

Private Letter Ruling 8920073, IRC Section 42

February 23, 1989

This is in response to your request for a ruling dated February 26, 1988 and subsequent communications submitted on your behalf by your authorized representative. Your letter requests a ruling regarding the availability of the low-income housing credit under section 42 of the Internal Revenue Code to the proposed transaction.

You have represented that Corporation X is a corporation organized in State A on b. Corporation X is a real estate broker licensed to sell, lease and otherwise transact in real property. In addition, Corporation X is an investor in real estate and buys and sells for its own account. As of c, Corporation X had d shares of common stock issued and outstanding. All the outstanding shares of Corporation X are held by Individual E. The federal income tax returns of Corporation X are filed on a fiscal year basis ending f.

Corporation Y is an S corporation incorporated in State A on g. Corporation Y constructs and builds single-family, condominium and townhouse buildings and structures. As of c, Corporation Y had h shares of stock which were issued and outstanding. All of the outstanding shares of Corporation Y are held by Individual I. Corporation Y computes its income under the accrual method of accounting and files its federal income tax returns on a calendar year basis.

The managements of Corporation X and Corporation Y have considered the possibility of implementing a plan in which newly constructed townhomes will be utilized to provide affordable housing for low-income individuals. Corporation Y has already constructed j townhouses, none of which are the subject of this request. The houses are newly constructed, high-quality and located in suburban City K on Street L. Corporation Y is in the process of constructing an additional m townhouse units on Street L and has commissioned and contracted with Corporation X, its agent, to sell these latter units to independent owners who will use such units as low-income housing buildings.

The m townhouses that Corporation Y is constructing for this purpose are the subject of this ruling request. Corporation X intends to market each of the m new townhouses as a qualified low-income housing project eligible for the low-income housing credit under section 42 of the Code. Such eligibility will serve as a marketing inducement for the purchasers of the townhouses to provide housing to qualifying low-income individuals.

Pursuant to an agency agreement between Corporation X and Corporation Y, Corporation X will obtain a separate 1988 credit allocation for each townhouse unit from the appropriate state housing credit agency. The allocation will be made in Corporation Y's name on Form 8609, Low-Income Housing Credit Allocation Certification. Corporation Y will enter into a sales contract with the independent third party purchasers and, pursuant to an assignment clause in such contract, will deliver to each purchaser of a townhouse unit, the Form 8609, on which the credit was allocated for the particular townhouse unit. Corporation Y does not intend to take any credit on any townhouse unit.

Each townhouse is intended to be sold individually and each purchaser will secure independent permanent commercial financing for the purchase of the respective townhouse. Each of the m unrelated absentee investors will own a townhouse unit and lot in fee simple with a Homeowners' Association. The common areas that are shared by th attached townhouses are the parking facilities, roadways, and grounds. Water and sewer service to each townhouse is independent as are heat, electricity and other amenities. No recreational facilities are planned.

The independent investors who purchase the townhouses will each take tax credits from the date the townhouse is acquired through the end of the 10-year credit period and then, once the required 15 year compliance period is over, the investors will be free to either continue the provision of low-income housing to qualifying individuals or sell, transfer, or otherwise dispose of their townhouses to subsequent investors. However, it is expected that any new townhouse purchaser will be eligible to continue to receive the credit allowable to the original owner for the period after such acquisition, as if that new owner were the original owner, using the same qualified basis and credit percentages as used by the original owner.

Accordingly, the following rulings are requested:

1. Each town house 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 under section 42(g)(1)(A) and (B), 42(g)(2)(A) and (B), and 42(g)(3)(A);
2. The eligible basis of each townhouse, determined when Corporation Y places each separate townhouse unit in service, will consist of Corporation Y's adjusted basis in each townhouse. The applicable fraction used to compute the qualified basis of each single-family townhouse unit will be the ratio of 1:1.
3. Each new purchaser is eligible to receive the credit allowable to the original owner for the period after acquisition of the townhouse unit, as provided in section 42(d)(7) of the Code, as if the new owner were the original owner, both as to the credit percentage and the basis. Each new owner will be liable for compliance with the requirements of section 42 and for recapture in the event of noncompliance.

Section 38(a) of the Code 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 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(c)(1)(A) of the Code defines the "qualified basis" of any qualified low-income building for any tax year as an amount equal to (i) the "applicable fraction" (determined as of the close of the tax year) of (ii) the eligible basis of the building (determined under section 42(d)). Section 42(c)(1)(B) provides that the term "applicable fraction" means the smaller of the unit fraction or the floor space fraction. The unit fraction is the number of low-income units divided by the number of all residential rental units in the building. The floor space fraction is the floor space of the low-income units divided by the floor space of all the residential rental units in the building. Generally, in these calculations, low-income units are those units presently occupied by qualifying tenants, whereas residential rental units are all units, whether or not presently occupied. See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89.

Section 42(d)(5)(A) of the Code provides that, generally, the eligible basis of any building for its entire compliance period shall be its eligible basis on the date it is placed in service. According to section 42(i)(1), the compliance period is the period of 15 tax years beginning with the first tax year of the building's credit period. Under section 42(d)(1), the eligible basis of a new building is its adjusted basis.

The "adjusted basis" is determined by taking into account the adjustments described in section 1016 of the Code (other than paragraphs (2) and (3) of section 1016(a), relating to depreciation deductions), including, for example, the basis adjustment provided in section 48(q) for any rehabilitation credits allowed under section 38. The cost of land is not included in adjusted basis. See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89.

In general, for purposes of the low-income housing credit, the term "residential rental property" has the meaning given in the regulations under section 103 of the Code. Under these regulations, residential rental property includes residential rental units, facilities for use by the tenants, and other facilities reasonably required by the project. Eligible basis may include the cost of such facilities and amenities (e.g., stoves, refrigerators, air conditioning units, etc.) only if the included amenities are comparable to the cost of the amenities in the low-income units. Additionally, the allocable cost of tenant facilities, such as swimming pools, other recreational facilities, and parking areas, may be included provided there is no separate fee for the use of these facilities and they are made available on a comparable basis to all tenants in the project. See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89.

Section 42(d)(7)(A) and (B) of the Code provides the general rules that apply if a taxpayer acquires an existing building for which a credit was allowed to any prior owner under section 42(a), and the acquisition occurs before the end of the building's compliance period. In that case, section 42(d)(7)(A)(ii) provides that the credit allowable to the taxpayer for any period after the acquisition shall be equal to the amount of credit that would have been allowable for that period to the prior owner had the owner not disposed of the building. In effect, the new owner steps into the shoes of the prior owner for the period after the acquisition of the building.

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)(A) of the Code provides that a residential 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 limitation that section 42(g)(1) imposes upon the occupants of such unit. According to section 42(g)(3)(A), a project consisting of a single building must meet the requirements of section 42(g)(1) not later than the date that is 12 months after the date such project is placed in service.

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.

Based upon the representations in your letter of February 26, 1988, and the subsequent correspondence submitted on your behalf, we rule as follows:

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 under section 42(g)(1)(A) and (B), 42(g)(2)(A) and (B), and 42(g)(3)(A);
2. The eligible basis of each townhouse, determined when Corporation Y places each separate townhouse unit in service, will consist of Corporation Y's adjusted basis in each townhouse. However, as the credit is to be allocated to a townhouse prior to Corporation Y's sale of the townhouse to an individual investor, Corporation Y may not include any amount relating to its expected profit on the sale in calculating its adjusted basis. The applicable fraction used to compute the qualified basis of each single-family townhouse unit will be the lesser of either the unit fraction or the floor space fraction, which in the case of a building containing only one residential rental unit occupied by a low-income tenant, is the ratio of 1:1.
3. Each new purchaser is eligible to receive the credit allowable to the original owner for the period after acquisition of the townhouse unit, as provided in section 42(d)(7) of the

Code, as if the new owner were the original owner, both as to the credit percentage and the basis. Each new owner will be liable for compliance with the requirements of section 42 and for recapture in the event of noncompliance.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations or to whether the building will qualify otherwise for the low-income housing credit under section 42 of the Code.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Because this ruling is issued under the authority of Rev. Proc. 88-18, 1988-20 I.R.B. 32, and section 5.07(3) of Rev. Proc. 89-1, 1989-1 I.R.B. 8, this ruling may be modified or revoked by the Service. However, when the criteria in section 16.05 of Rev. Proc. 89-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

A copy of this letter should be attached to the appropriate federal income tax return for the taxable year in which the transaction covered by this ruling is consummated.

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. In accordance with the power of attorney on file, we are sending a copy of this letter to your authorized representative. Assistant Chief Counsel (Passthroughs and Special Industries) By: Richard Keys Senior Technical Reviewer, Branch 5 Enclosure: 6110 copy