

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: January 10, 2008

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
February 1, 2008 Board Meeting – Chief Counsel Matters – Item J – Rulemaking

At the June 1, 2007 Board meeting, after denying a petition to amend Property Tax Rule¹ 140.1, *Requirements for Managing General Partner of Limited Partnership for Welfare Exemption for Low-Income Housing Properties*, to limit the rule's applicability to limited partnerships in which at least one general partner is a for-profit entity, the Board instructed staff to meet with petitioner to discuss possible administrative changes that would ease the compliance burden on limited partnerships with a sole non-profit general partner acting as the managing general partner.

This memorandum sets forth: (1) general background information on the welfare exemption for low-income housing; (2) a discussion of the current administration of the low-income housing exemption for limited partnerships and the petitioner's requested administrative changes; and (3) the staff's recommendation.

I. General Background Information on Rule 140.1

A. *Welfare Exemption for Low-Income Housing Properties*

California Constitution article XIII, section 4, subdivision (b)² authorizes the Legislature to exempt property used exclusively for religious, hospital or charitable purposes, which is owned by specified organizations (the "welfare exemption"). Revenue and Taxation Code³ 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

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

² See also Cal. Const., art. XIII, section 5.

³ All statutory references are to the Revenue and Taxation Code unless otherwise specified.

limited liability company, and the property is used exclusively for low-income housing.⁴ 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 a 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;
- (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.

⁴ 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.

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. Current Administration and Petitioner’s Requested Administrative Change

A. Current Administration

In order to be eligible to receive the welfare exemption for low-income housing under section 214, subdivision (g)(1), a limited partnership must obtain, from the Board, a Supplemental Clearance Certificate⁵ (SCC) for each low-income housing property it owns. The managing general partner of the limited partnership must also obtain, from the Board, an Organizational Clearance Certificate. After the adoption of Rule 140.1, the SCC claim form was amended to reflect, among other requirements, the rule’s “material participation” and “substantial management duties” requirements.⁶ The SCC claim form now requires identification of the specific sections of the limited partnership agreement that authorize the managing general partner to materially participate and to perform substantial management duties. To ensure continued compliance with the SCC requirements, the new SCC claim form also requires that organizations holding an SCC file the claim form periodically at the same time the managing general partner makes its OCC periodic filing.

⁵ A claim for a Supplemental Clearance Certificate is made on BOE-277-L1, *Claim for Supplemental Clearance Certificate for Limited Partnership, Low-Income Housing Property – Welfare Exemption*.

⁶ In 2007, the Board’s Exemptions staff required all existing SCC holders to file the new SCC claim form in order to ensure compliance with Rule 140.1.

B. *Petitioner's Requested Changes*

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 or eligible limited liability company, is met when all general partners are eligible nonprofit corporations or eligible 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, then all required management duties must, by necessity, be performed by an eligible nonprofit general partner.⁷ On this basis, petitioner argues that the application of Rule 140.1 to limited partnerships in which there are only eligible nonprofit general partners creates the unnecessary administrative burden of reviewing each limited partnership agreement for the authority to perform duties that, in actuality, no other entity could perform.

To ease this perceived administrative burden, petitioner requests that the current SCC claim form be amended so that limited partnerships with a single general partner that is an eligible nonprofit organization be excused from completing the sections detailing the “material participation” and “substantial management duties” requirements of Rule 140.1, and instead merely certify under a new section the following:

The undersigned swears under penalty of perjury that it and its affiliate entities (be they corporations or limited liability companies in which it or its affiliate is the sole member) comply with the requirements of Rule 140.1 in regards to performing the duties when serving as the sole general partner of a limited partnership.

III. *Staff's Opposition and Alternative Recommendation*

Staff is opposed to petitioner's requested administrative change. First, under Rule 140.1 the limited partnership agreement must require the managing general partner to perform certain duties, and the limited partnership agreement must not authorize another general partner or limited partner (or third party) to perform those duties. Thus, even if a general partner is performing the requisite duties under Rule 140.1, in order to know whether it is authorized and empowered to do so, the staff must review the limited partnership agreement. Because of this, in staff's view, the petitioner's requested change in administration may not significantly reduce the time required to file the SCC claim form, since, in order to reasonably make the above certification, the limited partnership agreement must be reviewed to ensure that the particular

⁷ This reasoning is flawed, however. The Corporation Code only vests in a general partner the general ability to manage the limited partnership's business, and does not enumerate specific powers, duties, and responsibilities beyond those granted to all general partners of a limited partnership. Instead, specific duties of general partners beyond those authorized in the Corporations Code, are governed by the partnership agreement. Thus, Rule 140.1 requires the enumeration of specific “managing general partner” duties in a limited partnership agreement.

duties required to be performed by the managing general partner, to the exclusion of all others, as required by Rule 140.1, is reflected in the agreement.

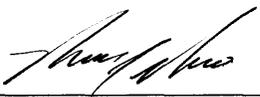
Second, such a change would cause limited partnerships with one nonprofit general partner and limited partnerships with more than one general partner to be treated differently for administration purposes, requiring the latter to complete the SCC claim form in its entirety while the former would be able to merely certify that it satisfies Rule 140.1. However, there is no rational basis upon which to treat such entities differently. Existing California law does not define "managing general partner" of a limited partnership for purposes of section 214, subdivision (g). It is Rule 140.1 that 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. This applies equally to both limited partnerships with one general partner and limited partnerships with more than one general partner. This should be reflected in the administration of the rule.

Finally, it is staff's view that such a change would not facilitate the audit of organizations holding an SCC. Currently, all limited partnerships are required to identify the sections of their limited partnership agreements that require particular duties to be performed by the managing general partner. This serves as a roadmap on audit for staff to review the proper sections of the agreement. Further, it facilitates an audit being completed more efficiently since the organization has already reviewed its limited partnership agreement and identified for staff the applicable sections.

Staff's Recommendation

While staff is opposed to the administrative change proposed by petitioner, staff recognizes the compliance burden placed upon organizations by the SCC claims process. In staff's view, that compliance burden can be eased by retaining the existing claims process for new filers but simplifying the periodic filing process for existing SCC holders. Thus, staff recommends that limited partnerships that are new filers seeking the welfare exemption for low-income housing be required to complete the existing SCC claim form, but that periodic filings be selected through a random selection process among existing SCC holders, with an organization not having to make a periodic filing more than once every four years, barring extraordinary circumstances. Additionally, staff would design the periodic filing form so that only certification of compliance, and not specific identification of the relevant sections of the limited partnership agreement, with Rule 140.1 need be made, reducing the time required to complete the form. In staff's opinion, this recommendation would alleviate some of the administrative burdens experienced by all limited partnerships, while at the same time, ensuring compliance with Rule 140.1.

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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