

**Internal Revenue Service**

Department of the Treasury

Washington, DC 20224

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Person To Contact:

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Telephone Number:

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Date: March 25, 2009

LEGEND:

Taxpayer =  
City =  
State =  
Address =

Landlord =  
Port Authority =

Date1 =  
Date2 =  
Corporation =

Project =

Plan =  
Year1 =  
Charter =

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:

Taxpayer is State limited liability company, which was created and exists for the purpose of constructing a building at Address. Specifically, Taxpayer is a real estate developer primarily focused on the construction and operation of residential properties located in City. The business operation for the property at Address is to develop and revitalize this property. Once the property is developed, the units will be sold to prospective purchasers as condominium units.

Taxpayer, which is the sponsor of the property, entered into a ground lease for the property with Landlord, a subsidiary of the Corporation, which is a corporate governmental agency of State, constituting a public benefit corporation and a political subdivision thereof.

The project area of Address is the site of the Project. The Project was designed pursuant to the development controls of the Plan. Under the Plan, an agreement was entered into by City, the Port Authority, and State to have the Port Authority undertake a waterfront development project in City. This agreement was contingent on the passage of waterfront development legislation pending in the State Legislature that would authorize the Port Authority to finance and implement the Project. The legislation was passed by State and signed into law in Year1. The principal goal of the Project is to establish within the project area a viable development consisting of residential, commercial, cultural and recreational facilities and to provide public access to the waterfront. In addition, the Project is designed to enhance the prosperity and welfare of State by achieving the following objectives:

- a) Expansion and reinforcement of outer boroughs of City.
- b) The creation of mixed used neighborhood.
- c) The creation of commercial sites for businesses to stimulate new employment and business opportunities and increasing the potential generation of revenue.
- d) The creation of public space for recreational usage.
- e) Elimination of the substandard and unsanitary conditions in the area.

On Date1, Taxpayer entered into a lease with Landlord for a term of . The amount payable by Taxpayer to Landlord consists of (a) Base Rent and (b) additional charges. Beginning Date1 and continuing throughout the term of the lease, Taxpayer shall pay the annual sum of \$ (Base Rent). Pursuant to the lease, real estate taxes will not be assessed against Taxpayer for a period of . According to the lease, the term "taxes" shall mean the following:

"the general ad valorem real estate taxes assessed and levied by the City against the premises or any part thereof by authority of [Charter], as the same may now or hereafter be amended, or any statute or ordinance in addition thereto

in lieu thereof in whole or in part and which would otherwise be payable if the premises or any part thereof or the owner thereof were not exempt therefrom; subject, in any event, to the abatement of, or deferral or exemption from such taxes for which tenant and the premises would actually qualify based on all the existing circumstances in the event tenant were the fee owner thereof.”

Rather than paying the taxes, Taxpayer must pay Landlord an annual sum, payable in equal semi-annual installments, which is referred to as “Payment in Lieu of Taxes” or “PILOT.” While each condominium unit (Unit) will become a separate tax lot once the Declaration of Condominium is recorded with City’s Registrar’s Office, PILOT payments will be made directly to Landlord. At the end of the PILOT period, Date2, Taxpayer shall pay PILOT to Landlord in an amount equal to the actual real estate taxes that would be due to City if the property was not exempt from paying real estate taxes. According to the lease between Taxpayer and Landlord:

“Tenant shall pay to Landlord an annual sum (each sum being hereinafter referred to as “Payment in Lieu of Taxes” or “PILOT”) equal to the amount set forth for the applicable Tax Year... If Tenant shall fail to make any such PILOT payment on or prior to the Due Date therefore, such late payment shall bear interest at the rate charged by the City for late payment of Taxes...”

Thus, throughout the lease the PILOT payments are treated as analogous to real estate taxes.

The Units, when sold by Taxpayer, will be sold as a leasehold condominium interest to purchasers. In the leasehold condominium form of ownership, each purchaser owns his Unit similar in use to the private ownership of a personal residence. The Unit Owner owns a condominium leasehold interest in the unit and is entitled to the exclusive possession thereof. The Unit Owner is also the owner, in common with the owners of all other Units, of an undivided leasehold interest in all remaining parts of the property except for the Units themselves, including the land, foundation and supports of the building (Common Elements). Each Unit Owner’s share of the Common Elements is determined based upon the Unit’s floor space, location, dimensions and relative value to other space in the condominium.

Under the terms of the Bylaws of the Condominium, each Unit Owner shall make his PILOT payment to the Condominium Board as part of the Common Charges, which will be allocated among all Unit Owners in proportion to each Unit’s percentage of common interest. The Board will pay Landlord an annual sum, payable in equal semi-annual installments (PILOT).

In sum, since the property located at Address is exempt from real estate taxes, the prospective purchasers must pay an annual amount, referred to as PILOT, for the period of . These payments will be part of the payment the Unit

Owners will make as part of their common charges. Each Unit Owner will be taxed as a separate lot for PILOT purposes and will not be responsible for any of the other Unit Owners' failure to pay their PILOT contribution.

#### RULINGS REQUESTED:

You ask us to rule that:

(1) Certain payments in lieu of taxes (PILOT) to be made by Taxpayer will constitute real property taxes deductible under §164; and

(2) After the property is converted to a condominium form of 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 Condominium Board as are applied by the Board toward PILOT obligations.

#### 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 §1.164-2(g) and §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 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 §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 in this case will satisfy the three-prong test of Rev. Rul. 71-49 because they: (1) Are measured by and imposed at the same general rate at which real property taxes are imposed; (2) are imposed pursuant to the Act as implemented by the Agreement; and (3) may only be used for public purposes.

Accordingly, we hold as follows:

1. The PILOT payments paid by Taxpayer constitute real property taxes allowable as a deduction to the payor under §164.
2. After the property is converted to a condominium form of ownership, the Unit Owners will be entitled to deduct, as real property taxes under §164, that portion of the common charges paid by the Unit Owners to the Condominium Board applied by the Board toward the PILOT obligations.

A taxpayer may not rely on a private letter ruling that has been issued to another taxpayer, and a private letter ruling addresses only the tax liability of the taxpayers who are parties to the ruling request. Rev. Proc. 2009-1, 2009-1, I.R.B. 1, section 12.02. We have entertained Taxpayer's second ruling request here because Taxpayer will be the initial owner of all condominium units from the time its interest in the Property is submitted to condominium ownership until the units are sold.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Kimberly Koch  
KIMBERLY KOCH  
Senior Technician Reviewer, Branch 2  
(Income Tax & Accounting)