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March 4, 2003

RE: *Qualification for exemption under section 214, subdivision (g) of lower-income housing property owned and operated by separate limited partnerships*

Dear Ms. _____ :

This is in response to your letter of August 15, 2002, in which you submitted agreements of limited partnership and related documents in support of exemption claims filed by the _____ (SBHAC). SBHAC is the managing general partner of the _____, Ltd. Limited Partnership, the owner of a lower-income rental housing property, the _____ Apartments, located at _____ (APN _____) in the City of _____. SBHAC has filed welfare exemption claims on behalf of this property for fiscal years 1998-1999, 1999-2000 and 2000-2001 under subdivision (g) of section 214 of the Revenue and Taxation Code.¹ For the reasons discussed below, this property does not meet the requirements for exemption under section 214, subd. (g).

Relevant Factual Background

SBHAC was organized on September 27, 1996, as a California public benefit corporation, and is exempt from federal income tax and state franchise and income tax under the respective code sections (Internal Revenue Code §501(c)(3); Rev. & Tax. Code § 23701d). SBHAC became the managing general partner of _____, Ltd. Limited Partnership pursuant to the Amended and Restated Limited Partnership Agreement of _____ Ltd. Limited Partnership, effective November 1, 1998.

The low-income housing properties of qualifying limited partnerships exempt under subdivision (g) of section 214, without exception, have been owned and operated by a sole limited partnership, with a qualified nonprofit corporation as the managing general partner. However, in this case, two limited partnerships are involved in the ownership and operation of the property. The _____, Ltd. Limited Partnership (hereinafter “K I LP”) is the owner and landlord/lessor, and _____ II Limited Partnership (hereinafter “K II LP”) is the tenant and lessee/operator. In your letter of August 15, 2002, you indicate that the

¹ All section references are to the Revenue and Taxation Code unless otherwise indicated.

involvement of two limited partnerships in this property is to facilitate restructuring the owner's substantial debt.

LAW AND ANALYSIS

I. Rental housing and related facilities owned by a limited partnership may qualify for exemption under subdivision (g) of section 214, notwithstanding the fact that its property is operated by another limited partnership, but both limited partnerships must meet all the requirements for exemption.

Subdivision (a) of section 214 provides, in relevant part, that property used exclusively for religious, hospital, or charitable purposes, owned and operated by qualifying organizations organized and operated for such purposes is exempt from taxation if all the requirements for exemption are met. In *Christ The Good Shepherd Lutheran Church v. Mathiesen* (1978) 81 Cal.App.3d 355, the court held that the phrase, "owned and operated," as used in section 214, subdivision (a), does not require ownership and operation of the property by the same legal entity. That provision "merely reflects the dual constitutional requirements that the property must be both owned and operated by welfare organizations in order to qualify for the exemption." (*Christ the Good Shepherd Lutheran Church, supra* at page 362; Article XIII, § 4, subd. (b)) Thus, the owner of property may qualify for the exemption, notwithstanding the fact that its property is used by another organization, but both organizations must meet all the requirements for exemption, and the property must be used for qualifying purposes. In that regard, the Assessor's Handbook AH 267, Welfare Church and Religious Exemptions, April 2002, provides the following guidance:

In general, if the owner of the property is a qualifying claimant, the property may be leased to another organization to operate without losing its exempt status, provided that the lessee also meets the requirements and files a claim for the welfare exemption. (page 14)

With respect to rental housing and related facilities, subdivision (g) of section 214 provides exemption for:

"[p]roperty used exclusively for rental housing and related facilities owned and operated by religious, hospital scientific or charitable funds, foundations for corporations, including limited partnerships in which the managing general partner is an eligible nonprofit corporation meeting all the requirements of this section."
(Emphasis added)

Thus, section 214, subdivision (g) requires a low income housing property to be both owned and operated by a qualifying entity. Moreover, this statute is specific concerning the type of limited partnership that may be eligible to receive the exemption on its lower-income housing property, it must be a limited partnership with an eligible nonprofit corporation as its managing general partner.

The Assessors' Handbook Section 267 Welfare, Church and Religious Exemptions April 2002, (hereinafter "Handbook") provides in that regard:

Subdivision (g) of section 214 allows for a two-entity operational structure, where one entity, a limited partnership, owns the property used for low-income housing and another entity, an eligible nonprofit corporation, is the managing general partners of that limited partnership. This two-entity structure must be reflected in both the terms of the limited partnership agreement and in the statement of limited partnership filed with the Secretary of State's office.

* *

Even if the limited partnership requirements are met, the exemption under section 214(g) applies only if and when its managing general partner is an "eligible nonprofit corporation."(page 73)

Accordingly, we conclude, that rental housing and related facilities owned by a limited partnership and operated by another limited partnership may qualify for exemption under subdivision (g) of section 214, but both limited partnerships must meet all the requirements for exemption. Our conclusion is consistent with the above-cited judicial precedent and the actual language of section 214, subdivision (g). Thus, a qualifying limited partnership for purposes of the exemption: (1) has an eligible nonprofit corporation as the managing general partner; (2) the limited partnership agreement designates such nonprofit corporation as the managing general partner; and, (3) the agreement provides the nonprofit managing general partner with management authority over the partnership operations, and specific management duties. In addition, both the owner of the property, and the operator of the property must file claims for the exemption. The nonprofit managing general partner of a limited partnership is the sole legal entity (claimant) authorized to file an exemption claim.

A. The owner of the property is a limited partnership, as specified in section 214, subd. (g).

As noted above, the K I LP is the property owner. The Amended and Restated Limited Partnership Agreement of the K I LP designates an eligible nonprofit corporation as its managing general partner, SBHAC. As such, K I LP is a limited partnership, as specified by section 214, subd. (g). An analysis of the managing general partner's management authority is discussed separately below.

B. The operator of the property is not a limited partnership, as specified in section 214, subd. (g).

The lessee/operator of the property is the K II LP. The II, Limited Partnership Agreement of the K II L.P., effective as of October 20, 1998, does not designate a nonprofit corporation as its managing general partner. The sole general partner is KPS K -2, Inc., a for-profit California corporation. The Amended and Restated Agreement of Limited Partnership of the K II L.P., effective as of May 3, 1999, and subsequent amendments thereto (First, Second and Third) also do not designate a nonprofit corporation as

the managing general partner of the limited partnership. As such, the operator of the property is not a limited partnership, as specified by section 214, subd. (g).

As discussed above, the lower-income housing property of a limited partnership may qualify for exemption, although its property is operated by another limited partnership, but both limited partnerships must meet all the requirements for exemption. Accordingly, we conclude that this property is not eligible for exemption under section 214, subdivision (g) as the lessee/operator [K II LP] is not a limited partnership as specified by section 214, subdivision (g).

II. The agreement provides broad management authority and specific management duties to SBHAC, which may satisfy the managing general partner requirement under subdivision (g) of section 214, provided that the limited partnership agreement is amended to add an acceptable delegation clause.

SBHAC became the managing general partner of K I LP, pursuant to the Amended and Restated Limited Partnership Agreement of K I LP (hereinafter "Agreement"), effective November 1, 1998. The limited partnership also has an Administrative General Partner, the KPS K I, LLC, and numerous limited partners comprising four classes.

Section 3.2 of the Agreement provides a broad grant of authority to the managing general partner. This provision states, in relevant part, that the overall management and control of the business, assets and affairs of the partnership shall be vested in the managing general partner, subject to the specific delegation of duties to the administrative general partner and specified limitations.

Section 11.1 has language similar to section 3.2 as to the managing general partner's authority to manage the partnership operation and business. This provision states that the management and control of the partnership and its affairs and business shall rest exclusively with the managing general partner, subject to specified limitations, referencing again "the specific delegation of duties to the Administrative General Partner set forth in this agreement." The agreement, however, does not indicate which [management] duties the managing general partner has delegated to the administrative general partner.

Section 11.1 further provides that the managing general partner shall have all the rights and powers that may be possessed by a general partner pursuant to section 15643 of the Act, and such rights and powers as are otherwise conferred by law or are necessary, advisable or convenient to the management of the Partnership's business and affairs. Subsections 11.1-11.1.11 enumerate major decisions authorized to the managing general partner, subject to the rights of the other partners and specified limitations. The managing general partner is also authorized to obtain financial information necessary for claiming the property tax exemption; maintain bank accounts for partnership funds (section 11.6); and, as Tax Matters Partner, cause the proper preparation and filing of tax returns (sections 2.26 and 11.2), and cause the limited partnership to make a tax election (section 9.1).

Section 11.2 provides that, in addition to the duties assigned to the managing general partner elsewhere in the agreement, SBHAC shall monitor the lessee of the property [K II

LP] and its operations to ensure compliance with Tax Credits requirements. SBHAC is paid a compliance-monitoring fee of \$7.00 per unit in the property per month, and additional compensation, as specified. (section 8.6.2).

With respect to the management role of the administrative general partner [KPS K I, LLC], substantially all its management authority, powers, and specific duties are within the agreement's provisions pertaining to the general partners. The general partners' management authority and duties relate to: capital contribution matters (sections 7.8.1, -7.8.3); maintenance of reserves (section 10.3); allocations (section 10.12); maintenance of partnership books and records (section 15.1); accounting and reports (section 15.2); agreement amendment (section 17.11); authority to call meetings (section 17.13); and, authority to sign and deliver on the partnership's behalf any instrument for the purchase of property or interest owned by the partnership (section 17.5). In addition, the general partners' consent is required, along with the consent of the Limited Partners holding a majority of the Partnership Interests held by Limited Partners, to authorize the partnership to engage in any other business (section 5); and to admit additional general partners to the limited partnership (section 7.6).

As noted above, the agreement designates an eligible nonprofit corporation, SBHAC, as the managing general partner, and authorizes broad management authority and several specific management duties to SBHAC. Nonetheless, the agreement is unclear regarding whether SBHAC has sufficient management authority and/or duties to qualify as the managing general partner, as required by section 214, subdivision (g). The agreement provides that SBHAC's management authority is subject to "the specific delegation of duties to the administrative general partner" (sections 3.2 and 11.1), without indicating which duties the managing general partner has delegated to the administrative general partner.² This ambiguity in the agreement is of particular concern because the scope of such delegation will determine whether the agreement provides SBHAC with sufficient management authority to qualify as the managing general partner (section 214, subdivision (g)). In that regard, the Handbook advises that a delegation clause, which authorizes delegation of the managing general partner's entire management authority and/or duties to an administrative general partner, is disqualifying for purposes of the exemption, as the managing general partner retains no decision-making authority over any aspect of the partnership operations. An acceptable delegation clause authorizes the managing general partner to delegate some, but not all its management authority/duties, and requires the managing general partner to remain fully responsible for any delegated duties or responsibilities. (page 78) Accordingly, it is necessary to amend the Amended and Restated Limited Partnership Agreement of the K I LP, to provide an acceptable delegation clause.

III. SBHAC's oversight of the K Village II Limited Partnership's operation of the low income housing property is not qualifying for purposes of the exemption, as SBHAC is not the managing general partner of this limited partnership.

²Some limited partnerships have used separate agreements to grant substantial management authority to a general partner other than the nonprofit managing general partner. In response to my inquiry on this issue, you assert that the K I LP does not have a separate agreement for this purpose.

As noted above, the K Village II Limited Partnership Agreement, the Amended and Restated Agreement of Limited Partnership, and subsequent amendments thereto, do not designate an eligible nonprofit corporation as the managing general partner of this limited partnership. As such, the K II LP is not a limited partnership as specified in section 214, subdivision (g). Nevertheless, the entities involved in the ownership and operation of this property have attempted to structure an alternative means of satisfying the requirements for exemption under section 214, subdivision (g). As noted above, the Amended and Restated Limited Partnership Agreement of the K I LP authorizes the managing general partner (SBHAC) to monitor the lessee limited partnership's [K II LP] operation of the low income housing property, to ensure compliance with tax credit requirements. (section 11.2) SBHAC and the administrative general partner [KPS K I, LLC] of the K I LP also executed a separate agreement for the same purpose. Oversight of a non-qualifying limited partnership operator of the property by the nonprofit managing general partner of the limited partnership, which owns the property, is insufficient to qualify for the exemption under section 214, subdivision (g). As noted above, a qualifying limited partnership, as specified in subdivision (g) of section 214, has an eligible nonprofit corporation as its managing general partner.

If you have further questions regarding this matter, please do not hesitate to contact me at (916) 324-1392.

Sincerely

/s/ Mary Ann Alonzo

Mary Ann Alonzo
Senior Tax Counsel

MAA:lg
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