Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:

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CC:ITA:B02
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Date:
December 04, 2014

LEGEND:

Taxpayer =
State =
City =
Authority 1 =

Authority 2 =

Act 1 =
Act 2 =
Affordability Plan =

Building =
Condominium =

Corporation =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Ground Lease =

Land =

Project Area =
Property =
Revenue

Allocation
Agreement =

Sponsor =
Tenant-
Shareholder =

TEP Agreement =

Unit Holder =
X =
Y =

Z =

Dear :

This responds to letter dated June 9, 2014. In the letter you request a letter ruling under section 164 of the Internal Revenue Code that payments in lieu of taxes, here known as tax equivalency payments (TEP), made by the Taxpayer to Authority 1 are real property taxes for purposes of such section, and that such TEP will be deductible by each tenant-shareholder of the Taxpayer as real estate taxes under section 216(a) of the Code, under the circumstances described below.

FACTS:

Authority Information

Authority 1 was created by Act 1 as a public benefit corporation for the purpose of developing housing and economic development in the State. Act 1 exempts Authority 1 from taxation as follows:

> Exemption from taxation. The exercise of the powers granted by this act will be in all respects for the benefit of the people of this state, for the increase of their commerce, welfare and prosperity, and for the improvement of their health and living conditions, and will constitute the performance of an essential governmental function and the corporation 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 corporation or any of its subsidiaries, levied by any municipality or political subdivision of the state, nor shall the corporation or its subsidiaries be required to pay state taxes of any kind, and the corporation, its subsidiaries, projects, property and moneys and, except for estate and gift taxes and taxes on transfers, any bonds or notes issued under the provisions of this act and the income therefrom, shall at all times be free from taxation of every kind by the state and by the municipalities and all other political subdivisions of the state.

Act 1 also provides that Authority 1's powers include, in part:

> to enter into agreements to pay annual sums in lieu of taxes to any municipality or political subdivision of the state, in respect of any real property which is owned by the corporation or any subsidiary thereof and is located in such municipality or political subdivision.

Authority 2 is a subsidiary of Authority 1 and was created by Act 2 as public benefit corporation for the purpose of operating the Project Area. Act 2 contemplated that, among other things,

> .

The Act provides, in part:

> [t]he creation of [the Authority] and the carrying out of its purposes is in all respects for the benefit of the people of the state and is a public purpose, and that [the Authority] will be performing an essential governmental function in the

> exercise of the powers conferred upon it by this act. [The Authority] and its operations, property and moneys shall be free and exempt from taxation of every kind by the city and the state and any subdivision thereof. Except as hereinabove provided and except as may otherwise specifically be provided, nothing contained in this act shall confer exemption from any tax, assessment or fee upon any person, firm, corporation or other entity, or upon the obligations of any of them.

The provides that the Tax Equivalent for Conventionally Financed Housing is:

> [City]'s then current real estate tax rate times [City]'s then current assessed valuation of land and buildings for each Improvement or part of an Improvement consisting of Completed Units of Conventionally Financed Housing after adjustment …. Such then current assessed valuation for rent and buildings shall from time to time be assessed and reassessed by [City] in the manner and subject to the limitations then currently imposed upon assessments of like properties by all laws and regulations applicable thereto.

The provides that both Y and City agree that the TEP's are in lieu of all local and municipal taxes, including real estate taxes on land and buildings, other than local assessments. The provides that Y may sublease any portion of Project area in order to carry out the development of the Project area. Thereafter, Y subleased the property to X and provided in the that the lessee is required to make the same payments in lieu of real estate taxes as Y is obligated to pay to City, which are referred to as TEP in the .

already paid in respect thereof.

Background

TEP

The Affordability Plan established certain restrictions on rent increases and sales prices during the Affordability Plan period which is from the Affordability Plan effective date of . At the end of the Affordability Plan period, the TEP would be calculated for all units on the same basis as that for Market Apartments. As noted above, pursuant to Act 1, Act 2, the Affordability Plan, the Assignment and Assumption Agreement dated as of the Assignment Date between Authority 1 and Authority 2, and the Revenue Allocation Agreement, Authority 1 and Authority 2 are exempt from taxation on property, including real property, but pursuant to the , Authority 1 is obligated to pay TEP to City. Under Act 2, the Unit Holder would not be exempt from payment of the TEP to Authority 2:

> Except as hereinabove provided and except as may otherwise specifically be provided, nothing contained in this act shall confer exemption from any tax, assessment or fee upon any person, firm, corporation or other entity, or upon the obligations of any of them.

Act 2, Section 5 of Act 1, the , the Affordability Plan, and the TEP agreement collectively provide the authority and mechanism for the payment and

collection of TEP. The TEP is calculated in the same manner as conventional real estate taxes for the “Market Apartments” (conventionally financed) and (after the 30 year Affordability Plan period) “Affordable Apartments” (subsidized/middle income). The computation of the TEP also reflects all real estate tax deductions and exemptions for which the qualified tenants in such apartments were eligible, such as STAR and Veterans Abatements, Senior Citizen and Disabled Rent Increase exemptions, and for Market Apartments, the Cooperative and Condominium Real Estate Tax Abatement.

Pursuant to Section 4 (B)(i) of the Second Amendment to the , the TEP is deemed payable only on the building, and not on the land.

Under the terms of the bylaws of the Corporation, each Tenant-Shareholder shall make his TEP payment to the Corporation as part of , which are allocated among all Tenant-Shareholders on a . The Taxpayer will pay Authority 1 an annual sum, payable in monthly installments, i.e. the TEP.

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 Treasury 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 Treas. Reg. §1.164-2(g) and §1.164-4.

Whether a particular charge is a “tax” within the meaning of Section 164 of the Code depends on its true nature as determined under federal law. The word “taxes” as used in the statute is nowhere defined in the Code, and it must be “given its ordinary and commonly accepted meaning as established by judicial decisions.” See United Gas Improvement Company v. Commissioner, 25 B.T.A. 1382 (1932), aff’d. 64 Fed. 2d 957 (1933), Ct. D. 733, C.B. XII-2, 207 (1933). The designation given by local law is not determinative, and if it is in the nature of a tax, it is not material that it is called by a different name. 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.

Section 216 of the Code provides that a tenant-stockholder in a cooperative housing corporation shall be allowed a deduction for amounts paid or accrued to the corporation within his taxable year representing his proportionate share of real estate taxes paid or incurred by the corporation. To be proportionately deductible by the tenant-stockholders, such taxes must be allowable as a deduction to the corporation under section 164.

Ordinarily, when amounts are paid into a specific fund, they are treated as imposed as a regulatory measure (such as licensing fees), or as a charge for a privilege or service rendered. The TEP in the instant case cannot be so treated. They are not exacted for

the purpose of regulating or restraining an occupation deemed dangerous to the public, nor are they imposed as a charge for a privilege or service rendered. They are charges imposed on the Building by Authority 1 and Authority 2 under the authority provided in Act 1 and Act 2 to provide for a public purpose. The payments are made in lieu of real estate taxes, in the manner provided for in the regular taxing statutes whether for subsidized or conventionally financed properties, in order to provide revenue to Authority 1 and Authority 2, both public benefit corporations of State for an expressed public purpose. This is evident from the definition of TEP which describes a formula that mirrors the computation of traditional City real estate taxes. Accordingly, the TEP payments do not constitute local benefit assessments which are expressly excluded from the definition of TEP in the Lease.

The TEPs are measured by and are equal to the amounts imposed by the regular taxing statutes, and are themselves are imposed by City and then State even though the vehicle of the leasing agreement is utilized. Although the proceeds from these payments are paid directly to Authority 1 and shared with Authority 2, as subsidiaries or units of State, these payments would be deemed as part of State's general revenue fund, and they 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.

RULINGS REQUESTED:

1. TEP exacted from the Taxpayer as owner of the pursuant to Act 1 and Act 2 and imposed through the instrument of the with Authority 1 and Authority 2 is a tax for the purposes of section 164 of the Code.

2. Tenant-Shareholders of the Taxpayer are entitled to deduct their proportionate share of TEP as real estate taxes paid by the Taxpayer attributable to the .

A taxpayer may not rely on a private letter ruling that has been issued to another taxpayer. Section 11.02 of Rev. Proc. 2014-1, 2014-1 I.R.B. 1, 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 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 Treasury 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 Treas. Reg. §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 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.

Section 216 provides that a tenant-stockholder in a cooperative housing corporation shall be allowed a deduction for amounts paid or accrued to the corporation within his taxable year representing his proportionate share of real estate taxes paid or incurred by the corporation. To be proportionately deductible by the tenant-stockholders, such taxes must be allowable as a deduction to the corporation under section 164.

The TEP obligations in this case 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 Affordability Plan; and (3) may only be used for public purposes.

Accordingly, we hold as follows:

1. TEP exacted from the Taxpayer as owner of the pursuant to Act 1 and Act 2 and imposed through the instrument of the with Authority 1 and Authority 2 is a tax for the purposes of section 164 of the Code.

2. Tenant-Shareholders of the Taxpayer are entitled to deduct their proportionate share of TEP as real estate taxes paid by the Taxpayer attributable to the .

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,

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THOMAS D. MOFFITT
Chief, Branch 2
Associate Chief Counsel
(Income Tax & Accounting)

cc: