

# Internal Revenue Service

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## Department of the Treasury

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Date:  
June 13, 2002

Taxpayer	=	EIN:
A	=	
B	=	
B-Lease	=	
C	=	
X	=	
City Act	=	
State Law	=	

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

This responds to a private letter ruling request dated September 10, 2001. The Taxpayer requests a ruling that the proposed amendment to its lease with B and subsequent lease assignment, will not affect the deductibility under section 164 of the Internal Revenue Code of the tax equivalency payments (the "PILOT") made to the Taxpayer by other unrelated residential lessees pursuant to leases of other sites within A (the "Unrelated Lessees") B holds legal title to certain real property and the improvements located thereon (the "Project") pursuant to a Declaration of Interest, of record, on behalf of C, the owner of all of the beneficial and equitable interest therein.

### REQUESTED RULING:

The Taxpayer requests a ruling that the proposed amendment to the (the "B-Lease") will not adversely affect the tax treatment of the PILOT made by the Unrelated Lessees pursuant to leases entered into after the enactment of Section 1974-b of the State Law, which leases are governed by Section 1974-b(2).

### APPLICABLE FACTS:

The facts are represented to be as follows:

## A. The Taxpayer

The Taxpayer is a public benefit corporation created by the Legislature of the State of X through the passage of the City Act. The City Act is codified in Section 1970 through 1988 of the State Law. Section 1971 of the State Law describes the legislative purpose for the creation of the Taxpayer as:

...the creation in such area, in cooperation with the city of X and the private sector, 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 the city of X and of the state as a whole, and is a public use and public purpose for which tax exemptions may be granted...

The Taxpayer is exempt from X City Real Property Tax pursuant to Section 1981(1) of the State Law which provides:

It is hereby determined that the creation of the authority and the carrying out of its corporate purposes is in all respects for the benefit of the people of the state of X, the county of X and the city and is a public purpose, and the authority shall be regarded as performing a governmental function in the exercise of the powers conferred upon it by this title and shall be required to pay no taxes upon any of the properties acquired by it or under its jurisdiction or control or supervision nor upon its activities.

The Taxpayer owns all of the property within its approximately \_\_\_\_\_ project area. Section 1974(3) of the State Law authorizes the Taxpayer to enter into contracts, including leases, with regard to the land that it owns. In 1981, the State Law was amended with the enactment of Section 1974-b, governing leases entered into by the Taxpayer with respect to property owned by the Taxpayer. Section 1974-b(2)(a) of the State Law provides as follows:

(A) If an underlying parcel is exempt from real property taxes or no real property taxes are payable with respect thereto, pursuant to the provisions of section nineteen hundred eighty-one of this title or of section twenty-two of chapter one hundred seventy-four of the laws of nineteen hundred sixty-eight, 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 or exemptions, if any, which would be applicable thereto, if the provisions of section nineteen hundred eighty-one of this title or of section twenty-two of chapter one hundred seventy-four of the laws of nineteen hundred sixty-eight were not applicable to such underlying parcel.

Pursuant to Section 1974-b(2) of the State Law, all leases entered into by the Taxpayer since 1981 require the lessees thereunder to make PILOT to the Taxpayer. The amount of the PILOT is equal to the amount of real property tax that would otherwise be due with respect to such underlying parcel, had the lessee owned the property instead of the Taxpayer. In determining the amount of the PILOT for the Unrelated Lessees, the taxing authority takes into account the use of the property as well as any tax abatements or exemptions, which would be available to the lessee had it owned the property outright. All of the leases by the Taxpayer with the Unrelated Lessees were entered into after \_\_\_\_\_ and comply with the requirements of Section 1974-b(2) of the State Law. The Taxpayer makes annual payments to the City of X of Taxpayer's revenues (including revenues constituting PILOT) to the extent such aggregate revenues exceed the total amount of specific claims and commitments, such as debt service on the Taxpayer's bonds, and miscellaneous capital costs for improvements at A.

#### B. The Proposed Transaction

In \_\_\_\_\_, before the enactment of Section 1974-b of the State Law, the Taxpayer and B entered into a lease agreement, which required B to make PILOT to the Taxpayer (the "B-Lease"). Pursuant to the express terms of the B-Lease, as long as the Project is encumbered by a mortgage insured by the United States Department of Housing and Urban Development, the PILOT under Section 3.1 of the B-Lease is, and will be, equal to \_\_\_\_\_ of the rents received from tenants minus the cost of certain utilities (the "TEP Amount"). As the B-Lease predated the enactment of Section 1974-b of the State Law, the terms of the B-Lease are not governed by Section 1974-b. However, the parties agreed, purely as a contractual matter to the imposition of PILOT in an amount calculated to equal the amount of real property tax which B, a private housing corporation would have had to pay under Section 33 of the Private Housing Finance Law, had the Taxpayer not owned the property.

B intends to transfer its record ownership of the Project, including its interest in the B-Lease, to C and thereafter dissolve. Immediately before assigning the B-Lease to C, B will enter into an amendment of the B-Lease with the Taxpayer. Under the proposed lease amendment, the PILOT to be made by C would: (i) for the \_\_\_\_\_ equal the TEP Amount currently payable by B; (ii) for each of the next \_\_\_\_\_ thereafter, increase annually by \_\_\_\_\_ of the difference between the amount of real property tax C, as the assignee of B, would have paid for the property had the Taxpayer not been the owner and the TEP Amount; and (iii) effective as of the \_\_\_\_\_ of the proposed amendment and for each year thereafter, equal the amount of real property tax C would have paid for the property had the Taxpayer not been the owner. After such transfer and dissolution none of the provisions and restrictions set forth in the Private Housing Finance Law including Section 33 thereof will apply to the Project or C. The terms and conditions, including, without limitation, the payment obligations of C thereunder are enumerated in the agreement among the Taxpayer, the City of X, B and C. The agreement was executed on \_\_\_\_\_

## LAW AND ANALYSIS

Section 164(a)(1) of the Internal Revenue Code allows as a deduction state, local, and foreign real property taxes paid or accrued within 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 Section 1.164-4 of the regulations.

Whether a particular charge is a tax within the meaning of section 164 depends on its true nature as determined under federal law. The designation given by local law is not determinative. A charge will be 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. See 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 section 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-shareholder of the cooperative housing corporation was allowed to deduct the payments in the amount of the stockholder's proportionate share.

In the instant case, the PILOT obligations of the Unrelated Lessees to the Taxpayer appear to satisfy the three-prong test of Rev. Rul. 71-49. The PILOT are made pursuant to the State Law which indicates that (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 the Taxpayer for public purposes. Accordingly, the PILOT made by the Unrelated Lessees are deductible under section 164 of the Code.

With respect to the deductibility of the PILOT following the proposed amendment and assignment of the B-Lease, we believe the proposed transaction should not affect the deductibility under section 164 of the PILOT made by the Unrelated Lessees. After the closing of the proposed transaction, the PILOT made by the Unrelated Lessees to the Taxpayer would not change. The Unrelated Lessees would still be required to make PILOT at the general rate at which real property taxes are imposed. The PILOT would be required by Section 1974-b of the State Law, and the proceeds of the PILOT

would continue to be used for a public purpose.

Further, as the B-Lease predates the enactment of Section 1974-b of the State Law, it is not applicable to the B-Lease or any amendments thereto. The Taxpayer is not required by the State Law to impose any PILOT on B, and if it chooses to impose a PILOT on B, the State Law would not control the amount of that payment. Accordingly, the fact the Taxpayer is imposing a PILOT on B which may be different than that imposed on the Unrelated Lessees does not undermine the authority of Section 1974-b of the State Law.

**RULING:**

Based solely on the facts and representations submitted, we conclude and rule as follows: The proposed amendment to the B-Lease should not affect the deductibility under section 164 of the Code of the PILOT made by the Unrelated Lessees.

**DISCLAIMERS AND LIMITATIONS:**

Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of the transaction under any other provisions of the Code and the Income Tax Regulations that may be applicable or under any other general principles of federal income taxation. Neither is any opinion expressed as to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above ruling.

This ruling is directed only to the taxpayer(s) who requested it. Section 6110(k)(3) of the Code provides that it may not be cited as precedent.

Sincerely yours,  
THOMAS D. MOFFITT  
Chief, Branch 2  
Associate Chief Counsel  
(Income Tax & Accounting)

cc: