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Board of Equalization
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Memorandum

County-Assessed Properties Division
State Board of Equalization

To: Lisa Thompson
Principal Property Appraiser

Date: February 1, 2008

From: Andrew Jacobson
Tax Counsel



Subject: ***Qualification of Single Member Limited Liability Companies for Organizational Clearance Certificates and Supplemental Clearance Certificates Assignment No.: 07-318***

I am writing in response to your August 20, 2007, memorandum directed to Mr. Robert Lambert, Acting Assistant Chief Counsel. In your memorandum, you requested that Legal staff respond to a number of questions relating to the qualification of single-member limited liability companies for an Organizational Clearance Certificate (OCC), as well as the qualification for a Supplemental Clearance Certificate (SCC) of limited partnerships having single-member limited liability companies acting as the managing general partner (MGP). Specifically, you raised the following issues:

1. Can a limited liability company formed solely to serve as a MGP in a limited partnership meet the organizational and operational requirements to qualify for an OCC under Revenue and Taxation Code¹ section 214 and section 254.6?
2. Can a limited liability company without employees or assets meet the MGP requirements of Property Tax Rule² 140.1 when its nonprofit sole member performs the MGP duties?
3. If a limited liability company can serve as a MGP, then, in the case of a single-member limited liability company, must the sole member also be a general partner in the limited partnership?

Legal Analysis and Discussion

Question 1: Can a limited liability company formed solely to serve as a MGP in a limited partnership meet the organizational and operational requirements necessary to qualify for an OCC under section 214 and section 254.6?

Answer: Yes. A limited liability company formed solely to serve as a MGP in a limited partnership may qualify for an OCC.

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

² All references to Property Tax Rule or Rule are to title 18 of the California Code of Regulations.

California Constitution article XIII, section 4, subdivision (b)³ authorizes the Legislature to exempt from property taxation, property that is used exclusively for religious, hospital or charitable purposes and owned and operated by “corporations or other entities.” In 2004, the Legislature revised section 214, subdivision (a), the principal statute implementing the welfare exemption. Under the revised statute, which had an effective date of August 30, 2004, organizations that wish to qualify for the welfare exemption may now be organized as limited liability companies. Section 214, subdivision (a) now reads in relevant part:

Property used exclusively for religious, hospital, scientific, or charitable purposes owned and operated by community chests, funds, foundations, *limited liability companies*, or corporations organized and operated for religious, hospital, scientific, or charitable purposes is exempt from taxation (Emphasis added.)

If the organization meets the above criteria, as well as the other requirements of section 214 et seq, then the Board may issue an OCC pursuant to section 254.6.

Provision of low-income housing has long been recognized as a qualifying charitable purpose on the ground that it lessens the burdens of government.⁴ The legislature passed section 214, subdivision (g)(1), which exempts from property tax any rental housing owned or operated by “limited partnerships in which the managing general partner is an eligible nonprofit corporation or eligible limited liability company, meeting all the requirements of this section.” There are no other provisions of section 214 et seq. that require the MGP of a limited partnership owning low-income housing to have any other charitable purposes aside from managing the limited partnership.

Thus, the lack of any additional statutory requirements suggests that the Legislature wished to encourage the development of low-income housing rather than to limit the MGP designation to preexisting nonprofit organizations or nonprofits that have performed or intend to perform other charitable activities in addition to acting as a MGP. Moreover, when the Legislature added limited liability companies to the types of organizations that could qualify for the welfare exemption in 2004, it placed no additional restrictions on limited liability companies. Rather, the Legislature permitted nonprofits to create qualifying entities in any of these forms, as long as the property in question was actually owned or operated by a limited partnership as required under section 214, subdivision (g)(1).

Additionally, except for enforcing the MGP requirement of section 214, subdivision (g)(1), the Board has not required that the MGP perform any other charitable activity other than serving as the MGP of a limited partnership providing low-income housing. Indeed, the Legal Department has previously concluded that a limited liability company

³ See also Cal. Const. art. XIII, § 5.

⁴ See *John Tenant Memorial Homes v. City of Pacific Grove* (1972) 27 Cal.App.3d 372, 382 (private retirement home for the elderly lessens the need for a public agency to house them); *Fifield Manor v. Los Angeles County* (1961) 188 Cal.App.2d 1, 20 (private homes for the elderly replace public housing).

formed solely to hold title to a low-income housing property operated by its sole member in pursuance of the sole member's qualifying purpose satisfies the operational requirements of section 214, subdivision (a), as interpreted by Property Tax Rule 136, subdivision (e).⁵

Therefore, a limited liability company that is constituted solely to serve as the MGP of a low-income housing property has a qualifying charitable purpose that may enable it to receive an OCC.

Question 2: Can a limited partnership qualify for a SCC if its MPG is a limited liability company without employees or assets and the limited liability company's nonprofit single member performs the MGP duties?

Answer: Yes. A limited partnership, whose MGP is a limited liability company without employees or assets, may qualify for a SCC when the limited liability company's nonprofit single member performs the MGP duties.

The Board enacted Property Tax Rule 140.1, which sets forth the requirements that a nonprofit organization must satisfy in order to qualify as a MGP under section 214, subdivision (g). The Board adopted Property Tax Rule 140.1 on March 28, 2006, with an effective date of July 23, 2006. Among its requirements, the limited partnership agreement or other agreement must require that the managing general partner perform "substantial management duties" as defined in Property Tax Rule 140.1, subdivision (a)(10).⁶ In order to meet the definition of "substantial management duties," the Board's rule provides that a partnership agreement or other agreement must assign to the MGP at least 5 or more of 12 partnership management duties to be performed on behalf of the limited partnership.⁷

You have indicated that an increasing number of nonprofit organizations are creating single-member limited liability companies to act as MGPs of limited partnerships. Therefore, it is important to examine why many nonprofit organizations are choosing to create single-member limited liability companies. The main characteristic that differentiates a limited liability company from other entities is that it offers limited liability to all its members, including those that actually manage the limited liability company.⁸ Thus, using a LLC as an operating company may be useful in insulating a nonprofit member from liability in the event that the limited partnership were, for example, to default on any recourse financing.

Taking into account the fact that the limited liability company exists primarily to shield the nonprofit single member from liability, and, given that the nonprofit single member

⁵ See Memorandum, September 26, 2006, Limited Liability Companies, Application for Organizational Clearance Certificate.

⁶ Property Tax Rule 140.1, subd. (a)(7)(B).

⁷ Property Tax Rule 140.1, subd. (a)(10).

⁸ See Corp. Code, §§ 17101 and 17150.

itself has been delegated the substantial management duties, thus effectively merging the various entities, it is appropriate to permit a limited liability company to act as the MGP even though it is performing no functions by itself and has no officers or employees to carry out these functions. In essence, the link between a nonprofit single member and a limited liability company without employees or financial statements is so close that the actions of the nonprofit single member may be imputed to the limited liability company.⁹ Thus, if a limited liability company has a single member that is a nonprofit organization and the nonprofit member has received an OCC and, as a result, qualifies under Property Tax Rule 136, subdivision (b), then the nonprofit member (including the member's officers or employees) may perform the MGP duties as the agent of the limited liability company.

Under circumstances such as these, of course, you and your staff should request financial statements, formative documents and other documents from the nonprofit single member to demonstrate that the requirements of section 214 et seq. have been satisfied.¹⁰

We note that there is precedent for allowing a limited liability company to satisfy a welfare exemption requirement through its nonprofit member. The Legislature has already permitted a limited liability company to use the member's income tax exemption letter to qualify under section 214.8. Section 214.8, subdivision (c)(1) provides that:

For purposes of subdivision (a), a limited liability company wholly owned by one or more qualifying organizations, which may include governmental entities and nonprofit organizations, that are exempt under Section 23701d or under Section 501(c)(3) of the Internal Revenue Code shall qualify as an exempt organization.

Because a limited liability company may use its member's income tax exemption letter to qualify under section 214.8, it follows that substantial management duties performed by a nonprofit member may be imputed to the limited liability company itself as long as both entities possess OCCs and the member, thus, fully complies with the requirements of Rule 136, subdivision (b).

Therefore, a limited partnership whose MGP is a limited liability company without employees and without financial statements, nonetheless, may qualify for a SCC, as long as the limited liability company's nonprofit sole member has qualified for an OCC and the nonprofit member has the employees and resources to carry out the limited liability company's MGP duties.

⁹ Property Tax Rule 136, subdivision (a) provides that:

A limited liability company may be a qualifying entity for welfare exemption purposes, if it is wholly owned by a qualifying organization or organizations and if it meets specific organizational and operating requirements.

¹⁰ See Rev. & Tax Code, § 254.6, subd. (c)(1).

Question 3: If a limited liability company can serve as a MGP, then, in the case of a single-member limited liability company, must the sole member also be a general partner in the limited partnership?

Answer: No. The sole nonprofit member of a limited liability company does not need to serve as a general partner in the limited partnership.

A nonprofit member of a limited liability company does not have to serve as a general partner in a limited partnership that owns low-income housing alongside the limited liability company. The primary rationale for this conclusion is provided above: the main link between the nonprofit sole member and the limited liability company is one of control. As long as the limited liability company is controlled solely by a nonprofit organization that qualifies under Property Tax Rule 136, subdivision (b), it does not matter whether the nonprofit organization is also a general partner in the limited partnership itself. Indeed, such a requirement would defeat the entire purpose of using a single-member limited liability company by making the nonprofit organization liable for the limited partnership's debts and obligations as one of the general partners.¹¹

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cc: Mr. Dean Kinnee, MIC: 64
Mr. James Anderson, MIC: 64
Ms. Ladeena Ford, MIC: 64

¹¹ Nevertheless, the MGP must itself, of course, be a general partner in the limited partnership.