

Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B03
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Date:
July 09, 2014

Taxpayer =

Property =

State A =

State B =

Authority =

Act =

Corporation =

Not-for-Profit Corporation =

Project Area =

Park =

City =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Ground Lease Agreement =

Agreement =

Dear :

This is in response to your letter dated . In your letter, you requested a private letter ruling that certain payments in lieu of taxes ("PILOT") are deductible under section 164 of the Internal Revenue Code as real property taxes under the circumstances described below.

FACTS

Taxpayer is a limited liability company created under the laws of State A to consummate development of the Property. State B created Authority pursuant to the Act as a State B corporate governmental agency and public benefit corporation for the purpose of financing, constructing, and improving industrial, manufacturing, commercial, educational, recreational and cultural facilities, and housing accommodations for persons and families of low income. The legislative purpose of the Act is stated to be as follows:

to promote the development of such plants and facilities, reasonably accessible to residential facilities, in those areas where substantial unemployment or underemployment exists, to the end that the industrial and commercial development of our urban areas will proceed in sound fashion and in coordination with development of housing, mass transportation and public services, and that job opportunities will be available in those areas where people lack jobs....

to promote the safety, health, morals and welfare of the people of the state and to promote the sound growth and development of our municipalities through the correction of such substandard, insanitary [sic], blighted, deteriorated or deteriorating conditions, factors and characteristics by the clearance, replanning, reconstruction, redevelopment, rehabilitation, restoration or conservation of such areas . . . including the provision of educational, recreational and cultural facilities and the encouragement of participation in these programs by private enterprise....

The Act provides that Authority may acquire, construct, reconstruct, rehabilitate, improve, alter or repair lands, buildings, improvements, real and personal properties, including a residential project, an industrial project, a land use project, a civic project or multi-purpose project. The Act also provides that “the [Authority] and its subsidiaries shall not be required to pay any taxes, other than assessments for local improvements, upon or in respect of a project or of any property or moneys of the [Authority] or its subsidiaries, levied by any municipality or political subdivision of the state.” Thus, under the Authority’s originating legislation, Authority’s real property is exempt from real property taxes.

Authority has the right under the Act “to exercise and perform its powers and functions through one or more subsidiary corporations.” Pursuant to this right, Authority formed Corporation on Date 1 to implement development of the Park.

With respect to Corporation property within the Project Area that is exempt from real property taxes pursuant to the Act or otherwise, the Act requires payment to the Authority of periodic amounts equal to the amount of real property taxes that otherwise would be paid or payable with respect to the property if the Corporation were not exempt from real property taxes after giving effect to any real property tax abatements and exemptions which would be applicable to the property if Corporation did not hold title to the property. Under the Act, these payments must be used to improve, operate, and maintain the Park unless the Corporation, City, and State B (through an entity designated by the governor of State B) agree to (1) set aside such payments in appropriate and reasonable reserve accounts, taking into account all other revenue received or anticipated by the Corporation from properties in the Project Area, for expenses to improve, operate and maintain the Park, or (2) transfer such payments into the general fund of the City to be used for its general public purposes.

State B and City entered into a Memorandum of Understanding, dated Date 1, in which State B and City agreed in principle to jointly create, develop, and operate the Park as a sustainable park providing recreational, cultural, and educational opportunities for residents and visitors, and for developing portions of the Park with appropriate commercial uses, provided that all revenues derived therefrom be used exclusively for maintenance and operation of the Park.

On Date 2, Corporation, as fee owner and ground lessor, entered into a master ground lease with Not-for-Profit Corporation, as tenant and ground lessee, with respect to the Project Area. The master ground lease was subsequently replaced with a Ground Lease Agreement dated Date 3 and which expires on Date 4. Not-for-Profit Corporation selected Taxpayer to develop, construct, maintain and operate the particular development parcel designated as the Property. Accordingly, Not-for-Profit Corporation, as Landlord, and Taxpayer, as tenant, entered into an Agreement dated Date 3, which commenced on Date 5 and expires on Date 6. The Agreement is subject and subordinate to the Ground Lease. Taxpayer, at its election but subject to the terms of the Agreement, may convert its leasehold interest in the Property to a qualified leasehold condominium and sell apartment units in the condominium to third parties pursuant to a leasehold condominium offering plan approved by State B's Attorney General. Each purchaser of a unit will acquire from Taxpayer a qualified leasehold condominium interest in the unit and a proportionate undivided interest in the common elements of the condominium for the balance of the leasehold term.

The Agreement implements the provisions of the Act regarding payments of PILOT. Specifically, the Agreement requires Taxpayer to pay to Not-for-Profit Corporation an annual sum equal to the PILOT that Not-for-Profit Corporation must pay with respect to the property.

Taxpayer intends to submit its interest in the Property to a condominium regime pursuant to the laws of State B and to assign to condominium unit purchasers the Taxpayer's interests in the units and proportionate undivided interests in the common elements. Taxpayer represents that, after the Property is converted to condominium ownership, the Corporation's exemption under the Act will exempt each unit of the Property from real property tax assessment. The terms of the Agreement provide that, once the Property is converted to the condominium form of ownership, PILOT shall be paid by the condominium unit owners pro rata in accordance with their interest in the common elements, which amounts shall be included with their proportionate common charges for their units and paid directly to the condominium board.

RULINGS REQUESTED

You ask us to rule that:

- (1) The PILOT obligations to be made pursuant to the Agreement to Not-for-Profit Corporation (or to City should it reacquire the Project Area) constitute real property taxes allowable as a deduction to the Taxpayer under section 164; and
- (2) Following the 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 that portion of the common charges paid by them to the condominium board as are applied by the condominium board towards the PILOT obligations, but only to the

extent such payments represent the owner's proportionate share of the total amount of PILOT imposed on the condominium unit the owner has purchased.

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 sections 1.164-2(g) and 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 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 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 will 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 pursuant to the Act as implemented by the Agreement; and (3) may only be used by the Authority for public purposes, including the improvement, maintenance, and operation of the Park.

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 section 164.
2. Taxpayer as a unit owner will be entitled to deduct as real property taxes under section 164 that portion of the common charges paid by Taxpayer to the condominium board as applied by the condominium board towards the PILOT obligations.

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,

Christopher F. Kane
Chief, Branch 3
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: