

created by the legislature of State 2. The Authority was created for the purposes of financing, constructing and operating a planned community development in the Project Area. The legislative purpose was set forth in the Act as follows:

[T]he creation in such area, in cooperation with the [City] 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] and of [State 2] as a whole, and is a public use and public purpose for which tax exemptions may be granted

[T]he creation of the [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 the [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 the Authority's founding legislation, the Authority is exempt from real property taxes on property in the Project Area.

The Project Area was originally owned by City, which leased the Project Area to the Authority. This Master Lease incorporates a master plan which governs the development of the Project Area.

Corporation is an agency of State 2. In order to expedite development of the Project Area, Corporation exercised its power of eminent domain to acquire fee simple absolute title to the Project Area, subject to the lease above. Subsequently, Corporation conveyed title to Subsidiary, subject to the Master Lease. The Subsidiary then conveyed fee simple absolute title to the Authority.

However, pursuant to the terms of the deed and the Master Lease, there was no merger of the fee estate in the Project Area and the leasehold estate created by the Master Lease, even though the Authority became both landlord and tenant under the Master Lease. At the time of the original acquisition of the Project Area by the Corporation, City was granted the right to reacquire, for a nominal sum, all rights of Corporation, Subsidiary, and the Authority in the Project Area, as well as the net assets of the Authority, once the Authority or City repays all indebtedness incurred in respect of the Project Area.

The Act provides that each sublease of a parcel in the Project Area that is to be improved with housing shall provide for the payment to the Authority of the applicable amount of tax equivalency payments. These tax equivalency payments are required by the Act that created the 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 statutory provisions exempting the property from real property taxes] were not applicable to such underlying parcel.

If the 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 thereon, multiplied by the applicable real property tax rate in City, less the amount of any tax exemptions or abatements, that would be available if the fee were not owned by a tax exempt entity.

The Authority leases land in the Project Area (the "Property") to Taxpayer under a Site Lease for a period coterminous with the Master Lease. The Site Lease requires Taxpayer to construct a building containing approximately X residential units and Y commercial units on the property.

Taxpayer intends to subject its leasehold estate in the Property to condominium ownership under State 2 law and to assign to condominium purchasers leasehold interests in the apartment units and proportionate individual leasehold interests in the common elements of the building. Under the condominium laws of State 2, once any part of the Project Area becomes subject to condominium ownership, the unit owners are deemed to be the owners of the parcel (the Property) in which such units are included and the unit owners are personally liable for taxes assessed against such parcel. The law requires common expenses to be charged to the unit owners according to their respective common interests.

The Master Lease provides that the sublease of the Property which is to be improved with housing shall provide for the payment to the Authority of a specified rent plus the applicable amount of tax equivalency payments. 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 rent due under the Site Lease to the 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 to be maintained under the Authority's Bond Resolution; and
- (c) to pay the Authority's operating and administrative expenses.

Any remaining funds will be transferred to the Fund.

The Fund was established solely for the purpose of paying City the rent 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 Fund. Accordingly, although the Master Lease requires a tenant to pay the landlord, as additional rent, 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 Fund 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 the Authority's revenues, including the tax equivalency payments, must be used in furtherance of the Authority's statutorily declared public purpose.

RULINGS REQUESTED

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

2. That 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 section 164 of the Code that portion of the common charges paid by them

to the board of managers as 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. Section 11.02 of Rev. Proc. 2009-1, 2009-1 I.R.B. 47. 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 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 section 1.164-4 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 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.

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-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 the 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 payments to be made pursuant to the Site Lease to the Authority (or to City should it reacquire the Project Area) constitute real property taxes allowable as a deduction to the payor under section 164 of the Code.

2. Following the submission of the leasehold estate in the property to condominium ownership, the taxpayer as the unit owner will be entitled to deduct as real property taxes under section 164 of the Code that portion of the common charges paid by it to the board of managers as applied by the board of managers towards the PILOT obligations.

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) of the Code 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 representatives.

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,

Christopher F. Kane
Branch 3, Branch Chief
(Income Tax & Accounting)