Private Letter Ruling 8814030, IRC Section 42

Jan. 6, 1988

This is in reference to your letter of August 10, 1987, in which you request a private letter ruling concerning the low-income housing credit under section 42 of the Internal Revenue Code.

The following relevant representations have been submitted for consideration:

The Building, a hotel, was acquired by K and L on a. In b Partnership was formed with general partners, K and M, and a limited partner. Ownership of the Building was acquired by Partnership at the same time. In the spring of c the limited partner was bought out leaving K and M with a 50 percent interest in Partnership. In d the Building was sold to another group, and K's interest in Partnership was purchased by M.

In e the trustees on a note held by Partnership foreclosed on the Building and M purchased the Building in the name of Partnership at public auction. On f, M took possession of the property. Partnership was reconstituted with M as general partner and with N, M's wife, as limited partner. The Building continued to be operated as a hotel. No substantial improvements of the Building were made from the date of acquisition to the present.

A loan has been tentatively approved to rehabilitate the Building with the upper floors becoming low and moderate income housing. The loan is not federally subsidized within the meaning of section 42(i)(2) of the Code. It is expected construction will begin about g. The upper floors should be placed in service as low and moderate income housing about h.

Partnership asks that we rule on whether rehabilitation expenditures incurred by Partnership will be treated for purposes of section 42 of the Code as a separate new building and thus eligible for the "70 percent present value credit" (70 percent PVC) under section 42(b)(2)(B)(i).

With respect to buildings placed in service after 1987, Section 42(b)(2)(B) of the Code

provides for a 70 percent PVC for certain new buildings that are not federally subsidized for the taxable year, and a 30 percent PVC for certain other buildings. The credit may be earned and received in each year of a 10-year credit period. The total of the series of 10 equal annual credit amounts will have a present value equal to 70 percent (or 30 percent) of the qualified basis of the qualified low-income building, with present value determined as of the last day of the first year of the 10-year credit period, using a prescribed discount rate applicable to the month the building is placed in service.

Section 42(b)(2)(B)(ii) of the Code provides also that the 30 percent PVC is earned by placing in service either new buildings that are federally subsidized for the taxable year, or existing buildings. Section 42(d)(2) provides rules for determining the eligible basis of an existing building, which is a factor in the determination of its qualified basis. In general, the eligible basis of an existing building that meets certain requirements is the cost of an existing building that meets certain requirements is the cost of its acquisition plus certain rehabilitation expenditures incurred by the taxpayer within a limited period of time. One of the requirements in section 42(d)(2)(B) is that, as of the date of its acquisition by the taxpayer, 10 years must have elapsed since the date the building was last placed in service; another requirement is that the building must not have been previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service.

Section 42(e)(1) of the Code provides that certain rehabilitation expenditures paid or incurred by the taxpayer with respect to any building shall be treated for purposes of that section as a separate new building. In general, rehabilitation expenditures may qualify for this new building treatment if the qualified basis attributable to such expenditures incurred during any 24-month period, when divided by the low-income units in the building, is $2,000 or more. The cost of the building's acquisition is not includable in such rehabilitation expenditures.

Section 42(e)(5) of the Code provides that rehabilitation expenditures may be treated either as a separate new building under section 42(e) or as an addition to the building's acquisition cost under section 42(d)(2), but may not be taken into account under both subsections. Section 42(e)(4) provides that nothing in section 42(d)(2) shall prevent a credit from being allowed by reason of section 42(e).

Partnership represents that it will rehabilitate the Building, spending more than $2,000 (on the Building as a whole) for each low-income unit contained therein, comply with all the requirements of section 42 and related sections of the Code, and place the renovated structure in service in 1988. The only issue we have been asked to rule on is whether the 70 percent PVC will be allowable on the rehabilitation expenditures.

There is nothing in the facts, as represented, concerning the Building or Partnership's history that would require the disallowance of the 70 percent PVC on the proposed rehabilitation. Although the availability to Partnership of the 30 percent PVC on the Building's acquisition cost may be questionable because of failure to meet one or more of the requirements under section 42(d)(2)(B) of the Code, we are not ruling on that question. Pursuant to section 42(e)(4), the new building treatment on rehabilitation expenditures is allowable even if the requirements of section 42(d)(2)(B) are not met.

Based on the representations in your letter of August 10, 1987, we rule as follows:

If rehabilitation expenditures are paid or incurred by Partnership with respect to the Building in a sufficient amount as required by section 42(e) of the Code and the Building is placed in service by Partnership before January 1, 1990, as a qualified low-income building under section 42, such expenditures will be treated for purposes of the credit as a separate new building under the provisions of section 42(e), regardless of whether the Building in the hands of Partnership meets the requirements of section 42(d)(2)(B).

No opinion is expressed or implied regarding whether Partnership's proposed rehabilitation expenditures 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)(3) of the Code provides that it may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusions in the ruling. See section 16.04 of Rev. Proc. 87-1, 1987-1 I.R.B. 7, 17. However, when the criteria in section 16.05 of Rev. Proc. 87-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

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.