FINANCE
NEW • YORK
THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

February 22, 2005

Re:
Request for Letter Ruling
Real Property Transfer Tax
FLR-044828-021

Dear :

This is in response to your request dated October 13, 2004 on behalf of , a not-for-profit corporation (the "Taxpayer"), for a letter ruling exempting the transfer of the property located at , New York (the "Property") by the Taxpayer to L.P. a limited partnership ( the "Partnership") from the New York City Real Property Transfer Tax ("RPTT"). Additional information was received on November 15 and December 15, 2004, and January 12, 2005.

FACTS

The facts presented are as follows:

As indicated in its Certificate of Incorporation dated , the Taxpayer was "organized exclusively for the purpose of acquiring, developing, owning, rehabilitating, managing, maintaining and operating a housing project for persons of low income". The Taxpayer has applied for but has not received a determination from the Internal Revenue Service that it is exempt from federal taxation. Its sole member is , a non-profit corporation exempt from federal taxation pursuant to section 501(c)(3) of the Internal Revenue Code (the "Parent"). On , the Taxpayer acquired the Property for $ from the Department of Housing Preservation and Development ("HPD"). The Taxpayer is in the process of renovating the Property to provide supportive housing to formerly incarcerated women and their families (the "Project"). On the same day, the City made a loan under its Supportive Housing Loan Program secured by a mortgage on the Property (the "Mortgage") to finance the renovation of the Property. In connection with the loan and the granting of the Mortgage, the Taxpayer signed the Regulatory Agreement that states that the Property "shall be used exclusively as housing

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accommodations for persons of low income" meaning persons whose household income does not exceed 60% of the area media income, at least 80% of whom were homeless before they moved into the Property. Under the terms of the loan and the Mortgage, the principal and interest owed the City will be forgiven if these restrictions (and all of the other requirements contained in the loan documents and Regulatory Agreement) are complied with for at least 30 years.[1]

Since its creation, the Taxpayer has been actively preparing for and conducting the renovation of the Property. Among other things, it has engaged the services of a general contractor, an architect, and a surveyor and has received and disbursed loan funds from the City.

Sometime this year, the Property will be transferred to the Partnership so that the Project can take advantage of the Federal low-income housing tax credit under section 42 of the Internal Revenue Code ("IRC"). The general partner of the Partnership is , Inc. ("G.P., Inc."), a business corporation owning a .01% interest in the Partnership. The Taxpayer owns 100% of G.P., Inc. The limited partner of the Partnership is , (the "Limited Partner"), a limited partnership, with a 99.99% interest in the Partnership. The Limited Partner will contribute to the Partnership approximately $ , which is expected to exceed the value of the tax credits and losses allocated to the Limited Partner.

After it transfers the Property to the Partnership, the Taxpayer will retain the stock of G.P., Inc. In this manner it will be able to ensure that the Partnership continues to provide housing to low-income, formerly incarcerated women and their families at rents affordable to them. The Partnership will enter into a management agreement with The Parent to manage the Property under which the Parent will receive fees. The Parent is also functioning as sponsor, developer, and supportive services provider for the Project. The Taxpayer may retain a right of first refusal or a purchase option with respect to the Property so that, once the Limited Partner receives its anticipated tax credits and losses, the Taxpayer may reacquire the Property and operate the Project directly.

In your letter dated January 7, 2005, you stated that HPD has informed the Taxpayer that HPD is regarding the Project as a qualified low-income housing project described in IRC section 42(h)(5)(B). You have also provided a copy of a declaratory ruling of the HPD dated December 29, 2004, stating that the Project will be eligible for exemption from the Real Property Tax under section 420-c of the New York Real Property Tax Law, assuming the Project satisfies all statutory and regulatory requirements of that section at the time of issuance of the Certificate of Eligibility.

The Taxpayer has represented that it has not engaged and will not engage in any activities other than those described above. No part of the net earning of the Taxpayer has inured or will inure to the benefit of any private shareholder or individual. No substantial part of the activities of the Taxpayer involved or will involve the carrying on of propaganda or otherwise attempting to influence legislation.

ISSUE

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[1] The property is also subject to another non-interest bearing "enforcement lien" that will also be forgiven if the Property is used in accordance with its intended purpose.

You have requested a ruling that the conveyance of the Property from the Taxpayer to the Partnership will be exempt from the RPTT under section 11-2106(b)(2) of the New York City Administrative Code (the "Code").

CONCLUSION

Based upon the facts presented and the representations submitted, we have determined that Code section 11-2106(b)(2) will apply to the conveyance of the Property from the Taxpayer to the Partnership. Thus, the conveyance will be exempt from the RPTT. [2] However, the Taxpayer will be required to inform this office in the event that its application for exemption under IRC section 501(c)(3) is denied.

DISCUSSION

The RPTT applies to each deed conveying an interest in New York City Real Property when the consideration for the real property interest exceeds $25,000. Code §2102(a). Code section 11-2101.9 defines "consideration" as the price paid or required to be paid for the property and includes the amount of any indebtedness on the property, whether or not the indebtedness is assumed.

Code section 11-2106(b) exempts certain deeds, instruments and transactions from the RPTT. Code section 11-2106(b)(2) exempts conveyances of real property by or to any corporation:

> organized and operated exclusively for religious, charitable, or educational purposes…and no part of the net earnings of which inures to the benefit of any private shareholder or individual and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation; provided, however, that nothing in this paragraph shall include an organization operated for the primary purpose of carrying on a trade or business for profit, whether or not all of its profits are payable to one or more organizations described in this paragraph…

The Taxpayer's certificate of incorporation requires that all income and earnings must be used exclusively for the Taxpayer's corporate purposes; that no part of its earnings can inure to the benefit of any individual or private entity and that, in the event of dissolution any assets remaining in the Taxpayer after satisfying its liabilities must be distributed to organizations qualifying under IRC section 501(c)(3). You have represented that no substantial part of the activities of the Taxpayer has involved or will involve the carrying on of propaganda or otherwise attempting to influence legislation. In addition, you have represented that the Taxpayer's only activities have been in connection with the ownership and operation of its Property and securing an investor to provide equity for the Project; that virtually all of its income has been in the form of loans that have been used for renovation of the Project; and that no portion of the Taxpayer's income has inured to the benefit of any private stockholder. Thus,

[2] This office is not opining as to the applicability of the RPTT to the transfer of a controlling economic interest in the Limited Partner.

assuming that the Taxpayer is organized and operated for one of the enumerated exempt purposes, Code section 11-2106(b)(2) will apply.

PURPOSE OF ORGANIZATION

Code section 11-2106(b)(2) closely resembles IRC section 501(c)(3), which exempts certain religious, charitable, and educational organizations from federal income tax. Code section 11-2106(b)(2) does not expressly require an organization to have received a federal exemption under IRC section 501(c)(3) to be exempt from the RPTT. However, because of the substantial similarity between the IRC and Code provisions, this Department will take notice of judicial and administrative interpretations of IRC section 501(c)(3) in applying Code section 11-2106(b)(2).

In Revenue Ruling 70-585, 1970-2 C.B. 115, the Internal Revenue Service ("IRS") addressed the question of when an organization formed and operated to provide housing qualifies as "charitable". Situation 1 of that ruling involved an organization formed and operated to provide housing for low-income persons. The IRS concluded that '[b]y providing homes for low-income families who otherwise could not afford them, the organization is relieving the poor and distressed [and thus] is organized and operated exclusively for charitable purposes" under IRC section 501(c)(3). In Situation 4 of that ruling, the IRS considered an organization formed to provide rental housing at cost to moderate income families; the IRS found that organization did not provide relief to the poor or carry out any other function within the definition of "charitable." In Situation 3 of Revenue Ruling 70-585, the IRS addressed the exemption of an organization formed and operated to combat community deterioration by assisting in the rehabilitation of an old and run-down residential area. The IRS concluded that the organization was organized and operated for charitable purposes under IRC section 501(c)(3). This case appears similar to Situation 1 of the revenue ruling since the Taxpayer's certificate of incorporation provides that it is "organized exclusively for the purpose of acquiring, developing, owning, rehabilitating, managing, maintaining, and operating a housing project for persons of low income."

PURPOSE OF OPERATION

In Revenue Procedure 96-32, 1996-20 IRB 14, the IRS established safe harbor guidelines for determining when low-income housing organizations will be considered to relieve the poor and distressed. Organizations not meeting the safe harbor guidelines may, nevertheless qualify as "charitable" pursuant to other criteria set forth in the revenue procedure. An organization will qualify under the safe harbor guidelines if it establishes, for each project, that (1) at least 75 percent of the units are occupied by residents that qualify as low-income (defined generally as persons earning no more than 80 percent of the median area income); and (2) either at least 20 percent of the units are occupied by residents that also meet the very low-income limit for the area (defined generally as persons earning no more than 50 percent of the median income) or 40 percent of the units are occupied by residents that also do not exceed 120 percent of the area's very low-income limit. Up to 25 percent of the units may be provided at market rates to persons who have incomes in excess of the low-income limit.

In this case, the Project meets the safe harbor guidelines specified in Revenue Procedure 96-32 because all of its units are required to be occupied by persons whose household income does not exceed 60% of the area median income, at least 80% of whom were homeless before they moved into the Property. However, Revenue Procedure 96-32 further provides that if an organization furthers a charitable purpose such as relieving the poor and distressed, it nevertheless may fail to qualify for exemption because private interests of individuals with a financial stake in the project are furthered. For example, the role of a private developer or management company in the organization's activities will be examined to identify impermissible private benefit resulting from real property sales, development fees, or management contracts. In this case the Limited Partner in the Partnership has a significant financial stake in the Project and stands to benefit as the result of the tax credits and losses flowing from the Partnership.

In Housing Pioneers, Inc., T.C. Memo 1993-120, affirmed 75 A.F.T.R. 2d 95-1398, 49 F.3d 1395, 58 F. 3d 401($9^{th}$ Cir. 1995) the Ninth Circuit upheld the denial of IRC section 501(c)(3) exemption status to a corporation acting as a co-general partner in for-profit limited partnerships that owned real estate to be used as low income housing. The court concluded that the corporation's activities as co-general partner, including its duty to ensure compliance with IRC section 42, substantially furthered non-exempt purposes and served private interests as a result of the benefit the other partners received from a state property tax reduction and low-income housing credits under IRC section 42. In Housing Pioneers, the petitioner's authority as co-general partner under the management agreements was severely limited. In general the management agreements denied the petitioner the authority to screen or select the tenants or conduct general maintenance. Moreover, the petitioner had no on-site management authority. The petitioner was however required to maintain records sufficient to ensure that the limited partnership continued to qualify for the property tax reduction and the general business credit under IRC sections 42 and 38 and, under one of the agreements, was required, as co-general partner to monitor the residential units so as to comply with IRC section 42. On appeal, the petitioner argued that its partnership with a for-profit entity was implicitly authorized under IRC section 42(h)(5)(b)[3] despite the restrictions under IRC section 501(c)(3). That argument was rejected because of the petitioner's limited role in the project. Housing Pioneers, 75 A.F.T.R. 2d 95-1398 at 95-1401. The Ninth Circuit noted that to qualify under IRC section 42(h)(5)(b) it was necessary for a qualified nonprofit organization to own an interest in the project (directly or through a partnership) and to materially participate within the meaning of IRC section 469(h) in the development and operation of the project throughout the period involved. IRC section 469(h) provides that a taxpayer is treated as "materially participating" in an activity only if the taxpayer is involved in the operations of the activity on a basis that is regular, continuous and substantial. The appellate court in Housing Pioneers noted that the because of its limited role in the partnership, the petitioner's participation in the project was not regular, continuous or substantial.

In Rev. Rul. 98-15, 1998-1 C.B. 718, the IRS analyzed two alternate situations involving partnerships between non-profit and for-profit entities. In the first situation, the non-profit entity was found to qualify for exemption because the partnership's governing documents committed the partnership to a charitable purpose rather than maximizing profit. The IRS concluded that through the entity's voting control of the board and its specifically enumerated powers over changes in activities, disposition of assets and renewal of the management agreement ensured

[3] Under IRC §42(h)(5)(a), not more than 90% of a state's housing credit ceiling may be allocated to a project other than qualified low income housing projects, which are defined as projects in which a 501(c)(3) or (c)(4) organization materially participates directly or through a partnership. Participation through a wholly-owned subsidiary is permitted for this purpose.

that the assets it owned through the partnership and the activities of the partnership were used primarily to further exempt purposes. In the second situation, these factors were not present and the IRS concluded that the benefit to the for-profit entity was not incidental to the furtherance of an exempt purpose and that the non-profit, under that situation, was not being operated exclusively for exempt purposes.

The facts presented here differ substantially from those presented in Housing Pioneers because the Taxpayer has control of the Project through its ownership of 100 percent of the stock of the Partnership's only general partner G.P., Inc. G.P. Inc. has exclusive direct management authority over the Partnership including the authority to have the Partnership enter into a management agreement with the Parent, an organization exempt from federal taxation under IRC §501(c)(3) and the Taxpayer's sole member. In addition, the Parent is the sponsor and developer of the Project and, thus, has been involved from its inception. Because of this pervasive control of the operation of the Project, the Taxpayer will be able to ensure that the Project is operated in accordance with the Taxpayer's charitable purpose, similar to the first situation described in Rev. Rul. 98-15. Furthermore, as you have indicated, HPD has determined that the Project qualifies for the 10 percent set-aside specified in IRC section 42(h)(5)(B)[4] based on the fact that the Parent is exempt under IRC section 501(c)(3). Thus unlike the situation in Housing Pioneers, the Parent, an organization exempt under IRC §501(c)(3), will materially participate (within the meaning of IRC section 469(h) through the Taxpayer and G.P., Inc. and through the management agreement) in the development and operation of the project. Because of these facts, it is our opinion that the participation by the Taxpayer, through its wholly-owned subsidiary, in the Partnership does not substantially further a non-exempt purpose so as to disqualify the Taxpayer from the exemption under Code §11-2106(b)(2).

Based on the facts and representations presented, it is our opinion that the Taxpayer is a charitable organization within the meaning of Code §11-2106(b)(2) and the transfer of the Property to the Partnership is exempt from the RPTT. Notwithstanding the exemption granted by this ruling, the Taxpayer must report the transfer of the Property on form NYC-RPT and should attach a copy of this ruling to that return.

The Department reserves the right to verify the information submitted. Furthermore, the Taxpayer must advise the Department of any change in its Federal tax status, including a grant or denial of IRC section 501(c)(3) status.

Very truly yours,

/S/ Ellen E. Hoffman
Assistant Commissioner, Tax Law and Conciliations

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[4] See footnote 3.