

M e m o r a n d u m

To: Honorable Betty T. Yee, Chairwoman
Honorable Judy Chu, Ph.D., Vice-Chair
Honorable Bill Leonard, Second District
Honorable Michelle Steel, Third District
Honorable John Chiang, Controller

Date: May 4, 2007

From: Kristine Cazadd
Chief Counsel 

Subject: **Petition for Amendment of Property Tax Rule 140.1**
Requirements for Managing General Partner of Limited Partnership for Welfare Exemption for Low-Income Housing Properties
June 1, 2007 Board Meeting – Chief Counsel Matters – Item J – Rulemaking

By letter dated March 28, 2007, Ms. Dianne J. Spaulding, on behalf of the Non-Profit Housing Association of Northern California, petitioned the Board, pursuant to Government Code section 11340.6, to amend Property Tax Rule¹ 140.1, *Requirements for Managing General Partner of Limited Partnership for Welfare Exemption for Low-Income Housing Properties*, to make it applicable only to limited partnerships in which at least one general partner is not a qualifying nonprofit corporation or an eligible limited liability company under Revenue and Taxation Code² section 214. This matter is scheduled for the Board's consideration at the June 1, 2007 meeting³ on the Chief Counsel Matters Agenda. On June 1, the Board may: (1) deny the petition; (2) grant the petition in part or in whole and commence the official rulemaking process by ordering publication of the notice pursuant to Government Code section 11346.5; or (3) direct staff to commence an interested parties process to consider the requested amendment in part or in whole. Staff recommends that the petition be denied because Rule 140.1 is consistent with constitutional and statutory requirements for the welfare exemption for low-income housing properties, specifically defining the term "managing general partner" of a limited partnership for purposes of section 214, subdivision (g). For the reasons stated below, this definition should apply to all limited partnerships owning low-income housing properties in order to qualify for the welfare exemption for low-income housing properties.

This memorandum sets forth: (1) a general background of the welfare exemption for low-income housing properties; (2) a discussion of the petition and the requested amendment; and

¹ All Property Tax Rule or Rule references are to title 18 of the California Code of Regulations.

² All section references are to the Revenue and Taxation Code unless otherwise specified.

³ Under Government Code section 11340.7, the Board has 30 days from receipt to deny the petition in whole or in part, indicating the reasons why, or to initiate the rulemaking process. Ms. Spaulding waived the 30-day deadline.

(3) a discussion of the staff's recommendation to deny the petition.

I. General Background of Rule 140.1

A. Welfare Exemption for Low-Income Housing Properties

California Constitution article XIII, section 4, subdivision (b)⁴ authorizes the Legislature to exempt property used exclusively for religious, hospital or charitable purposes, which is owned by specified organizations (the "welfare exemption"). Section 214 is the primary statute implementing the welfare exemption. As relevant herein, subdivision (g) of section 214 extends the welfare exemption to property owned and operated by a limited partnership in which the managing general partner is a qualifying nonprofit corporation or limited liability company and the property is used exclusively for low-income housing.⁵ Subdivision (g)(1) of section 214 provides, in relevant part:

Property used exclusively for rental housing and related facilities and owned and operated by religious, hospital, scientific, or charitable funds, foundations, limited liability companies, or corporations, including limited partnerships in which the managing general partner or eligible limited liability company is an eligible nonprofit corporation, meeting all of the requirements of this section, or by veterans' organizations, as described in Section 215.1, meeting all the requirements of paragraphs (1) to (7), inclusive, of subdivision (a), shall be deemed to be within the exemption provided for in subdivision (b) of Section 4 and Section 5 of Article XIII of the California Constitution and this section. . . .

This statute has been interpreted and implemented by Property Tax Rules 140, 140.1 and 140.2, effective July 23, 2006, with Rule 140.1 defining the term "managing general partner" of a limited partnership.

B. Property Tax Rule 140.1

Rule 140.1 defines "managing general partner" and implements and makes specific the requirements that the managing general partner must meet in order for the low-income housing property, owned and operated by the limited partnership, to qualify for the welfare exemption. Rule 140.1, subdivision (a)(6) states that a "managing general partner" means a general partner that:

- (A) is a nonprofit corporation, or an eligible limited liability company meeting the requirements of Revenue and Taxation Code section 214, designated in the limited partnership agreement as the 'managing general partner' of the limited partnership;

⁴ See also Cal. Const., art. XIII, section 5.

⁵ In order to qualify for the welfare exemption for low-income housing, in addition to the requirements of section 214, subdivision (g), the managing general partner must meet the other applicable requirements of sections 214, subdivision (a), 214.01, 214.8, 254.5 and 254.6.

- (B) is authorized to receive a partnership management fee, or similar form of compensation, payable in the amount and the manner set forth in the limited partnership agreement or other agreement executed by all of the general partners for performing its duties;
- (C) has ‘material participation,’ as defined in subdivision (a)(7) below, in the control, management, and direction of the limited partnership’s business; and
- (D) the officers and directors of the for-profit general partners, for-profit limited partners, or any of its for-profit affiliates, do not, as individuals or collectively, have a controlling vote or majority interest in the nonprofit managing general partner.

To have “material participation” in the control, management, and direction of the limited partnership’s business as required under Rule 140.1, subdivision (a)(6)(C), the limited partnership or other agreement must expressly provide that the managing general partner:

- (A) has a right to vote in all the ‘major decisions,’ defined in subdivision (a)(8) . . . ;
- (B) performs ‘substantial management duties,’ defined in subdivision (a)(10) . . . ;
- (C) directly, or indirectly under its supervision, manages the limited partnership;
- (D) annually conducts a physical inspection of the low-income housing property to ensure that the property is being used as low-income housing and meets all of the requirements set forth in Regulation 140; and
- (E) annually submits a certification to the county assessor for the county in which the property is located that the low-income housing property meets all of the requirements set forth in Regulation 140.

Furthermore, Rule 140.1, subdivision (b) requires the managing general partner to maintain records and documents evidencing the performance of its required duties, and Rule 140.1, subdivision (d) specifies that, if the limited partnership agreement contains a delegation of authority clause, the managing general partner must demonstrate that it is actually supervising the performance of the delegated duties.

II. Discussion of Petition

The petition requests that the Board amend Rule 140.1 to add a new subdivision (g) that would make Rule 140.1 applicable only to limited partnerships, owning low-income housing property, in which at least one general partner is not a qualifying nonprofit corporation or an eligible

limited liability company under section 214. Petitioner's Proposed Rule 140.1, subdivision (g) reads as follows:

The provisions of this regulation shall not apply to limited partnerships in which all of the general partners are nonprofit corporations and/or eligible limited liability companies meeting the requirements of Revenue and Taxation Code section 214. The provisions of this paragraph shall apply effective as of January 1, 2007.

Petitioner states that the intent of section 214, subdivision (g) with respect to its requirement that limited partnerships have a managing general partner that is an eligible nonprofit corporation is met when all general partners are eligible nonprofit corporations or limited liability companies. Petitioner reasons that since the provisions of the Corporations Code require that the general partners of a limited partnership have control over the limited partnership, if all the general partners are qualifying nonprofit corporations or eligible limited liability companies, all required management duties will, by necessity, be performed by an eligible nonprofit general partner. Thus, the application of Rule 140.1 to limited partnerships in which there are only eligible nonprofit general partners creates an unnecessary administrative burden.

III. Staff's Recommendation

Staff recommends that the Board deny the petition because existing California law does not define "managing general partner" of a limited partnership for purposes of section 214, subdivision (g), and Rule 140.1 makes specific the duties which a general partner must fulfill to be considered a "managing general partner" for purposes of the welfare exemption for low-income housing properties.

A. Corporations Code Does Not Define "Managing General Partner"

Section 214, subdivision (g) extends the welfare exemption to a low-income housing property when it is owned and operated by a limited partnership in which the "managing general partner" is an eligible nonprofit corporation meeting all the requirements of section 214. Neither section 214, Corporations Code sections 15611, et seq. (the California Revised Limited Partnership Act (CRLPA)), nor Corporations Code sections 16100, et seq. (the Uniform Partnership Act of 1994 (UPA)), which govern limited partnerships and general partnerships, respectively, defines "managing general partner."

Corporations Code section 15643 provides the general authority for a general partner to manage the business of a limited partnership and provisions of the UPA provide other general rights and duties of general partners. However, these only vest in a general partner the general ability to manage the limited partnership's business.⁶ They do not enumerate specific powers, duties, and responsibilities beyond those granted to all general partners of a limited partnership. Instead, specific duties that govern the relationship between partners and the duties of general partners,

⁶ Advising California Partnerships (Cont.Ed.Bar 3d ed. 2007 Supp.) Planning Limited Partnerships, §5.14, p. 164.

beyond those listed in the Corporations Code, are governed by the partnership agreement.⁷ Thus, as discussed below, the Board adopted Rule 140.1 in order to specifically define the term “managing general partner.”

B. Rule 140.1 Requires “Managing General Partners” to Perform Specific Duties to Qualify for the Welfare Exemption for Low-Income Housing Properties

As indicated, Rule 140.1 was adopted to define the duties and activities in which a general partner must be engaged to be considered a “managing general partner” for purposes of section 214, subdivision (g). While it may be true that some of the management duties enumerated in Rule 140.1 are duties commonly recognized as authorized by the general provisions of the Corporations Code for general partners of a limited partnership to engage, Rule 140.1 imposes additional duties that are not specifically authorized nor required by the Corporations Code, as well as ensure that those duties are *actually performed or the performance of such duties are supervised by the managing general partner*. These duties include, among others, the following:

1. The managing general partner must be authorized to receive a partnership management fee (Rule 140.1, subdivision (a)(6)(B));
2. Neither a for-profit limited partner nor any of its for-profit affiliates may have a controlling or majority interest in the nonprofit managing general partner (Rule 140.1, subdivision (a)(6)(D));
3. The managing general partner must annually conduct a physical inspection of the low-income housing property to ensure that the property is being used as low-income housing (Rule 140.1, subdivision (a)(7)(D));
4. The managing general partner must submit annually a certification to the county assessor that it meets the all of the requirements of Rule 140 (Rule 140.1, subdivision (a)(7)(E));
5. The managing general partner must maintain records and documents evidencing the performance of its required duties (Rule 140.1, subdivision (b)); and
6. The managing general partner must demonstrate that it is actually supervising the performance of any delegated duties (Rule 140.1, subdivision (d)).

Thus, if Rule 140.1 were not applicable to a sole eligible nonprofit general partner of a limited partnership, that general partner would not be bound by the requirements listed above and, as a result, would not need to verify that it is performing the function of a managing general partner for purposes of section 214, subdivision (g). Further, the amendment requested by petitioner creates the potential of for-profit entities creating a nonprofit entity solely to act as the sole general partner in a limited partnership which it controls, which it is currently prohibited from

⁷ See Corporations Code section 16103, subdivision (a); see also 9 Witken, Summary of Cal. Law (10th ed. 2005) Taxation, Partnership, Corporations, § 19, p. 565.

doing under Rule 140.1, subdivision (a)(6)(D). Therefore, Staff recommends that the petition be denied.

IV. Conclusion

To summarize, staff recommends that the Board deny the petition to amend Rule 140.1 to make it applicable only to limited partnerships in which there is not a qualifying nonprofit corporation or an eligible limited liability company under section 214. It is staff's opinion that Rule 140.1, as currently written, is consistent with statutory and constitutional requirements for the welfare exemption for low-income housing properties and should be equally applied to all limited partnerships.

If you need more information or have any questions, please contact Acting Assistant Chief Counsel Robert Lambert at (916) 324-6593.

Approved: _____


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Executive Director

KEC:jlh

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