

## Private Letter Ruling Favorable on Including Certain Dedicated Infrastructure Improvements Costs in Eligible Basis

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Private letter ruling (PLR) 200916007 released on April 17, 2009 allows the taxpayer to include certain dedicated infrastructure improvements costs in eligible basis. Although not precedential, the PLR sheds light on Treasury's thoughts on the treatment of certain permanent offsite infrastructure improvements costs.

The facts in the PLR involve a developer who intended to construct and operate a project to meet the requirements of Section 42 of the Internal Revenue Code (IRC) for qualifying for the low-income housing tax credit (LIHTC). As one of the requirements to receive the certificates of occupancy for the project's residential rental buildings, the developer was required by a city to construct local streets, curbs, sidewalks, storm water drainage, domestic water inflow and utilities, including utility steel casings, wiring and installation fees (collectively referred to as infrastructure improvements) for the project. Upon completion of the infrastructure improvements, the developer was required by the city to dedicate all of the infrastructure improvements to the use of the public. Upon acceptance of the dedication, the city would own and maintain the streets and the utility steel casings. The city had also agreed to modify the scope of the infrastructure improvements if the developer decided to expand or constrict the project in ways that had been planned originally.

The taxpayer that requested the PLR sought rulings from the IRS on three issues. First, were the infrastructure improvements capitalizable as amounts paid to create an intangible? Second, were the infrastructure improvements capitalizable into the residential rental buildings produced by the taxpayer? Third, were the infrastructure improve-

ments includible in the eligible basis of a qualified low-income building under IRC Section 42(d)(1)?

As to the first issue, Treasury determined that the infrastructure improvements were not capitalizable as amounts paid to create an intangible. Section 1.263(a)-4(d)(8)(i) of the federal tax regulations requires a taxpayer to capitalize amounts paid for real property as an intangible if the taxpayer transfers ownership of the real property to another person and if the real property can reasonably be expected to produce significant economic benefits to the taxpayer after the transfer. However, Section 1.263(a)-4(d)(8)(iv) of the federal tax regulations provides that the previous sentence will not apply to amounts paid to satisfy one-time charges imposed by a state or local government on new development (or expansion of existing development) where the fees are intended to finance specific offsite capital improvements for general public use that are necessitated by the new or expanded development. In the situation described in the PLR, the developer is engaged in the new development of the project and is required by the city to construct specific offsite infrastructure improvements to get the certificate of occupancy. The infrastructure improvements will be dedicated to the use of the public and the city will own and maintain the infrastructure improvements thereafter. Therefore, the infrastructure improvements are dedicated improvements within the meaning of Section 1.263(a)-4(d)(8)(iv) of the federal tax regulations and are not capitalizable as amounts paid to create an intangible.

As to the second issue, the infrastructure improvements are capitalizable into residential rental buildings produced

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by the taxpayer. Section 1.263A-1(a)(3)(ii) of the federal tax regulations provides that taxpayers that produce real property and tangible personal property must capitalize into the cost of the produced property all the direct costs of producing the property and the properly allocable share of indirect costs. Section 1.263A-2(a)(1)(i) of the federal tax regulations states that the term "produce" includes construct, build, install, manufacture, develop, improve, create, raise or grow. Section 1.263A-1(e)(3)(i) of the federal tax regulations defines indirect costs as all costs other than direct material costs and direct labor costs. It further provides that indirect costs are properly allocable to property produced when the costs directly benefit, or are incurred by reason of, the performance of production activities. In *Von-Lust v. Commissioner* (104 T.C. 207 (1995)), the Tax Court held that a partnership organized to manage, hold and develop land for investment had to capitalize payments to independent contractors for obtaining building permits and zoning variances, and negotiating permit fees as costs allocable to property "produced" by the partnership. In Revenue Ruling 2002-9, 2002-1 C.B. 614, Treasury held that impact fees incurred by a taxpayer in connection with the construction of a

new residential rental building are treated as capitalized indirect costs allocable to the building under IRC Section 263A.

In the PLR, the infrastructure improvements incurred by the developer are neither direct material nor direct labor costs under IRC Section 263A. However, the infrastructure improvements are indirect costs under IRC Section 263A because they directly benefit and are incurred by reason of the developer's construction of the residential rental buildings. The infrastructure improvements are assessed by the city because of the developer's plan to construct residential rental buildings. Therefore, the infrastructure improvements, similarly to the impact fees described in Revenue Ruling 2002-9, are allocable among and only to the capitalized costs of the project's residential rental buildings.

As to the third issue, the PLR concluded that the infrastructure improvements are includable in the eligible basis of a qualified low-income building under IRC Section 42(d)(1). IRC Section 42(d)(1) provides that the eligible basis of a new building is its adjusted basis as of the close

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of the first taxable year of the credit period. IRC Section 42(d)(4)(A) provides that the adjusted basis of any building shall be determined without regard to the adjusted basis of any property that is not residential rental property.

However, IRC Section 42(d)(4)(B) provides that the adjusted basis of any building shall be determined by including the adjusted basis of any depreciable property used in common areas or provided as comparable amenities to all residential rental units in such building. As stated in the PLR, the infrastructure improvements are indirect costs capitalizable to the project's residential rental buildings under IRC Section 263A. The developer intends to construct and operate the project's residential rental buildings to meet the requirements of Section 42 of the IRC for qualifying for the low-income housing tax credit, which indicates that the residential rental buildings will be depreciated as residential rental prop-

erty under IRC Section 168. Therefore, the infrastructure improvements are includable in the eligible basis of the project's residential rental building under IRC Section 42(d)(1).

The PLR concludes favorably as to the inclusion of permanent offsite infrastructure improvements costs to depreciable and eligible basis. Practitioners have argued since Revenue Ruling 2002-9 that offsite costs mandated by local governments should be included in eligible basis on the theory that they are tantamount to impact fees that are includable in eligible basis under 2002-9, and the ruling is evidence that Treasury agrees with that conclusion. This PLR expands the offsite costs that will now be included in determining the eligible basis for LIHTC purposes. Although the PLR may not be cited or relied upon for precedent, the PLR provides considerable guidance as to the thinking of Treasury on the treatment of permanent offsite infrastructure costs. ❖

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