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April 24, 2007

In re: Letter Ruling Request Regarding Real  
Property Taxes

**LEGEND:**

Taxpayer =

State =

City =

Project Area =

Authority =

Act =

Corporation =

Subsidiary =

Property =

Dear \_\_\_\_\_ :

This responds to your request of \_\_\_\_\_, for a private letter ruling that certain payments in lieu of taxes ("PILOT") are deductible under § 164 of the Internal Revenue Code as real property taxes under the circumstances described below.

## FACTS

The facts are represented to be as follows. Taxpayer is a limited liability company created and existing under the laws of the State for the purpose of constructing a building on the Property situated in the Project Area. Authority is a public benefit corporation created by the legislature of the State through passage of

Authority was created for the purpose of financing, constructing and operating a planned community development at the Project Area. The legislative purpose was set forth in the Act as follows:

the creation in such area ... of a mixed commercial and residential community, with adequate utilities systems and civic and public facilities such as schools, open public spaces, recreational and cultural facilities, is necessary for the prosperity and welfare of the people of ..., and is a public use and public purpose for which tax exemptions may be granted....

[T]he creation of ... [Authority] and the carrying out of its corporate purposes is in all respects... for the benefit of the people of the...and is a public purpose, and...[Authority] shall be regarded as performing a governmental function in the exercise of the powers conferred upon it...and shall be required to pay no taxes upon any of the properties acquired by it or under its jurisdiction or control or supervision or upon its activities.

Thus, under Authority's originating legislation, Authority is exempt from real property taxes on property in the Project Area.

The Project Area was originally owned by City. City leased the Project Area to the Authority under an executed Master Lease. The Master Lease incorporates a master development plan, which governs the development of the Project Area. The master development plan provides, in part, that the Authority will provide municipal facilities, including but not limited to, sewers, water lines, hydrants, parks and plazas, a water front esplanade, and other cultural and recreational facilities.

power of eminent domain to acquire from City fee simple title to the Project Area,

subject to the Master Lease. Subsequently, Corporation conveyed title to the Project Area to its subsidiary, (Subsidiary) which then transferred title to the Authority. Pursuant to the terms of the deed and the Master Lease, there is no merger of title even though Authority then became both landlord and tenant.

At the time of the original acquisition of the Project Area by Corporation, City was granted the right to reacquire (for one dollar) all rights of Corporation, Subsidiary, and Authority in the Project Area, in addition to all net assets of Authority, once Authority or City repays all indebtedness incurred in respect of the Project Area.

Pursuant to the Master Lease, each sublease of a parcel in the Project Area must provide for payment to Authority of the applicable amount of tax equivalency payments in respect to the leased parcel. Tax equivalency payments are required by the Act that created Authority, which provides:

If an underlying property is exempt from real property taxes ... the residential lease for such underlying property shall provide for the payment by the owner of such residential lease to the Authority of annual or other periodic amounts equal to the amount of real property taxes that otherwise would be paid or payable with respect to such underlying parcel, after giving effect to any real property tax abatements and exemptions, if any, which would be applicable thereto...[if the statutory provisions exempting the property from real property taxes] were not applicable to such underlying parcel.

If City reacquires the Project Area, it will be required to impose tax equivalency payment obligations.

The Master Lease defines the term "Tax Equivalent," for the type of property the Taxpayer will construct on the Parcel, as equal to the product of the assessed value of a Parcel with improvement multiplied by the City's real property rate, less the amount of Tax exemptions or abatements that would be available if the fee was not owned by a tax exempt entity.

Authority will lease a parcel of the land in the Project Area to Taxpayer (Property) under a site lease (Site Lease) for a period ending the day before the Master Lease. The Site Lease requires Taxpayer to construct a building containing approximately residential units and commercial units on the Property.

The Site Lease provides that Taxpayer shall pay "Payments in Lieu of Taxes" or "PILOT." For the first years of the lease term, PILOT shall equal the greater of actual taxes or the "minimum PILOT." Thereafter, PILOT shall equal actual taxes. The term, "actual taxes," generally means the taxes determinable pursuant to the Act and the term "minimum PILOT," means a schedule of yearly amounts determined by the

Taxpayer and applicable to the first      years of the lease term. The Site lease further provides that PILOT for any tax year during the first      years shall not be less than the minimum PILOT for the tax year.

Taxpayer intends to subject its leasehold estate in the Property to condominium ownership pursuant to the laws of the State and to assign to condominium purchasers leasehold interests in the apartment units and proportionate individual leasehold interests in the common elements of the buildings appertaining to such apartment units. The law of State, applicable to condominium ownership, is specifically applicable to land under a lease or sublease the unexpired term of which, at the time of recording of the declaration, is not less than      years. This law requires common expenses to be charged to the unit owners according to their common interests. Under the terms of the Site Lease, the common charges include PILOT as defined and adjusted pursuant to the Site Lease.

Taxpayer will own all of the units in the condominium from the time of its leasehold estate in the Property until such units are sold. Therefore, Taxpayer, as owner of the units, is liable for PILOT payments with respect to such units until such time as they are sold.

After the Property is converted to condominium ownership, the establishment of a condominium, and the sale of the units, the affairs of the units owners relating to the Property will be governed by a board of managers, designated or elected by unit owners, which will have authority to administer the affairs of the condominium including, without limitation, the determination of common charges. Additionally, as required by the Site Lease, common charges, due on a monthly basis, include rent, of which PILOT payments are a part, plus other assessments. The board of managers is required to pay directly to the Authority, the rent due under the Site Lease. Thus, the common charges will be payable by each unit owner to the board of managers, and the board of managers, in turn, is required to pay the rental due under the Site Lease to Authority.

The Master Lease and the Site Lease, therefore, provide the collection vehicles for PILOT obligations which are authorized and imposed under specific statutory authority.

Authority will commingle PILOT with other monies it receives from the Project Area. Authority may disburse the funds for the following purposes:

- (a) to meet the debt service on bonds issued by the Authority, the proceeds of which have been and will be used to construct the above described municipal facilities and services in the Project Area;
- (b) to maintain the various reserves and sinking funds required to be maintained under the Authority's Bond Resolution; and
- (c) to pay the Authority's operating and administrative expenses.

Revenues of the Authority attributable to PILOT that exceed those needed for the purposes set forth in (a) through (c) immediately above or for other public purposes generally will be remitted to the

The was established solely for the purpose of paying City the required under the original lease between the City and the Authority. As part of a Settlement Agreement, City and Corporation assigned to the Authority all their rights to receive payments from the . Accordingly, although the Master Lease requires the tenant thereunder to pay the landlord thereunder, as additional , the excess of all revenues derived by the Authority from the Project Area over all obligations incurred with respect to the Project Area for the preceding fiscal year, notwithstanding the present capacity of the Authority as both landlord and tenant under the Master Lease, the assignment to the Authority of the right to receive payment from the results in all revenue from the Project Area remaining with the Authority in its capacity as tenant under the Master Lease. Under the Master Lease, the Authority, as tenant, may not use the funds derived from the Project Area for any purposes except as contemplated by the Master Lease or "with respect to the Project Area." Accordingly, all of Authority's revenues, including the tax equivalency payments, must be used in furtherance of the Authority's statutory declared public purpose.

#### RULINGS REQUESTED

1. The PILOT payments to be made pursuant to the Site Lease to Authority (or to City should it reacquire the Project Area) will constitute real property taxes allowable as a deduction to the payor under §164.

2. Following Taxpayer's submission of the leasehold estate in the property to condominium ownership, the unit owners will be entitled to deduct as real property taxes under §164 that portion of the common charges paid by them to the board of managers as are applied by the board of managers towards the PILOT obligations.

A taxpayer may not rely on a private letter ruling that has been issued to another taxpayer. Revenue Procedure 2007-1, 2007-1 I.R.B.1, §12.02. Therefore, a private letter ruling addresses only the tax liability of taxpayers who are party to the ruling request. However, Taxpayer will be the owner of all units in the condominium from the time its interest in the Property is submitted to condominium ownership until the units are sold and, as such, will be liable for PILOT until the units are sold. We consider Taxpayer's second ruling request in that context.

#### LAW AND ANALYSIS

Section 164 of the Internal Revenue Code allows as a deduction the state, local and foreign real property taxes paid or accrued in the taxable year. Section 1.164-3(b) of the Income Tax Regulations defines real property taxes as taxes imposed on interests in real property that are levied for the general public welfare. Assessments for

local benefits are not treated as real property taxes. See § 1.164-4 of the Regulations.

Whether a particular charge is a tax within the meaning of §164 depends on its true nature as determined under federal law. The designation given by local law is not determinative. A charge will constitute a tax if it is an enforced contribution, exacted pursuant to legislative authority in the exercise of taxing power, and imposed and collected for the purpose of raising revenues to be used for public or governmental purposes. Rev. Rul. 71-49, 1971-1 C.B. 103; Rev. Rul. 61-152, 1961-2 C.B. 42.

Rev. Rul. 71-49 involved tax equivalency payments to the New York City Educational Construction Fund, a public benefit corporation, by a cooperative housing corporation. The payments were applied to debt service on obligations funding public school construction. The ruling holds that the cooperative housing corporation may deduct the payments as real property taxes under § 164 because (1) the payments are measured by and are equal to the amounts imposed by the regular taxing statutes, (2) the payments are imposed by a specific state statute (even though the vehicle of a lease agreement is used), and (3) the proceeds are designated for a public purpose rather than for some privilege, service, or regulatory function, or for some other local benefit tending to increase the value of the property upon which the payments are made. Accordingly, each tenant-stockholder of the cooperative housing corporation may deduct the payments in the amount of the stockholder's proportionate share.

Subject to the disclaimer set forth below, the PILOT obligations in this case satisfy the three-prong test of Rev. Rul. 71-49: (1) PILOT are imposed at the same general rate at which real property taxes are imposed; (2) PILOT are imposed by state statute although the law uses the vehicle of leasing agreements; and (3) PILOT may only be used by Authority for public purposes, including debt service of bonds issued to construct municipal facilities and services, and payment of operating and administrative expenses.

A distinction exists between the present case and that discussed in Rev. Rul. 71-49. In the present case, there is a possibility that in a future tax year, the actual taxes, that is, the tax determined pursuant to the Master lease as generally applicable to real estate in City, may be less than the Minimum PILOT required under the Site Lease. In such circumstance, the Site Lease, by contract, would collect more taxes than otherwise required by City, that is, the amount of tax the City would collect if the property were not exempt from tax. Although Taxpayer represents that it does not reasonably expect this to occur, the amount of taxes imposable by City is not within the Taxpayer's control.

That the taxes collected under the Site lease might be more raises an inquiry on whether the Minimum PILOT meets the "like rate" language of §1.164-4(a) of the Regulations. Section 6.12 of Rev. Proc. 2007-3, 2007-1 I.R.B. 1, 16 provides that advance rulings will not be issued in a matter involving hypothetical situations. In view of the regulatory language, we express no opinion as to the deductibility of any amount of PILOT greater than the amount of tax otherwise collected by City.

Accordingly, based upon the foregoing and subject to the limitation expressed in the immediately preceding paragraph about Minimum PILOT, we hold as follows:

1. The PILOT payments to be made pursuant to the Site Lease to the Authority (or City should it reacquire the Project Area) will constitute real property taxes allowable as a deduction to the payor under §164.

2. Following Taxpayer's submission of the leasehold estate in the condominium ownership, the unit owners will be entitled to deduct as real property taxes under § 164 that portion of the common charges paid by them to the board of managers as is applied by the board of managers toward the PILOT obligations.

Caveats:

A copy of this letter must be attached to any income tax return to which it is relevant. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Thomas A. Luxner  
Chief, Branch 1  
Associate Chief Counsel (Income  
Tax & Accounting)