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Person to Contact:  
Telephone Number:  
Refer Reply To: CC:PSI:5 -- PLR-164146-02

Date: MAY 23, 2003

Legend:  
Taxpayer =  
Partnership =  
General Partner =  
Corporation =  
Lender =  
Limited Partner =  
Agency =  
State =  
a =  
b =  
c =  
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e =  
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i =  
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l =  
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n =

Dear [redacted data]:

This letter responds to your letter dated November 20, 2002, and subsequent correspondence submitted on behalf of the Taxpayer involving § 42 of the Internal Revenue Code. The relevant facts and representations are set forth below.

**FACTS:**

The Taxpayer is a State limited partnership. The Taxpayer's General Partner is a for-profit wholly-owned State subsidiary of Corporation. General Partner owns a a percent interest in the Taxpayer and

Limited Partner owns the remaining b percent interest in the Taxpayer. New limited partners may invest in the Taxpayer.

The Partnership received a \$d carryover allocation under § 42(b)(1)(A) for 70-percent present value credits (9 percent credits) on c from Agency under § 42(h)(1)(E) with a reasonably expected basis of Se under § 42(h)(1)(E)(ii) for a building located in a State qualified census tract. The building is one of two condominium units. Condominium A contains commercial space and Condominium B, which is the building for purposes of § 42, consists of f units. The Taxpayer represents that the Partnership placed Condominium B in service on g.

The Taxpayer represents that, after Condominium B was placed in service, the Partnership incurred approximately \$h in rehabilitation expenditures during i in an amount that met or exceeded the minimum expenditures required by § 42(e)(3)(A). The rehabilitation expenditures were financed by Lender by means of a modification of the construction loan. The Taxpayer will acquire Condominium B and the property attributable to the rehabilitation expenditures (the "Rehabilitated Property") before the Partnership places the rehabilitation expenditures in service. After the closing date, the Taxpayer anticipates that it will incur approximately \$Q in rehabilitation expenditures. The Taxpayer represents that the total cost for rehabilitation will not exceed \$m. The Taxpayer further represents that these rehabilitation expenditures will not be included in the calculation of the eligible basis of Condominium B.

The Taxpayer will finance at least 50 percent of the purchase price of the Rehabilitated Property with the proceeds of State tax-exempt volume cap "exempt facility" bonds issued by Agency or other instrumentality of State (the "Bonds") with a face amount of not less than \$l. The contract for sale, the Bonds, and conduit loan documents will refer to, or incorporate, a certification by the Partnership of the amount of rehabilitation expenditures incurred by it and will expressly attribute the use of the proceeds of the Bonds to the rehabilitation expenditures under § 42(e). The sources of the remaining amount of the purchase price for the acquisition of Condominium B will be the assumption of the Partnership's outstanding debt plus other available amounts. The Taxpayer represents that the issuance of the Bonds and the conduit loan to the Taxpayer are independent of the allocation of 9 percent credits by the Agency to the Partnership, and the transactions are not conditioned upon, or other related to, one another.

Pursuant to § 42(e)(3)(A), the Taxpayer plans to place the total rehabilitation expenditures in service on or about j. According to the Taxpayer, the 24-month look-back period for the rehabilitation expenditures will extend back to on or about k.

The Taxpayer has requested the following rulings: (1) the expenses incurred and deemed to be incurred by the Taxpayer for purposes of § 42(e)(3)(A) in connection with the rehabilitation of Condominium B will constitute a "separate new building" within the meaning of § 42(e)(1), provided the Taxpayer chooses a 24-month period pursuant to § 42(e)(4)(A) which begins before the closing date and which ends after such date; (2) for purposes of § 42(e)(4)(A), the rehabilitation expenditures are considered placed in service as a separate new building on the last day of the 24-month period chosen by the Taxpayer to aggregate its rehabilitation expenses; (3) that portion of the purchase price of Condominium B financed with the proceeds of the Bonds and paid by the Taxpayer on the closing date shall, for purposes of § 42, be attributed to the aggregate rehabilitation expenditures determined pursuant to § 42(e)(3)(A) and (4)(A); (4) the Taxpayer is entitled to claim 4 percent low-income housing tax credits pursuant to § 42(h)(4)(B) with respect to § 42(e) rehabilitation expenditures where the Bonds will be issued to finance the rehabilitation portion of the purchase price to acquire

Condominium B; and (5) by virtue of its acquisition of Condominium B, the Taxpayer, pursuant to § 42(d)(7), may claim 9percent credits for the remaining credit period.

#### LAW AND ANALYSIS:

Section 42(a) provides a tax credit for investment in low-income housing buildings placed in service after December 31, 1986. For any taxable year in a 10-year credit period, the amount of credit is equal to the applicable percentage of the qualified basis of each qualified low-income building.

In the case of any qualified low -income building placed in service by the taxpayer after 1987, § 42(b) provides, in part, that the term "applicable percentage" means the appropriate percentage prescribed by the Secretary for the month applicable under § 42(b)(2)(A)(i) or (ii). Section 42(b)(2)(B) provides that the percentages prescribed by the Secretary for any month shall be percentages that will yield over a 10-year period amounts of credit that have a present value equal to (i) 70 percent of the qualified basis of new buildings that are not federally subsidized for the taxable year (70-percent present value credit), and (ii) 30 percent of the qualified basis of existing buildings, and of any new buildings that are federally subsidized for the taxable year (30-percent present value credit).

Section 42(c)(1)(A) provides that the qualified basis of any qualified low-income building for any taxable year is an amount equal to the applicable fraction (defined in § 42(c)(1)(B)) of the eligible basis of such building. In general, under § 42(d)(1), the eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period.

Section 42(e)(1) provides that rehabilitation expenditures paid or incurred by the taxpayer with respect to any building are treated for purposes of § 42 as a separate new building.

Section 42(e)(2)(A) provides that the term "rehabilitation expenditures" means amounts chargeable to capital account and incurred for property (or additions or improvements to property) of a character subject to the allowance for depreciation in connection with the rehabilitation of a building. However, under § 42(e)(2)(B), such term does not include the cost of acquiring any building (or interest therein).

Under § 42(e)(3)(A), rehabilitation expenditures with respect to any building may be treated as a separate new building only if (i) the expenditures are allocable to one or more low-income units or substantially benefit such units, and (ii) the amount of such expenditures during any 24-month period meets the greater of the following requirements: (I) the amount is not less than 10 percent of the adjusted basis of the building, or (II) the qualified basis attributable to such amount, when divided by the low-income units in the building, is \$3,000 or more.

Section 42(e)(4)(A) provides that, for purposes of applying § 42 with respect to expenditures which are treated as a separate building by reason of § 42(e), such expenditures are treated as placed in service at the close of the 24-month period referred to in § 42(e)(3)(A).

The Taxpayer has requested rulings on whether the rehabilitation expenditures paid or incurred by the Partnership and the Taxpayer qualify as a separate new building under § 42(e)(1). Question and Answer 7 in Rev. Rul. 91-38, 1991-2 C.B. 3, addresses a situation in which a taxpayer purchases a building before the prior owner placed in service rehabilitation expenditures that qualified under § 42(e)(3)(A) that the owner paid or incurred for the building. Because the taxpayer acquired the property attributable to the rehabilitation expenditures before such property was placed in service, the

taxpayer is treated as having paid or incurred the rehabilitation expenditures to the extent of the lesser of the rehabilitation expenditures paid or incurred before the acquisition or the taxpayer's cost or other basis attributable to the rehabilitation expenditures. When the taxpayer places the rehabilitated property in service, that property's original use is considered to begin with the taxpayer. In addition, Question and Answer 8 in Rev. Rul. 91-38 demonstrates that a taxpayer who purchases a building before the prior owner places in service the rehabilitation expenditures may also incur its own rehabilitation expenditures for purposes of § 42(e)(3)(A).

In the instant case, because the Taxpayer will purchase Condominium B and the Rehabilitated Property before the Partnership places the rehabilitation expenditures in service, the Taxpayer is treated as having paid or incurred such expenditures to the extent of the lesser of the rehabilitation expenditures paid or incurred before the acquisition or the Taxpayer's cost or other basis attributable to the rehabilitation expenditures. As the Taxpayer represents that the expenditures meet or exceed the minimum expenditures requirements under § 42(e)(3)(A), and the Taxpayer, not the Partnership, will place those expenditures in service, the Rehabilitated Property will be treated as new building under § 42(e)(1).

After g, during i, the Partnership rehabilitated the building. The placed-in-service date for rehabilitation expenditures treated as a new building under § 42(e) is based on the 24-month period a taxpayer chooses to aggregate its rehabilitation expenditures under § 42(e)(4)(A). The 24-month period chosen by the Taxpayer under § 42(e)(3)(A) and (4)(A) will start after g on or about k. The Taxpayer has chosen on or about i as the end of the 24-month period under § 42(e)(4)(A). The Taxpayer represents that the rehabilitation of Condominium B as a separate new building under § 42(e)(1) will not result in any double counting of expenses incurred by the Partnership in connection with the construction of Condominium B. Accordingly, once the Taxpayer places the Rehabilitated Property in service on or about j, the building will be a "separate new building" under § 42(e)(1).

The Taxpayer also requests rulings as to whether the Bonds are attributable to the Rehabilitated Property for the 30-percent present value credit (4 percent credit) on the Rehabilitated Property under § 42(h)(4)(B).

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)(4)(A) provides that § 42(h)(1) shall not apply to the portion of any credit allowable under § 42(a) that is attributable to eligible basis financed by any obligation the interest on which is exempt from tax under § 103 if such obligation is taken into account under § 146 and 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 for purposes of § 42(h)(4)(A), if 50 percent or more of the aggregate basis of any building and the land on which the building is located is financed by an obligation exempt from tax under § 103, § 42(h)(1) shall not apply to any portion of the credit allowable under § 42(a) with respect to such building.

In order to satisfy § 42(h)(4)(B), 50 percent or more of the aggregate basis of any building and the land on which the building is located must be financed by an obligation exempt from tax under § 103. We believe that the 50-percent test under § 42(h)(4)(B) is calculated based upon the aggregate

basis of all residential rental property financed by the proceeds of tax-exempt bonds. For example, in the case of an acquisition of an existing building and rehabilitation using a common plan of financing, the 50-percent test is calculated on the aggregate cost of the existing building and rehabilitation. In comparison, the Taxpayer's acquisition of Condominium B relate to costs previously allocated § 42 credits under §42(h)(1)(E) by Agency on c. Consequently, for purposes of § 42(h)(4), the Bonds are attributable solely to the Rehabilitated Property.

The Taxpayer represents that the face amounts of the Bonds to be issued for the Rehabilitated Property will not be less than \$1. The Taxpayer has represented that it will treat approximately \$h incurred by the Partnership for the rehabilitation as rehabilitation expenditures under § 42(e). The Taxpayer further represents that the total cost of the Rehabilitated Property will not exceed \$m. Based on the Taxpayer's representations, the amount of the Bonds will be greater than 50percent of all the costs and, therefore, satisfy the requirements under § 42(h)(4)(B).

The final ruling requested involves whether the Taxpayer is entitled to claim the 9 percent credit on Condominium B by virtue of § 42(d)(7)(A) which treats the purchaser of a § 42 project as "stepping into the shoes" of the seller's allowable credits.

Section 42(d)(7)(A) generally provides that in the case of a building described in § 42(d)(7)(B)(or interest therein) that is acquired by the taxpayer (i) § 42(d)(2)(B) does not apply, but (ii) the credit allowable by reason of § 42(a) to the taxpayer for any period after the acquisition is equal to the amount of credit which would have been allowable under § 42(a) for such period to the prior owner referred to in § 42(d)(7)(B) had such owner not disposed of the building.

Section 42(d)(7)(B) provides that a building is described in § 42(d)(7)(B) if (i) a credit was allowed by reason of § 42(a) to any prior owner of such building, and (ii) the taxpayer acquired the building before the end of the compliance period for the building with respect to such prior owner (determined without regard to any disposition by such prior owner).

Section 42(i)(2)(A) provides that, except as otherwise provided in § 42(i)(2), a new building shall be treated as federally subsidized for any taxable year if, at any time during such taxable year or any prior taxable year, there is or was outstanding any obligation the interest of which is exempt from tax under § 103, or any below market federal loan, the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof.

While Taxpayer is "stepping into the shoes" of the Partnership's 9 percent credit, it is also using tax-exempt bond financing, the proceeds of which will be used indirectly for Condominium B. Because § 42(i)(2)(A) applies at any time during the compliance period, the Taxpayer is subject to its provisions for the allowable years of the credit period for Condominium B.

Accordingly, based solely on the above representations of facts and law as set forth above, we rule that:

1. The Rehabilitated Property may be treated a "separate new building" under § 42(e)(1);
2. The Bonds are solely attributable to the Rehabilitated Property for purposes of satisfying the requirements of § 42(h)(4)(B); and

3. Pursuant to § 42(i)(2)(A), Condominium B shall be treated as federally subsidized for the Taxpayer's allowable 30-percent present value credits for Condominium B under § 42(d)(7).

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. Further, no opinion is expressed or implied on the calculation of the eligible bases of Condominium B and the Rehabilitated Property.

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, this letter is being sent to you as Taxpayer's authorized legal representatives. Also, a copy of this letter is being sent to the Taxpayer.

Sincerely yours,

SUSAN J. REAMAN

Chief, Branch 5  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures:  
6110 copy  
Copy of Letter  
cc: