



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

**WORK
COPY**

Spokane Downtown Foundation
1400 Seafirst Financial Center
601 West Riverside
Spokane, WA. 99201

Date:
June 22, 2004

Person to Contact:
Derek Knight
75-07593
Telephone Number:
720-956-4293

RECEIVED

JUN 28 2004

EIN: 91-1940922

Randall & Danskin, P.S.

Re: Proposed Adverse Determination (Final)
Spokane Downtown Foundation
\$ 31,465,000 Parking Revenue Bonds 1998

This is to inform you that we have concluded our examination of the Bond Issue(s) named above (the "Bonds"). We have made a proposed determination that the interest paid to bondholders is not excludable from gross income under section 103 of the Internal Revenue Code. The enclosed agents report provides an explanation the facts, law, and analysis on which this proposed determination is based.

We encourage you to immediately contact the person named above to begin negotiations to resolve problems with the Bond Issue through a closing agreement. **This will be your last opportunity to conduct settlement negotiations with this office.**

If you choose to not pursue a closing agreement, you may formally respond to this proposed determination as follows:

- 1. Request an administrative appeal of your case to the Office of Appeals of the IRS.** The Office of Appeals is separate and independent of the IRS office that made this proposed adverse determination with respect to the bonds. The administrative Appeals process is explained in Revenue Procedure 99-35, 1999-41 I.R.B. 501.

Private benefit arising from an organization's activities must be "incidental" in both qualitative and quantitative aspects in order to be entitled to exemption under IRC §501(c)(3). If they are not, the activities are deemed to serve other than a public purpose. The substantiality of the private benefit is measured in the context of the overall public benefit conferred by the activity³⁵.

Applying the principles discussed above to this case, it is clear there was substantial and excessive private benefit derived by private interests. The Issuer must engage in activities which are essentially public in nature in order to qualify as an "on behalf" of Issuer. The Issuer engaged in activities that, more than insubstantially, benefited private parties.

The Issuer was;

- (1) Established by the developer; and
- (2) The developer's Attorney established the corporation and served as registered agent of the corporation³⁶; and
- (3) The developer initially approached, engaged and essentially hired Bond Counsel; and
- (4) The developer initially approached and hired the Board of Directors as listed in the Amended Articles of Incorporation³⁷; and
- (5) Via the original 501(c)(3) language in the Articles of Incorporation filed by the Developer's Attorney & the 501(c)(3) language in the Amended Articles of Incorporation did obfuscate the true nature of the corporation/Issuer; and
- (6) Developer required a revenue stream analysis, provided a number of the assumptions for the analysis, used the analysis as an appraisal with the knowledge that the analysis substantially overstated the value of the garage; and
- (7) Allowed the parking rates in the analysis to determine revenue stream to be up to double the rate in effect, the hours of stay to be double a reasonable number, ignored the validation programs, etc...all of which have the effect of overstating the value of the property which ultimately (if the financing is to be paid) demand the garage to set rates much higher than would be necessary were this a true arms length transaction³⁸; higher parking rates is diametrically opposed to the purpose of the Issuer/corporation established by the developer; and
- (8) The developer adjusted and set the land lease rates in opposition to the garage purchase price based on the Walker parking analysis study; and
- (9) The developer benefited excessively from the land lease since it was predicated on the parking analysis study that was overstated and the revenue stream was discounted on a tax exempt bond financing rate; and
- (10) The developer put in place prior to the sale of the garage a parking oversight committee (composed of the Developer & Developer's tenants) to set the hours of the garage, the pricing structure of the garage, and various other items that amount to special legal entitlements³⁹; and
- (11) The developer sought to conceal the AMC theatre default on the garage, prior to the sale of the garage, via confidentiality agreements and a payment to AMC to cover shortfalls in the garage revenue for the first year as a result of the default, thus keeping the purchase price of the garage artificially elevated; and
- (12) The developer required the City to pledge parking meter revenues for fixed ground rent (payment to the developer for what appears to be an encumbrance on the property) and operating expenses, which increased the rating on the bonds and added to the overvaluation of the garage via discounting the revenue stream at the bonds interest rate; and

³⁵ Rev. Rule 75-286, 1975-2 C.B. 210; Rev. Rule 68-14, 1968-1 C.B. 243

³⁶ Duane Swinton Testimony (Pages 38-39) & Mike Ormsby Testimony (Page 428)

³⁷ Betsy Cowles Testimony (Pages 249-250)

³⁸ John Dorsett Testimony (Pages 139-140)

³⁹ Article 2.1 of Parking Agreement & John Dorsett Testimony (Page 139-140) & Parking Covenants

- (13) The developer wrote into the bond documents, via Bond Counsel, the 4th priority payment of administrative variable ground rent which was designed to reimburse the developer for the administrative costs incurred by the City and the Issuer to get the financing (this is why bond counsel inquires of the developer to increase his fees because any administrative fee that comes out of proceeds reduces the developer's overall take); and
- (14) The developer wrote into the bond documents, via Bond Counsel, the 5th priority payment of "variable ground rent" more appropriately known as a 50/50 split of revenue/profits; and
- (15) The developer wrote and entered the ground lease prior to the sale of the garage including a provision that allows the developer to purchase the garage at the end of the lease for its then fair market value not its "investment value" based on revenue stream that the developer is selling the garage to the Issuer for.

It is clear from the facts that a number of priorities were at work here. The City priority was clearly to keep that portion of downtown viable and ensure sales tax revenues. The developer's priorities were to keep that area of downtown viable and the retail shops in place to ensure continued lease revenue and property value protections. The developer owned that area of downtown known as River Park Square.

In order to accomplish these goals the River Park Square area had to be redeveloped. The developer did not have the financial wherewithal to go it alone on the estimated \$100 million project. So a scheme was devised that would allow the developer to renovate and sell the garage to the City and in the process generate approximately \$10 million in cash the developer would plow back into the "private" portion of the project. It is unreasonable from the facts of this case to conclude otherwise. It is unreasonable from the facts of this case, in their entirety, to conclude that this is an everyday willing buyer and willing seller at fair market value transaction. Given the facts it is unreasonable to conclude this is an arms length transaction. No reasonable person given the facts would have purchased this facility under these terms for the price paid.

The City now states (and claims to have stated all along) that part of the purchase price was designed to provide capital to the developer to assist in the overall project. Given the facts, as we now know them, this appears to be the case. The price was determined prior to the Issuer being created, subsequent events that affected the price were ignored, obviously incorrect revenue stream assumptions were ignored, validation programs were ignored, control contracts and issues were ignored, AMC default was concealed, developer's ground rent was secured (parking meter revenues), etc..

The Issuer ultimately issued \$ 31,465,000 in tax exempt bonds and paid \$ 26,500,000 to the developer for the purchase of a garage whose fair market value at best was \$15,000,000. Even today, current independent appraisals indicate the fair market value of the garage to be \$ 14,000,000 maximum.

The Issuer 63-20 corporation is not a qualified "on behalf" of issuer because it has not engaged in activities which are essentially public in nature. Failure to negotiate a fair market value based on all the facts and subsequent events is not an activity which is essentially public in nature. This single fact will result in harm to the public through higher parking fees. Enriching the developer via the purchase by at least \$10 million is not essentially public in nature. Providing special legal entitlements to the merchants (who are tenants of the developer) to set hours of operations and rates charged is not an activity essentially public in nature. In fact, almost none of the activities of the Issuer/Foundation were essentially public in nature. All of the activities were directed at getting the financing in place to provide funds to the developer to assist in the redevelopment of a private retail center. The private benefit is direct and indirect, is substantial and is both qualitative & quantitative.