years later sold a 50% interest to City? It still appears that the entire office building is a single project, but now there is no qualified equity, so it cannot be an eligible mixed-use project. It is in this circumstance where the “project” definition starts to break down. Consider the potentially different results if City acquires (i) a condominium interest, (ii) a tenancy in common interest, or (iii) a partnership interest.

(i) If City acquires and uses a 50% condominium interest in the building, then there is no partnership created. It seems that City has financed a discrete portion of the project under Treasury Regulations Section 1.141-3(g)(4)(iv), and the discrete portion is treated as a “separate facility.” If so, Developer would not be a private business user of City’s condominium (separate facility) interest. Does the discrete portion rule override the project definition in this way?
(ii) If City acquires a 50% tenancy in common (or other undivided ownership interest) in the building, and City’s ownership interest results in specific space within the building always being used by and the responsibility of City and never changing, then in substance the tenancy in common interest appears to be a discrete portion. But see the special rule for output facilities in Treasury Regulations Section 1.141-6(a)(3)(ii) which conflicts with this favorable conclusion by negative implication (since the building is not an output facility). Also, keep in mind that the tenancy in common arrangement is a partnership for tax purposes. As a policy matter, it is odd to think Developer is somehow a user of the portion of the space physically dedicated to City, but absent application of the aggregate rule to the contrary, the undivided ownership interest of Developer would seem to mean Developer is a 50% private business user of every square foot in the building.

(iii) Because partnerships allow for more fluid shared ownership than a tenancy in common, there may be even more tension with respect to measuring private business use if City and Developer form a partnership to own the building, and City acquires a straight up 50% ownership interest in the partnership. Or maybe the partnership scenario is technically the same as the undivided ownership scenario once the rule in Treasury Regulations Section 1.141-1(e) is applied, because the partnership is ignored and all that is left is City and Developer undivided ownership interests.

In any event, there is no qualified equity in the building when City acquires its ownership interest. If the Physical space within the building that is actually used by City will change over the private business use measurement period, there is a private business use problem. One might argue that this is the natural result of using the discrete portion rule, or at least that if the discrete portion rule overrides the project definition for what would otherwise be a split-ownership project, this is the natural result. Qualified equity only floats within a single project.

Conflicts with Remedial Action Rules. Compare the opposite fact pattern. What if City acquired the building entirely with governmental bond proceeds and a few years later sold a 50% partnership interest to Developer? Assume City then uses all the cash received from Developer to redeem 50% of the outstanding City bonds. The entire office building is a single project, and the amount of nonqualified bonds is 50%, so the remedial action offsets all private business use by Developer.\[^{8}\] \[^{9}\] \[^{10}\]

---

\[^{8}\] This must be right, but note that Developer could be treated as owning 50% of every square foot in the building, and if there is dedicated Developer space, Developer also would physically control specific square footage. Does that mean there is 75% private business use (50% for the physically controlled space and 50% of the remainder)? What are we to make of the “project” definition in this context?

\[^{9}\] Note also how none of this would be a problem if the building was an output facility and Developer acquires a 50% tenancy in common interest. Is there a legitimate policy reason for undivided ownership interests of non-output facilities to be treated differently?

\[^{10}\] The author has thought that redeeming or defeasing nonqualified bonds as a remedial action has the effect of injecting qualified equity into a project. For example, if City leased 50% of the building to Developer (e.g., floors 6-10 of a 10-floor building) and redeemed 50% of the bonds issued to finance the building, it would be fine for Developer to later move to floors 1-5. Note how this result means the remedial action rules allow for more favorable treatment than the project definition.
Housing Project Hypothetical and Different Partnership Structures. With this background, consider how one would apply the rules to a few different partnership scenarios. Assume there is an existing low-income housing project (Project) that is in need of significant rehabilitation. We shift to a housing project from an office building to limit the private business use inquiry to the impact of the private ownership by Developer and get away from the issues raised in footnote 5 relating to physical use by Developer. In each scenario below, “A” is a state or local government agency, “B” is a for-profit entity and “Partnership” is a 50/50, straight up partnership between A and B. Also, assume the Project has an “as is” fair market value of 100 and requires 100 of rehabilitation.

Scenario 1: Project Acquired by Partnership from Unrelated Owner and Rehabilitated

Assume A contributes 50 of tax-exempt proceeds and B contributes 50 of equity to Partnership for Partnership to acquisition the Project from a third party. Partnership is ignored under 1.141-1(e), and Project is viewed as owned individually by A and B. Notwithstanding the deemed individual ownership by A and B, Project is a single project under Treasury Regulations Section 1.141-6(a)(3)(i) with 50% private business use. B’s 50 of equity is qualified equity under Treasury Regulations Section 1.141-6(b)(3), and all of the private business use is allocated to the qualified equity.

Assume A contributes 50 of tax-exempt proceeds and B contributes 50 of equity to Partnership for the rehabilitation. The analysis above applies whether the rehabilitation is part of the same plan of financing as the acquisition under Treasury Regulations Section 1.141-6(b)(4), and therefore part of the same project, or not.

Scenario 2: Project Originally Owned by A and Contributed to Partnership

Assume A owns Project free and clear of all debt and contributes Project to Partnership and B contributes 100 to Partnership to be used for rehabilitation. No tax-exempt governmental debt can be issued because B is not a government.

Scenario 3: Project Originally Owned by A and 50% Interest is Sold to B

Assume A owns Project free and clear of all debt and sells a 50% interest in Project to B for 50. Immediately thereafter, each of A and B contribute to the Partnership (i) their interests in the Project, (ii) 50 of tax-exempt proceeds (by A) and (iii) 50 of equity (by B). There are no tax-exempt proceeds allocated to the building acquisition, and the rehabilitation is a single project under Treasury Regulations Section 1.141-6(a)(3)(i), and the 50 contributed by B is qualified equity that is allocated to all the private business use. Are the different results between Scenarios 2 and 3 simply a matter of form?

---

11 Under Treasury Regulations Section 1.141-6(b)(3), “qualified equity does not include equity interests in real property,” so the 50 payment by B to acquire its 50% interest would seem not to be qualified equity. If instead the 50 paid by B to acquire is qualified
Scenario 4: Project Acquired by Partnership from A and Rehabilitated

Assume A contributes 50 of tax-exempt proceeds and B contributes 50 of equity to Partnership, and Partnership acquires Project from A for 100, by transferring the 100 of contributed capital to A. Economically, this is the same as A selling a 50% interest in Project to B for 50, but technically Partnership is not a related person to A or B. Even so, it is hard to conclude that A’s 50 of proceeds has been spent to acquire 50% of the asset it previously owned. The result must be that 50 of the 100 acquisition price received by A is unspent tax-exempt proceeds, and those funds can instead be retained by or allocated to Partnership and used to pay for A’s share of the rehabilitation. Assume B contributes another 50 to Partnership to pay for B’s share of the rehabilitation. Does this cause the acquisition to be part of the Project along with the rehabilitation? See footnote 11.

Scenario 5: Project Acquired by Partnership from B and Rehabilitated

Assume A contributes 50 of tax-exempt proceeds and B contributes 50 of equity to Partnership, and Partnership acquires Project from B for 100, by transferring the 100 of contributed capital to B. Economically, this is the same as B selling a 50% interest in Project to A for 50. Since B was the original owner, it may not matter that its partnership contribution of 50 is used to acquire the interest it already owned.

If the acquisition and the rehabilitation are separate projects, then A can finance its 50 of rehabilitation costs with tax-exempt proceeds because there is 50 of B-contributed qualified equity. If there is no qualified equity for the acquisition project, however, A can only finance half of its 50 partnership contribution on a tax-exempt basis.

If the acquisition and rehabilitation are a single project, and if the 50 contributed by B for the initial acquisition by Partnership is respected as qualified equity, all of A’s 100 can be financed on a tax-exempt basis. If the 50 contributed by B for the initial acquisition by Partnership is not respected as qualified equity, then A can only finance 75 of its 100 of requirements on a tax-exempt basis.

What is the Solution? The discussion above is complicated. It compares and contrasts the longer standing private business use measurement rules, the new qualified equity rules, the new partnership rules, and the remedial action rules, and points out areas in which these rules do not fit together neatly or in fact appear to conflict. The core of the problem seems to be with the project definition and specifically with the treatment of undivided ownership interests as a separate project only for output facilities.

Start with the proposition that the impact of Treasury Regulations Section 1.141-1(e) is to ignore the partnership and to treat the partnership property as being owned on an undivided basis by equity, and if the acquisition of the building is part of the “project” along with the rehabilitation, then we have a total project cost of 150 and only 50% private business use. Does that mean 75% of the rehabilitation costs can be financed with government bonds?
the partners. If that is right, then expanding the existing undivided ownership rule to all facilities is a critical first step. It effectively adds a type of robust floating equity concept to all undivided ownership scenarios (which must be the reason the current rule is limited to output facilities). That step seems warranted in and of itself, but expanding the undivided ownership rule to all facilities would not, by itself, solve the uncertainty for partnerships, because not all partnership have straight up allocations (and the current rule is limited to straight up allocations). Thus, the rule would also need to incorporate a rule like the special private business use measurement rule in Treasury Regulations Section 1.141-3(g)(2).
APPENDIX

1.103-7(c) Example (13). In order to construct an electric generating facility of a size sufficient to take advantage of the economies of scale: (1) City H will issue $50 million of its 25-year bonds and Z (a privately owned electric utility) will use $100 million of its funds for construction of a facility they will jointly own as tenants in common. (2) Each of the participants will share in the ownership, output, and operating expenses of the facility in proportion to its contribution to the cost of the facility, that is, one-third by H and two-thirds by Z. (3) H’s bonds will be secured by H’s ownership in the facility and by revenues to be derived from the sale of H’s share of the annual output of the facilities. (4) Because H will need only 50 percent of its share of the annual output of the facility, it agrees to sell to Z 25 percent of its share of such annual output for a period of 20 years pursuant to a contract under which Z agrees to take or pay for such power in all events. The facility will begin operation, and Z will begin to receive power, 4 years after the City H obligations are issued. The contract term of the issue will, therefore, be 21 years. (5) H also agrees to sell the remaining 25 percent of its share of the annual output to numerous other private utilities under a prevailing rate schedule including demand charges. (6) No contracts will be executed obligating any person other than Z to purchase any specified amount of the power for any specified period of time and no one such person (other than Z) will pay a demand charge or other minimum payment under conditions which, under paragraph (b)(5) of this section, result in a transfer of the benefits of ownership and the burdens of paying the debt service on obligations used directly or indirectly to provide such facilities. The bonds are not industrial development bonds because H’s one-third interest in the facility (financed with bond proceeds) shall be treated as a separate property interest and, although 25 percent of H’s interest in the annual output of the facility will be used directly or indirectly in the trade or business of Z, a nonexempt person, under the rule of paragraph (b)(5) of this section, such portion constitutes less than a major portion of the subparagraph (5) output of the facility. If more than 25 percent of the subparagraph (5) output of the facility were to be sold to Z pursuant to the take or pay contract, the bonds would be industrial development bonds since they would be secured by H’s ownership in the facility and revenues therefrom, and under the rules of paragraph (b)(5) of this section a major portion of the proceeds of the bond issue would be used in the trade or business of Z, a nonexempt person.

1.141-1(e) Partnerships. A partnership (as defined in section 7701(a)(2)) is treated as an aggregate of its partners, rather than as an entity.

1.141-3(g)(2)(v) Special rule for partners that are nongovernmental persons—

(A) The amount of private business use by a nongovernmental person resulting from the use of property by a partnership in which that nongovernmental person is a partner is that nongovernmental partner’s share of the amount of use of the property by the partnership. For
this purpose, except as otherwise provided in paragraph (g)(2)(v)(B) of this section, a nongovernmental partner's share of the partnership's use of the property is the nongovernmental partner's greatest percentage share under section 704(b) of any partnership item of income, gain, loss, deduction, or credit attributable to the period that the partnership uses the property during the measurement period. For example, if a partnership has a nongovernmental partner and that partner's share of partnership items varies, with the greatest share being 25 percent, then that nongovernmental partner's share of the partnership's use of property is 25 percent.

(B) An issuer may determine a nongovernmental partner's share of the partnership's use of the property under guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).

1.141-3(g)(4)(iv) Discrete portion. For purposes of this paragraph (g), measurement of the use of proceeds allocated to a discrete portion of a facility is determined by treating that discrete portion as a separate facility.

1.141-6(a) (3) Definition of project—

(i) In general. For purposes of this section, project means one or more facilities or capital projects, including land, buildings, equipment, or other property, financed in whole or in part with proceeds of the issue.

(ii) Output facilities. If an output facility has multiple undivided ownership interests (respectively owned by governmental persons or by both governmental and nongovernmental persons), each owner's interest in the facility is treated as a separate facility for purposes of this section, provided that all owners of the undivided ownership interests share the ownership and output in proportion to their contributions to the capital costs of the output facility.

1.141-6(b) Special allocation rules for eligible mixed-use projects.

(1) In general. The sources of funding allocated to capital expenditures for an eligible mixed-use project (as defined in paragraph (b)(2) of this section) are allocated to undivided portions of the eligible mixed-use project and the governmental use and private business use of the eligible mixed-use project in accordance with this paragraph (b). Qualified equity (as defined in paragraph (b)(3) of this section) is allocated first to the private business use of the eligible mixed-use project and then to governmental use, and proceeds are allocated first to the governmental use and then to private business use, using the percentages of the eligible mixed-
use project financed with the respective sources and the percentages of the respective uses. Thus, if the percentage of the eligible mixed-use project financed with qualified equity is less than the percentage of private business use of the project, all of the qualified equity is allocated to the private business use. Proceeds are allocated to the balance of the private business use of the project. Similarly, if the percentage of the eligible mixed-use project financed with proceeds is less than the percentage of governmental use of the project, all of the proceeds are allocated to the governmental use, and qualified equity is allocated to the balance of the governmental use of the project. Further, if proceeds of more than one issue finance the eligible mixed-use project, proceeds of each issue are allocated ratably to the uses to which proceeds are allocated in proportion to the relative amounts of the proceeds of such issues allocated to the eligible mixed-use project. For private business use measured under §1.141-3(g), qualified equity and proceeds are allocated to the uses of the eligible mixed-use project in each one-year period under §1.141-3(g)(4). See Example 1 of paragraph (f) of this section.

(2) Definition of eligible mixed-use project. Eligible mixed-use project means a project (as defined in paragraph (a)(3) of this section) that is financed with proceeds of bonds that, when issued, purported to be governmental bonds (as defined in §1.150-1(b)) (the applicable bonds) and with qualified equity pursuant to the same plan of financing (within the meaning of §1.150-1(c)(1)(ii)). An eligible mixed-use project must be wholly owned by one or more governmental persons or by a partnership in which at least one governmental person is a partner.

(3) Definition of qualified equity. For purposes of this section, qualified equity means proceeds of bonds that are not tax-advantaged bonds and funds that are not derived from proceeds of a borrowing that are spent on the same eligible mixed-use project as the proceeds of the applicable bonds. Qualified equity does not include equity interests in real property or tangible personal property. Further, qualified equity does not include funds used to redeem or repay governmental bonds. See §§1.141-2(d)(2)(ii) and 1.141-12(i) (regarding the effects of certain redemptions as remedial actions).

(4) Same plan of financing. Qualified equity finances a project under the same plan of financing that includes the applicable bonds if the qualified equity pays for capital expenditures of the project on a date that is no earlier than a date on which such expenditures would be eligible for reimbursement by proceeds of the applicable bonds under §1.150-2(d)(2) (regardless of whether the applicable bonds are reimbursement bonds) and, except for a reasonable retainage (within the meaning of §1.148-7(h)), no later than the date on which the measurement period begins.

1.141-12(i) Effect of remedial action on continuing compliance. Solely for purposes of determining whether deliberate actions that are taken after a remedial action cause an issue to meet the private business tests or the private loan financing test—
(1) If a remedial action is taken under paragraph (d) of this section, the amount of private business use or private loans resulting from the deliberate action that is taken into account for purposes of determining whether the bonds are private activity bonds is that portion of the remaining bonds that is used for private business use or private loans (as calculated under paragraph (j) of this section);

1.141-12(j) Nonqualified bonds.

(1) Amount of nonqualified bonds. The nonqualified bonds are a portion of the outstanding bonds in an amount that, if the remaining bonds were issued on the date on which the deliberate action occurs, the remaining bonds would not meet the private business use test or private loan financing test, as applicable. For this purpose, the amount of private business use is the greatest percentage of private business use in any one-year period commencing with the one-year period in which the deliberate action occurs.

1.145-2(b) Modification of private business tests. In applying §1.141-0 through 1.141-15 to section 145(a)—

(3) References to the private business use test in §§1.141-2 and 1.141-12 include the ownership test of section 145(a)(1).