State of Wisconsin • DEPARTMENT OF REVENUE

DIVISION OF STATE AND LOCAL FINANCE • MADISON, WI

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October 23, 2008

Mr. Michael P. May
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Mr. Timothy J. Radelet
Attorney, Foley & Lardner LLP
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Dear Mr. May & Mr. Radelet,

This letter is in response to Mr. May's April 23, 2008 inquiry to the Wisconsin Attorney General J.B. Van Hollen and to Mr. Radelet's July 18, 2008 letter to the Department of Revenue. I appreciate having the opportunity to respond. Both of your letters request clarification of sec. 70.11, Wis. Stats.

As you know, sec. 70.109, Wis. Stats., provides for a strict interpretation of exemptions, a presumption of taxability, and places the burden of proof with the entity that is requesting an exemption. In addition, it is important to note that a recent Dane County Circuit Court decision[1] ruled on the definition of maintenance as it relates to property tax exemptions under sec. 70.11, Wis. Stats. The decision stated that there was clear legislative intent to limit the expenditure of leasehold income whereby the court held maintenance only includes expenses for the physical upkeep of the premises.

With this in mind, the questions at issue are listed below with the Department's response.

1. Do you concur that the leasehold income must be used for the stated purpose "of the leased property" that generated the income?

   The lease exception clause in sec. 70.11, Wis. Stats., is specific to a particular property. In order for that property to maintain its exemption, the lessor must apply all of a property's leasehold income to that same property.

   "... if the lessor uses **all** of the leasehold income for maintenance of **the leased property** or construction debt retirement of **the leased property**, or both ..." (Emphasis added)

2. Is the word "maintenance" in the statute limited to physical repairs, cleaning, and other actions taken on the property, or may it be interpreted to cover any costs that keep the property as a going concern, such as operating costs (utilities, insurance, mortgage debt, administration) of any variety?

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[1] *Future Madison Eastpointe, Inc. et al. v. City of Madison*, Case Nos. 07-CV-1129, 1130 and 1817, (Dane Cty. Cir Ct. Sept. 26, 2008)

On page 22-4 of the 2008 *Wisconsin Property Assessment Manual*, definitions of maintenance are provided from *Webster's Third Unabridged Dictionary* and the *International Association of Assessing Officers*. The definitions from these two sources are "...the labor of keeping something (as buildings or equipment) in a state of repair or efficiency" and "An expenditure of a fixed asset that increases or tends to preserve the asset's value..."

As provided in sec. 70.11, Wis. Stats., "maintenance" is specific to "the leased property." Only those expenses for maintenance of the leased property would qualify. In accord with the definitions above, such maintenance would include expenses for the exterior structure and interior components of the property. Examples of those expenses that qualify as maintenance are cleaning expenses, ventilation system repairs and maintenance, elevator repairs and maintenance, flooring repairs, wall repairs and painting, refuse collection, snow removal, property insurance, and government fees required for completion of maintenance such as a building permit fee for roof replacement. Reserves for replacement would also qualify as maintenance for those annual allowances to replace building components, fixtures, and equipment, such as flooring replacement, roof replacement, window replacement, and ventilation system replacement. Maintenance includes the cost of labor and the related supplies required to complete the aforementioned tasks.

Other expenses that are associated with the entity's going concern would not qualify as maintenance. Examples of non-qualifying expenses are business insurance, advertising, depreciation, property additions, property acquisitions, debt payments, management fees, legal fees, accounting fees, financing fees, income taxes, franchise taxes, corporate taxes, real estate taxes, fees and expenses that are associated with a different property or business of the entity, and any costs associated with providing social, healthcare, and other services for residents. The cost of labor and any related supplies for these types of expenses would not qualify as maintenance.

3. Does the phrase "construction debt retirement" mean only the debt incurred to initially construct the property, implying that payment of other debt retirement is not meant to be included?

Construction debt retirement is specific to the "the leased property" under sec. 70.11, Wis. Stats. Payment of construction debt due to the initial construction of the leased property would qualify along with debt due to subsequent construction to the leased property.

A construction loan, converted to a conventional loan, would continue to qualify as construction debt retirement. However, any refinancing where other debt is included, such as new appliances, inventory, unpaid utilities, etc., would not be construction debt retirement. When such debts are combined, the property would not comply with sec. 70.11, Wis. Stats., and result in the property losing its tax exempt status.

In addition, other types of debt retirement by the leasehold income would not qualify as construction debt retirement. Examples include those debts associated with the business of operating the property, the debts of a parent or subsidiary entity, or the debts incurred from the construction of another property.

Mr. Radelet has argued that a narrow interpretation of the words "maintenance" and "construction debt retirement" is illogical because housing authorities and benevolent associations would be able to collect all possible leasehold income, but would not be able to apply it to all of the property operating expenses. The Department disagrees. The Department concurs with the Dane County Circuit Court in concluding that the statute shows clear legislative intent to limit lessors' use of rental income. It may be inferred that the Legislature was concerned that without such limitations, lessors could take unfair advantage of their exemption and use the leasehold income for speculative investments and other purposes. Or it may be that the Legislature wished nonprofit lessors to cover their expenses through benevolent activities and charitable donations rather than leasehold income.

Mr. Radelet also suggested that sec. 70.11 must only be applicable to subleases of property. He argues that the provision as to leasing states that it is only applicable to "property described in" sec. 70.11, and that apartment buildings of the type at issue are only described in § 70.11(4). The Department disagrees. Property described in sec. 70.11 includes property described in its subsections.

I hope you find the information helpful.

Sincerely,

Jean Gerstner
Deputy Administrator
Division of State and Local Finance

cc: Municipal Assessors