General Counsel Memorandum 37927

Date Numbered: 04/26/1979

CC:I-209-78, 210-78, 211-78, 212-78, 213-78

Memorandum to:

JOHN L. WITHERS

Assistant Commissioner (Technical)

Attention: Director, Individual Tax Division

In a memorandum dated June 2, 1978, the Director of the Individual Tax Division (T:I) forwarded to us, the five above-captioned ruling request cases for our concurrence or comment on the adverse position Technical proposes to take on the issue stated below.

ISSUE

Whether certain sewer and water charges cases are taxes assessed against local benefits of a kind tending to increase the value of the property assessed, within the meaning of I.R.C. 164(c)(1), so that the maintenance and interest portions of such charges, if properly allocated, are deductible, or whether such charges are otherwise deductible under section 164(a)(1)-(4)?

CONCLUSION

Your memorandum takes the position that taxes assessed against local benefits as contemplated by section 164(c)(1) and Treas. Reg. 1.164-4 are restricted to one-time (even though paid in installments over a long period) taxes or special assessments imposed under the taxing power of a governmental unit against property for the capitaltype expenditures incurred for that part of the improvement system which abuts such property . You state that deductible maintenance and interest expenses are thereby restricted by such tax or special assessment to the maintenance and interest expenses related to that particular part of the improvement system and do not encompass maintenance and interest expenses incurred for the improvement system as a whole. You further state that annual user charges, even if imposed on a flatrate basis do not constitute taxes assessed against local benefits even if such charges are used for

maintenance and interest purposes. You conclude that the charges imposed by the municipal authorities are not taxes, or special assessments, but service fees. Your memorandum also asks us to reexamine Rev. Rul. 76-45, 1976-1 C.B. 51.

The long-standing administrative construction of section 164(c)(1), currently embodied in Treas. Reg. 1.164-4, and the case law, support the view that insofar as assessments against local benefits are for maintenance and interest purposes they are deductible. The legislative history of section 164 leads us to conclude that the maintenance and interest portions of a tax assessed against local benefits are deductible under section 164(c)(1).

We recommend that Rev. Rul. 76-45 be clarified to remove the implication therein that payments for services can be taxes for local benefits. We also suggest your reconsideration of of the maintenance tax there at issue.

Based upon the language of section 164(c)(1) and Treas. Reg. 1.164-4(a), a tax assessed against local benefits must be assessed against property. But in the ---- case the flat-rate charge for water and sewage is imposed against renters, as well as property owners. Therefore, the charge does not constitute a tax against local benefits, and the maintenance and interest portion of such charge is not deductible as a result thereof. Neither is the charge deductible under section 164(a).

In the ---- and ---- cases, the charges are imposed only against property owners. All residential property is charged a flat-rate per residential establishment. Treas. Reg. 1.164-4(a) describes taxes for local benefit as being measured by some benefit inuring directly to the property assessed. The charges are not based, to any degree, on the benefit to the property assessed. The charges are levied on only one criteria, the number of residential units. We conclude that the charges are not taxes assessed against local benefits, and that the portions of the charges that are allocable to maintenance and interest are not deductible under section 164(c)(1). The ground we have used for deciding that the charges are not taxes against local benefits can be used in the ---- case.

The charges are not deductible under section 164(a), either. Specifically, they do not constitute real property taxes, because they are not based on the value of the land assessed and a significant amount of property in the jurisdiction is not subject to the tax.

The annual uniform charge for maintenance and interest imposed by the ---- Authority against property owners is not deductible as a tax against local benefits under section 164(c)(1). Treas. Reg. 1.164-4(a) requires that the assessment must be measured by some benefit inuring directly to the property assessed. The ---- uniform charge is computed without regard to the benefit to the property assessed. Thus, the ---- uniform charge is not a tax assessed against local benefits and the portion of the charge allocable to maintenance and interest is not deductible under section 164(c)(1) as a result thereof.

The ---- uniform charge is not deductible under section 164(a), either. It is not a real property tax because it is computed without regard to the value of the real property assessed.

The ---- private letter ruling, dated August 17, 1960, was cited by the ---- Authority. We have examined that ruling and suggest that you may wish to reconsider it.

The ---- ruling request is similar to that of ---- The ---- uniform charge is not deductible, to any extent, for the same reasons as the uniform charge. Additionally, ---- charges renters as well as property owners. Hence, as in the ---- and ---- cases, the charges do not constitute an assessment or tax against property, and thus are not deductible under section 164(a) or (c).

FACTS

The ---- was incorporated in 1956 by the ---- pursuant to ---- The Authority currently provides its customers with sewage service for domestic, commercial, and other miscellaneous uses in three townships and two boroughs. The Authority also has a mandatory sewer hook-up ordinance.

The Authority has issued a series of bonds pursuant to a trust indenture, dated March 15, 1977, to refund bonds previously issued in connection with the acquisition and construction of its sewer system. In the trust indenture, the Authority covenanted that its charges for the use of its system shall at least be sufficient to meet the current expenses of the Authority and to pay 110% of the annual debt service on the bonds.

The Authority charges for capital improvements by a “benefits' method whereby the benefits of the improvements are determined by viewers, in accordance with ---- A tapping fee and a service connection fee are also charged by the Authority. Such charges are one-time fees, but such fees may be paid in installments over a period of five years. Because there constantly are additions to the system, there are

such assessment charges being paid at the present time. The Authority will not change its method of assessing property owners for capital improvements if it adopts its proposed plan for charging customers.

The Authority proposes to assess each of its customers with an annual uniform charge computed by dividing the sum of the annual maintance and interest expenses incurred by the Authority by the total number of customers who receive service from the Authority. Thus the uniform charge would apply to all customers of the Authority, including nonresidential customers. In addition to the uniform charge, customers will continue to pay a minimum service charge based on water usage. The Authority bills property owners only, not renters.

The purpose of the proposed plan, as stated in the Authority's ruling request letter, is to enable the Authority's customers to deduct the interest and maintenance expenses incurred by the Authority for the construction and preservation of capital facilities of a kind tending to increase the value of the customer's property pursuant to section 164(c).

The ---- was incorporated by the ---- The Authority has issued sewer revenue bonds under trust indentures. Under the trust indenture, dated February 1, 1973, the Authority covenanted that it would pay from the revenues of the sewer system the debt service on the sewer revenue bonds. The Authority has on past occasions charged a portion of the net cost of the sewer system and of subsequent capital improvements against the benefited properties according to the front foot rule, but there are no front footage charges currently outstanding. The Authority has leased the entire sewer system to ---- The Authority has assigned its rights in the lease to the trustee of the trust indenture agreements. The Authority has a mandatory hook-up ordinance.

---- sets a flat-rate for sewer charges for each private dwelling or living unit. The charge is $40.00 per quarter. The charges are not imposed against renters. Commercial and industrial establishments are charged on the basis of usage above a minimum number of gallons.

The ruling request in ---- is limited to the flatrate “sewer rental or charge paid by each owner of residential (non-trade or business) real property “ (Ruling Request, at 1.) The ruling request, at 5, states:

It is recognized that the sewer rentals or charges here involved are imposed against local benefits of a kind tending to increase the value of the property. Therefore, it is only submitted that so much of the

sewer rental or charge as is properly allocable to maintenance or repair and to interest is deductible for federal income tax purposes under I.R.C. Section 164. I.R.C. Section 164(c). Reg. 1.164-4(b)(1).

The ruling request asserts that for 1976, 43.94% of residential sewer charges are allocable to maintenance, repair, and interest expenses, and hence $63.27 (43.94% x 36.00 per quarter x 4 quarters) is deductible by each residential (non-trade or business) real property owner for 1976 federal income tax purposes under I.R.C. Section 164 "

The ---- was organized in 1966 pursuant to the ---- In order to finance the construction of its sewerage facilities, the Authority sold bonds which were later refunded by a second bond issue. In the trust agreement securing the bonds, the Authority agreed to fix its rates so that its pledged revenues would be sufficient to pay the expenses of operating, maintaining, and repairing its facilities, administrative expenses, and debt service requirements.

A service agreement obligates the ---- to pay the operating and administrative expenses of the Authority, the Authority's debt service expense, and other payments required under the trust agreement should the collections of the Authority fail to defray these expenses.

The Authority has no front footage charges. A one-time connection or tapping fee payable over a period of five years is charged, Also, the ---- a municipal corporation separate from the Authority, enforces a mandatory hook-up ordinance against all residences or other structures within 100 feet of a sewer main.

The Authority charges a flat-rate of $145.00 per year for sewer rental for each single dwelling unit. The charges are imposed against all users of the system, owners and renters. The billing method of the Authority may vary; if a landlord requests that individual tenants be billed, the Authority does that. The Authority prefers to bill the landlord for his rental units, and have the landlord charge the tenant. All users, other than single dwelling units, are charged on the basis of usage above a minimum number of gallons.

The ruling request asserts that 88.3% of the Authority's total revenues in 1976 are allocable to interest expense, and hence that 88.3% of the Authority's customers' payments are deductible. The ---- ruling request is not expressly limited to residential customers, who pay a flat-rate charge, as opposed to non-residential users, who pay a flat-rate up to a certain number of gallons of water used and a rate based on usage should they exceed the specified number of gallons.

The ---- was incorporated in 1964 pursuant to the ---- The Authority provides approximately 10,000 customers with water in several ---- townships and boroughs. The Authority does not have a mandatory hook-up ordinance.

In order to finance the construction of its capital facilities, the Authority issued Water Revenue Bonds pursuant to a trust indenture. The trust indenture obligates the Authority to impose rates sufficient to pay its administrative expenses, the expenses of operating, maintaining, and repairing the water system, and after July 31, 1968, 1.20 times the average annual debt service requirements.

The ---- Authority charges for capital improvements in the same manner as the ---- Authority. As was true in the ---- case, assessment charges for capital improvements are being paid at the present time. There will be no change in the Authority's method of assessing property owners for capital improvements should the proposed plan, described below, be adopted by the Authority.

The Authority proposes to assess each of its customers with an annual uniform charge computed in the same manner as in the proposed plan of the ---- In addition to the uniform charge, customers will continue to pay a minimum service charge based on meter size and an additional amount based on water usage. Renters, as well as property-owners will be billed. The stated purpose of the proposed ---- plan is the same as the proposed ---- plan.

The ruling request represents that had the uniform charge plan been in effect in 1976, each customers of the authority would have been assessed an annual charge of approximately $22.37.

---- was incorporated in 1951 pursuant to the ---- The Authority has issued bonds for the construction of sewer facilities. In the 1974 trust indenture, the Authority assigned to a trustee all receipts and revenues from the sewer system.

The Authority's sewer system is divided into two districts. The Authority has leased the entire sewer system to the ---- The Authority has assigned its interest in the lease to the trustee of the trust indenture agreement. Under a management agreement, the ---- has appointed the Authority as its agent for the operation of the sewer system. The sewage charges are fixed by township ordinance. There is also a mandatory hook-up ordinance for the Authority's customers.

Township ordinances impose a flat-rate on the owners of residential property of $25.00 per quarter for each residential establishment in ---- and $42.25 per quarter in ---- Renters are not billed by the Authority.

The owners of noncommercial property are generally charged a rate based on usage. [2] The ruling request includes a sample allocation for 1977, in which it is asserted that 20.48% of the 1977 sewer rentals are allocable to maintenance interest costs.

ANALYSIS

Section 164(a) provides:

General Rule.-Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

(2) State and local, personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) State and local general sales taxes.

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income).

Section 164(c) provides in part:

Deduction Denied in Case of Certain Texes.-No deduction shall be allowed for the following taxes:

(1) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not prevent the deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

Treas. Reg. 1.164-4 regarding taxes for local benefits provides in part:

(a) So-called taxes for local benefits referred to in paragraph (g) of 1.164-2 more properly assessments, paid for local benefits such as street, sidewalks, and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied are not deductible as taxes. A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The real property taxes deductible are those levied for the general

public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction. Assessments under the statutes of California relating to irrigation, and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and if the assessments are so limited, the amounts paid thereunder are not deductible as taxes.

For treatment of assessments for local benefits as adjustments to the basis of property, see section 1016(a)(1) and the regulations thereunder.

(b)(1) Insofar as assessments against local benefits are made for the purpose of maintenance or repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible. In such cases, the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation cannot be made, none of the amount so paid is deductible.

The allowance of a deduction for taxes and the denial of a deduction for taxes assessed against local benefits dates from the Revenue Act of 1913. Section IIB of the 1913 Act provided that in computing "net income for the purpose of the normal tax there shall be allowed as deductions ... all national, State, county, school, and municipal taxes paid within the year, not including taxes assessed against local benefits " The Revenue Act of 1918, 214(a)(3) (with respect to individuals), and 234(a)(3) (with respect to corporations), added the words "of a kind tending to increase the value of the property assessed" to describe the taxes assessed against local benefits that were not deductible under prior law. The legislative history of sections 214(a)(3) and 234(a)(3) of the Revenue Act of 1918 does not reveal the reasons for this addition in language. The Board of Tax Appeals in <u>Caldwell Milling Co. v. Comissioner</u>, 3 B.T .A. 1232, 1236 (1926) stated that the words "of a kind tending to increase the value of the property assessed" were added by Congress in 1918 in an attempt to clarify the clause and to distinguish local public improvements, the cost of which is assessed only against the property benefited, from those indirect benefits resulting from improvements such as schools, parks, water works, etc., which are usually paid out as general taxes.

The provision denying the deduction of taxes assessed against local benefits was changed in section 23(c)(3) of the Revenue Act of 1928. Section 23(c)(3) of that Act contained the new language that "this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance and interest charges " The Board of Tax Appeals in <u>Little v. Commissioner</u>, 21 B.T.A. 911, 915 (1930), <u>acq.</u>, X-2 C.B. 42, stated that "[w]e are of the opinion that the said additional

language used in the 1928 Act is explanatory of the next proceeding phrase used in the 1928 and prior acts, rather than amendatory " The Board viewed the 1928 Act as clarifying the law to the effect that the part of a tax against local benefits that is allocable to maintenance and interest does not increase the value of the property assessed, and hence should not be disallowed as a deduction.

Contrary to the Board's opinion in Little, the pre-1928 Acts were not uniformly interpreted so as to exempt maintenance and interest charges from the denial of a deduction for taxes assessed against local benefits. In S.M. 231 (May 22, 1918), modified by S.M. 387 (July 31, 1918), the Solicitor of the Bureau took the position that no deduction was permitted for taxes levied ad valorem by California irrigation districts to pay off the interest on bonds issued by the districts (no principal was to be paid for 20 years) because the taxes were assessed against local benefits. S.M . 387 modified this conclusion to allow the deduction as business expenses of those portions of irrigation district assessments that were allocable to maintenance and interest.

The regulations were also not consistent with the Board's position in Little . Treas. Reg. 33, art. 194 (Revenue Act of 1913) does not mention maintenance and interest. Treas. Reg. 45, art. 133 (Revenue Act of 1918) permitted the deduction as a business expense of assessments made for the purpose of maintenance and repair, or so much of an assessment made for the purpose of both construction and maintanance or repair as was allocable to maintenance and repair. The deduction of interest was not mentioned in Treas. Reg. 45, art. 133. The regulations under the Revenue Act of 1928, Treas. Reg. 74, art. 153, provided as do the current regulations, Treas. Reg. 1.164-4(b)(1), that "in so far as assessments against local benefits are made for the purpose of maintenance or repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible "

While as pointed out in Little, 21 B.T.A. at 915, the only issue in Comstock v. Commissioner, 15 B.T.A. 769 (1929), was whether the assessment for interest on drainage districts bonds could be deducted by the taxpayer as interest paid (under what is now section 163), the Board's statements in Comstock are inconsistent with its position in Little that the insertion of the language in the 1928 Act concerning the deduction of maintenance and interest was merely explanatory rather than amendatory. The Board in Comstock stated, at 773, that whatever part of the drainage taxes that were used in payment of interest on the bonds (the drainage taxes were used to pay both principal and interest in Comstock) was not a separate payment of interest, or a separate tax. The Board did not admit of the possibility of allowing a deduction for that part of the drainage taxes allocable to interest.

The statutory scheme of section 164 prior to the 1964 amendments was relatively straightforward. All taxes were deductible except those listed as being nondeductible. Taxes assessed against local benefits of a kind tending to increase the value of the property assessed were made nondeductible, but this statutory prohibition was not to prevent the deduction of so much of such taxes against local benefits as was properly allocable to maintenance and interest charges. The maintenance and interest charges were deductible under the general deduction of taxes provision (section 164(a), prior to 1964 amendment), since the deduction of such charges was not denied elsewhere in section 164 (or in the balance of the Code).

In 1964, section 164 was amended by the Revenue Act of 1964, 207, to allow the deduction only of those taxes listed in subsection (a) of section 164. The only change made by the 1964 Act regarding taxes assessed for local benefits was the repeal of the exception to the denial of the deduction for taxes assessed against local benefits levied by a special taxing district.[3] The legislative history of section 207 of the 1964 Act indicates no intent on the part of Congress to alter the law with respect to taxes assessed against local benefits and the maintenance and interest charges allocable thereto. See H.R. Rep. No. 749, 88th Cong., 1st Sess. 47-51 (1963); S. Rep. No. 830, 88th Cong., 2nd Sess. 53-57 (1964).

The statutory scheme of section 164 after the 1964 amendment is not as straightforward as previously. Section 164(c)(1) denies a deduction for "[t]axes assessed against local benefits of a kind tending to increase the value of the property assessed " It would seem reasonable that taxes assessed against local benefits would be deductible under section 164(a) absent subsection (c), otherwise there would be no need to deny a deduction therefor in subsection (c).

A tax against local benefits is not, however, one of the taxes described in sections 164(a)(3) and (4) (state, local, or foreign, income, war profits, and excess profits taxes; or state and local general sales taxes).

With respect to section 164(a)(2) dealing with personal property taxes, G.C.M. 821, V-2 C.B. 38, declared obsolete, Rev. Rul. 71-498, 1971-2 C.B. 434, states that the weight of state law authority is to the effect that special assessments, can be levied against personal property. However, G.C.M. 821 found that to the extent taxes for the purpose of constructing levees were assessed against personal property they were not taxes of a kind tending to increase the value of the property assessed because while personal property would be benefited from not being submerged in the river, upon removal of the personal property from the levee districts there would be no increase in the property's capital value . As was the situation in

G.C.M. 821, generally taxes assessed against personal property will not increase the value of such property, and hence the denial of a deduction in section 164(c) for “[t]axes assessed against local benefits of a kind tending to increase the value of the property assessed” will not be applicable. We note also that a personal property tax must be levied, inter alia, on an ad valorem basis to be deductible. Section 164(b)(1).

Taxes assessed against local benefits must be assessed against real property. It is implicit in section 164(c)(1) and in Treas. Reg. 1.164-4 that a tax for local benefits is assessed against property. Section 164(c)(1) denies a deduction for “[t]axes assessed against local benefits of a kind tending to increase the value of the property assessed “ (Emphasis added.) Treas. Reg. 1.164-4(a) speaks of “the property against which the assessment is levied “ (Emphasis added.) The property mentioned in Treas. Reg. 1.164-4(a) is impliedly real property since the regulation contrasts taxes for local benefits with deductible real property taxes: “The real property taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction “ Treas. Reg. 1.164-4(a).

While taxes assessed against local benefits (section 164(c)) must be assessed against real property, it is still to be determined whether they are real property taxes deductible under section 164(a). The term “real property taxes' is not defined in section 164. H.R. Rep. No. 749, 88th Cong., 1st Sess. A41 (1963) says that “the term “real property taxes' means taxes imposed on interests in real property “ The Report continues:

Those real property taxes which are now deductible under section 164 remain so; those real property taxes which are not presently deductible are not made deductible by the amendment.

Treas. Reg. 1.164-3(b) defines “the term real property taxes to mean taxes imposed on interests in real property and levied for the general public waelfare, but it does not include taxes assessed against local benefits “ Treas. Reg. 1.164-4(a), quoted above, further delimits the real property taxes that are deductible.

It is to be noted that the treatment of real property taxes in section 164 is confusing. On the one hand, state, local, and foreign real property taxes are deductible under section 164(a), but on the other hand, H.R. Rep. No. 749 speaks of real property taxes that are not deductible.

We have concluded that taxes assessed against local benefits are not real property taxes deductible under section 164(a) but for subsection (c) . Treas. Reg. 1.164-3 expressly excludes taxes assessed against local benefits from the term "real property taxes " Moreover, as discussed below in connection with the ---- case, the term real property taxes is limited to ad valorem taxes.

The question remains under what language in section 164 is maintenance and interest deductible. Section 164(c)(1), quoted above, contains no language affirmatively authorizing the deduction of that portion of taxes assessed against local benefits that is allocable to maintenance and interest charges. All that is said in section 164(c)(1) is that "this paragraph shall not prevent the deduction of so much of such taxes as is properly allocable to maintenance or interest charges " (Emphasis added.) Prior to 1964, the maintenance and interest portion of taxes assessed against local benefits were deductible under the language in section 164(a) allowing the deduction of all taxes except those listed as being nondeductible. There is no indication that the 1964 amendments were meant to change the law with respect to the deduction of the maintenance and interest portions of taxes assessed against local benefits. On the contrary, H.R. Rep. No. 749, at A41, quoted above, expressly stated that it was not Congress' intent to change the law regarding the real property taxes that are deductible. Assuming, as is likely, that the reference to non-deductible real property taxes is to, among other things, taxes assessed against local benefits, the Committee Report buttresses out view that no change in the law regarding taxes assessed against local benefits was intended by Congress in 1964.

It is our view that the maintenance and interest portions of taxes assessed against local benefits are impliedly deductible under section 164(c) as a result of the continuance of the language of present section 164(c)(1) after the 1964 amendment of section 164. Congress in 1964 simply did not mean to change the law in this respect. Additionally, the longstanding (since 1928, see Treas. Reg. 74, art. 153) administrative construction of section 164(c)(1) in regard to maintenance and interest, currently embodied in Treas. Reg. 1.164-4(b)(1), is that "[i]nsofar as assessments against local benefits are made for the purpose of maintenance or repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible " We note that the case law is in agreement with this regulation. See Missouri State Life Insurance Co. v . Commissioner, 29 B.T.A. 401, 414 (1933), acq. in part and non-acq. in part (on other grounds), XIII-1 C.B. 11, 26, aff'd in part and rev'd in part on other grounds , 78 F.2d 778 (8th Cir. 1934) (involving the Revenue Act of 1928, 203 pertaining to the deductions of insurance companies); Chapman & Dewey Lumber Co. v. Commissioner , 25 B.T.A. 1166 (1932), acq., XI-2 C.B. 2; Lee Wilson & Co. v. Commissioner, 25 B.T.A. 840 (1932); Little. It is thus our conclusion that the

maintenance and interest portions of taxes assessed against local benefits are deductible by implication from the language in section 164(c)(1) because of the retention of such language by Congress during the amendment of section 164 in 1964, and because of the longstanding regulatory construction of this provision, currently embodied in Treas. Reg. 1.164-4(b)(1).

It should be emphasized that section 164(c)(1) only denies a deduction to "[t]axes assessed against local benefits of a kind tending to increase the value of the property assessed " (Emphasis added.) Treas. Reg. 1.164-4 describes "[s]o called taxes for local benefits' as being imposed because of and measured by some benefit inuring directly to the property benefited. It is not necessary, for purposes of section 164(c)(1), that the tax actually increase the value of the property assessed; it suffices that the tax be "of a kind tending to increase the value of the property " Noble v. Commissioner, 70 T.C. 916, 920 (1978) (citing Caldwell Milling Co.); Mitchell v. Commissioner, 27 B.T .A. 101 (1932), acq. on other grounds and nonacq., XII-1 C.B. 9, 19 (1933). One Tax Court Memorandum Decision, Guggenheimer v. Commissioner, Docket No. 111821, 2 T.C.M. 814 (1943), stated that the construction of jetties protected certain shore properties from the destructive effect of the ocean, and although the jetties did not increase the dollar value of the property, they protected it from decrease resulting from ocean damage. The court held that the assessment for the jetties was a tax against local benefits within the meaning of the statute (1939 I.R.C. 23(c)(4)).

The purpose of denying a deduction of taxes assessed against local benefits of a kind tending to increase the value of the property assessed is well-stated in G.C.M. 821, V-2 C.B. at 39: "The purpose of exception (C) in section 214(a) (a predecessor of section 164(c)(1)), is to prevent the deduction in computing net income of payments which are subsequently returned to the taxpayer through increased capital value of his property " To the same effect, see S.M. 387, at 2 (July 31, 1918). The maintenance and interest portions of taxes assessed against local benefits do not tend to increase the value of the property assessed, and consequently their deduction is not denied. Missouri State Life Insurance Co.; Little; cf. S.M. 387, at 2 (such portions of an irrigation district assessment as are to be expended in paying the interest on the debt of the district or in repairing the plant and maintaining the flow of water are not capital expenditures, but current payments which maintain capital value without adding to it; such portions of the assessment are deductible as business expenses).

In determining whether a utility charge is deductible under section 164, we find it necessary to deal with local law characterizations of the charges in question.

The Tax Court in Roth v. Commissioner, 17 T.C. 1450, 1454 (1952), acq., 1952-2 C.B. 3, considered a Muskogee, Oklahoma ordinance that charged a flat-rate for use of the city sewer system. The Tax Court held that this charge was a service charge, and not a tax.[4] The Tax Court, in reaching this conclusion, relied on an Oklahoma Supreme Court decision. This reliance is contrary to the dictates of Rev. Rul. 76-215, 1976-1 C.B . 194, considered in G.C.M. 36540, ---- I-539-74 (Jan. 5, 1976) (involving sections 901 and 164), which stated that principles developed under federal law, but not state or foreign interpretations or designations, determine whether an arrangement falls within the meaning of the word "tax" as used in federal statute. See also Lyeth v. Hoey , 305 U.S. 188, 194 (1938); Burnet v. Harmel, 287 U.S. 103, 110 (1932). Aside from its reliance on state law, the Tax Court in Roth gave no reasons why the sewer charges were service charges and not taxes. We find this approach inadequate and believe that the proper approach is careful analysis of the water and sewer charges in question under sections 164(a) and (c).

The Service has issued a number of revenue rulings dealing with section 164(c). The one ruling that has caused some problems to the public due to misinterpretation is Rev. Rul. 76-45, 1976-1 C.B. 51. Rev. Rul. 76-45, considered in G.C.M. 36401, ---- I-247-75 (September 5, 1975) is cited and relied on to various extent in all of the subject ruling requests with the exception of that of ---- . In Rev. Rul. 76-45 municipal utility districts were formed to construct facilities, plants, equipment, and appliances needed to provide a water system, sanitary sewer system, storm sewer system, etc. The utility districts issued bonds. Under state law, the principal and interest on the bonds could be repaid from the levy and collection of ad valorem taxes on all real property, or by pledging all or any part of the designated revenue from the ownership or operation of the districts' works, or a combination of both. The utility districts were authorized, under state law to levy and collect a tax for maintenance purposes, including funds for planning, maintaining, repairing, and operating all necessary plants, works, facilities, improvements, appliances and equipment of the district, and for paying costs of proper services, engineering, legal fees, and organization and administrative expenses. The ruling holds that "payments made to the utility districts are taxes paid for local benefits because the property subject to the taxes is limited to the property benefited " (Emphasis added.) Hence the ruling concludes that "the taxes imposed by the municipal utility districts are not deductible under section 164 of the Code, except to the extent that they can be shown to be allocable to maintenance or interest charges.

The ruling request letters in the ---- and cases both state that Rev. Rul. 76-45 does not indicate whether the payments made to utility districts that are deductible to the extent allocable to maintenance and

interest are payments of ad valorem taxes or payments for services provided by the district. Furthermore, the ---- (March 2, 1978) construed Rev. Rul. 76-45 to mean that the portion of a water bill that is allocable to maintenance, interest, or repair costs is deductible.

We do not believe that it was the intent of Rev. Rul. 76-45 to take the position that payments for services provided by the utility districts are deductible to the extent allocable to maintenance and interest. In fact, the last paragraph of Rev. Rul. 76-45 concludes that "the taxes imposed by the municipal utility districts are not deductible under section 164 of the Code, except to the extent that they can be shown to be allocable to maintenance or interest charges " (Emphasis added.)

We recommend that you clarify Rev. Rul. 76-45 to remove the implication that payments for services are taxes for local benefits. You may also wish to reconsider the treatment of the maintenance tax in Rev. Rul. 76-45. The ruling does not state that the maintenance tax is imposed upon property. The underlying file indicates that the maintenance tax was based on the maintenance tax authorized by ---- does not specify the manner in which the maintenance tax must be levied; specifically it does not require that the tax be levied against property, real or personal. However, ---- provides that in determining the rate for the ad valorem tax to pay off the principal and interest on the bonds used to finance the construction of the utility district's facilities, the utility district's Board of Directors shall consider the amount which should be levied for maintenance purposes. This would seem to imply that the maintenance tax is an ad valorem tax on real property. We would also question whether the tax applies solely to real property.

We would also have you note that while the ruling clearly states that only the portion of the taxes imposed by the utility districts that is allocable to maintenance and interest is deductible, there is some confusion regarding the deductibility of the maintenance tax. The maintenance tax, both as stated in the ruling and in ---- may be used for a variety of purposes, not all of which may be deductible as maintenance for purposes of section 164. You may wish to give consideration to clarifying this point. In this regard you may wish to consider defining "maintenance" along the lines of Brecklein v. Bookwalter, 70-2 U.S.T.C . P9602 (W.D. Mo. 1970), wherein it was stated that "Maintenance" is the art of maintaining. In respect to property, maintaining is holding or keeping in a particular state or condition. Webster's New International Dictionary, Second Edition, Unabridged, page 1484 " 70-2 U.S.T.C. at 84499.

We turn now to the ruling requests.

The ---- ruling request does not spell out why the Authority's customers are entitled to a deduction. The ruling request, at 4, quotes from Rev. Rul. 76-45 that “payments made to the utility districts are taxes paid for local benefits because the property subject to the taxes is limited to property benefited “ and that “[a]ccordingly, the taxes imposed by the municipal utility districts are not deductible under section 164 of the Code, except to the extent that they can be shown to be allocable to maintenance or interest charges “ The clear implication of the ruling request is that by virtue of the language quoted from Rev. Rul. 76-45 the Authority's customers are entitled to deduct the portion of their water bill that is allocable to maintenance and interest.

We disagree with the assertion of the requesting party in the ---- case that the sewer rentals or charges there involved are imposed against local benefits of a kind tending to increase the value of the property assessed. As discussed above, a tax against local benefits must be assessed against property. In ---- all private dwelling units, including renters, are charged a flat-rate for sewer use. Since renters are charged as well as property owners, the charges are not assessed against property and hence section 164(c)(1) is inapplicable. Neither are the charges one of the deductible taxes listed in sections 164(a)(1)-(4), quoted supra. Thus, no part of the ---- flat-rate sewer charges is deductible by the customers of the system.

The Authority states to us that it prefers to bill the landlord for every unit he rents, but if the landlord requests that individual tenants be billed, the Authority will oblige him. The important point is that the Authority charges renters as well as property owners; hence its flat-rate charges are not imposed against property, and are not deductible by the customers of the system. The reliance on Rev. Rul. 76-45 by the ---- is to no avail. We have earlier recommended that the language from Rev. Rul. 76-45 quoted in the ---- ruling request letter be clarified to remove any implication that payments for services are taxes for local benefits. The flat-rate charges imposed by the ---- on its residential customers are simply not taxes assessed against local benefits, nor are they deductible under section 164(a).

We wish to note that the rationale developed in our treatment of the ---- case, that the charges must be measured by some benefit inuring directly to the property assessed, is applicable to the ---- case.

The non-residential charges, which are based in part on usage, are not deductible to any extent. It is well established that water and sewer rents on the basis of usage are payments for services rendered, not taxes. See Mahler v. Commissioner , 119 F.2d 869, 873 (2d Cir.), cert. denied, 314 U.S. 660 (1941); Marx v. Commissioner, Nos. 15310, 15311 (T.C.M. 1949), aff'd , 179 F.2d 938 (1st Cir. 1950), cert. denied, 339 U.S. 964 (1950); Rev. Rul. 75-346, 1975-2 C.B 66 (sewage charge based on amount of water used was

additional payment for the use of city sewage system, and local real property tax.) The non-residential charges imposed by the ---- are only based in part on usage, but we think that the principle is the same as in the cited cases and ruling. A charge based on usage in whole or in part, is a charge for a service rendered, not a tax. We have earlier concluded that Rev. Rul. 76-45 does not allow taxpayers to deduct the portions of ordinary water bills that are allocable to maintenance or interest. Hence, the nonresidential customers of the ---- Sewerage Authority may deduct no part of the charges imposed on them.

In its ruling request, ---- at 8, asserts that:

the sewer system users' rental charges imposed by the Authority are imposed because of, and are measured by a benefit inuring directly to the property against which the rentals are charged and therefore the rental charges are deductible as taxes to the extent they are properly allocable to maintenance and/or interest charges.

First, as to nonresidential customers, no part of the charges imposed by the Authority are deductible. Nonresidential customers of the Authority in both sewer districts are charged on the basis of usage, and for the reasons stated in our analysis of the ---- -no part of the charges imposed on nonresidential customers is deductible under section 164, although such charges may be deductible under section 162.

There remains for our consideration the residential charges. Although our discussion will deal with ---- our analysis generally applies equally to the ---- case. In the ---- case, the sewer charges were imposed on both property owners and renters. This led us to conclude that the charge in that case was not against property and hence was not a tax against local benefits or a real property tax. In the ---- case, only property owners are charged for sewage, and thus a different analysis is required. The first question that arises, assuing arguendo that the charges are taxes, is whether they are “[t]axes assessed against local benefits of a kind tending to increase the value of the property assessed “ As stated above, for purposes of section 164(c)(1), “it is not necessary to prove that the taxpayer's property <u>actually</u> increased in value by virtue of the benefit conferred upon the property “ <u>Noble</u> , 70 T.C. at 920 (emphasis in original, citing <u>Caldwell Milling</u>). All that is required by section 164(c)(1) is that the benefit be “of a kind tending to increase the value of the property assessed “ <u>Noble</u>.

The ruling request, at 5, contains a summary of cash receipts and disbursements of the Authority for the year ended December 31, 1977.

(PRESENTED FOR ILLUSTRATION PURPOSES ONLY)%n5%n

SEWER REVENUE ACCOUNT

SUMMARY OF CASH RECEIPTS AND DISBURSEMENTS

FOR THE YEAR ENDED DECEMBER 31, 1977

RECEIPTS

Sewer rentals $1,600,000

Other operating receipts 30,000

Other receipts 300,000

Total receipts $1,930,000

DISBURSEMENTS

Operating Expenses $50,000

Maintenance 810,000

Other operating expenses $860,000

Administration expenses 120,000

Debt Service Requirements Series of 1974 Bonds:

Interest 277,710

Principal 307,290 585,000

Other debt service requirements 51,000

Capitalized additions and improvements 2,000

Other non-operating disbursements 295,000

Total Disbursements 1,913,000

EXCESS OF TOTAL RECEIPTS OVER DISBURSEMENTS $17,000

[Footnote omitted.]

Some of the Authority's disbursements are of a kind tending to increase the value of the property assessed. Specifically, there is the $307,290 to pay the principal on the 1974 bonds,[6] and $2,000 for capitalized additions and improvements. Also, note that there are disbursements to pay the interest on the 1974 bonds and for maintenance. Thus, the ---- charges may arguably satisfy the requirement that they be of a kind tending to increase the value of the property assessed.

However, the ---- charges go primarily for operating and other non-capital expenses. Treas. Reg. 1.164-4(a) describes taxes for local benefits as being “imposed because of ... some benefit inuring directly to the property against which the assessment is levied “ That the charges in the instant case are imposed for operational purposes as well as for capital improvements leads us to question whether the charges are “imposed because of some benefit inuring directly to the property against which the assessment is levied “ In this regard consider Rul. 67-337, 1967-2 C.B. 92, considered in G.C.M. 33254 ---- I-1975 (May 23, 1966). In that ruling an irrigation district, in order to finance its operation, imposed an annual ad valorem assessment against all farm property within the district . This assessment was allocated by the district as follows: operation and maintenance, 2x dollars; administration, 1x dollars; water purchase cost, 3x dollars; and, repayment to the United States of the construction costs of the water distribution system, 4x dollars. The ruling found that the assessments levied by the district were imposed because of, and measure by a benefit inuring directly to the property against which the assessment is levied, i.e., that the assessments were taxes for local benefits.

It is questionable whether Rev. Rul. 67-337 is correct in concluding that the district's ad valorem assessment was imposed because of a benefit inuring directly to the property against which the assessment is levied. The proceeds of the assessment went in part for purposes other than capital improvements, maintenance, or interest. We do not, however, call for modification of Rev. Rul. 67-337. The result reached in Rev. Rul. 67-337 is a sensible one and reasonable interpretation of the law. The “some benefit” in Treas. Reg. 1.164-4(a) is the 4x dollars. The maintenance and interest portions of a tax, which in part goes for capital improvements, should be deductible according to section 164(a)(1) and (c) and Treas. Reg. 1.164-4(b)(1), whether or not part of the tax is for purposes other than capital improvements, maintenance, or interest.

Treas. Reg. 1.164-4(a) states that taxes for local benefits, “more properly assessments “ are “measured by some benefit inuring directly to the property against which the assessment is levied “ Rev. Rul. 60-327, 1960-2 C.B. 65, provides an example of a tax for local benefits that is measured by a benefit inuring directly to the property against which the assessment is levied. In Rev. Rul. 60-327, assessments were levied against property owners in a city-created parking improvement district to provide public parking facilities within the central business district of the city. Each assessment was determined by the need for parking spaces created by each particular business and was proportional to the benefit expected to be realized from the improvements. The assessments in Rev. Rul. 60-327 were held to be taxes assessed against local benefits, not deductible except for so much as was properly allocable to maintenance and

interest. For another example of a tax against local benefits that is measured by the benefit inuring to the property against which the tax is assessed, see Rev. Rul. 75-455, 1975-2 C.B. 68 (front foot benefit charges assessed against property by the ---- for water main and sewer improvements).

In the ---- case, the owners of residential property pay sewer rental at a flat-rate per quarter annum for each residential establishment connected to the sewer system. The number of residential units in a property is not necessarily related to the increase in the property's value as a result of the portion of the sewer charges that is used for capital improvements. A mansion containing only one residential unit may be worth much more than a rental property with a small number of residential units, and it may experience greater appreciation from the capital improvement than the rental property; yet ---- will charge the owner of the rental units more than the owner of the mansion.[7] There is no indication that the charge per rsidential unit is in any way a measurement of the benefit inuring directly to the property. The computation of the charges are not based to any degree on the increase to the value of the property, from the improvement, or even on the value of the property, which can be considered a rough approximation of the increase in the value of the property. Thus, the ---- charges are not “measured by some benefit inuring directly to the property against which the assessment is levied “

Another problem with the ---- case stems from the fact that Treas. Reg. 1.164-4(a) provides that “[a] tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited “ The portion of the ---- charges that is used to pay the principle and interest on the 1974 bonds benefits only ---- See note 6, supra. Presumably, however, the capitalized additions and improvements benefit both sewer districts. Hence, we cannot say that ---- is not benefited at all, although it seems to us that it is not intended that a tax against local benefits benefit predominantly the property in one district, and only minimally the property in another district. We do not choose to rest on this narrow ground because an opinion based thereon would leave you without guidance in cases where it is clear that all the property assessed is benefited in a roughly equal fashion.

Your transmittal memorandum states, at 2, that “[a]nnual user charges, whether imposed on a flat rate or consumption basis, do not qualify as “taxes assessed against local benefits' even though such charges are applied in part toward maintenance and interest purposes of the improvement system “ Lower Paxton's system of charging a flat-rate per residential unit for sewage could easily be viewed as a charge per user rather than a tax. Other utilities charge a flat-rate for their services. For example, it is common for telephone companies to charge for telephone service on a flat-rate basis. While the theory stated in your

transmittal memorandum that the charges in question are annual user charges, rather than taxes, is appealing, we do not think that there is sufficient legal analysis to warrant our reliance thereon. We do believe as a conclusion, however, that the charges are in substance user charges.

In summary, in order for the charges in question to constitute a "[t]ax assessed against local benefits of a kind tending to increase the value of the property assessed "[8] they must be "measured by some benefit inuring directly to the property against which the assessment is levied "[9] ---- system of charging a flat-rate for sewage per residential unit, as discussed above, is not "measured by some benefit inuring directly to the property against which the assessment is levied " and therefore is not a tax assessed against local benefits. Hence, the portion of the ---- charges that are allocable to maintenance and interest are not deductible by virtue of their being a tax assessed against local benefits. See Treas. Reg. 1.164-4(b)(1).

Next, we consider whether the ---- charges constitute a tax deductible in whole under section 164(a)(1)-(4). The ---- charges are not any of the taxes listed in paragraphs (2)-(4) of section 164; the only question is whether the charges constitue a local real property tax deductible under section 164(a)(1). Treas. Reg. 1.164-3(b) defines real property taxes as "taxes imposed on interests in real property and levied for the general public welfare " Treas. Reg. 1.164-4(a) contrasts taxes for local benefits with real property taxes by pointing out that the deductible real property taxes "are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction "

Real property taxes, in order to satisfy the requirement in Treas. Reg . 1.164-3(b) that they be imposed on interests in real property, must be imposed on an ad valorem basis, that is, measured by the value of the real property. G.C.M. 37560, ---- I-481-76 (June 6, 1978), at 11-12 (Treas. Reg . 1.164-3(b) has generally been construed to mean that the charge must be based on the value of the real property and not income derived from the use of such property); G.C.M. 36466 (Supp.), ---- I-238-75 (Feb. 1, 1977), at 6; Rev. Rul. 75-558, 1975-2 C.B. 67; G.C.M. 37880, ---- I-318-78 (March 12, 1979). See also Rev. Rul. 73-600, 1973-2 C.B. 47, considered in G .C.M. 35499, ---- I-232-73 (Sept. 5, 1973) ---- tax because it is a tax on the occupation or use of real property, computed on the basis of the presumed rental value thereof, and for which there is only personal liability).

A contrary argument can be made based on the definition of personal property taxes in section 164(b)(1), which requires that personal property taxes be imposed on an ad valorem basis, and the lack of a similar requirement for real property taxes in section 164. We think that the legislative history of the 1964

amendment to section 164 indicates that Congress may have had a specific concern when it required that personal property taxes be levied on an ad valorem basis. H.R. Rep. No. 749, 88th Cong., 1st Sess. A42 (1963), gave as an example of a tax that was not not levied on an ad valorem basis, a motor vehicle tax based on weight, model year, and horsepower. It is arguable that Congress was not aware of taxes that were arguably real property taxes and were not levied on an ad valorem basis, and therefore did not feel compelled to specify in the statute that real property taxes must be levied ad valorem to be deductible. Thus we find as a ground for holding that the ---- charges are not deductible as real property taxes under section 164(a)(1) their failure to be levied on an ad valorem basis.

Another ground for finding that the ---- charges are not real property taxes deductible under section 164(a)(1) is their failure to meet the requirement in Treas. Reg. 1.164-4 that they be levied on all property in the territory over which the taxing authorities have jurisdiction. The ---- flat-rate charges are levied only on residential property. The omission of nonresidential property from the tax constitutes the omission of a significant amount of real property in the taxing jurisdiction, and hence the ---- charges do not constitute a deductible real property tax. See G.C.M. 36466 (Supp.), at 7 ---- [10]

In sum, the ---- residential sewer charges are not deductible to any extent.

The proposed plan of ---- would impose an annual uniform charge on each customer, computed by dividing the sum of the annual maintenance and interest expenses incurred by the Authority by the total number of customers who receive service. In addition to the uniform charge, the ---- customers will pay a minimum service charge based on water usage. The Authority charges only property owners, not renters. The Authority requests a ruling that the annual uniform charge for maintenance and interest, imposed against all the Authority's customers, is deductible by the Authority's customers “pursuant to 164(c) of the Internal Revenue Code “ The ruling request materials do not give an estimate of the annual uniform charge that would be imposed if the ---- plan were adopted.

The Authority in its ruling request quotes from section 164(c)(1) and Treas. Reg. 1.164-4(b)(1), concluding that taxpayers can clearly deduct taxes assessed against local benefits to the extent that the taxpayers meet the burden of demonstrating that the deduction is properly allocable to interest and maintenance charges. The ruling request, without so much as pausing to consider whether the uniform charge is deductible under section 164(c)(1) and Treas. Reg. 1.164-4(b)(1), asserts that the Authority's plan meets the taxpayer's burden of allocation under section 164(c)(1) and Treas. Reg. 1.164-4(b)(1). Rev. Rul. 76-45 and Rev. Rul. 67-337 are discussed in support of the taxpayer's position. The ---- private

letter ruling, dated August 17, 1970, is also cited, and in a letter to the Service, dated June 22, 1978, the taxpayer asserts that the rationale for its view is straightforward and follows the reasoning of the ---- private letter ruling.

It is not asserted by the Authority that its service charge based on usage is deductible under section 164. The service charge is not deductible under section 164. See the discussion of the ---- case, supra .

We turn next to whether the uniform charge for maintenance and interest purposes is deductible. (We will assume, without deciding, that what is labeled maintenance by the Authority is maintenance for purposes of section 164(c)(1).) We note first that section 164(c)(1) provides that "this paragraph shall not prevent the deduction of so much of such taxes as is properly allocable to maintenance or interest charges " We have concluded, supra, that maintenance and interest charges are by implication deductible under section 164(c)(1). But we note that "such taxes' refers to taxes assessed against local benefits of a kind tending to increase the value of the property assessed. So it would seem that a tax solely for purposes of maintenance and interest would not be deductible under section 164(c) because it would not be of a kind tending to increase the value of the property assessed. Maintenance and interest expenses do not tend to increase the capital value of property. S.M. 387 (July 31, 1918), at 2 (maintenance and interest); Little (interest); Birch Ranch & Oil Co. v. Commissioner, 13 T.C. 930, 942 (1949), nonacq., 1950-1 C.B. 7, aff'd, 192 F.2d 924 (9th Cir. 1951) (interest). We also note that Treas. Reg. 1.164-4(b)(1) states that "[i]nsofar as assessments against local benefits are made for the purpose of maintenance or repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible " This provision of the regulations does not expresly state that assessments for local benefits that are solely for maintenance and interest purposes are deductible.

The case law is, however, clear that taxes assessed solely for the purpose of paying maintenance and interest charges of local improvements are deductible. See Noble v. Commissioner, 73 T.C. 916, 920 (1978); Walker v. United States, 59-2 U.S.T.C. P9773 (W.D. Okla. 1959) (maintenance); First National Bank of Enid v. Hinds; 55-1 U.S.T.C. P9529 (W.D. Okla. 1955) (maintenance); Birch Ranch & Oil Co.; Harwell v. Commissioner, 170 F.2d 517 (10th Cir. 1948) (interest); Glide v. Commissioner, 27 B.T.A. 1264 (1933), rev'd upon stipulation of counsel on other grounds , 75 F.2d 1014 (9th Cir. 1935) (interest); Little (interest). These cases were all decided before the 1964 amendments to section 164, but as pointed out above, the legislative history of the 1964 amendments to section 164 contain no indication that Congress intended to change the law with respect to taxes against local benefits or the deduction of maintenance

and interest allocable thereto. Indeed, a recent Tax Court case, Noble, stated that "[s]ection 164(c)(1) does not prevent the deduction of a tax assessed for maintenance or interest charges "

Given that a tax solely for maintenance and interest purposes may be deductible, are there any additional requirements to be met. We believe that there the additional requirements. Treas. Reg. 1.164-4(b)(1) speaks of "assessments against local benefits " Treas. Reg. 1.164-4(a) states that "[a] tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited " The ---- uniform charge for maintenance and interest seems to satisfy the above requirement since it is imposed on every owner of property served by the system. [11] Treas. Reg. 1.164-4(a) also describes "[s]o-called taxes for local benefits ... more properly assessments' as being "imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied "

The ---- uniform charge is not a tax assessed against local benefits because it is not measured by some benefit inuring directly to the property against which the assessment is levied. The ---- charge is computed by allocating an equal share of the Authority's maintenance and interest expense to each customer of the system. The benefit to the property assessed is thus not taken into account in computing the Authority's uniform charge for maintenance and interest.

In Little a tax was levied to pay the interest on bonds in the same proportion as the annual assessment of benefits for the cost of the system and maintenance. None of the other cases cited above for the proposition that taxes levied solely for maintenance and interest purposes are deductible under section 164(c)(1) state the manner in which the tax at issue was computed.

It is our view that a tax levied solely for maintenance and interest purposes, in order to be deductible under section 164(c)(1) and Treas. Reg . 1.164-4(a), must be measured by some benefit inuring directly to the assessed property. In other words, the tax must bear some relationship to the benefit to the property from the capital improvements, which are being maintained by the proceeds of the tax, and which were financed by the bonds upon which interest is being paid. The ---- uniform charge fails to meet this requirement and is therefore not deductible under section 164(c)(1).

We must still consider whether the ---- charge is deductible under section 164(a). It is clearly not deductible under section 164(a)(2)-(4), hence if it is deductible under section 164(a), it must be as a local real property tax (section 164(a)(1)). But under the ---- plan, the property-owner would be required to pay a uniform charge for maintenance and interest, which would be computed without regard to the value of

his property. This would contravene the requirement discussed in connection with the ---- case that a real property tax must be levied on an ad valorem basis. Thus the ---- charge is not deductible as a real property tax under section 164(a).

The ---- private letter ruling relied upon in the ---- ruling request is of no assistance. The charged each household a $75.00 annual fee to cover the city's rental payments for water and sewerage plants. ---- households were separately charged, in addition, an amount based on the number of gallons used. The private letter ruling implies, without directly stating, that if properly allocated the maintenance and interest portions of the flat-rate charge would be deductible.

We first note that the proceeds of the ---- flat-rate charge are used by the city to pay the rental on water and sewage plants. This is different than in the cases before us. We do not here intend to answer whether the ---- charge is a tax against local benefits, but we note that section 164(c)(1) applies only to a tax of a kind tending to increase the value of the property assessed. Also, the ---- flat-rate charge does not appear to us to be measured by the value of the property assessed. You may wish to reconsider the ---- private letter ruling. Our Office will be happy to be of assistance to you in that endeavor.

The ---- ruling request is similar in most respects to the ---- ruling request. The ---- Authority intends to assess each of its customers with an annual uniform charge computed in the same manner as the ---- charge. In addition to the uniform charge, ---- customers will continue to pay a minimum service charge based on meter size and an additional amount based on water usage. Unlike the ---- case, renters as well as property owners are charged. The arguments presented by the ---- Authority in support of its position that its proposed uniform charge is deductible are substantially identical to those advanced by the ----

The ---- uniform charge is not deductible for the same reasons as the ---- uniform charge. Additionally, the ---- charge, is imposed on renters as well as property owners. As discussed above, taxes against local benefits must be imposed against property. Therefore, the ---- charge is not deductible under section 164(c)(1). It is not a property tax because it is imposed on renters as well as property owners, therefore it is not deductible under sections 164(a)(1) & (2). It is also not deductible under sections 164(a)(3) & (4).

We have carefully considered your transmittal memorandum and would like to address several of the points raised therein. The definition of tax as stated in Rev. Rul. 71-49, 1971-1 C.B. 103, considered in G.C.M. 34111, ---- I-3423 (April 28, 1969), and Rev. Rul. 61-152, 1961-2 C.B. 42, considered in G.C.M. 31738, ---- A-634059 (July 19, 1960), is set forth in your memorandum. We considered whether the

instant charges met the definition of tax. We ran into difficulty with this approach. First, every tax for local benefits is not, as is required by the definition of tax in Rev. Rul. 71-49 and Rev. Rul. 61-152, levied for the purpose of raising revenue; instead it is levied for the purpose of, for example, constructing a sidewalk. Second, we had difficulty setting forth reasons why the instant charges were payments for privileges granted or service rendered and not taxes or, as stated in Treas. Reg. 1.164-4(a), more properly, assessments.

Your memorandum takes the position that "taxes assessed against local benefits' as contemplated by section 164(c)(1) of the Code and section 1.164-4 of the regulations are restricted to one-time (even though paid in installments over a long period) taxes or special assessments ... " We find no requirement in section 164(c)(1) or Treas. Reg. 1.164-4 to that effect. We caution that to be a tax against local benefits the requirements of section 164(c)(1) and Treas. Reg. 1.164-4 must be met.

Your memorandum states that the sewer and water authorities involved in this case probably qualify as political subdivisions on the basis of Rev. Rul. 58-473, 1958-2 C.B. 100. In Rev. Rul. 58-473, a ---- , incorporated under the ---- was held to be a political subdivision of the ---- for purposes of section 170(c)(1). The four ---- authorities in our cases, are incorporated under the same Act. We see no substantial difference between the ---- (West 1964), and the ----

You state, however, that there is doubt under ---- and ---- law whether municipal authorities have the power to tax. This is of significance because a tax must, according to the definition in Rev. Rul. 71-49 and Rev . Rul. 61-152, be exacted pursuant to legislative authority in the exercise of the taxing power. We regard the power to tax as raising a potentially difficult state law question. We prefer at this time to resolve the instant cases on federal tax law grounds. We reserve judgment on the issue of whether these authorities have the power to tax within the meaning of section 164(c). We, however, would point out that the power to tax under section 164(c) may include the power to levy special assessments, or taxes against local benefits. See generally Caldwell Milling Co.

STUART E. SEIGEL

Chief Counsel

DONALD J. DREES, JR.

Chief

Branch No. 1

Interpretative Division

Attachments:

Admin. files

---

[2]

School property is charged based on the number of students, teachers, and other employees of the school.

---

[3]

Prior to the 1964 amendment of section 164, the denial of the deduction for taxes assessed against local benefits was contained in section 164(b)(5) (now it is in section 164(c)(1)). The exception for taxes assessed against local benefits levied by a special taxing district was contained in section 164(b)(5)(B).

---

[4]

Several Tax Court Memorandum Decisions, involving the Muskogee ordinance, are in accord with Roth. See, e.g., Thornbrough v. Commissioner, No. 30088 (T.C.M. 1952); Ward v. Commissioner , Nos. 26687, 27164 (T.C.M. 1952); Gilliam v. Commissioner, No. 27541 (T.C.M. 1952). Also in Wolf v. United States, 64-1 U.S.T.C. P9211 (W.D. Mo. 1964), the court, relying on Roth, held that sewer charges imposed by city ordinance were services charges, not taxes. (The Wolf opinion does not reveal whether the city sewer charges were imposed on a flat-rate or on a usage basis.)

---

[6]

The 1974 bonds were issued to obtain funds to redeem the 1971 bonds, which were issued to finance construction of sewer collection facilities in ----

---

[7]

The same difficulty, i.e., one property that benefits more by the assessment may be charged less than another that benefits less, is present with respect to an ad valorem tax. G.C.M. 36401 considered whether an ad valorem tax could be a tax against local benefits and concluded affirmatively, based on

section 164(b)(5)(B) (pre-1964 amendment) concerning levies of special taxing districts. Although G.C.M. 36401 did not analyze the language of Treas. Reg. 1.164-4(a), we conclude that an ad valorem tax for a local benefit may be a measurement of some benefit inuring directly to the property against which the assessment is levied.

8

Section 164(c)(1).

9

Treas. Reg. 1.164-4(a)

10

We recognize that most, if not all, real property tax statutes exempt certain specified real property, see, e.g., N.J. Stat. Ann. 54:4-3.6 (West Supp. 1978) (exemption for, inter alia, buildings used for historical societies, public libraries, and religious worship). However, we think Treas. Reg. 1.164-4 was not written with the intent of making real property taxes with limited specified exemptions nondeductible . If such were the intent, then very few, if any, state or local real property taxes would be deductible, a clearly unintended result.

11

We say “seems to satisfy” this requirement because it is not clear to us that the ---- Authority's tax is imposed upon property, rather than upon property owners in their capacity as users of the system.