



LAND USE AND REAL ESTATE PRACTICE GROUPS | JUNE 2013

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Otten Johnson Alert:

Internal Revenue Service Issues Technical Advice Memorandum Impacting Public Infrastructure Financing

On May 9, 2013, the national office of the Internal Revenue Service (IRS) issued a Technical Advice Memorandum (TAM) finding that a certain community development district in Florida was not a "political subdivision" within the meaning of Section 1.103-1(b) of the Income Tax Regulations. The TAM was generally made available to the public on June 4, 2013. Whether a community development district, which is factually similar to a Title 32 special district in Colorado, is a political subdivision under the IRS's new interpretation of Section 1.103.1(b) has significant ramifications, because interest on bonds sold by an issuer that is a "political subdivision" may qualify under Section 103(a) of the Income Tax Regulations for an exemption from tax liability for federal income tax purposes.

The subject community development district was organized under Florida law by a developer of a retirement community to provide public infrastructure and other public amenities to serve the community. The district appears to function in much the same way, and is subject to similar state regulation, as Title 32 special districts in Colorado. Further, the district was organized and operated in a manner that provided for continued long-term control of the board of directors of the district by the developer, again similar to Title 32 special districts serving commercial developments or so-called "control districts" serving mixed-use developments.

Section 1.103-1(b) defines "political subdivision" as "any division of any state or local government unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit." In considering what entities satisfy this "political subdivision" test, the IRS opined that a "governmental unit is inherently accountable, directly or indirectly, to a general electorate. In effect, § 103 relies, in large part, on the democratic process to ensure that subsidized bond

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financing is used for projects which the general electorate considers appropriate state or local government purposes. A process that allows a private entity to determine how the bond subsidy should be used without appropriate government safeguards cannot satisfy § 103."

Central to the IRS's determination that the Florida district was not a political subdivision was that the district was "organized and operated in a manner intended to perpetuate private control, and to avoid indefinitely responsibility to a public electorate..." Although the board of directors of the district was elected by a majority of the landowners within the boundaries of the district, the developer and its affiliates owned a substantial majority of such land and therefore effectively controlled the district and its board of directors.

Title 32 special districts in Colorado are often organized in a manner that provides for long-term developer control of the district through election of its board, either because the property within the boundaries of the district is owned in fee by the developer and leased to retail and commercial users, or because the boundaries of the district are limited to ensure that only the developer owns property within such boundaries (i.e., a "control district"). Because the TAM, in determining the Florida district did not qualify as a political subdivision, focused on whether a sufficient number of non-developer-related landowners existed within the boundaries of the district for purposes of electing its governing board, the long-standing method of financing public improvements in Colorado by issuance of tax-exempt bonds by Title 32 special districts generally controlled by the developer may be substantially impacted.

As the TAM only interprets federal tax law, it has no effect on the State of Colorado's interpretation of "political subdivision," including with respect to a Title 32 special district's issuance of bonds that are tax-exempt at the state level (for state income tax purposes). Accordingly, a control district may issue bonds that are taxable at the federal level but tax-exempt at the state level. Developers contemplating using a Title 32 special district to issue tax-exempt bonds to finance public infrastructure should consider the effect of the TAM as it relates to the developer's control of the issuing district and a lack of third-party landowners having voting rights with respect to such district. The TAM does not address the potential impact on owners (purchasers) of tax-exempt bonds previously issued by control districts.

Otten Johnson will continue to monitor this matter and its implications on Title 32 special district financing of public infrastructure improvements.

Our Land Use and Real Estate groups have extensive experience representing private-sector developers in public-private financing and related matters. This Alert is intended to be generally informative about a complex area of tax law; however, nothing in this Alert should be construed as providing tax advice with respect to any particular transaction or matter. For more information on this Alert or for help evaluating your current situation, contact any of the attorneys in the Land Use ([click here](#)) or Real Estate practice groups ([click here](#)).