

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

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Date:
November 28, 2012

Legend

Taxpayer =
Owner 1 =
Owner 2 =
Initial Tenant =
Initial Sponsor =
Authority =
Address =
Location =
City =
State 1 =
State 2 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Year 1 =
Year 2 =
Act =
A =
B =

Dear

This responds to your request of June 4, 2012 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 a limited liability company created and existing under the laws of State 1 for the purpose of purchasing condominium units and reselling them to private owners. Taxpayer is an entity disregarded as separate from its % owner, Owner 1. Owner 1 is an entity disregarded as separate from its % owner, Owner 2.

On or about Date 1, Initial Tenant entered into an agreement of lease between the Authority and Initial Tenant dated as of Date 2 (the "Site Lease") with respect to the property located at Address (the "Land"), for a period coterminous with a master lease covering all of the property in the Location project area under which the Authority is the tenant (the "Master Lease"). Initial Tenant constructed a building (the "Building") which it operated as an apartment building. On Date 3, Initial Sponsor acquired Initial Tenant's leasehold estate in the Site Lease and the Building from Initial Tenant, and Initial Tenant assigned its leasehold interest in the Site Lease to Initial Sponsor. Initial Sponsor subjected its leasehold interest in the Site Lease to condominium ownership pursuant to that certain Declaration of Condominium dated Date 4. Finally, following the commencement of a foreclosure action by Initial Sponsor's lender with respect to A unsold residential units and B commercial units, a judgment of foreclosure in favor of the lender was entered against Initial Sponsor, and thereafter having acquired the winning bid at the ensuing foreclosure sale, Taxpayer acquired the A unsold residential units and the B commercial units on Date 5. Taxpayer is the holder of the A unsold residential units as of the filing of the Amended and Restated Leasehold Condominium Offering Plan, which was accepted for filing by the State 2 Department of Law as of Date 6.

The Authority was created in Year 1 by the Act. The Act declares the Authority to be "a body corporate and politic, constituting a public benefit corporation." The Authority was created for the purposes of financing, constructing and operating a planned community development in Location (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 the Authority's originating legislation, the Authority is exempt from real property taxes on property in the Project Area.

City, the original owner of the Project Area, leased the Project Area to the Authority in Year 2, which lease, as amended, provided for the development of the Project Area by the Authority in accordance with the terms thereof, the Master Development Plan, and the special zoning district for the Project Area. On Date 7, the State 2 Urban Development Corporation ("UDC"), in order to expedite development of the Project Area, exercised its power of eminent domain to acquire fee simple absolute title to the Project Area, subject to the aforementioned lease. UDC conveyed title to the Project Area to the Location Development Corporation, a wholly owned subsidiary of UDC by deed dated Date 7, subject to the aforementioned lease. The aforementioned lease was further amended by the Authority and Location Development Corporation and restated (the "Master Lease"). Location Development Corporation conveyed fee simple absolute title to the Project Area to the Authority by deed dated Date 8, subject to the Master Lease. Pursuant to the terms of said 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 by reason of the fact that the Authority became both landlord and tenant under the Master Lease.

In connection with the acquisition of the Project Area by UDC, City was granted the right to reacquire for one dollar all of UDC's, the Location Development Corporation's, and the Authority's rights in the Project Area and all of the net assets of the Authority, once the 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 Act 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 the Authority of the applicable amount of tax equivalency payments. 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 tax] were not applicable to such underlying parcel.

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

A board of managers designated or elected by unit owners administers the affairs of the condominium including the determination of common charges. The common charges are payable by each unit owner to the board of managers. The Site Lease provides that PILOT is payable by the condominium board of managers, on behalf of all condominium unit owners, to the Authority in an annual sum equal to a tax equivalency payment, as defined and adjusted in the Site Lease. PILOT obligations of the condominium are payable as part of common charges and allocated to each unit in accordance with its pro rata common interest. The board of managers in turn is required to pay the rental (which includes PILOT) due under the Site Lease to the Authority.

The Master Lease defines the term "Tax Equivalent," for the type of property Taxpayer's predecessor in interest constructed on the Land, as equal to the product of the assessed value of the Land with improvement multiplied by 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.

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.

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

- (a) to satisfy 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.

The Authority revenues attributable to PILOT that exceed those needed for these or other public purposes generally will be remitted to various City housing projects. The

assignment of such excess revenues is a public purpose for which monies may be granted.

As described above, Initial Sponsor subjected its leasehold estate in the property to condominium ownership under State 2 law and assigned to condominium purchasers leasehold condominium interests in the apartment units and proportionate appurtenant undivided interests in the common elements of the condominium. Taxpayer will similarly assign to its condominium purchasers leasehold condominium interests in the apartment units, and proportionate appurtenant undivided interests in the common elements of the condominium. Under the condominium laws of State 2, once any part of the Project Area becomes subject to condominium ownership the unit owners are personally liable for taxes assessed against their individual units. The law generally requires common expenses to be charged to the unit owners according to their respective common interests. As described above, PILOT obligations of the condominium are payable as part of common charges and allocated by the board of managers to each unit in accordance with its pro rata common interest. Therefore, Taxpayer, as owner of the A unsold residential units, is liable, as part of its common charges, for PILOT payments with respect to such units until such time as they are sold.

RULINGS REQUESTED:

You ask us to rule that:

(1) The PILOT payments to be made pursuant to the Site Lease 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 § 164.

(2) That prior to and following Taxpayer's sale of units, unit owners (including Taxpayer), will be entitled to deduct as real property taxes under § 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. 2012-1, 2012-1 I.R.B. 50. 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 units in the condominium 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 §1.164-2(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 obligations in this case also satisfy the three-prong test of Rev. Rul. 71-49 because they: (1) are imposed at the same general rate at which real property taxes are imposed; (2) are imposed by state statute although the law uses the vehicle of leasing agreements; and (3) 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) will constitute real property taxes allowable as a deduction to the payor under § 164.
2. Taxpayer as a unit owner will be entitled to deduct as real property taxes under § 164 that portion of the common charges paid by Taxpayer to the board managers as applied by the board 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 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,

Thomas D. Moffitt
Branch Chief, Branch 2
(Income Tax & Accounting)