

Private Letter Ruling 8811039, IRC Section 42

Dec. 21, 1987

This letter is in response to your letter dated November 9, 1987, submitted on behalf of Partnership, in which you request a private letter ruling pertaining to the low-income housing credit under section 42 of the Internal Revenue Code.

The following relevant representations have been submitted for consideration:

Partnership is a limited partnership formed under the laws of State M for the purpose of acquiring, owning, and operating a low-income housing project (the Project) located in City N. Partner O, Partner P and Partner Q are each both a general partner and a limited partner in Partnership. It is anticipated that the partners will withdraw as limited partners upon the admission of additional limited partners.

On a, Partnership entered into a binding contract to acquire the Project. The contract was entered into pursuant to the terms of a Joint Amended Plan on Reorganization confirmed on b by the R, in a proceeding filed under Chapter 11 of the Bankruptcy Code.

Partnership will fund all the operating reserves required by the U.S. Department of Housing and Urban Development (HUD), pay all unsecured creditors, assume the underlying first mortgage loans and complete all necessary maintenance and repairs. The acquisition by Partnership pursuant to the Plan of Reorganization will prevent a potential foreclosure action against one or more buildings in the Project and thus will avoid assignment of the mortgages to HUD.

The buildings in the Project were constructed in three separate phases. Each phase is owned by a separate State M non-profit corporation. The Boards of Trusts of each corporation has identical membership and the buildings have been operated as a single integrated project. Construction of each phase was financed with separate mortgages insured by HUD pursuant to Section 221(d)(3) of the National Housing Act of 1934 and phase II and III are assisted under Section 8 of the United States Housing Act of 1937. The acquisition by the Partnership will consolidate ownership and management of all the buildings in a single entity and will eliminate the ineffective management which has resulted in the financial distress and ultimate bankruptcy of the present ownership of the Project. Bankruptcy proceedings were commenced in c against each of the owners of the Project.

The Boards of each of the present owners were paralyzed by division and dissention and thus were not able to effectively manage the Project. Lack of effective management has resulted in a complete dissipation of operating reserves and project accounts, including tenant security deposit accounts. Rehabilitation expenditures of approximately \$d are needed to complete neglected maintenance and repairs. The financial stability of the

Project was destroyed when the original contractor for the Project obtained and executed on a \$e judgement against the present owners.

Phase I is presently owned by the original mortgagor, S; Phase II is presently owned by original mortgagor, T; and Phase III is presently owned by original mortgagor, U. All the buildings in the Project were placed in service by their present owners in f except for one building in Phase III, which was placed in service in g. Partnership represents that to the best of its knowledge there has been no nonqualified substantial rehabilitation made on any of the buildings in the Project.

In connection with the proposed claim for the credit under section 42 of the Code, Partnership represents that all terms and conditions of section 42 and related sections will be met except for the requirement in section 42(d)(2)(B)(ii); and Partnership asks that such requirement be waived under the authority given the Secretary of Treasury by section 42(d)(6)(A)(i).

Section 42(d) of the Code provides rules for determining the eligible basis of a new or existing building, a factor used in computing the amount of credit earned. In the case of an existing building that meets certain requirements the eligible basis consists of the building's acquisition cost plus rehabilitation expenditures incurred within a limited period of time. Section 42(d)(2)(B)(ii), however, requires that as of the date the building is acquired by the taxpayer at least 10 years must have elapsed since the later date of the date the building was last placed in service or the date of the most recent nonqualified substantial improvement of the building.

Section 42(d)(6)(A)(i) of the Code provides that on application by the taxpayer, the Secretary may waive the 10-year requirement of section 42(d)(2)(B)(ii) with respect to any federally-assisted building if the Secretary (after consultation with the appropriate federal official) determines that such waiver is necessary to avert an assignment of the mortgage secured by property in the project (of which such building is a part) to HUD or the Farmers' Home Administration.

Section 42(d)(6)(B)(iii) of the Code defines the term "federally-assisted building" as including any building that is substantially assisted, financed, or operated under section 8 of the National Housing Act of 1937 or section 221(d)(3) of the National Housing Act of 1934.

Section 1.42-2T of the Temporary Income Tax Regulations contains requirements that must be satisfied to permit the waiver referred to in section 42(d)(6)(A)(i) of the Code.

We have examined Partnership's representations and have determined that the buildings in the Project are federally-assisted buildings within the meaning of sections 42(d)(6)(B)(i) and 42(d)(6)(B)(ii) of the Code, and that the Project's transfer to Partnership was approved by HUD to avert foreclosure due to delinquencies and shortages in project accounts or to the present owners' non-compliance with the terms and

conditions of the real estate mortgages, and that the requirements of section 1.42-2T of the temporary regulations have been satisfied.

Based on your letter dated November 9, 1987, we rule as follows:

The requirement under section 42(d)(2)(B)(ii) of the Code is waived with respect to Partnership's proposed acquisition of the Project.

No opinion is expressed or implied regarding whether Partnership's costs of acquisition and rehabilitation of the buildings in the Project will qualify otherwise for the low-income housing credit under section 42 of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(i) of the Code provides that it may not be used or cited as precedent. A copy of this letter should be filed with the income tax return of each partner in Partnership for the taxable year in which the transaction covered by this ruling is consummated.

We are sending a copy of this letter to HUD in accordance with that agency's request.