



Section of Taxation

10th Floor  
740 15th Street N.W.  
Washington, DC 20005-1022  
(202) 662-8670  
FAX: (202) 662-8682  
E-mail: tax@abanet.org

July 10, 2007

Mr. Kevin Brown  
Acting Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

Re: Comments on Proposed Regulations Relating to Payment In Lieu of Taxes under Section 1.141-4 of the Treasury Regulations

Dear Acting Commissioner Brown:

Enclosed are comments on proposed regulations relating to payments in lieu of taxes under section 1.141-4 of the Treasury regulations. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Susan P. Serota  
Chair, Section of Taxation

Enclosure

cc: Donald L. Korb, Chief Counsel, Internal Revenue Service  
Eric Solomon, Assistant Secretary (Tax Policy), Department of the Treasury  
Michael J. Desmond, Tax Legislative Counsel, Department of the Treasury  
John J. Cross III, Associate Tax Legislative Counsel, Department of the Treasury  
Lon B. Smith, Associate Chief Counsel (Financial Institutions & Products),  
Internal Revenue Service  
Rebecca L. Harrigal, Branch Chief, Tax Exempt Bonds, Internal Revenue Service  
Clifford J. Gannett, Director, Office of Tax Exempt Bonds, Internal Revenue Service  
Steven Chamberlin, Senior Manager-Compliance & Program Management,  
Office of Tax Exempt Bonds, Internal Revenue Service

*CHAIR*

Susan P. Serota  
New York, NY

*CHAIR-ELECT*

Stanley L. Blend  
San Antonio, TX

*VICE CHAIRS*

*Administration*

Rudolph R. Ramelli  
New Orleans, LA

*Committee Operations*

Elaine K. Church  
Washington, DC

*Communications*

Gregory F. Jenner  
Washington, DC

*Government Relations*

William M. Paul  
Washington, DC

*Professional Services*

Elinore J. Richardson  
Toronto, Canada

*Publications*

Louis Mezzullo  
Rancho Sante Fe, CA

*SECRETARY*

Christine L. Agnew  
Houston, TX

*ASSISTANT SECRETARY*

Armando Gomez  
Washington, DC

*COUNCIL*

*Section Delegates to the*

*House of Delegates*

Paul J. Sax  
San Francisco, CA

Richard M. Lipton  
Chicago, IL

*Immediate Past Chair*

Dennis B. Drapkin  
Dallas, TX

*MEMBERS*

Ellen P. Aprill  
Los Angeles, CA

Samuel L. Braunstein  
Fairfield, CT

Glenn R. Carrington  
Washington, DC

Peter J. Connors  
New York, NY

Richard S. Gallagher  
Milwaukee, WI

Sharon Stern Gerstman  
Buffalo, NY

Helen M. Hubbard  
Washington, DC

Emily A. Parker  
Dallas, TX

Priscilla E. Ryan  
Chicago, IL

Charles A. Pulaski, Jr.  
Phoenix, AZ

Stephen E. Shay  
Boston, MA

Barbara Spudis de Marigny  
San Antonio, TX

*LIAISON FROM ABA*

*BOARD OF GOVERNORS*

Raymond J. Werner  
Chicago, IL

*LIAISON FROM ABA*

*YOUNG LAWYERS DIVISION*

Brian P. Trauman  
New York, NY

*LIAISON FROM LAW*

*STUDENT DIVISION*

Heather McKee  
Lincoln, NE

*DIRECTOR*

Christine A. Brunswick  
Washington, DC

**COMMENTS ON PROPOSED REGULATIONS RELATING TO  
PAYMENTS IN LIEU OF TAXES UNDER SECTION 1.141-4 OF THE  
TREASURY REGULATIONS  
(REG - 136806-06, RIN 1545-BF87)  
71 FED REG 61694 (OCTOBER 19, 2006)**

The following comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, the Comments should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Linda Schakel, Chair of the Tax Exempt Financing Committee’s Task Force on PILOT regulation comments. Substantive contributions were made by Nancy M. Lashnits, Richard Kornblith, Robert Price and Michela Daliana. Additional helpful comments were made by Richard Chirls. These Comments were reviewed by Clifford M. Gerber, Chair of the Tax Exempt Financing Committee. These Comments were further reviewed by Milton S. Wakschlag of the Section’s Committee on Government Submissions and by Peter J. Connors, the Council Director for the Tax Exempt Financing Committee.

Although members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact Persons:	Linda B. Schakel	Clifford M. Gerber
Phone:	(202) 661-2228	(415) 772-1246
Fax:	(202) 626-9025	(415) 772-7400
E-Mail	<a href="mailto:schakel@ballardspahr.com">schakel@ballardspahr.com</a>	<a href="mailto:cgerber@sidley.com">cgerber@sidley.com</a>

Dated: July 10, 2007

## Executive Summary

These Comments relate to the request for comments contained in the preamble to the proposed regulations (the “Proposed Regulations”) relating to payments in lieu of taxes (“PILOTs”) under Reg. § 1.141-4 as published in the Federal Register on October 19, 2006.<sup>1</sup> In particular, these Comments address the stated concern in the preamble that existing standards potentially could be interpreted in an unduly broad manner to provide favorable treatment for certain payments in lieu of taxes that may have an insufficient link to generally applicable taxes.

The Comments outline the historical development of legislation and regulations regarding generally applicable taxes, tax equivalency payments and payments in lieu of taxes. The Comments further discuss the development and rationale of State and local governments in imposing payments in lieu of taxes.

The Comments respectfully recommend that the proposed “commensurate” standard be withdrawn on the basis that this standard unnecessarily limits the ability of State and local governments to establish tax and subsidy programs to meet their goals and could result in differing federal tax treatment of economically equivalent subsidies. The Comments provide specific alternate regulatory language to address the concern of a potential insufficient link between a payment in lieu of taxes and generally applicable taxes.

The following is a summary of the major discussion points of these Comments.

1. The Regulations generally provide the appropriate standards for determining whether there is a sufficient link between generally applicable taxes and PILOTs by placing the focus on the nature of the payments, that is, whether a payment is pursuant to the taxing authority of a jurisdiction and is not a special charge, rather than on the actual calculation of the payment. This approach is consistent with legislative history, regulatory history and industry practice and should not be changed.

2. The formulaic approach of the commensurate standard in the Proposed Regulations frustrates the historical purposes behind the development of PILOTs and reduces the ability of State and local governments to tailor economically equivalent subsidies to address local needs and resources.

3. The great variety of existing taxes, combined with evolving views on what constitutes public purposes and creative sources of revenues and taxes, makes it impractical to develop a commensurate standard that would be administrable.

4. The language in the Regulations, which excludes “special charges” from the definition of both PILOTs and generally applicable taxes, provides sufficient guidance for issuers and the Internal Revenue Service (the “Service”) to determine whether payments are private payments. We do agree with the deletion of the sentence in

---

<sup>1</sup> 71 Fed. Reg. 61693 (2006); REG-136806-06

the Regulations treating PILOTs made in consideration for use of bond-financed property as a special charge.

5. The Section respectfully requests that Treasury and the Service announce that the proposed effective date will be modified to apply to bonds sold after the regulations are finalized. The Proposed Regulations represent a departure from existing Regulations that have been in place for ten years and that affect many transactions in the municipal market. Changes should apply only after careful consideration of public comments.

### **Summary of Proposed Regulations**

On October 19, 2006, the Treasury and the Service published the Proposed Regulations modifying the standards for treating payments in lieu of taxes as generally applicable taxes for purposes of the private security or payment test under section 141 of the Internal Revenue Code of 1986, as amended (the “Code”).<sup>2</sup>

The preamble to the Proposed Regulations (the “Preamble”) states that the Regulations under Reg. § 1.141-4(e)(5) treat certain tax equivalency payments or PILOTs as generally applicable taxes if (1) the payments are commensurate with and not greater than the amounts imposed by the statute for a tax of general application, and (2) the payments are designated for a public purpose and are not special charges (as described in Reg. § 1.141-4(e)(3)). In addition, existing Reg. § 1.141-4(e)(5) provides an example pursuant to which a PILOT made in consideration for the use of property financed with tax-exempt bonds is treated as a special charge.

The Preamble states that Treasury and the Service are concerned that additional guidance may be needed regarding the existing standards for treating PILOTs as generally applicable taxes and that the existing standards potentially could be interpreted in an unduly broad manner to provide favorable treatment for certain PILOTs that may have an insufficient link to generally applicable taxes. Conversely, the Preamble states that Treasury and the Service are concerned that the last sentence of existing Reg. § 1.141-4(e)(5)(ii), which provides as an example of a special charge a PILOT paid in consideration for the use of property financed with tax-exempt bonds, could be interpreted in an unduly restrictive manner to prevent any PILOTs with respect to property financed with tax-exempt bonds from being treated as generally applicable taxes. Thus, the Preamble states that Treasury and the Service propose to modify the standards to better assure a reasonably close relationship between eligible PILOT payments and generally applicable taxes.

Under the Proposed Regulations, a tax equivalency payment or other PILOT is treated as a generally applicable tax if:

---

<sup>2</sup> Unless otherwise indicated, all “section” references herein are to sections of the Code. References to the “Regulations” are to the Treasury Regulations issued thereunder.

1. The payment is commensurate with and not greater than the amounts imposed by a statute for a generally applicable tax in each year;<sup>3</sup> and
2. The payment is designated for a public purpose and is not a special charge (as described in Reg. § 1.141-4(e)(3)).

The Proposed Regulations then add a new section entitled “commensurate standard.” Under this proposal, a payment is “commensurate” with generally applicable taxes only if the amount of the payment represents a fixed percentage of, or reflects a fixed adjustment to, the amount of generally applicable taxes that would otherwise apply to the property in each year if the property were subject to tax. Commensurate is further defined by way of example. A payment is commensurate with generally applicable taxes if it is equal to the amount of generally applicable taxes in each year, less a fixed dollar amount or a fixed adjustment determined by reference to characteristics of the property, such as size or employment. Under the Proposed Regulations, a payment does not fail to be a fixed percentage or adjustment as a result of a single change in the level of the percentage or adjustment following completion of development of the subject property. Further, the payment must be based on the current assessed value of the property for property tax purposes for each year in which the PILOTs are paid, and that assessed value must be determined in the same manner and with the same frequency as property subject to generally applicable taxes. Finally, a payment is not commensurate if it is based in any way on debt service of an issue or is otherwise set at a fixed dollar amount that cannot vary with the assessed value of the property determined in the manner described in paragraph (e)(5)(ii).

The proposed effective date of the Proposed Regulations is for bonds sold on or after February 19, 2007, that are subject to section 141.<sup>4</sup>

---

<sup>3</sup> This portion of the Proposed Regulations differs from the existing Regulations primarily by imposing an annual test on whether the payment is commensurate with and not greater than the generally applicable tax. The other change in the text from “tax of general application” to “generally applicable tax” appears to be a conforming change to current provisions of Reg. § 1.141-4(e).

<sup>4</sup> This date is 120 days after the date of publication of the Proposed Regulations in the *Federal Register*.

## Comments

### 1. The approach of the Regulations should not be changed

The Regulations generally provide the appropriate standards for determining whether there is a sufficient link between generally applicable taxes and PILOTs by focusing on the nature of the payments, that is, whether a payment is pursuant to the taxing authority of a jurisdiction and is not a special charge, rather than on the actual calculation of the payment. This approach is consistent with legislative history, regulatory history and industry practice and should not be changed.

The Section believes that the Regulations implement the intent of Congress to carve out State and local taxes, and payments in lieu of such taxes, from the definition of private business payments. In addition, they take into account the numerous comments and public hearing testimony that occurred prior to the finalization of the private activity bond regulations in January 1997 (the “1997 Final Regulations”).<sup>5</sup> The Section believes the commensurate standard of the Proposed Regulations represents a departure from the Service’s own recent legal analysis of PILOT payments, is an unnecessary change in approach that was considered and rejected in the past, creates uncertainty in the market and should be withdrawn.

*Legislative History.* The Senate Report to the Tax Reform Act of 1986 (the “1986 Act”) and the Conference Report to the 1986 Act both stated that payments from private users of bond-financed facilities will be taken into account whether or not the payments are formally pledged as security or are directly used to pay debt service.<sup>6</sup> This rule, however, applies only to payments from persons treated as using the bond-financed facility under the use test. Revenues from generally applicable taxes are not payments that are considered in determining whether the private payment and security interest test is satisfied. On the other hand, special charges imposed on persons satisfying the use test, but not on members of the public, would be considered if those charges are in substance fees paid for the use of the bond-financed property. Congress also expressed its concern about special charges with respect to payments in the form of special assessments for benefited property. Congress stated that these payments should be treated as private loan payments unless certain requirements were met.

*Regulatory History.* Regulations issued prior to the 1986 Act did not define either generally applicable taxes or payments in lieu of taxes. The concepts were first addressed in the proposed regulations issued on December 30, 1994 (the “1994 Proposed Regulations”).<sup>7</sup> The 1994 Proposed Regulations defined “generally applicable taxes” as 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

---

<sup>5</sup> 62 Fed. Reg. 2275 (January 16, 1997).

<sup>6</sup> S. Rep. No. 99-313, at 831 (1986); H.R. Conf. Rep. No. 99-841, at II-688 (1986).

<sup>7</sup> 59 Fed. Reg. 67658 (December 31, 1994).

for governmental purposes. The 1994 Proposed Regulations also stated that generally applicable taxes must have a uniform tax rate applied to all persons in the same classification and have a generally applicable manner of determination and collection. Under the 1994 Proposed Regulations, special charges, including payments for a special privilege granted or service rendered, or special assessments paid by property owners benefiting from financed improvements, were not treated as generally applicable taxes. Further provisions describing impermissible and permissible agreements focused almost exclusively on factors dealing with the imposition of real property taxes, but notably did not include any concept of abatement of taxes common in the real estate tax statutes of most jurisdictions.

The 1994 Proposed Regulations would have treated a “tax equivalency payment and any other payment in lieu of a tax” as a generally applicable tax if (1) the payment is “measured by and equal to” the amounts imposed by a regular statute for a tax of general application, (2) the payment is imposed by a specific statute (even if another agreement, such as a lease, was used as the vehicle for collection), and (3) the payment is designated for a public purpose rather than for a privilege, service or regulatory function, or for any other local benefit tending to increase the value of the property with respect to which the payments are made. The third provision was an indirect reference to tax assessments, which were dealt with in the 1994 Proposed Regulations under the tax assessment bond exception to the private loan test. Under the private loan test, an assessment was defined as an enforced contribution imposed and collected for the purpose of raising revenue to be used for a specific purpose (that is, to defray the capital cost of an improvement). The 1994 Proposed Regulations provided that assessments “must be levied on a property frontage basis, an ad valorem basis, or in any other comparable method that results in equivalent mandatory assessment to all residents benefiting from the improvements in an amount proportionate to the benefit to the assessed property.”

The Service and Treasury received a substantial number of comment letters, many of them related to the tax assessment provisions, but also to the generally applicable taxes and PILOT provisions. These comments were generally to the effect that the 1994 Proposed Regulations were overly restrictive and would undermine the flexibility of legitimate financing vehicles in many States. According to the Preamble to the 1997 Final Regulations, the regulations were revised with respect to PILOTs and generally applicable taxes to make the rules “more flexible for arrangements that reduce the amount of tax paid and permit a wider range of tax equivalency payments.”<sup>8</sup> To provide this flexibility, the 1997 Final Regulations made the following changes:

1. The provision dealing with generally applicable taxes was revised to treat as a permissible arrangement an agreement to reduce or limit the amount of taxes collected to further a bona fide governmental purpose, citing as an example an agreement to abate taxes to encourage a property owner to rehabilitate property in a distressed area.

---

<sup>8</sup> 62 Fed. Reg. 2279 (January 16, 1997).

2. The 1997 Final Regulations eliminated the “measured by and equal to” language in favor of permitting payments “commensurate with” the amounts imposed by a regular statute for a tax of general application.

3. In the tax assessment area, the regulations dropped the specific methods of calculating payments that were deemed proportionate to the benefit and looked instead to whether the terms of payment of the tax or assessment are the same for all taxed or assessed persons.

4. PILOTs imposed by contract (rather than by statute) were permitted.

*Recent Private Letter Rulings.* This legislative and regulatory history, together with the 1997 Final Regulations, now have guided the analysis of issuers and their counsel for the past ten years for transactions that involve taxes, PILOTs and assessments. In fact, the Service took this legislative and regulatory history into account as recently as 2006 in issuing two private letter rulings regarding the treatment of certain payments in lieu of taxes in connection with two sports stadiums (PLR 200640001 (July 11, 2006) and PLR 200641002 (July 19, 2006), collectively the “Stadium Rulings”). In these rulings, the Service discussed the history of the “measured by and equal to” standard and the “commensurate with” standard, specifically noting the change to the “commensurate” standard when the 1997 Final Regulations were published. In the Stadium Rulings, the Service looked to the general dictionary definition of “commensurate” and the regulatory history, to conclude that “commensurate with” is more appropriately defined, not as equal in measure, but as “corresponding to or proportionate in measure.”

The Stadium Rulings described how the issuer determined the amount of PILOTs and the various factors it considered in reducing the PILOT. In each case, the Service ruled that this method satisfied the so-called “commensurate” standard. The Section questions whether these considerations would satisfy the commensurate standard in the Proposed Regulations, because the issuer considered the benefits expected to be received from the projects generating the PILOTs and what it would take to induce the private users to complete the projects on a basis that would secure those benefits. The issuer in each of those cases did not calculate the tax under the very specific parameters of the commensurate standard under the Proposed Regulations.

The detailed commensurate standard in the Proposed Regulations does not comport with the announced purpose of the 1997 Final Regulations to permit a wider range of tax equivalency payments. Rather, the proposed commensurate standard falls into the trap of the 1994 Proposed Regulations of being intrusive by specifying the calculation of a State or local tax and eliminating flexibility by limiting the ways that the standard can be satisfied.

The Section believes that the Service took the correct approach to focus on the nature of the payment as a tax with respect to PILOTs in the 1997 Final Regulations and in its interpretation of the regulations in the Stadium Rulings.

*Recommended Alternative Language.* While the Section believes that the existing PILOT regulations are consistent with the legislative and regulatory history, we have provided alternative language to respond to the Service and Treasury concern that the existing standards could potentially be interpreted in an unduly broad manner to allow favorable treatment for PILOTs that may have an insufficient link to generally applicable taxes. The Section respectfully recommends that, if the government believes change is required, the language of the current regulation be revised to require that the tax equivalency payment or PILOT be made pursuant to an arrangement put in place because of a modification under State law of a generally applicable tax and the payment be no greater in any year than the generally applicable tax that would have been due in the year had no exemption applied. The specific language for your consideration is as follows:

Reg. § 1.141-4(e)(5). Payments in lieu of taxes. --- 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 made pursuant to an arrangement put in place because of a modification (including an exemption) under State law of a generally applicable tax; and
- (ii) The payment is not greater in any year than the generally applicable tax that would have been due in that year had there been no modification (including an exemption); and
- (iii) The payment is designated for a public purpose by a governmental entity that is a party to the arrangement and is not a special charge (as described in paragraph (e)(3) of this section).

The Section believes that this regulatory language is administrable because issuers can document the applicable statutory basis that provides the Service with the ability to review the payments in any particular situation against the identified generally applicable tax and exemption, while preserving the flexibility in the actual calculation of the tax essential to State and local governments in the administration of their own tax systems. This recommended language retains the prohibition against treating special charges as tax equivalency payments or PILOTs, which is an important tool in applying these Regulations.

## 2. The approach of the Proposed Regulations is contrary to the purpose of PILOTs

The formulaic approach of the commensurate standard of the Proposed Regulations frustrates the historical purposes behind the development of PILOTs and reduces the ability of State and local governments to tailor economically equivalent subsidies to address local needs and resources. The Section believes that focusing on the nature of the tax rather than on the actual calculation of tax equivalency payments or PILOTs is consistent with the historical development of PILOT agreements. PILOTs have typically arisen either because a State or local entity was required to take title to certain economic development projects in order to avoid legal prohibitions on the lending of public credit for private purposes, or because the jurisdiction provided certain

charitable property with a property tax exemption for activities that produced a public benefit. In both cases, the property was no longer on the tax rolls.

*Prohibition Against Lending of Public Credit.* The first problem, the prohibition against lending of public credit, is an older one. It has its roots in the era of defaulted bonds issued by municipalities to make loans to private companies to finance railroad construction more than 150 years ago. When a number of State courts agreed with the claim of municipalities that the issuance was *ultra vires* because the bonds involved the lending of public credit for private purposes, many States passed constitutional bans limiting the ability of a government to make loans to private entities absent a finding of public purpose. In other States without such a constitutional ban, their courts reached the same result by holding that there was an absence of authority to make such loans.

To avoid even the appearance of lending of governmental credit while permitting tax-exempt financing for economic development, some States enacted a structure whereby the governmental issuer (or a separate authority or controlled nonprofit corporation) would acquire the land, build and own the project and lease it to the private entity. This approach, however, automatically removed the governmental property from the real estate tax rolls under long-standing exemptions for such property. To remedy this automatic removal, the issuers were authorized (or directed) to negotiate a payment in lieu of the real estate taxes that had been lost.

These PILOTs were individually negotiated. The calculation of the amount of the payments to be made and when they were to be paid depended on the amount of the subsidy the governmental entity whose taxes had been eliminated had to offer in order to ensure that the prospective user would come to that jurisdiction. The timing of the payments also varied depending on the immediate revenue needs of the governmental entities. The one consistent feature was that the amount of the PILOT was less than the taxes that would have been paid, because the whole process was designed to induce a business to locate in the jurisdiction. Different jurisdictions accomplished this through different means, including freezing the assessed value of the property at an agreed-upon value; freezing the rate of taxation; imposing a payment that was only a percentage of either the assessed valuation or the tax rate; and phasing in an increasing assessed valuation or tax rate to reflect the phase-in of the profitability of a new plant. Any particular PILOT could be based on one or more of these variations.

*Charitable Property with Property Tax Exemption.* The second type of PILOT, for charitable exemptions, stems primarily from the physical expansion of museums, medical facilities and educational institutions within jurisdictions, with a concomitant increased demand on resources for public safety, maintenance and public infrastructure that were traditionally funded in whole or in part by taxes from which these entities had been exempted. While many jurisdictions generally cannot assess the real estate taxes required to pay for these services, over time some of these organizations have agreed, for any number of reasons, to enter into PILOT agreements with their governmental hosts.

PILOT payments for charitable entities also tend to be individually negotiated. The amount of the payments is generally computed with at least some regard to the cost

of the services being provided, in part because it may otherwise be difficult to estimate with any degree of accuracy what the valuation of the otherwise taxable real estate of a charity should be. The amounts payable through PILOTs in these instances are the result of negotiations, which take into account the services provided, the ability of the organization to pay for them and the value of the charitable or public purposes provided by the organization that the jurisdiction does not have to pay for or provide.

*Equivalency of PILOT Payments.* PILOT payments have been used historically in the same way that a jurisdiction used receipts from real estate and other taxes. In some cases, as illustrated in the Stadium Rulings, the PILOT payments may be used to support projects financed with tax-exempt bonds that the government has determined would serve the public interest. Those bonds satisfied the private use test but were deemed to fail the private security or payment test in the same manner as bonds supported by generally applicable real estate taxes would fail the payment test. Both historically and pursuant to current practice, PILOTs are imposed and negotiated in the same manner, whether used to repay tax-exempt bonds or in conjunction with other incentive packages the State or local government plans to implement.

PILOTs are only one component of a very complex, evolving panoply of revenue raising and expenditure options that a State or local government must balance. When a specific tax, such as a real estate tax, becomes unpopular or controversial, the State or local government may increase sales taxes or deed recordation taxes to pay for some of the services previously financed with real estate taxes. When the budget will not cover grants to for-profit organizations that provide specialized job training programs, the local government may offer property tax abatement or a short-term PILOT agreement. The Section is concerned that the commensurate standard will create inequality under the federal tax regulations among economically equivalent structures, skewing State and local decision making when tax-exempt bonds are involved. If a project may be financed on a tax-exempt basis through bonds supported by partially abated incremental taxes, then it should be able to be financed on a tax-exempt basis through bonds supported by payments in lieu of, but equal to, such partially abated incremental taxes.

Once a State or local jurisdiction decides to subsidize a project, either as a way to generate more revenues through economic development or to provide more public benefits through increasing the resources of charitable organizations, it may adopt any of several structures with substantially identical economic consequences. For example, if the mayor and city council desire to encourage the building of affordable, workforce housing in a city for the benefit of teachers and first responders, they may choose to subsidize that project in any of the following ways: (1) sell city property to the developer at below market value, foregoing additional general revenues that could have been derived from the sale of the land at full value for an alternate use; (2) provide direct cash subsidies from its general tax revenues to the private owner to pay operating expenses that reduce rents, while maintaining the project on the tax rolls and fully subject to real estate taxes, sales and other excise taxes; (3) maintain the project on the tax rolls but provide for partial abatement of real estate, utility or other taxes; (4) exempt the property from the general real estate taxes to provide the public benefit of workforce housing but require that the private owner make payments in lieu of taxes in accordance with a

negotiated schedule that reflect the benefit provided to the city by the project; (5) make an annual grant from general tax revenues to subsidize rents; or (6) leave the property on the tax rolls, but pay for all or a portion of the capital cost of the project by making a direct grant from the proceeds of tax increment bonds derived from incremental real property taxes.

In each case, the local government has provided an incentive to the private developer to undertake the project by reason of the resulting reduced net tax burden on the developer or reduced net costs to the city. Each of these structures can be employed to produce the same economic consequences; but from the perspective of the local government, the choices may not be fungible given the status of local law, politics, budgetary conditions or the timing of competing demands. A PILOT may be offered instead of a grant or direct governmental assistance, because it is more feasible for the jurisdiction to lose revenue over a 10-year PILOT period than to provide a grant from current revenues.

The 1997 Final Regulations gave PILOTs the same exclusion from private payment classification that is available with respect to the generally applicable taxes in lieu of which they are made. The flexibility that characterizes the treatment under existing Regulations on abatements should be similarly permitted for PILOTs, regardless of whether they are calculated under a formula or in accordance with negotiated schedules; provided that, like a partially abated tax, the PILOT does not exceed the tax and is imposed pursuant to a general taxing statute, including specific exceptions. Regardless of the political, legal or other reason that a PILOT financing structure is selected over other potential options, if that financing could be accomplished on a tax-exempt basis when supported by real estates taxes, that same financing should be permitted when supported by PILOTs. In other words, the federal tax rules should not dictate the structure of the transaction when there are valid governmental purposes dictating the selection from among alternative taxing structures.

Given the way that PILOTs came into being and have matured, the Section believes that any agreement under which the PILOT is established must apply to the same property or activity that would have been subject to the generally applicable tax. This approach ties the PILOT to the tax it is in lieu of, without unnecessarily imposing the mechanics of the inapplicable tax statute to the mechanics of the PILOT.

### 3. The proposed commensurate standard would not be administrable

The great variety of existing taxes, combined with evolving views on what constitutes public purposes and creative sources of revenues and taxes, make it impractical to develop an administrable commensurate standard. The Proposed Regulations do not take into account the enormous variety of arrangements for computing taxes and PILOTs. The Section recognizes the efforts of Treasury and the Service to draw from some existing methods for calculating payments in lieu of real estate taxes in formulating its commensurate standard in the Proposed Regulations. However, these limited permitted variations to the uniform method of calculating real estate taxes, all of which apparently must be met to fall within the commensurate standard, would

immediately exclude many existing PILOTs negotiated under a jurisdiction's taxing authority, including those approved in the Stadium Rulings. The Service and Treasury requested public comment regarding whether any special rules are needed to address PILOTs based on other taxes, including sales taxes. One need only look at the index of the volume in each of the State codes set aside for taxes to get a sense of the great variety of taxes that State and local governments use to generate revenues, each with its own set of exemptions. The base for each of these taxes varies, so to develop a set of standards to establish that any PILOT or abatement of the tax is commensurate would likely result in voluminous regulations. Such an endeavor would require continuous updates as new generally applicable taxes and abatements or PILOTs are put into place.

Whether written as safe harbors or as examples to illustrate a stated general calculation standard, the approach taken in the Proposed Regulations to define the commensurate standard is not likely to achieve clarification. The adoption of the commensurate standard will be disruptive in the many cases where existing State or local PILOT statutes meet all but one of the factors described in the discussion of the commensurate standard, and will generate uncertainty in the market for any bonds involving the pledge of payments in lieu of taxes that may evolve in the future. Accordingly, the Section respectfully recommends that the commensurate standard be withdrawn because it would be unadministrable by issuers and the Service.

#### 4. The Regulations provide the necessary framework to determine PILOTs

The language in the Regulations, which excludes “special charges” from the definition of both PILOTs and generally applicable taxes, provides sufficient guidance for issuers and the Service to determine whether payments are private payments. Further, although Reg. § 1.141-4(e)(3) does not cross reference section 164, it paraphrases the essential elements used under this more general tax provision. The Section believes that the principles developed under section 164, which look at the nature of the payment, provide the necessary flexibility to distinguish the wide variety of taxes and payments in lieu of taxes that may be pledged to repayment of a tax-exempt bond financing from private payments.

Under general tax principles, a tax is considered to be “distinguishable from other various charges for particular purposes under particular powers or functions of government. In view of such distinctions, the question of whether a particular charge is to be regarded as a tax depends on its real nature. If it is in the nature of a tax, it is not material that it be called by a different name; conversely, if it is not in the nature of a tax, it is not material that it be so called.”<sup>9</sup>

In Rev. Rul. 71-49, 1971-1 C.B. 103, the Service concluded that an amount paid by a taxpayer to a taxing authority 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, is not a tax that is deductible under section 164 or its predecessor. Reg. § 1.141-4(e)(3) draws from Rev. Rul. 71-49, stating that “[a] payment for a special

---

<sup>9</sup> Rev. Rul. 61-152, 1961-2 C.B. 42.

privilege granted or a service rendered is not a generally applicable tax. Special assessments made by property owners benefiting from financed improvements are not generally applicable taxes. For example, a tax or payment in lieu of tax that is limited to the property or persons benefited by an improvement is not a generally applicable tax.”

The Regulations under section 164 distinguish between taxes that provide a targeted benefit and taxes that are levied for the general public welfare. Reg. § 1.164-4(a) provides:

So-called taxes for local benefits such as street, sidewalks, and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied are not deductible as taxes. A tax is considered assessed against local benefits when the property subject to the tax is limited to the property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The real property taxes deductible are those levied for the general public welfare by the proper taxing authority at a like rate against all the property in the territories against which such authorities have jurisdiction.<sup>10</sup>

The authorities are clear that certain types of payments are not taxes *per se*, but they do satisfy the requirements set forth under the Code to be considered “generally applicable taxes” for purposes of section 164. Those payments have certain characteristics that allow them to be treated as if they were taxes eligible to be deducted by the taxpayer under section 164. These principles are set out in more detail in Rev. Rul. 71-49.

In Rev. Rul. 71-49,<sup>11</sup> a property had been removed from the tax rolls pursuant to State law by virtue of its ownership by a local government agency. The law also provided that in certain situations where property was exempt, but the property comprised an improvement other than a school, the agreement pursuant to which the non-school property could be occupied had to provide for “the payment to the [local governmental agency] 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 . . . [non-school property].” The purpose of this provision was to

furnish the [local governmental agency] with the monies necessary to meet debt service on obligations . . . issue[d] 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 [c]ity . . . collecting the real estate taxes on the space rights covered by the leasehold and then paying a rental to the [local governmental agency] in an amount sufficient for it to meet its obligations, a direct tax equivalency payment was utilized.<sup>12</sup>

---

<sup>10</sup> See also Reg. § 1.141-5(d)(2) describing certain circumstances in which tax assessment loans will not be considered private loans.

<sup>11</sup> 62 Fed. Reg. 2279 (January 16, 1997).

<sup>12</sup> *Id.* at 103.

Rev. Rul. 71-49 concluded that there was no substantive difference between the tax equivalency payment and the traditional real estate tax that would have been paid but for the tax exemption afforded the property. The tax equivalency payments would be considered taxes eligible to be deducted under section 164, even if paid directly to the local governmental agency, a public benefit corporation, rather than to a governmental revenue fund because such payments were (1) measured by and equal to amounts imposed by the regular taxing statutes, (2) themselves imposed by a specific state statute (even though a lease agreement was used as the vehicle of collection), and (3) the proceeds were designated for a public purpose rather than for some privilege, service or regulatory function, or some other local benefit tending to increase the value of the property upon which the payments were made. This language formed the basis of the 1994 Proposed Regulations on PILOTs, as later modified by the 1997 Final Regulations.

PILOTs afforded treatment as taxes eligible for deduction under section 164 have been payable where the local government is seeking to recapture all or a part of the revenue lost as a consequence of certain property being exempt under a particular statutory provision intended to achieve a local benefit. The private letter rulings issued since Rev. Rul. 71-49 all involved similar situations.<sup>13</sup> In these cases, land was exempt from real property taxes by application of a State or local governmental legislative pronouncement, was used by a private business user, and State or local legislation provided for a recapture mechanism whereby the tax revenues that would otherwise have been lost to the local governmental unit were recovered and dedicated to a general public use, similar to the payment of the cost of school construction described in the revenue ruling. Each of the private letter rulings carefully distinguishes the payment of the tax equivalent amount from “a charge imposed 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.”<sup>14</sup>

In addition, in each instance but one, the payment was assessed at a like rate against all property in the territory over which the taxing authority in question had jurisdiction. In PLR 9109030 (Nov. 30, 1991), a payment in lieu of real estate taxes was determined to be deductible to the same extent as the real estate taxes in lieu of which such payment was assessed, but only to the extent that such payment exceeded the amount of the real estate tax that could be levied against the property. Notwithstanding the fact that the payment was deposited to a local government agency and applied to pay the costs of that agency, including to pay the debt service on tax-exempt bonds issued to pay the cost of providing infrastructure in the area over which the agency had

---

<sup>13</sup> See PLR 200025043 (Mar. 27, 2000); PLR 9515035 (Jan. 17, 1995); PLR 9150056 (Sept. 12, 1991); PLR 9029057 (Apr. 25, 1990); PLR 8632030 (May 13, 1986); PLR 8139097 (June 30, 1981).

<sup>14</sup> See *e.g.*, PLR 200720016 (Feb. 12, 2007), in which the Service concluded that certain PILOT obligations satisfied the three-pronged test of Rev. Rul. 71-149 and therefore constituted real property taxes allowable as a deduction under section 164. State law created a community development authority and provided that residential leases in the applicable project area were subject to tax equivalency payments. The payments were amounts equal to the product of the assessed value of the parcel and any improvements multiplied by the city’s real property tax rate, less the amount of any otherwise applicable tax exemptions or abatements.

jurisdiction, the payment was determined not to be an assessment paid for local benefits, such as street, sidewalks, and other like improvements, and was thus deductible as a tax.

The Section believes this line of guidance under section 164 lends support to the premise that PILOT payments that are the economic equivalent of payments made under general taxing statutes to raise revenues for general purposes are not special charges. Payments that exceed the amount that would otherwise be imposed under the general tax, or that are measured by special benefits, are special charges. The Section believes that the general principles and specific criteria developed under section 164 and indirectly incorporated into the Regulations to determine whether a payment in lieu of tax may qualify as a “generally applicable tax” for purposes of Reg. § 1.141-4(e)(2) are sufficient without changes. The fact that the Service has developed a body of law dealing with taxes under other Code sections provides further foundation for both bond counsel and the Service when addressing whether any specific payment is a private payment.

#### 5. The Regulations should apply prospectively

The Section respectfully requests that Treasury and the Service announce that the proposed effective date will be modified to apply to bonds sold after the regulations are finalized. The Proposed Regulations represent a departure from existing Regulations that have been in place for ten years that affect many transactions in the municipal market. Changes should apply only after careful consideration of public comments and the regulations are finalized.

The proposed effective date of the Proposed Regulations is for bonds sold on or after February 19, 2007. The Section believes it is of critical importance that Treasury and the Service announce, as soon as possible, that any changes made to existing Regulations will apply to bonds sold after the date of publication of final regulations. The Section is concerned that the proposed effective date will cause confusion in the municipal markets and will have a chilling effect on the sale and marketing of any bonds secured by PILOTs, regardless of whether they meet the standards in the Proposed Regulations or the existing Regulations. Further, for the fair and consistent administration of the tax laws, the Section believes that restrictive changes made to Regulations that have been in place for ten years should be implemented only after thorough consideration of public comments.

The proposed effective date is a departure from the typical effective date for tax-exempt bond regulations. Proposed Regulations on a wide variety of topics related to tax-exempt bonds, including natural gas prepayments, guaranteed investment contracts (“GICs”) and broker fees, private activity bond refunding, remedial actions for qualified zone academy bonds, refunding/acquisition rule under section 150, allocation and accounting, the definition of sewage and the definition of solid waste, have all had proposed effective dates for bonds sold on or after 60 days after publication of final Regulations. Thus, even in areas where the Service and Treasury may have had concerns about perceived abuses raised in audits, such as natural gas prepayments and GIC bidding, the Service did not propose to apply new rules prior to finalizing the regulations.

The announcement of a proposed effective date that fell only a short time after the published comment deadline and public hearing date conveys the message that State and local governments issue at their peril if they do not conform to rules that have not been fully subject to the public comment process. The premature effective date also adversely affects the decision of potential purchasers. While the Preamble characterizes the Proposed Regulations as a “clarification” of the existing regulations, they represent a narrow interpretation contrary to recent private letter rulings, which contained extensive discussions of the legislative history and interpretation of the Regulations. The Section recommends that the public comment process be respected, and that the Service and Treasury announce the postponement of the effective date for any changes to the Regulations to bonds sold on or after 60 days after the date of publication of final Regulations.

The Section recommends the following language for any final Regulations:

“The rules of Reg. § 1.141-4(e)(5) apply to bonds sold on or after [Insert date 60 days after the date of publication of final Regulations], that are subject to section 141.”