

# PLR 200220011 - IRC Section 42 - Low-Income Housing Credit

## IRC Section 42

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### Legend:

Taxpayer =

GP =

ILP =

LPB =

LPS =

LPO =

State 1 =

State 2 =

State 3 =

Project =

City =

City 2 =

Issuer =

Bank 1 =

Bank 2 =

Program =

Corporation =

Guarantors =

Agency =

Tax-Exempt Bonds =

b =

c =

e =

j =

k =

m =

n =

o =

p =

r =

s =

t =

v =

Dear

This letter responds to your authorized representative's letter dated October 5, 2001, and subsequent correspondence, submitted on behalf of Taxpayer, requesting a ruling that redemption of the Project's tax-exempt financing at any time after the date on which the Project is placed in service for all purposes under § 42 of the Internal Revenue Code will not, in and of itself, result in a determination that the Project was not financed by tax-exempt bonds for purposes of §42(h)(4)(B).

The relevant facts as represented in your submission are set forth below.

Taxpayer, a State 1 limited partnership, was formed pursuant to a limited partnership agreement dated b, to develop, construct, own, and operate the Project. The general partner of Taxpayer is GP, a State 1 corporation. The Class B Limited partner of Taxpayer is LPB, a State 1 corporation. The original limited partner was LPO, a State 1 limited liability company. The original partnership agreement was amended on c to provide for the withdrawal of LPO and the admission of ILP, a State 2 limited liability company, as the Investor Limited Partner, and LPS, a State 3 corporation, as the Special Limited Partner (the Partnership Agreement).

The Project will be located in City and will consist of e units in l building. All of the units in the Project will be rented to families whose incomes are equal to or less than 60 percent of area median income. Taxpayer began constructing the Project in City during j, on land that it acquired for \$k. Taxpayer expects to complete construction and place the Project in service in m, and to have all units in the Project occupied by Q.

Taxpayer expects to incur construction costs for the Project in the aggregate amount of approximately \$o. Taxpayer is financing the construction of the Project with capital contributions from ILP in the aggregate amount of \$p and with the \$r proceeds of the Tax-Exempt Bonds. Taxpayer represents that it will finance more than 50 percent of the costs of the Project with the proceeds of the Tax-Exempt Bonds.

The Tax-Exempt Bonds were issued by Issuer. They are secured by an indenture of trust between Issuer and Bank 1 and its successors, as trustee (the Trustee). The Tax-Exempt Bonds are credit enhanced during the construction period with an irrevocable direct pay letter of credit that Bank 2 issued to the Trustee for the benefit of the holders of the Tax-Exempt Bonds. The Tax-Exempt Bonds are subject to the volume cap under § 146. Taxpayer represents that the interest on the Tax-Exempt Bonds is excludable from gross income under § 103.

The Issuer will lend the proceeds of the Tax-Exempt Bonds to Taxpayer (the Bond Loan). The Bond Loan is a recourse obligation of Taxpayer that will bear interest at a variable rate. Taxpayer's obligation to repay the Bond Loan has been personally guaranteed by the Guarantors pursuant to the Joint and Several Guaranty of Payment executed by the Guarantors in favor of Bank 2.

Taxpayer intends to claim low-income housing tax credits permitted under § 42 for the Project.

Taxpayer expects that the Project will satisfy all requirements under § 42, and has received the governmental approvals for the Project as required by § 42 that are available prior to the completion of the Project. Agency has determined in accordance with the provisions of §42(m)(1)(D) that the Project will satisfy the requirements for allocations of housing tax credit under its qualified allocation plan. Further, Agency anticipates that the allowance of the housing tax credit to the Project will satisfy the financial feasibility and project viability requirements of §42(m)(2)(D), although a final determination to this effect cannot be made until the Project is placed in service. Based on the information provided to Agency, Agency and Issuer anticipate that the annual amount of the housing tax credit allowable for the Project will be approximately \$v.

Following the completion of construction and the placement in service of the Project, Taxpayer expects that the Bond Loan will be repaid and that the Issuer will retire the Tax-Exempt Bonds. Taxpayer expects that LPB will assume \$s of the principal balance of the Bond Loan as part of a transaction that will entirely redeem LPB's interest in Taxpayer. Taxpayer expects that LPB will repay the portion of the Bond Loan that LPB assumed with the proceeds of the sale of certain certificates issued by City 2 after the Project has been placed in service under the Program. Taxpayer expects to retire approximately \$t of the Bond Loan with the proceeds of a permanent loan from Corporation, in conjunction with a local housing program of City 2.

Taxpayer represents that it is retiring the outstanding Tax-Exempt Bonds for three business reasons. First, Taxpayer expects that the revenues to be generated by the Project would not be sufficient to pay the debt service on the Tax-Exempt Bonds. The Project is targeting very low-income tenants, which results in less rental income available to Taxpayer than in a conventional low-income housing project. Taxpayer expects that the retirement of the Tax-Exempt Bonds will reduce the amount of debt service payments for the Project and will protect the Project's financial stability. Second, Issuer has provided a local subsidy under the program that permits Taxpayer to reduce its outstanding debt. A condition of the subsidy is that Taxpayer must use the subsidy to retire the Tax-Exempt Bonds. Finally, under the terms of the Tax-Exempt Bonds, Taxpayer is required to redeem the Tax-Exempt Bonds upon completing the construction of the Project. As a condition to the assumption of the balance of the Bond Loan by LPB, ILP must be provided with evidence that at least 50 percent of the aggregate basis (within the meaning of §42(h)(4)(B)) of the land and buildings comprising the Project has been financed with the proceeds of the Tax-

#### **Exempt Bonds.**

Taxpayer makes the following additional representations. First, Taxpayer will claim only the 30 percent value credit allowable under § 42(b)(2)(B)(ii) for the Project. Taxpayer will not claim any 70 percent present value credit described in § 42(b)(2)(B)(i) for the Project. Second, in order for Taxpayer to be entitled to claim the low-income housing tax credit, Taxpayer must satisfy, in addition to the other requirements of § 42, the requirements of § 42(h). Section 42(h) limits the aggregate amount of credit allowable under § 42 in each state. Taxpayer intends to claim the credit under the provisions of § 42(h)(4)(B). Third, Taxpayer has not applied for or received an allocation of housing credit dollar amounts under § 42(h)(1). Finally, Taxpayer will retire the total outstanding amount of principal and interest on the Bond Loan after the Project has been completed and placed in service.

Taxpayer requests a ruling that, provided the requirements of § 42(h) are otherwise satisfied with respect to the Project, the repayment of the Bond Loan and the redemption of the Tax-Exempt Bonds at any time after the date on which the Project is placed in service under § 42 will not, in and of itself, permit a determination that the Project was not financed with the Tax-Exempt Bonds in accordance with § 42(h)(4)(B).

Section 42(a) provides a tax credit for investment in low-income housing buildings placed in service after December 31, 1986.

Section 42(h)(1)(A) provides that the amount of credit determined under § 42 for any taxable year with respect to any building shall not exceed the housing credit dollar amount allocated to such building under § 42(h).

Section 42(h)(1)(B) provides that an allocation generally shall be taken into account under §42(h)(1)(A) only if it is made not later than the close of the calendar year in which the building is placed in service.

Section 42(h)(3)(A) provides that the aggregate housing credit dollar amount which a housing credit agency may allocate for any calendar year is the portion of the state housing credit ceiling allocated under § 42(h)(3)(A) for such calendar year to such agency.

Section 42(h)(4)(A) provides that § 42(h)(1) does not apply to any portion of the credit otherwise allowable under § 42(a) which is attributable to eligible basis financed by any obligation the interest on which is exempt from tax under § 103 if-

- (i) such obligation is taken into account under § 146, and
- (ii) principal payments on such financing are applied within a reasonable period to redeem obligations the proceeds of which were used to provide such financing.

Section 42(h)(4)(B) provides that, if 50 percent or more of the aggregate basis of any building and the land on which the building is located is financed by a tax-exempt obligation described in § 42(h)(4)(A), § 42(h)(1) does not apply to any portion of the low-income housing credit allowable under § 42(a) with respect to such building.

In the present case, Taxpayer represents that tax-exempt bond proceeds representing 50 percent or more of the aggregate basis of the single-building Project and the land on which the Project is located will be spent on or before the date on which the Project is placed in service. Taxpayer further represents that the Tax-Exempt Bonds will be redeemed after the date that the Project is placed in service for all purposes under § 42.

Accordingly, based solely on the representations and relevant law as set forth above, we conclude that the redemption of the Tax-Exempt Bonds at any time after the date on which the Project is placed in service for all purposes under § 42 will not, in and of itself, result in a determination that the Project was not financed with the Tax-Exempt Bonds under § 42(h)(4)(B). No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations, including §§ 103 and 141-150. Specifically, we express no opinion on whether the Project qualifies for the low-income housing credit under § 42, the validity of costs included in the Project's basis, whether and when the "50-percent aggregate basis" requirement in § 42(h)(4)(B) is met, or whether any other requirement of § 42(h)(4) is met.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file, a copy of this letter is being sent to Taxpayer's authorized legal representative.

Sincerely yours,

HAROLD BURGHART

Assistant to the Chief, Branch 5  
(Passthroughs and Special Industries)

Enclosure:

Copy of letter

Copy for 6110 purposes