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Person To Contact:
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Telephone Number:

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Date:
March 15, 2007

Legend:

X =

Sub1 =

Sub2 =

Sub3 =

State =

Dear :

This letter responds to your authorized representative's letter, dated November 8, 2006, and subsequent correspondence, on behalf of X requesting a ruling that a proposed corporate restructuring involving X will not result in a recapture of low-income housing tax credits under § 42(j) of the Internal Revenue Code.

Facts

X is the parent corporation of an affiliated group of corporations filing a consolidated federal income tax return. X owns 100 percent of the stock of Sub1. Sub1 owns 100 percent of the stock of Sub2. Sub2 owns 100 percent of the stock of Sub3.

Sub3, through various ownership structures, is a direct or indirect partner in multiple operating limited partnerships (“OLPs”) that claim the § 42 low-income housing credit. (The names and taxpayer identification numbers of the OLPs are listed in Attachment A and are incorporated by reference into this ruling). Each OLP interest represents a 50 percent or more total interest in the capital and profits of the OLP. Some OLPs have § 754 elections in effect.

X proposes the following transaction. Under applicable state law, Sub3 will elect to convert to a state limited liability company wholly-owned by Sub2. Under federal income tax law, as a single-member domestic limited liability company, Sub3 will be disregarded as an entity separate from Sub2.

X represents that the proposed transaction will be a complete liquidation of a subsidiary under § 332 and will cause a termination under § 708(b)(1)(B) of all of the OLPs of which Sub3 is currently a partner.

X represents that § 42(j)(5) does not apply to any of the OLPs and that except for the proposed transaction, there is no intention to sell, transfer, or dispose of any of the OLP interests during the 15-year compliance period as defined in § 42(i)(1).

Ruling Requested

X requests a ruling that the proposed transaction will not cause recapture of § 42 low-income housing credits.

Law and Analysis

Section 38(a) provides for a general business credit against tax that includes the amount of the current year business credit. Section 38(b)(5) provides that the amount of the current year business credit includes the low-income housing credit determined under § 42(a).

Section 42(a) provides that, for purposes of § 38, the amount of the low-income housing credit determined under § 42 for any taxable year in a 10-year credit period shall be an amount 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, and (ii) 30

percent of the qualified basis of existing buildings, and of new buildings that are federally subsidized for the taxable year.

Section 42(c) 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) the eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period.

Under § 42(j)(1), if at the close of any taxable year in the compliance period, the amount of the qualified basis of any building with respect to the taxpayer is less than the amount of such basis as of the close of the preceding taxable year, the taxpayer's tax for the taxable year will be increased by the credit recapture amount. The credit recapture amount is determined under § 42(j)(2) and § 42(j)(3).

Generally, under § 42(j)(1), any disposition by a taxpayer of a building (or an interest therein, including a partnership interest) upon which credits were claimed during the compliance period is a recapture event. Under § 42(j)(6), however, no recapture will be imposed on a disposition of a low-income building (or an interest therein) if the taxpayer furnishes to the Secretary a bond, and it is reasonably expected that the building will continue to be operated as a qualified low-income building through the end of the compliance period.

Little guidance is available to illustrate when, under § 42(j), a reduction in qualified basis of a building with respect to the taxpayer has occurred or when there has been a disposition that requires the taxpayer to post a bond to avoid recapture. However, analogous provisions concerning recapture of investment tax credit (ITC) property provide relevant guidance for determining recapture under § 42(j).

Section 50(a)(1) provides, generally, for recapture if during any taxable year ITC property is disposed of or otherwise ceases to be ITC property with respect to the taxpayer before the close of the recapture period. Currently, there are no regulations under § 50. However, for property placed in service before January 1, 1991, former § 47(a)(1) (and the regulations thereunder) contained a similar ITC recapture rule. The regulations under former § 47 (which are still effective) mirror the general recapture rule of former § 47 that a disposition or cessation of ITC property before the close of the estimated useful life of the property that was taken into account in computing the taxpayer's qualified investment will result in ITC recapture. However, there are some exceptions to the general rule concerning the recapture of ITC property.

Section 1.47-3(f) of the Income Tax Regulations provides that ITC recapture shall not apply to § 38 property that is disposed of, or otherwise ceases to be § 38 property with respect to the taxpayer, by reason of a mere change in the form of conducting the trade or business in which the § 38 property is used if (1) the § 38 property is retained

as § 38 property in the same trade or business; (2) the transferor (or where the transferor is a partnership, the partner) of such § 38 property retains a substantial interest in the trade or business; (3) substantially all the assets (whether or not § 38 property) necessary to operate the trade or business are transferred to whom the § 38 property is transferred; and (4) the basis of the § 38 property in the hands of the transferee is determined in whole or in part by reference to the basis of the § 38 property in the hands of the transferor.

Section 1.1502-3(f)(2) provides that ITC recapture shall not apply to a transfer of § 38 property from one member of an affiliated group to another member of the group during a consolidated return year. Rev. Rul. 75-245, 1975-1 C.B. 6, holds that there is no ITC recapture under § 1.1502-3(f)(2) where a corporate partner sells its interest in a partnership owning § 38 property to a member of the corporate partner's affiliated group during a consolidated return year.

Section 708(a) provides that a partnership shall be considered as continuing if it is not terminated. Section 708(b)(1)(B) provides that, for purposes of § 708(a), a partnership shall be considered terminated if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

Section 1.708-1(b)(4) provides that if a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: the partnership is treated as contributing its assets to a new partnership in exchange for a partnership interest which is then distributed to the continuing partner and the new partner in liquidation of the terminated partnership.

In the present case, X represents that X, Sub1, Sub2, and Sub3 are members of an affiliated group that files a consolidated federal income tax return. X intends to have Sub3 convert to a disregarded entity for federal tax purposes. As a result of the conversion Sub3's assets, including the interests in the OLPs, will be deemed distributed under § 332 to another member of the consolidated group, Sub2. The liquidating distribution of the OLP interests held by Sub3 will constitute an exchange of interests for purposes of §708(b)(1)(B). The liquidation of Sub3 will, therefore, cause a termination of the OLPs under § 708(b)(1)(B) on the date of conversion.

However, based on the analogous ITC recapture provisions under § 1.1502-3(f)(2) and the regulations under former § 47, the proposed transaction will not cause recapture of the § 42 low-income housing credits.

Conclusion

Accordingly, based solely on X's representations and the law and analysis set forth above, we conclude that there is no recapture of § 42 low-income housing credits.

Because of the § 708(b)(1)(B) termination, the depreciable property of all the partnerships will have a new placed in service date for purposes of depreciation pursuant to § 168(i)(7). Partnerships that have a § 754 election in effect may be required to make adjustments to the basis of partnership property. Also, under § 1.708-1(b)(3), the taxable years of all the partnerships will close on the date on which the partnerships terminate.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations. Specifically, we express no opinion on whether the requirements for the low-income housing credit under § 42 are met, whether the partnerships are partnerships for federal income tax purposes, whether § 332 applies to the proposed transaction, or whether there is any recapture with regards to any other credit under the § 38 general business credit. Further, we express no opinion on the effect of the proposed transaction under state law. Specifically, we express no opinion on whether Sub3 is a disregarded entity under state law or whether, following the proposed transaction, losses of Sub3 will be reported on X's consolidated state income tax return.

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, we are sending a copy of this letter ruling to X's authorized representatives.

Sincerely,

Dianna K. Miosi
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes