

Dear _____ :

This is in response to the letter sent by your attorneys dated June 13, 2014. In the letter, your attorneys 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 and existing under the laws of State 1 to consummate development of the Property. State 2 created the Fund, pursuant to the Act, as a State 2 corporate governmental agency, constituting a political subdivision and public benefit corporation for the benefit of the people of the City and State 2 and to facilitate the timely construction of elementary and secondary school buildings in combination with buildings of other compatible and lawful uses. The legislative purpose of the Act is:

the timely and responsive provision of such combined occupancy structures in accordance with the foreseeable needs of the [City] for additional or replacement elementary and secondary educational facilities and the desirability of facilitating maximum and appropriate utilization of available land.

As part of its program, the Fund contemplated the construction of high-rise structures on air rights or air space above school structures. Some of these high-rise structures were leased on a long-term basis to cooperative housing corporations and more recently, to condominiums.

The Act provides in part that “the monies and properties of the [F]und, including all properties constructed, acquired, reconstructed, rehabilitated or improved by it or on its behalf and all properties under its jurisdiction, control or supervision, and all of its operations and activities shall be exempt from taxation.” Thus, under the Fund's originating legislation, the Fund's real property is exempt from real property taxes.

The Act also provides that:

Whenever the easements, space rights, air rights or other fee or leasehold interests held or retained by such owner or developer, if other than the [City] housing authority, and/or the non-school improvements constructed or erected therein or thereon, shall be exempt from real property taxes..., such lease, sublease or other agreement shall also provide for the payment to the fund of annual or other periodic amounts equal to the amount of real property taxes that would otherwise have been paid or payable with respect to such easements,

space rights, air rights or other fee or leasehold interests, and with respect to the non-school improvements constructed or erected therein or thereon, over the term of such lease, sublease or other agreement.

The foregoing provision of the Act was intended to furnish the Fund with the monies necessary to meet debt service on obligations which it would issue for the purpose of obtaining monies to pay the cost of construction of the school portion of the combined occupancy structure. Therefore, instead of the City collecting the real estate taxes on the space rights covered by the leasehold and then paying a rental to the Fund in an amount sufficient for it to meet its obligations, the Act utilizes a direct tax equivalency payment.

Taxpayer will be the tenant under a lease of the land underlying the Property upon which the building will be constructed. The fee owner of the Property and the landlord under the lease is the Fund, which acquired the land underlying the Property by deed from the City on Date 1. Taxpayer plans to convert its leasehold interest in the Property to a qualified leasehold condominium. The landlord of the leasehold condominium will be the Fund as of the recording date of the condominium declaration, and after approximately A years following the conveyance of the land to the Fund, the landlord's interest will revert to the City. The condominium will consist of three sections: a residential section with apartments which will be sold to third parties, a rental unit with rental apartments, and the retail section which will consist of several retail units.

Taxpayer intends to sell certain units in the condominium which are part of the residential section to third parties pursuant to a leasehold condominium offering plan approved by State 2's Attorney General. Each purchaser of a condominium unit will acquire from Taxpayer a qualified leasehold condominium interest in the condominium unit and a proportionate undivided interest in the common elements of the condominium for the balance of the leasehold term. Each owner of a condominium unit shall pay their proportionate share of the common charges for the residential section of the condominium to the condominium's board of managers.

As of Date 2, Affiliate 1 is the tenant under a lease with the Fund, covering the Property and Adjacent Property. Pursuant to the lease, upon receipt of the first temporary certificate of occupancy for a condominium unit in the building and Affiliate 1's delivery to the landlord of a notice of its intention to create the condominium, the lease will be severed into two leases, one covering the Adjacent Property, under which Affiliate 2 will be the tenant, and one covering the condominium, under which Taxpayer will be the tenant. Taxpayer will then submit the Property to condominium ownership by recording a declaration and will immediately assign the Taxpayer's interest in the lease covering the condominium to the condominium's board of managers which will thereafter become the tenant under that lease. The Adjacent Property will not be part of the condominium.

The Property is exempt from City real estate taxes because the Fund holds fee title to the land underlying the Property, and after the reversion, the City will hold fee title to the land. Similar to other qualified leasehold condominiums, the condominium lease requires the Taxpayer, as tenant, to make PILOT in amounts similar to the amount of real estate taxes that would otherwise be payable if the Property were not exempt from real estate taxes. Unlike real estate taxes, PILOT is not separately billed to each unit owner. Rather, PILOT is collected by the condominium's board of managers from the unit owners pro rata in accordance with their interest in the residential section and included with their proportionate common charges for their condominium units and paid to landlord under the condominium lease. The condominium lease specifies the amount of PILOT payable by each of the three sections of the condominium for specific periods of years during the term of the condominium lease. The amount of PILOT allocable to the residential section is fixed until Date 3.

RULINGS REQUESTED

- (1) The PILOT to be made pursuant to the Act and the condominium lease will constitute real property taxes allowable as a deduction to the payor under section 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 section 164 that portion of the common charges paid by the unit owners to the condominium board as applied by the condominium board toward the PILOT.

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 condominium lease; and (3) may only be used for public purposes.

Accordingly, we hold as follows:

1. The PILOT payments to be made pursuant to the condominium lease to the Fund (or to City should it reacquire the Property) 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: