

Possible impact of advertising transactions on tax-exempt and Build America Bonds

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In an effort to generate badly needed revenue, many school districts are considering placing advertisements on or in bond-financed facilities and assets such as athletic facilities and school buses. Under current Internal Revenue Service regulations and rulings, it is clear that advertising displays are a type of private business use and therefore can pose a risk to continued tax-exemption and/or Build America Bond credits if not carefully managed.

One of the requirements applicable to both tax-exempt and Build America Bonds is that use of bond-financed facilities (and payments from private parties for such use) must be strictly limited. In general, if more than 5% of the proceeds of the bonds is used by private parties (and the payments to the school district for such use exceed 5% of the debt service on the bonds), then, in the case of tax-exempt bonds, the interest could become taxable. In the case of Build America Bonds, the direct payment by the US Treasury to the school district could be lost.

Such private business use can arise in a number of circumstances. For example, a lease of bond-financed property to any party (other than a state or local governmental unit) can give rise to private use. Contracts with private parties to manage a bond-financed facility can also generate private use.

A special rule provides that if the advertising (together with other similar non-possessory private use) does not exceed 2.5% of the proceeds used for a particular asset, such use can be ignored. For example, under this rule, if the advertising use of a school bus is equivalent to less than 2.5% of the bond proceeds spent on the bus, such private use can be ignored. The proper method for determining the extent of use of advertising in a bus or other school asset is very fact dependent.

We recommend that you consult with your bond counsel before entering into advertising arrangements connected to bond-financed assets, so as to protect the tax status of your outstanding bonds.

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