

June 12, 2002

RE: Request for a Ruling on RPTL §420-a Exemption

FLR-024794-003

Dear _____ :

This is in response to your ruling request as to the tax-exempt status of property used exclusively as a school facility, to be held by single-member LLC with _____ as the sole member.

FACTS:

_____ is a private, not-for-profit school organized exclusively for charitable and educational purposes. The school provides a comprehensive curriculum to students from pre-K to 12th grade. Since _____, _____ has been tax exempt pursuant to IRC § 501(c)(3). _____ currently owns property located at _____ Street used exclusively for educational purposes that is fully exempt pursuant to RPTL §420-a.

_____ is constructing a new school facility on property it recently acquired, located at _____ Street and _____ Street. To finance this project, _____ will cause a single member LLC (with _____ as the sole member) to enter a financing arrangement with lenders using the _____'s currently exempt property at _____ Street (the "Mortgaged Property") as security. The financing will consist of a loan and/or a letter of credit. To isolate the security from other potential liabilities, the lender requires (1) that the Mortgaged Property be owned by a single member LLC with _____ as the sole member; and (2) that the LLC's operating agreement limit its activities to acquiring, owning, holding, financing, mortgaging and otherwise dealing with the mortgaged property. _____ will continue to occupy the Mortgaged Property and use it exclusively as a school facility. The LLC will be disregarded for federal income tax purposes. Its assets, income and operations will be reported by _____ on its annual returns.

ISSUE:

Whether real property owned by a not-for-profit educational organization and used exclusively for educational purposes may retain its exemption pursuant to RPTL §420-a where such property

is transferred to a single-member limited liability company (“LLC”) with the not-for-profit educational organization as its sole member?

CONCLUSION:

Based on the facts provided, the Mortgaged Property would continue to be exempt from real property tax while held by a single-member LLC for financing purposes, where the single member is the not-for-profit , and the property continues to be used by exclusively as school facility. Provided that the LLC meets the criteria established below and the property, based on ownership and use, would otherwise qualify for a § 420-a exemption, the organizational form would not preclude exemption.

DISCUSSION:

RPTL § 420-a provides tax exemptions for mandatory classes of not-for-profits as follows:

[r]eal property owned by a corporation or association organized or conducted exclusively for religious, charitable, hospital, educational, or moral or mental improvement of men, women or children purposes or for two or more such purposes, and used exclusively for carrying out thereupon one or more of such purposes either by the owning corporation or association provided shall be exempt from taxation as provided in this section.

As the statute specifically requires ownership, the first issue is whether an LLC is a “corporation or association organized or conducted exclusively for” an exempt purpose pursuant to RPTL §420-a. An LLC is defined by §102(m) of the NYS Limited Liability Company Law (LLCL) as “an unincorporated organization of one or more persons having limited liability for the contractual obligations and other liabilities of the business other than a partnership or trust, formed and existing under this chapter of the laws of the state.” In Mohonk Trust v. Board of Assessors of Town of Gardiner, 47 N.Y.2d 476, which held that a trust was an association within the meaning of §421 (predecessor to §420-a), the Court of Appeals found that “[w]hatever the meaning of the term ‘corporation or association’ in another context, the phrase has long been understood in tax exemption statutes of this sort . . . simply to indicate that the particular organization granted the exemption need not be incorporated. Although the word “corporation” is strictly defined in the law, the word ‘association’ is a broad term which may be used to include a wide assortment of differing organizational structures including trusts, depending on the context.” 47 N.Y.2d at 482-83. Therefore, the term ‘association’ appears broad enough to include a limited liability company.

IRS regulations permit a single-member LLC to be disregarded from its owner for federal income tax purposes, in which case the entity would be “treated as a branch or division of the owner. Therefore, an owner that is exempt from taxation under section 501(a) of the Internal Revenue Code must include, as its own, information pertaining to the finances and operations of a disregarded entity in its annual information return.” IRS Announcement 99-102 (Oct. 13, 1999). Under federal “check-the-box” regulations, a single-member LLC is disregarded unless an election is made to treat it as a corporation. Neither nor the LLC will make this election

and for federal tax purposes, the school will be treated as though owned it directly. Thus, for federal tax purposes, the single-member LLC will have no tax status of its own and will be treated as a branch of an exempt educational institution.

Where a separate not-for-profit “operates solely to carry out a purpose of the exempt corporation” and the property is used exclusively to benefit a separate exempt organization, the Court of Appeals has held that property may be exempt under §420-a, even though title is held by a related not-for-profit organization. St. Joseph’s Properties v. Srogi, 541 N.Y. 127, 129 (1980). Although here the related organization is a single-member LLC, not a not-for-profit corporation, the reasoning remains applicable. “While exemption statutes should be construed strictly against the taxpayer seeking the benefit of the exemption, an exemption so literal and narrow that it defeats the exemption’s settled purpose is to be avoided.” Symphony Space v. Tishelman, 60 N.Y.2d 33 (1983).

It must be considered, however, that the LLC is not statutorily a not-for-profit entity. LLCL §202 states that “[a] limited liability company may be formed under this chapter for any lawful business purpose or purposes” The term “business” is defined as “every trade, occupation, profession or commercial activity.” LLCL §102 (e). The Practice Commentary to the LLCL notes that “[a]lthough the LLCL does not expressly prohibit the formation of not-for-profit LLCs, the definition of ‘Business’ in Section 102(e) . . . suggests that the drafters intended that LLCs form for pecuniary profit.” LLCL, Practice Commentary at 7 (McKinney 2001-02). Accordingly, to retain the exemption, the LLC’s articles of organization and/or operating agreement, as appropriate, should provide an organizational purpose consistent with §420-a and specify that the LLC could not receive pecuniary profit or otherwise operate in any manner inconsistent with a not-for-profit organization.

Therefore, property owned by a single-member LLC, where the single-member is a not-for-profit educational organization, may qualify for an RPTL § 420-a exemption where the applicant establishes that:

1. The LLC’s sole member qualifies for §420-a exemption. The LLC must also show that it is effectively a not-for-profit entity, organized or conducted for §420-a purposes.
2. The articles of organization and/or operating agreement, as appropriate, must state there will be no pecuniary profit and the LLC will operate for not-for-profit purposes consistent with §420-a.
3. There must be commonality between the management of the LLC and its single member;
4. The property must be managed and maintained by the single-member; and
5. Rent may not exceed carrying, maintenance and depreciation charges as specified in §420-a.
6. Upon termination of the LLC, the property must revert to or another exempt entity. Also, transferring any interest in the LLC to a non-qualifying will result in loss of exemption.

7. The LLC and _____ annually file an affidavit stating that there has been no change in the LLC's beneficial ownership, which will be in addition to the certifications of continuing use otherwise required by the Department.

Upon transfer of the Mortgaged Property to the LLC, a new §420-a application must be filed with the Exemptions Unit. Based on the facts provided and assuming the criteria established above are satisfied, the property would qualify for exemption under the educational category of RPTL §420-a. The foregoing conclusions are based solely on the facts set forth above as provided to the Office of Legal Affairs. The Department of Finance reserves the right to review the information submitted.

Sincerely,

Devora Cohn
Associate Commissioner
Office of Legal Affairs

cc: Commissioner Martha E. Stark
Bruce Brasky
Robert Dauman

DJ: dj