

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
OFFICE OF CHIEF COUNSEL

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MEMORANDUM FOR: CHIEF, PLANNING AND SPECIAL PROGRAMS, AREA 11

(SB:11)

FROM: SENIOR TECHNICIAN REVIEWER, BRANCH 6
PASSTHROUGHS AND SPECIAL INDUSTRIES (CC:PSI:6)
SUBJECT: DENIAL OF CONSENT FOR CHANGE IN ACCOUNTING METHOD

In accordance with § 8.07(2)(a) of Rev. Proc. 2003-1, 2003-1 I.R.B. 1, 29, this Chief Counsel Advice advises you that consent for a change in accounting method has been denied to a taxpayer within your jurisdiction. Pursuant to § 6110 (k)(3), this Chief Counsel Advice is not to be cited as precedent.

LEGEND:

Taxpayer =
Date =
Amount =

Taxpayer filed the Form 3115, Application for Change in Accounting Method, under Rev. Proc.97-27, 1997-1 C. B. 680, to request permission to change its method of computing depreciation for certain residential rental property.

Taxpayer is a partnership that operates a low-income housing development to generate rental income. The property was financed using the proceeds of tax-exempt bonds. Taxpayer previously depreciated the residential rental property of issue under the general depreciation system of §168(a)of the Internal Revenue Code. Taxpayer believes this method is improper. Taxpayer proposes to depreciate the residential rental property under the alternative depreciation system of§ 168(g).

The depreciation deduction provided by § 167(a) for tangible property placed in service after1986 generally is determined under § 168. This section prescribes two methods of

accounting for determining depreciation allowances. One method is the general depreciation system in § 168(a) and the other method is the alternative depreciation system in § 168(g).

Section 168(g)(1)(C) provides that in the case of any tax-exempt bond financed property, the depreciation deduction provided by § 167(a) is determined under the alternative depreciation system. Except as otherwise provided in § 168(g)(5), § 168(g)(5)(A) defines the term "tax-exempt bond financed property" as meaning any property to the extent such property is financed directly or indirectly by an obligation the interest on which is exempt from tax under § 103(a). Section 168(g)(5)(C) provides that the term "tax-exempt bond financed property" does not include any qualified residential rental project within the meaning of § 142(a)(7).

Section 142(d)(1) defines a "qualified residential rental project" for purposes of § 142 as any project for residential rental property if, at all times during the qualified project period, such project meets either: (A) the 20-50 test (if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income); or (B) the 40-60 test (if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income), whichever is elected by the issuer at the time of the issuance of the bonds with respect to such project. See also § 1.103-8(b)(4) of the Income Tax Regulations.

In the present case, Taxpayer represents that the low-income housing project subject to Taxpayer's Form 3115 constitutes a qualified residential rental project within the meaning of § 142(a)(7). Accordingly, pursuant to § 168(g)(5)(C), Taxpayer's qualified residential rental project is not included in the term "tax-exempt bond financed property." Therefore, the depreciation deduction provided by § 167(a) for Taxpayer's residential rental property does not have to be determined under the alternative depreciation system. Taxpayer's present method of accounting for the residential rental property is a permissible method of accounting.

In addition, Taxpayer did not elect to depreciate the residential rental property at issue under the alternative depreciation system. Section 168(g)(7) provides that if a taxpayer makes an election under this paragraph with respect to any class of property for any taxable year, the alternative depreciation system under § 168(g) will apply to all property in such class placed in service during such taxable year. Notwithstanding the preceding sentence, in the case of nonresidential real property or residential rental property, such election may be made separately with respect to each property. An election made under § 168(g)(7) is irrevocable.

Section 301.9100-7T(a)(2)(i) of the Procedure and Administration Regulation provides that the election under § 168(g)(7) must be made in the same taxable year in which the property is placed in service. In the present case, Taxpayer placed the residential rental property in service on August 24, 1998. Therefore, Taxpayer needed to make the election under § 168(g)(7) on its federal tax return for the taxable year ending

December 31, 1998. Taxpayer did not make a timely election under § 168(g)(7) for the residential rental property subject to Taxpayer's Form 3115.

The method changes would have been effective with the taxable year beginning Date and would have resulted in a positive § 481(a) adjustment (increase in taxable income) of Amount.

If you have any questions on this matter, do not hesitate to call me at (202) 622-3110.

Kathleen Reed

KATHLEEN REED

CC: