Private Letter Ruling 8910015, IRC Section 42

December 7, 1988

This is in response to a request for ruling dated June 30, 1988, submitted on your behalf by your authorized representative concerning the application of section 42 of the Internal Revenue Code to a transaction as fully described below.

Authority is a political subdivision of and created under the laws of State A. Authority is responsible for the development, administration, and management of publicly-assisted housing programs in City B, State A. Authority, by agreement with City B, is required to own and/or manage a minimum of b units of publicly assisted housing for households whose annual adjusted income levels do not exceed c percent of the area median gross income adjusted for family size.

In d, Authority acquired a e-unit public housing project known as Development. These units were originally constructed by the United States government in r as temporary defense housing and not as permanent housing, and were conveyed to Authority after they were termed surplus by the United States. Pursuant to findings by Authority and City B, and by agreement of the United States Department of Housing and Urban Development (HUD), that the housing units in Development had outlived their originally anticipated useful lives and had deteriorated to a dangerous and uninhabitable condition, Authority proceeded to vacate the units and sell the property to private developers for demolition and redevelopment of the site as a mixed-use residential and commercial project.

On f, Partnership, a State A general partnership, entered into a contract with Authority to purchase a portion of the Development site to be redeveloped for residential purposes.

Subsequently, Partnership assigned its rights under the contract to Partnership II, another State A general partnership. Authority consented to this assignment. On g, a portion of the Development site was conveyed to Partnership II, for the construction of residential housing units and a portion was conveyed to another party for the construction of commercial buildings. On h, the final portion of Development was conveyed to Partnership II for the construction of additional residential units.

The contract and the City-approved development plan for Development require the construction of approximately i single family units, j townhouse units, and k multi-family condominium or rental units. The disposition by Authority of the Development site was authorized by HUD in accordance with federal regulations regarding the demolition and disposition of public housing projects. In order to comply with the conditions of HUD's authorization of the property disposition, Authority and City designed a replacement housing plan wherein all e Development public housing units will be replaced on a one-for-one basis with housing to be located on various sites dispersed throughout City B and that will be affordable to "low income persons," defined in accordance with federal public housing program standards.

Authority intends to create one or more limited partnerships to own the replacement housing units. The Authority itself or through an affiliated entity will act as the sole general partner of each limited partnership. It is anticipated that one (or more) subchapter C corporation(s) will become the limited partner(s) of such limited partnerships, and will make capital contributions that will be used to acquire and support the operations of the replacement housing units.

Pursuant to the contract, Partnership II and the Authority will designate 1 of the j townhouse units to be constructed on the Development site as low-income housing replacement units ("On-Site Replacement Units"). No less than m percent of the townhouse development will consist of low-income housing units, to be rented by low-income households. The remaining n townhouses will be sold by Partnership II to individual homeowners at market rate sales prices. A homeowners association will be formed, whose duties will include the maintenance of common area and grounds, and the operation of community facilities. Authority will manage the On-Site Replacement Units in accordance with federal public housing regulations and standards, although no federal public housing funds will be allocated to the development, purchase or subsidization of the units.

Authority holds an option to purchase the On-Site Replacement Units at a purchase price of no more than $ o for each townhouse, the actual purchase price to reflect the cost to Partnership II of producing the units exclusive of land costs and profits to Partnership II. Under the contract, the low-income units will be scattered throughout the townhouse development in a manner acceptable to Authority. The purpose of this requirement is to encourage economic integration and prevent the isolation of the low-income persons in one portion of the Development site.

As the sole general partner of the limited partnership(s) formed for the purpose of acquiring and managing the On-Site Replacement Units, Authority will have the responsibility for the selection of qualified tenants and will provide, on behalf of the partnership(s), property management services to the partnership(s) owned units.

The On-Site Replacement Units will be purchased by the partnership(s) as they are completed. It is anticipated that the first townhouse units will be ready for occupancy in November 1988 and the remainder by October 1989.

The Authority will use funds contributed by limited partners in one or more partnership to acquire no more than p existing or to be developed townhouses scattered in residential townhouse projects throughout City B ("Off-Site Replacement Units"). Such units shall be purchased individually and are likely to be located in housing developments comprised of townhouses that are individually owned by unaffiliated parties. Authority has developed unit acquisition guidelines that include the prohibition of acquisition of Off-Site Replacement Units in excess of q percent of total units in any particular townhouse development unless Authority acquires an entire rental townhouse development in which case Authority may elect to increase the percentage of units to be

occupied by low-income persons. By limiting the number of low-income units in any particular development, Authority will be able to further its public policy goals of providing affordable low-income housing opportunities in areas dispersed throughout City B. Authority will manage the Off-Site Replacement Units in accordance with federal public housing regulations and standards, although no federal public housing funds will be allocated to the acquisition, development, rehabilitation or subsidization of the units. It is anticipated that the Off-Site Replacement Units will be acquired and occupied by qualified low-income tenants during the years 1988 and 1989.

Based on these facts Authority has requested that we rule that an individual townhouse may be treated as a "qualified low-income building" constituting a one-building "qualified low-income project" provided that the other requirements of section 42 are otherwise met.

Section 38(a) of the Internal Revenue Code provides for a 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 section 42(a).

Section 42(a) of the Code, added by section 252 of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 106, provides that, for purposes of section 38, the amount of the low-income housing credit determined under section 42 for any tax year in the credit period shall be an amount equal to the "applicable percentage" of the qualified basis of each qualified low-income building.

Section 42(f)(1) of the Code, as amended by section 1002(1)-(2)(B) of the Technical and Miscellaneous Revenue Act of 1988, defines the credit period of any building as the period of 10 taxable years beginning with -- (A) the taxable year in which the building is placed in service, or (B) at the irrevocable election of the taxpayer the succeeding taxable year, but only if the building is a qualified low-income building as of the close of the first year of such period.

Section 42(g)(1) of the Code defines the term "qualified low-income housing project" to mean any project for residential rental property if the project meets the requirements of subparagraph (A) or (B), whichever the taxpayer elects. The election is irrevocable. Section 42(g)(1)(A) states that the project meets the requirements of subparagraph (A) if 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income, as adjusted for family size. Section 42(g)(1)(B) states that the project meets the requirements of subparagraph (B) if 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income, as adjusted for family size.

Section 42(g)(2) of the Code provides that a unit is rent-restricted if the gross rent (defined in section 42(g)(2)(B)) that is paid for the unit does not exceed 30 percent of the income limits that section 42(g)(1) imposes upon the occupants.

Notice 88-91, 1988-36 I.R.B. 28, indicates that final regulations under section 42 of the Code will provide that the term "qualified low-income building" includes residential rental property that is an apartment building, a single-family dwelling, a townhouse, a rowhouse, a duplex, or a condominium. A qualified low-income building does not include residential rental property owned or leased by a cooperative housing corporation or a tenant-stockholder, as those terms are defined under section 216(b)(1) and (2) of the Code.

Accordingly, an individual townhouse may be treated as a "qualified low-income building" constituting a one-building "qualified low-income project" so long as the project meets the minimum set-aside, tenant income, tenant rent, and other requirements with respect to low-income occupancy at all times during the 15-year compliance period.

Therefore, based upon the foregoing discussion of facts and legal analysis we rule that:

1. Each townhouse will be separately considered a "qualified low-income housing project" within the meaning of section 42(g)(1) of the Code for purposes of meeting the requirements of sections 42(g)(1)(A) and (B), 42(g)(2)(A) and (B), and 42(g)(3)(A).

This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than the sections described above. In particular, no opinion is expressed or implied as to whether any of the other requirements for eligibility for the low-income housing credit have been met.

The ruling is directed only to the taxpayer that requested it. Section 6110(j)(3) of the Internal Revenue Code provides that it may not be used or cited a precedent.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.