

**LETTER OPINION
2015-L-09**

December 17, 2015

Ms. Jolene Kline
Executive Director
Housing Finance Agency
2624 Vermont Avenue
Bismarck, ND 58504

Dear Ms. Kline:

Thank you for your letter raising several questions about the proper interpretation of N.D.C.C. § 57-02-08(43) relating to the tax exempt status of residential rental property used as affordable housing. Specifically, you asked several questions about the certification requirements of the Housing Finance Agency to a county director of tax equalization that a residential rental property is eligible for a property tax exemption¹ during the property's period of affordability.

1. You ask whether a property funded under the qualified nonprofit set-aside in the federal Low Income Housing Tax Credit program² is eligible for the exemption under N.D.C.C. § 57-02-08(43) if the ownership entity has a for-profit general partner holding a 48% share, and a nonprofit general partner holding a 52% share.
2. You also ask whether in such a partnership arrangement a nonprofit general partner would be required to have a controlling interest and materially participate in the property³ in order to obtain a state property tax exemption.

¹ Even though a property may be certified as being exempt from property taxes, the project is required to make a payment in lieu of taxes or PILOT, in order to cover certain governmental costs. N.D.C.C. § 57-02-08(43)(d).

² See 26 U.S.C. § 42(h)(5).

³ For purposes of this letter, the terms "property" or "residential property" are used interchangeably with "project" or "housing project." See N.D.C.C. § 57-02-08(43) and 26 U.S.C. § 42(h)(5).

3. You further ask whether the property would be eligible for the state property tax exemption (including whether the statutory right of first refusal for the nonprofit entity would remain as a requirement between the for-profit and nonprofit general partners) if a limited partner exits the partnership and the limited partner's interest is transferred to a general partnership consisting of both for-profit and nonprofit general partners.

Your questions will be addressed sequentially below.

ANALYSIS

State law provides for numerous exemptions from property taxation.⁴ The relevant subsection for exemptions related to affordable housing⁵ is found in N.D.C.C. § 57-02-08(43) and provides:

All residential rental property, inclusive of land and administrative and auxiliary buildings, used as affordable housing shall be exempt from taxation for the property's period of affordability.

- a. The property is exempt under this section if the housing finance agency certifies to the county director of tax equalization that on January 1, 2013, or thereafter, the residential rental property complies with the following:
 - (1) The property is subject to and in compliance with a land use restriction agreement that enumerates the mandatory income and rent restrictions;
 - (2) The property is owned by a qualified nonprofit entity, as defined in section 42 of the Internal Revenue Code [26 U.S.C. 42]. If under a partnership agreement or other legally enforceable instrument, a for-profit entity, such as a limited

⁴ See N.D.C.C. § 57-02-08.

⁵ N.D.C.C. § 57-02-08(43)(f) provides: For the purposes of this subsection, "affordable housing" includes property eligible for or receiving assistance through a local, state, or federal affordable housing program and in which rent and household income restrictions apply, and which is owned by nonprofit entities organized for the purpose of providing affordable housing. Affordable housing is limited to residential rental property owned by or with a controlling ownership or management interest by an organization organized and operated exclusively for exempt purposes set forth in section 501(c)(3) of the Internal Revenue Code [26 U.S.C. 501(c)(3)].

partner,⁶ has an ownership interest in the property, then the agreement must provide that the nonprofit entity must have the right of first refusal in any transfer of the ownership interest in the property. The partnership agreement or other legally enforceable instrument also must provide that any transfer of the ownership interest by the for-profit entity must be without financial gain; and

- (3) The general partner⁷ or other ownership entity is owned or controlled by a nonprofit entity or a political subdivision.⁸

In attempting to determine the legislative intent of a statute, both the North Dakota Supreme Court and this office have on a number of occasions said that “[t]he Legislature’s intent must be sought initially from the statutory language.”⁹ Generally, the legislative history will only be considered when a statute is considered ambiguous or when a latent ambiguity arises in the application of the statute to a particular set of facts.¹⁰ Isolated comments by a legislator or interested party in the record must be viewed cautiously and might not be sufficient proof of legislative intent.¹¹ The plain language of a statute is paramount and controls the broad statements of legislative intent.¹² Consequently, in addressing your questions, I must first attempt to construe these provisions and address your questions to the extent possible based on the plain language of the statute and only resort to extrinsic aids such as legislative history, if the statutes are ambiguous or unclear.¹³

In your letter you set out two examples preceded by several questions. In your first example you allude to the situation in which a general partnership interest held by a nonprofit entity was sold to a general partnership consisting of a nonprofit general partner with a 52% share and a for-profit general partner holding a 48% share.¹⁴ You

⁶ A limited partnership must have one or more limited partners and one or more general partners. N.D.C.C. § 45-10.2-02(26).

⁷ Id.

⁸ N.D.C.C. § 57-02-08(43)(a)

⁹ Cnty. of Stutsman v. State Historical Soc’y, 371 N.W.2d 321, 325 (N.D. 1985).

¹⁰ N.D.C.C. § 1-02-39; N.D.A.G. 2011-L-05.

¹¹ N.D.A.G. 87-19 (in determining legislative intent one may only cautiously rely on comments of a legislator or interested party) (citing Snyder’s Drug Stores, Inc. v. N.D. State Bd. of Pharmacy, 219 N.W.2d 140, 147 (N.D. 1974)).

¹² Teigen v. State, 749 N.W.2d 505, 513-14 (N.D. 2008).

¹³ N.D.C.C. § 1-02-39.

¹⁴ Letter from Jolene Kline, Exec. Dir., N.D. Housing Fin. Agency, to N.D. Att’y Gen. (May 4, 2015).

indicate that the property was funded under the qualified nonprofit set-aside provisions in the federal Low Income Housing Tax Credit program contained in section 42 of the Internal Revenue Code.¹⁵ A primary requirement contained in the federal set-aside provision is that a qualified nonprofit organization “is to own an interest in the project (directly or through a partnership) and materially participate . . . in the development and operation of the project throughout the compliance period.”¹⁶

I.

Based on the first example, you initially ask whether a project funded under the federal nonprofit set-aside that has a for-profit general partner and a nonprofit general partner (with a controlling interest) is eligible for the property tax exemption. Section 57-02-08(43), N.D.C.C., provides that all residential rental property used as affordable housing shall be exempt from taxation for the property’s period of affordability subject to a number of conditions.¹⁷ This statute provides that if the Housing Finance Agency certifies to the county director of tax equalization that the residential rental property complies with the statutory requirements, it may receive the property tax exemption.¹⁸

Specifically, the statute requires that: (1) the property must be subject to and in compliance with a land use restrictive agreement that sets out the income and rent restrictions; (2) the property must be owned by a “qualified nonprofit entity” as defined in section 42 of the Internal Revenue Code,¹⁹ but if a for-profit entity has an ownership interest, the qualified nonprofit entity must have the right of first refusal in any transfer of the ownership interest, and the transfer of ownership interest by the for-profit entity must

¹⁵ 26 U.S.C. § 42(h)(5).

¹⁶ Id.; the term “materially participate” is defined in 26 U.S.C. § 469(h) (“Material participation defined.--For purposes of this section--(1) In general.--A taxpayer shall be treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis which is--(A) regular, (B) continuous, and (C) substantial.”).

¹⁷ N.D.C.C. § 57-02-08(43).

¹⁸ Id.

¹⁹ The term “qualified nonprofit organization” means an organization “described in paragraph (3) or (4) of section 501(c) and is exempt from tax under section 501(a), (ii) such organization is determined by the State housing credit agency not to be affiliated with or controlled by a for-profit organization; and (iii) 1 of the exempt purposes of such organization includes the fostering of low-income housing.” 26 U.S.C. § 42(h)(5). The references to exempt organizations in section 42(h)(5) include what are commonly called 501(c)(3) and 501(c)(4) exempt organizations under 26 U.S.C. § 501.

be without financial gain;²⁰ and (3) the general partner or other ownership entity must be owned or controlled by a nonprofit entity or a political subdivision.^{21, 22}

As noted above, N.D.C.C. § 57-02-08(43)(a)(2) does not prohibit a for-profit entity from having an ownership interest in the property but does provide that if a for-profit entity such as a limited partner has an ownership interest in the property, the governing agreement must grant the nonprofit entity the right of first refusal in any transfer of the ownership interest and require that the transfer must be without financial gain; further, the general partner or other ownership entity must be owned or controlled by a nonprofit entity or a political subdivision.²³ In your first example, the general partnership interest was held by a nonprofit entity and sold to another general partnership consisting of a nonprofit entity holding a controlling 52% share and a for-profit entity holding a 48% share. You also noted that the property was funded under a nonprofit set-aside under the federal Low Income Housing Tax Credit program which requires the nonprofit entity to “materially participate” in the development and operation of the property throughout the compliance period.²⁴ You ask whether this property is eligible for the state property tax exemption under these circumstances.

Based on the foregoing circumstances and a plain reading of the statute involved, it is my opinion that a property held under a general partnership with the nonprofit general partner owning or controlling the partnership (in this case holding a 52% controlling share) and where the non-profit general partner has materially participated²⁵ in the development and operation of the property and which is otherwise in compliance with the requirements of N.D.C.C. § 57-02-08(43)(a) and (f) would be exempt from property taxation and would be eligible for certification by the Housing Finance Agency to the county director of tax equalization.

²⁰ N.D.C.C. § 57-02-08(43)(a)(2).

²¹ N.D.C.C. § 57-02-08(43)(a)(3).

²² However, it should be noted that in N.D.C.C. § 57-02-08(43)(f), the definition of “affordable housing” is limited to residential real property owned by or with a controlling ownership or management interest by a 501(c)(3) entity, and does not include a 501(c)(4) entity under the state provision. (There was a bill introduced in the Sixty-fourth Legislative Assembly to permit a 501(c)(4) entity to be included in the definition, but the bill was defeated.)

²³ N.D.C.C. § 57-02-08(43)(a).

²⁴ 26 U.S.C. § 42(h)(5)(B).

²⁵ The “materially participating” test is applicable in this case and must be met since the property was financed by the federal set-aside program found in 26 U.S.C. § 42(h)(5).
See n.15.

II.

You next ask, as a preliminary matter, what constitutes a controlling interest by a nonprofit entity. The phrase “controlling interest” is not defined in N.D.C.C. § 57-02-08(43), nor did I find a directly applicable definition elsewhere in the Code.²⁶ However, case law in other jurisdictions provides that a “controlling interest” in the case of a corporation is one in which a person or entity owns the majority of the issued capital stock.²⁷ In the case of a nonprofit entity, whether it held a controlling interest would depend on the type of nonprofit entity it is and how its interest was evidenced in the applicable governing documents.²⁸

You further ask whether a nonprofit general partner would be required to have a controlling interest and materially participate in the development and operation of the project in order to qualify for the property tax exemption. I assume that you are referring to your first example in which the project was funded with a federal set-aside under the Low Income Housing Tax Credit program.²⁹ That provision of federal law requires that

²⁶ But see N.D.C.C. § 6-08-08.1(7) (“control” for purposes of banking statutes is defined as ownership of at least 25% or more of any class of voting securities).

²⁷ See, e.g., Madison Pictures, Inc. v. Chesapeake Indus., Inc., 147 N.Y.Supp.2d 50 (N.Y. Supp. 1955). “[A] ‘controlling interest’ references dominant ownership of a corporation’s stock, not necessarily all of the stock.” Dixon v. Pro Image Inc., 987 P.2d 48 (Utah 1999).

²⁸ Exempt organizations such as nonprofit corporations have a number of fairly broad powers under state law. These include the authority to purchase, lease, or otherwise acquire, own, hold, improve, and use and deal in and with real property and any interest in property wherever situated. They also have the authority to sell, convey, mortgage, create a security interest in, lease, exchange, transfer, or otherwise dispose of all or any part of its real property or any interest in property wherever situated. N.D.C.C. § 10-33-21(4) and (5). Further, a “[nonprofit] corporation may participate in any capacity in the promotion, organization, ownership, management, and operation of any organization or in any transaction, undertaking, or arrangement that the participating [nonprofit] corporation would have power to conduct by itself, whether or not the participation involves sharing or delegation of control.” N.D.C.C. § 10-33-21(13). In addition, a nonprofit “corporation may be a member of or the owner of the ownership interest in another domestic or foreign organization” and a nonprofit corporation “may acquire an owner’s interest in another organization.” N.D.C.C. § 10-33-21(25) and (29). Thus, it is clear that a nonprofit organization, such as a nonprofit corporation, may have the authority to be an owner or member of another organization to the extent provided in any governing documents and would presumably also have the authority to hold a controlling interest in another entity such as a general partnership.

²⁹ See 26 U.S.C. § 42.

a qualified nonprofit organization must own an interest in the project either directly or through a partnership and materially participate in the development and operation of the project throughout the compliance period.³⁰ Section 57-02-08(43)(a)(3), N.D.C.C., requires that the general partner or other ownership entity be owned or controlled by a nonprofit entity or a political subdivision.³¹ Based on a plain reading of these provisions, it is my further opinion that a nonprofit general partner in a project funded under the nonprofit set-aside program of the federal Low Income Housing Tax Credit program would be required by federal law to own an interest in the project either directly or through a partnership and materially participate in the development and operation of the project, and, under state law provisions, it would be required to own or control the general partnership in the project, in order to be eligible for the Housing Finance Agency to certify the property tax exemption to the county taxing authorities.

III.

In your second example, you indicate that a nonprofit entity and a for-profit entity own a property as general partners but that the nonprofit general partner does not have a controlling interest nor has it materially participated in the development and management of the property. You further indicate that the partners are proposing to amend the partnership agreement to meet the qualifications for the exemption noting that because the project was not funded in part by the federal set-aside, “material participation” would not be required, although there would be a remaining question of eligibility for this partnership structure to receive the property tax exemption.

Thus, based on your second example, you ask that if a limited partner exits the partnership and that interest is transferred to a general partnership consisting of both for-profit and nonprofit entities, whether the project would be eligible for the property tax exemption. Assuming, as you stated in your second example, that the partners are proposing to amend the agreement to meet the qualifications for the exemption, the partners would need to take certain steps for the property to qualify for the exemption. Section 57-02-08(43)(a)(2), N.D.C.C., requires that the property must be owned by a qualified nonprofit entity as defined in 26 U.S.C. § 42, and subparagraph (3) of section 57-02-08(43)(a) requires the general partnership to be owned or controlled by a qualified nonprofit entity. Also, if the for-profit entity exits the partnership, the nonprofit entity must have the right of first refusal under a governing agreement and any transfer must be without financial gain.³² Based on these circumstances, the nonprofit general partner thus would have to have ownership or control of the general partnership.³³

³⁰ 26 U.S.C. § 42(h)(5)(B).

³¹ N.D.C.C. § 57-02-08(43)(a)(3).

³² N.D.C.C. § 57-02-08(43)(a)(2).

³³ Id.

Finally, you ask whether the right of first refusal for the nonprofit entity required under N.D.C.C. § 57-02-08(43)(a)(2) would remain as a requirement between the general partners, if a limited partner with an ownership interest decides to exit the partnership. Would the nonprofit entity's right of first refusal be applicable both at the time the limited partner left the partnership as well as at any time the for-profit general partner may choose to exit the general partnership? You indicate that although the limited partner left the partnership and transferred that interest to a general partnership, you did not indicate whether the governing agreement³⁴ granted the nonprofit general partner a right of first refusal in that case nor if a right of first refusal was granted to the nonprofit general partner for the interest of the for-profit general partner.

The application of the statutory language to this particular set of facts creates a latent ambiguity, so looking to the legislative history is appropriate. Statements by the sponsor of the bill creating this provision³⁵ indicated that these types of tax credit projects typically have both for-profit and nonprofit elements of ownership in order to facilitate the financing and that the for-profit limited partners typically go away after the tax credit incentive expires. He also indicated that as a practical matter, the statute accommodates these types of financing structures by providing for transfer of their ownership interests to the nonprofit entities (at no gain to the for-profit entity) so that the affordable housing can continue for an additional 15 years. The projects that are structured as provided in the statute would be eligible for property tax exemption both in the initial 15-year period of affordability and in the second 15-year period of affordability. It was noted that if the nonprofit entities are not eligible for the transfer of ownership to them through the right of first refusal, the project would not be eligible for a property tax exemption.³⁶

The legislation does not specifically state that such rights of first refusal apply to multiple transfers of ownership interests; however, N.D.C.C. § 1-01-35 provides that words used in the singular include the plural, unless a contrary intention clearly appears. Even though the right of first refusal is phrased in the singular, it can reasonably encompass multiple transfers. Moreover, under state law a limited partnership may consist of one or more limited partners and one or more general partners.³⁷ Thus, it is very possible for a nonprofit entity to have multiple rights of first refusal – one for each for-profit ownership entity that may transfer its ownership interest.³⁸

³⁴ See N.D.C.C. § 45-10.2-15 (“[a] person may be both a general partner and a limited partner”).

³⁵ Senate Floor Sess. on S.B. 2338, 2013 N.D. Leg. (Feb. 21) (Statement of Sen. Cook).

³⁶ Id.

³⁷ N.D.C.C. § 45-10.2-02(26).

³⁸ N.D.C.C. § 57-02-08(43)(a).

Consequently, in furtherance of the public policy intent, it is my opinion that if a limited partner exits a partnership and the interest is transferred to a general partnership consisting of both for-profit and nonprofit entities, the property would only be eligible for the state property tax exemption if it became compliant with all the applicable statutory requirements, including that the property be owned at least in part by a qualified nonprofit entity, the general partner is owned or controlled by a nonprofit entity, that the nonprofit entity would have a right of first refusal in any future transfer of any ownership interest of any for-profit entity in the property, and that if the for-profit entity transfers its interest, it must be without financial gain.³⁹

Sincerely,

Wayne Stenehjem
Attorney General

jjf

This opinion is issued pursuant to N.D.C.C. § 54-12-01. It governs the actions of public officials until such time as the question presented is decided by the courts.⁴⁰

³⁹ N.D.C.C. § 57-02-08(43)(a)(2).

⁴⁰ See State ex rel. Johnson v. Baker, 21 N.W.2d 355 (N.D. 1946).