

February 9, 2007

BY CERTIFIED MAIL

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Att: CC:PA:LPD:PR (REG 136806-06)

Re: Comments on Proposed Rulemaking (REG 136806-06), Treatment of
Payments in Lieu of Taxes under Section 141

Ladies and Gentlemen:

Enclosed are comments of New York City Industrial Development Agency on a notice of proposed rulemaking (REG 136806-06), Treatment of Payments in Lieu of Taxes under Section 141, RIN 1545-BF87, published in the Federal Register on October 19, 2006. We appreciate your consideration of these comments and we would be pleased to make ourselves available to discuss them with you should you want to engage in such a discussion.

If you have any questions or require any other materials or information, I may be reached at (212) 312-3823.

Very truly yours,

Kei Hayashi
Executive Director
New York City Industrial Development
Agency

NEW YORK CITY INDUSTRIAL DEVELOPMENT AGENCY

COMMENTS ON IRS PROPOSED REGULATION REGARDING TREATMENT OF PAYMENTS IN LIEU OF TAXES UNDER SECTION 141

I. INTRODUCTION

The following are comments prepared by New York City Industrial Development Agency (the "Agency") and its counsel with respect to the notice of proposed rulemaking (the "Proposed Regulations") published in the Federal Register on October 19, 2006 relating to the treatment of payments in lieu of taxes or "PILOTs" under Section 141 of the Internal Revenue Code of 1986 (the "Code"). These comments were prepared by the Agency in accordance with the Agency's purposes as an issuer of tax-exempt bonds. Reference herein to the term "we" or "the Agency" are to the Agency. We would welcome the opportunity to discuss these comments with representatives of the Department of the Treasury and the Internal Revenue Service ("IRS") and to answer any questions that the comments may raise.

II. BACKGROUND

A. New York City Industrial Development Agency

The Agency is a corporate governmental agency constituting a body corporate and politic and a public benefit corporation of the State of New York duly organized and existing pursuant to the New York State Industrial Development Agency Act, constituting Title I of Article 18-A of the General Municipal Law, Chapter 24 of the Consolidated Laws of New York, as amended, and pursuant to Chapter 1082 of the 1974 Laws of the State of New York, as amended (collectively, the "Agency Act"), for the purpose of promoting the economic welfare of the inhabitants of The City of New York (the "City") and promoting, developing, encouraging and assisting in the acquiring, constructing, reconstructing, improving, maintaining, equipping and furnishing of industrial, manufacturing, warehousing, commercial, research, recreational and civic facilities, thereby advancing the job opportunities, health, general prosperity and economic welfare of the people of the State of New York and improving their recreational opportunities, prosperity and standard of living. Under the Agency Act, the Agency has power to acquire, hold and dispose of personal property for its corporate purposes; to acquire, use for its corporate purposes and dispose of real property within the geographical jurisdictional limits of the City; to appoint officers, agents and employees; to make contracts and leases; acquire, construct, reconstruct, lease, improve, maintain, equip or furnish one or more projects; to borrow money and issue bonds and to provide for the rights of the bond owners thereof; to grant options to renew any lease with respect to any project and to grant options to buy any project at such price as the Agency may deem desirable; to designate depositories of its moneys; and to do all things necessary or convenient to carry out its purposes and exercise the powers given in the Agency Act.

In furtherance of its purposes, the Agency exercises the foregoing powers to acquire property in connection with its projects. Section 874 of the Agency Act generally exempts from all taxes and assessments “any of the property acquired by” industrial development agencies, including the Agency, or “under [their] jurisdiction or control or supervision.” In Title 1 (Public Property) of Article 4 (Exemptions) of the New York Real Property Tax Law, Section 412-a specifically exempts “real property owned by or under the jurisdiction, supervision or control of industrial development agencies” from all general *ad valorem* real property taxes. General Municipal Law § 874 generally provides for the exemption from “all taxes or assessments” of “any of the property acquired by [an industrial development agency] or under its jurisdiction or control or supervision.”

In order to clarify the application of General Municipal Law § 874 to real property taxation in particular, the New York State Legislature simultaneously added Real Property Tax Law § 412-a, which specifically exempts each industrial development agency’s real property from taxation, but requires that an application for such exemption—“Form RP 412-a, Application for Real Property Tax Exemption”—first be filed in the applicable assessor’s office, together with at least an extract of the material provisions of any applicable payment-in-lieu-of-tax agreement.

Because control of a parcel by an industrial development agency makes that parcel wholly exempt from general real property taxes, Section 858(15) of the Agency Act authorizes industrial development agencies to “enter into agreements requiring payments in lieu of taxes” by the occupants of projects undertaken by the agencies. Section 854(17) of the Agency Act defines a “payment in lieu of taxes” as “any payment made to an agency, or an affected tax jurisdiction equal to the amount, or a portion of, real property taxes, or other taxes, which would have been levied by or on behalf of an affected tax jurisdiction if the project was not tax exempt by reason of agency involvement.” Such payments, in whatever amount they are required to be made, are then usually allocated under Section 858(15) to the affected tax jurisdictions “in proportion to the amount of real property tax and other taxes which would have been received by each affected tax jurisdiction had the project not been tax exempt due to the status of the agency involved in the project.” In the case of real property tax PILOTs collected by the Agency, the City is the sole affected taxing jurisdiction.

The overall amount of payments in lieu of taxes that an industrial development agency in New York requires to be made in connection with a project is typically a function of that agency’s uniform tax exemption policy (the “UTEP”). Each industrial development agency in New York State is required under the Agency Act to adopt a UTEP describing, among other things, the standard levels of abatement of real property taxes that are available to agency projects through the use of PILOTs in order to induce development within the State and within that agency’s jurisdiction in particular. The Agency’s UTEP provides for several different levels of abatement (in some circumstances, none at all), primarily depending on the type of project in question. For example, “industrial projects” (which include manufacturing, recycling, warehousing and similar projects) are eligible for significant discounts relative to what real property taxes would otherwise be, and enjoy a set “financial assistance term” under the UTEP of 25 years. By contrast, most “commercial projects” (which are projects involving

“commercial endeavors,” as determined in the discretion of the Agency staff, but which exclude industrial projects) are eligible for real property tax abatement only under certain circumstances—sometimes only at the discretion of the Agency’s staff, subject to board approval—and enjoy financial assistance terms under the UTEP that are similarly determined in the discretion of the staff and approved by the Agency’s board. By recent amendment to the Agency’s UTEP, commercial construction projects in a designated geographic area on the far west-side of Manhattan, known as the Hudson Yards area, are eligible for real property tax abatement based primarily on fixed discount to actual taxes. Importantly, the ability of the Agency to enter into PILOT arrangements is essentially an extension of the ability to abate real property taxes under New York law. The purpose and the effect of the Agency’s exemption from real property taxes are identical to those contained in the New York Real Property Tax Law, but the Agency enjoys greater flexibility to use its exemption to effectively abate taxes.

In any event, however, the Agency Act acknowledges the inability of industrial development agencies to predict in their UTEPs the appropriate inducements for every potential project that might come before them, and Section 874 of the Agency Act therefore provides a notice and hearing mechanism by which agencies may “deviate” from their UTEPs under appropriate circumstances. This statutory deviation mechanism is incorporated into and amplified by the Agency’s UTEP, which describes the procedures by which the [NYCIDA] may make “a substantive departure from . . . the requirements for obtaining Financial Assistance . . . ; the extent to which Financial Assistance is available for specific Projects . . . ; [or] the kinds of Projects for which Financial Assistance generally (or categories of Financial Assistance specifically) is available.”

As noted above, payments in lieu of taxes, in whatever amount they are required to be made, are usually allocated to the affected tax jurisdictions in proportion to the amount of real property tax and other taxes that would have been received by each such jurisdiction but for the involvement of the industrial development agency. However, Section 858(15) further authorizes affected tax jurisdictions (here, the City) to agree to receive less than all of its allocation of PILOTs. This allows the City to consent to the use of all or a portion of real property tax PILOTs to finance economic development projects, such as using such PILOTs to pay the debt service on borrowings, including tax-exempt bonds. For this reason, the use of real property tax exemptions and payment in lieu of taxes arrangements in furtherance of the Agency’s purposes is a key economic development tool of the Agency and the City.

This approach was used most recently in connection with the financing for the construction of new stadia for use by the New York Yankees and New York Mets major league baseball teams. In 2006, the Agency submitted private letter ruling requests to the Internal Revenue Service (the “IRS”) in connection with those projects. Both projects involved the use of PILOTs for the repayment of bonds issued by the Agency. The IRS issued Private Letter Rulings (PLR 110172-06 and PLR 107899-06) (the “Private Letter Rulings”) which confirmed that the bonds issued by the Agency to finance the stadia are not private activity bonds within the meaning of Section 141 of the Internal Revenue

Code because the private security or payment test is not satisfied and the private loan financing test is not met based on the facts presented in the private letter ruling requests.

B. Discussion of the PILOT Rule

Under Section 103 of the Code, interest on the obligations of a State or political subdivision is not excluded from gross income if the obligations are private activity bonds as defined in Section 141. In part, Section 141 of the Code provides that obligations are private activity bonds if the private business tests of Section 141(b) of the Code are satisfied or if the private loan financing test of Section 141(c) is met. Under Section 141(a) of the Code, the private business tests are satisfied if both the private business use test and the private security or payment test are satisfied. Section 141(b)(1) provides that an issue meets the private business use test if more than 10 percent of the proceeds of such issue are to be used for any private business use. Section 141(b)(6) defines the term "private business use" as use in a trade or business carried on by any person other than a governmental unit. Further, any activity carried on by a person other than a natural person is treated as a trade or business.

Section 141(b)(2) provides that an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by an interest in: (i) property used or to be used for a private business use, or (ii) payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property or borrowed money used or to be used for a private business use. Treasury Regulation Section 1.141-4 provides guidance on the application of the private security or payment test. Section 1.141-4(a) provides that the private security or payment test relates to the nature of the security for, and the source of, the payment of debt service on an issue. The private payment portion of the test takes into account the payment of the debt service on the issue that is directly or indirectly to be derived from payments (whether or not to the issuer or any related party) in respect of property, or borrowed money, used or to be used for a private business use. The private security portion of the test takes into account the payment of the debt service on the issue that is directly or indirectly secured by any interest in property used or to be used for a private business use or payments in respect of property used or to be used for a private business use.

Under section 1.141-4(e), for purposes of the private security or payment test, generally applicable taxes are not taken into account (that is, are not payments from a nongovernmental person and are not payments in respect of property used for a private business use). The regulations state that a generally applicable tax is an enforced contribution exacted pursuant to legislative authority in the exercise of the taxing power that is imposed and collected for the purpose of raising revenue to be used for governmental purposes. A generally applicable tax must have a uniform tax rate that is applied to all persons of the same classification in the appropriate jurisdiction and a generally applicable manner of determination and collection.

A payment for a special privilege granted or service rendered is not a generally applicable tax. Special assessments paid by property owners benefiting from financed improvements are not generally applicable taxes. For example, a tax or a payment in lieu of tax that is limited to the property or persons benefited by an improvement is not a generally applicable tax. Section 1.141-4(e)(3).

Prior to the issuance of proposed private activity bond regulations in 1994, there was no regulatory or other guidance concerning the treatment of PILOTs under the private payment test. Those proposed regulations indicated the IRS' initial intent to treat generally applicable taxes and the PILOTs that replace such taxes in the same manner under the private security or payment test. The City and others urged the IRS to broaden the approach taken in those proposed regulations. The final regulations contained the PILOT Rule as described below. In addition, the preamble to the final private activity bond regulations adopted in 1997 (the "Final Regulations") contained the following statement: "In response to comments, the final regulations are more flexible for arrangements that reduce the amount of tax paid and permit a wider range of tax equivalency payments." We were pleased to see the IRS adopt suggestions that, in response to the City's comments, seemed designed to provide rules that worked under the provisions of New York law.

The "**PILOT Rule**" as adopted in section 1.141-4(e)(5) of the Final Regulations states that a tax equivalency payment and any other payment in lieu of a tax is treated as a generally applicable tax if—

- (i) The payment is commensurate with and not greater than the amounts imposed by a statute for a tax of general application; and
- (ii) The payment is designated for a public purpose and is not a special charge (as described in section 1.141-4(e)(3)). For example, a payment in lieu of taxes made in consideration for the use of property financed with tax-exempt bonds is treated as a special charge.

As discussed below, we agree that further clarification of the PILOT Rule would assist the Agency and other tax-exempt bond issuers with the implementation of projects involving PILOTs that will be pledged for the repayment of tax-exempt bonds. However, at the same time, we strongly disagree with the proposed change that eliminates the ability to enter into fixed PILOT arrangements in connection with tax-exempt bond financings.

C. The Proposed Regulations

The Proposed Regulations represent an important effort on the part of the Department of the Treasury ("Treasury") and the IRS to provide additional guidance for treating PILOTs as generally applicable taxes. In particular, we support the proposed elimination of the "example" in the last sentence of existing section 1.141-4(e)(5)(ii). However, the Agency respectfully but strongly suggests that the proposed clarification

requiring eligible PILOT payments to represent a fixed percentage of, or reflect a fixed adjustment to, the amount of generally applicable taxes in each year, based on current valuation assessments, would significantly limit the flexibility of the Agency to negotiate arm's length PILOT arrangements in connection with economic development projects taken on by the Agency to accomplish its governmental purposes as set forth in the Agency Act.

The Proposed Regulations are also inconsistent with the rules relating to the treatment of generally applicable taxes, which contain no limitations on the manner in which such taxes may be abated. This is particularly troubling in light of the fact that, under New York law, PILOTs are merely an extension of tax abatements. In this regard, we do not believe the Treasury and IRS should be regulating the manner in which entities such as the Agency abate property taxes through PILOTs so long as the PILOTs are not special charges and the amount of the PILOTs are authorized in the Agency Act.

The proposed limitations are also inconsistent with the negotiated PILOT arrangements described in the Private Letter Rulings, and if adopted in their current form, would adversely affect the Agency's ability to issue bonds to refund the bonds issued pursuant to the Private Letter Rulings, additional bonds in connection with those Projects (e.g., bonds to finance cost overruns) and bonds for new, similar projects. With those concerns in mind, the following comments are respectfully submitted.

III. COMMENTS

A. Clarification of Section 1.141-4(e)(5)

The Agency supports the proposed elimination of the example in the last sentence of existing section 1.141-4(e)(5)(ii). This language is both unclear and unnecessary and could render meaningless both the prior sentence in the regulation and the purpose of the PILOT Rule if it were interpreted to result in a special charge any time a private business user of bond proceeds made a PILOT. This is particularly true given the context that this rule would only need to be applied in circumstances where PILOTs were being made by such a user of proceeds. A generally applicable tax qualifies if it is generally applicable and the tax is not a special charge. If the notion is that a PILOT is treated just like the related tax, there is no reason to apply a different or additional special charge analysis to PILOTs.

B. Proposed Clarification of Eligible PILOT payments

The Proposed Regulations propose a standard to determine whether a PILOT payment is "commensurate" with generally applicable taxes, as such term is used in section 1.141-4(e)(5). The Agency concurs that clarifying the "commensurate" standard would provide more certainty to issuers with respect to the application of the PILOT Rule. However, we respectfully suggest that the proposal to limit that standard to PILOT payments that represent a fixed percentage of, or reflect a fixed adjustment to, the amount of generally applicable taxes that would otherwise apply to a particular property is an

unnecessarily restrictive standard that will limit the flexibility of issuers such as the Agency to negotiate with private parties the terms of economic development projects. In the case of the Agency, these new restrictions would limit the Agency from engaging in transactions otherwise permitted under the Agency Act. The standard in the Proposed Regulations may adversely affect projects of the Agency that have relied on charging PILOTs in amounts permitted under its UTEP, including permissible deviations from the UTEP.

Under the Agency Act, the PILOTs are most often imposed in lieu of the City's *ad valorem* property tax that generally applies to property in the City. This tax is a tax of general application within the meaning of the regulations. While the term "commensurate" is not otherwise defined in the current regulation, the Private Letter Rulings stated that the term commensurate is defined as corresponding or proportionate in measure, and applied this definition to conclude that the fixed PILOTs presented in the rulings were commensurate with the *ad valorem* real property taxes applicable in the City. The Agency Act limits the payments in lieu of the City's *ad valorem* tax to payments "equal to the amount, or a portion of, real property taxes" that would have been levied by the City on the Project. The abatement of the *ad valorem* tax implicit in the PILOT must be permitted under the UTEP of the Agency. Thus, the PILOT obligation under the Agency Act is derived from and measured in contemplation of the *ad valorem* tax obligation that otherwise would be applicable, and so is commensurate with the *ad valorem* tax. Given the statements in the preamble to the Final Regulations to the effect that the final regulations are to provide more flexibility for arrangements that reduce the amount of tax paid and permit a wider range of tax equivalency payments, the key factor under the current regulations seems to be that the PILOTs not be a special charge. Any PILOT that is not a special charge (1) will, by definition, not exceed the amounts imposed by the generally applicable tax, (2) will be consistent with the rules applicable to generally applicable taxes, and (3) will provide state and local governments with the flexibility to utilize their tax revenues as they see fit under local law to promote economic development in their jurisdictions.

The Agency believes that the Proposed Regulations should reflect the forgoing, rather than define a standard which requires PILOTs to be structured as a fixed percentage or adjustment of a single change in the level of the percentage or adjustment following completion of development of the subject property, and that prohibits setting PILOTs at a fixed dollar amount, as is currently proposed. Such a standard, if adopted as proposed, would deprive the Agency and other issuers of an important economic development tool that is authorized under State law. There are several examples of Agency negotiated PILOT arrangements in which the PILOT payor agrees to a PILOT payment arrangement that is based on fixed payments that do not vary with changes in market value or assessed value of a property. Such an approach provides the PILOT payor with "inflation protection" against changes in assessed value of a subject property that result in increases in real property carrying costs. The increased cost and expense of owning or leasing real property in the City is a key consideration of businesses that are weighing whether to locate in the City. The Agency has negotiated fixed PILOT arrangements in such cases, and the Treasury and IRS should not be limiting the

Agency's ability to do so in the future. The Agency wishes to preserve the ability to use fixed PILOTs under the PILOT Rule for future economic development projects that serve an important public purpose and for which the Agency, in coordination with the City, as the affected taxing jurisdiction, has determined that PILOTs should be used to support the issuance of tax-exempt bonds.

We also object to the distinction that would be created between PILOTs on the one hand and generally applicable taxes and abatements on the other. The current regulations, like the rules for the deductibility of PILOTs for income tax purposes, are intended to treat PILOTs and the related tax in the same manner. In New York, it is very difficult to make use of tax increment financing or techniques that subsidize economic development projects through tax abatements. Under New York law, this flexibility is found in the PILOT rules, which are merely an extension of the tax abatement rules for purposes of fostering economic development. It was for this reason that the City previously urged the IRS to adopt a broad, flexible approach to PILOTs under section 141 after the 1994 proposed regulations were issued and this was what the IRS did when those regulations were finalized. This approach should not be changed.

We respectfully recommend that the Proposed Regulations be modified so that it is clarified that PILOTs may be used so long as they are not a special charge, as that term is used in section 1.141-4(e)(3).

In addition to our general recommendation, we make the following technical comments should the Treasury and IRS decide to maintain the general approach in the Proposed Regulations.

First, the Proposed Regulations provide that a payment is not commensurate if it is based in any way on debt service on an issue or is otherwise set at a fixed dollar amount that cannot vary with the assessed value of the property. We are concerned that this provision is overly broad. Any PILOT, even one whose payments are based on the standards in the Proposed Regulations, used to pay the debt service on bonds may arguably be "based in any way on debt service" as the purchasers of the bonds will want to know that the PILOTs are expected to be sufficient to pay the debt service on the bonds. Given the general approach of the Proposed Regulations, we believe this sentence is unnecessary and should be deleted.

Second, we do not believe the Proposed Regulations should contain such a specific description on the types of PILOT arrangements that may be used under the rule. PILOT arrangements come in many different forms, and the regulations should not seek to define all of the permitted methods, as long as the policy concerns of the Treasury and the IRS are addressed. For example, as illustrated with the numerous variations of PILOT arrangements described below, under the Agency's UTEP, the Agency has broad discretion to negotiate and structure tax incentives and other benefits with private entities that enter into PILOT arrangements with the Agency. In addition to fixed PILOTs, the Agency generally computes negotiated, non-fixed PILOTs using three basic methods. One method is for the PILOT to be equal to actual real property taxes, less a negotiated fixed amount. The second method is for the PILOT to be based on a percentage of actual real

property taxes. The third method involves excluding some of the improvements that comprise the property from the computation of the PILOTs (referred to as "stabilized" real property taxes). For example, the PILOT could be computed by taking the actual tax rate multiplied by the assessed value of a property prior to the completion of any improvements thereto. This exclusion of improvements from the assessed value is typically phased out over a number of years. The third method often results in PILOTs that are very close to fixed, as the assessed value of the property is determined at the time of the transaction, and the only variable is the tax rate, which does not tend to change frequently or by significant amounts. In addition to and in conjunction with the foregoing methods, the NYCIDA also provides additional credits against the amount of PILOTs payable, based on measures such as employment relocation and growth.

The following is a more specific breakdown of the types of non-fixed arrangements the Agency has entered into:

1. Full real property taxes, less a fixed dollar amount, less an Employment Growth Credit;
2. Lesser of (a) stabilized real property taxes (i.e., taxes computed by excluding certain improvements from the assessed value), and (b) actual real property taxes, less a Commercial Rent Tax Credit, less an Employment Growth Credit, less an Energy Credit;
3. Stabilized real property taxes, less certain fixed credits for particular facility improvements;
4. (a) Full real property taxes on land, less a fixed dollar amount, plus (b) a percentage of full real property taxes on improvements;
5. Stabilized real property taxes (amount excluded from assessed value is phased out 20% per year for final 4 years);
6. Stabilized real property taxes (amount excluded from assessed value is phased out 10% per year for 9 years);
7. Full real property taxes, less an Employment Relocation Credit;
8. Fixed schedule of PILOTs per square foot, less a Commercial Rent Tax credit, less an Employment Growth Credit;
9. Fixed assessed value of land and building multiplied by current tax rate; and
10. Stabilized real property tax, less certain fixed credits (credits phase out over last 4 years).

Given the variety of PILOT arrangements that the Agency employs in connection with its tax incentive programs, we respectfully request that the regulation not state the permissible forms of PILOT arrangements, but rather state the types of arrangements that

are not permissible. This will provide flexibility in the future to structure PILOT arrangements that do not run afoul of the policy concerns of the IRS and Treasury.

Third, the Agency has entered into fixed PILOT arrangements in connection with the bond financings described in the Private Letter Rulings. Those projects involve the construction of stadia that will be owned by the Agency and leased to entities affiliated with the respective major league baseball teams. In each case, those entities entered into fixed PILOT arrangements with the Agency. The Proposed Regulations, if adopted, would foreclose the Agency from issuing additional tax-exempt governmental bonds to complete construction of the stadia if additional funds are required. Nor would the Agency be able to utilize the current fixed PILOT structure to issue tax exempt bonds to refund the outstanding stadia bonds. In light of these and other similar transactions, we recommend adding transition rules to the regulations allowing (1) refundings of outstanding bonds issued under the existing regulations to the extent that the weighted average maturity of the bonds does not exceed 120% of the useful life of the assets financed, and (2) the existing regulations to be applied to bonds issued to complete projects initially financed with bonds subject to the existing regulations.

C. Summary.

The Agency appreciates the substantial efforts involved in reviewing and interpreting the PILOT Rule and related regulations over the past year. The Proposed Regulations represent an important effort to clarify the application of the PILOT Rule and to provide needed guidance to issuers and bond counsel. The Agency strongly agrees with elimination of the example in the last sentence of section 1.141-4(e)(5)(ii). We also agree that it is necessary to further define a standard to determine whether a PILOT payment is "commensurate" with generally applicable taxes, as such term is used in the section 1.141-4(e)(5). However, we recommend preserving a more flexible approach with respect to such definition that is consistent with the original intent of the PILOT rule. Specifically, the determination of whether a PILOT is to be treated as a generally applicable tax should be based on a determination that such PILOT is not a special charge. Such an approach would both be consistent with the current interpretation of the PILOT Rule and would preserve the Agency's flexibility to negotiate and implement PILOT-based economic development projects that involve the issuance of tax-exempt bonds.