

**Internal Revenue Service**

**Department of the Treasury**

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Date: March 27, 2000

**LEGEND:**

- Taxpayer =
- State =
- Project Area =
- Authority =
- Act =
- City =
- Corporation =
- Subsidiary =

Dear

This responds to your request of November 3, 1999, 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.

**FACTS**

The facts are represented to be as follows. Taxpayer is a limited liability company created and existing under the laws of State for the purpose of constructing a 39-story mixed use building at the Project Area. Authority is a public benefit corporation created by the legislature of State through passage of the Act. 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...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, which executed a Master Lease to Authority. The Master Lease incorporates a master plan which governs the development of the Project Area and provides, in part, that Authority will provide municipal facilities in the Project Area, including sewers, water lines, hydrants, parks and plazas, a waterfront esplanade, and other civic, cultural, and recreational facilities.

Corporation is an agency of State. In order to expedite development of the Project Area, Corporation exercised its power of eminent domain to acquire fee simple title to the Project Area, subject to the Master Lease. Subsequently, Corporation conveyed title to the Project Area to Subsidiary, which then transferred title to the Authority. However, 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 all rights of reacquisition with respect to all rights of Corporation, Subsidiary, and Authority in the Project Area, in addition to all net assets of Authority, once Authority repays the indebtedness incurred in respect of the Project Area. Alternatively, City can reacquire the Project Area at an earlier date by providing funds sufficient to repay such indebtedness.

The Master Lease provides that each sublease of the property, i.e., of a parcel in the Project Area, that is to be improved with housing shall provide for the payment to Authority of the applicable amount of tax equivalency payments. Tax equivalency payments are required by the Act that created Authority, which provides:

If the underlying parcel is exempt from real property taxes ...the residential lease for such underlying parcel 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 tax equivalency payments that apply to the type of housing that Taxpayer is constructing in the Project Area is the amount equal to the product of the assessed value of the parcel and any improvements multiplied by City's real property tax rate, less the amount of any tax exemptions or abatements that would be available if the fee

was not owned by a tax exempt entity.

Authority leased land (under the "Site Lease") in the Project Area (the "property") to Taxpayer for a period coterminous with the Master Lease. The Site Lease requires Taxpayer to construct a 39-story building containing approximately 170 residential units and two commercial units on the property.

Taxpayer intends to subject its leasehold estate in the property to condominium ownership under state law and to assign to condominium purchasers leasehold interests in the apartment units and proportionate individual leasehold interests in the common elements of the buildings. Under the condominium law of State, once any part of the Project Area becomes subject to condominium ownership the unit owners are personally liable for taxes assessed. The law requires common expenses to be charged to the unit owners according to their respective common interests.

The Site Lease provides that the common charges include a rental payment, part of which is PILOT. The amount of PILOT is equal to the tax equivalency payments as defined and adjusted in the Site Lease. After the property is converted to condominium ownership a board of managers designated or elected by unit owners will administer the affairs of the condominium including the determination of common charges. The common charges will be payable by each unit owner to the board of managers. 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 thus provide the collection vehicles for the tax equivalency payment and corresponding PILOT obligations which are, however, 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.

Authority revenues attributable to PILOT that exceed those needed for these or other

public purposes generally will be remitted to the City Rent Fund.<sup>1</sup>

### 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. Rev. Proc. 99-1, 1999-1 I.R.B. 6, § 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 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.

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 the 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.

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<sup>1</sup> The City Rent Fund was established solely for the purpose of paying City additional rent required under the Master Lease, in the amount of the excess of revenues derived over obligations incurred with respect to the Project Area. City and Corporation subsequently assigned to Authority their rights to receive payments from the City Rent Fund. Accordingly, all revenue from the Project Area remains with Authority and Authority may use the funds only in furtherance of Authority's public purpose.

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.

The PILOT obligations in this case also 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.

Accordingly, we hold as follows:

1. The PILOT obligations to be made pursuant to the Site Lease to Authority (or to City should it reacquire the Project Area) constitute real property taxes allowable as a deduction to the payor under § 164.
2. Following the submission of the leasehold estate in the property to condominium ownership, Taxpayer as a unit owner will be entitled to deduct as real property taxes under § 164 the portion of the common charges that Taxpayer pays to the board of managers and that are applied by the board of managers to 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,  
Assistant Chief Counsel  
(Income Tax & Accounting)  
By George Baker  
Assistant to Branch Chief, Branch 2