Private Letter Ruling 8943069, IRC Section 42

August 2, 1989

This letter responds to your letter dated October 25, 1988, and subsequent correspondence submitted on behalf of Taxpayer, as its authorized representative, requesting a ruling regarding whether a building Taxpayer purchased from City A qualifies as a new building as defined in section 42(i)(4) of the Internal Revenue Code. The represented facts as they pertain to the request for a ruling are set forth below.

City A Redevelopment Agency ("Agency") developed a low-income housing project (the "Project") consisting of n units in a. In b, when H had nearly completed the Project, Agency discussed with a consultant the possibility of qualifying the Project for the low-income housing credit under section 42 of the Code. Agency's Finance Committee met on c and d to discuss the potential for syndicating the Project to take advantage of the credit.

A Staff Report, dated d and prepared for Agency Finance Committee, outlined the process of qualifying the Project for the low-income housing credit under section 42 of the Code. The Staff Report advised Agency Finance Committee to hire a law firm and a consultant to perform the necessary tasks to establish a partnership to take possession of the Project before placing the Project in service, and to pursue syndication of limited partnership interests in the Project.

In a letter dated e, B, of law firm C, outlined the steps City A needed to take to qualify the Project for the low-income housing credit. That letter stated, " {t} o be eligible for both the federal and {State D} low-income housing tax credits, the Project must be transferred to a limited partnership before it is 'placed in service.' For tax purposes, a project is considered placed in service when it is available for occupancy. . . . As soon as the partnership has acquired the Project, it can proceed with leasing it up. I anticipate no problem in completing this phase before the end of the year."

Agency Finance Committee met on f with B and a consultant to learn more about the procedure and potential for using the low-income housing credit. By action of Agency Board of Directors on f, Agency retained C and a consultant to perform the initial steps necessary to transfer the Project.

After Agency retained C and a consultant, Agency negotiated with E to be the Project's property manager. The Staff Report to Agency Finance Committee, dated c, indicated that they expected tenants to occupy the Project in g. The staff recommended finalizing the agreement with E the first week of g. However, Agency and E did not execute a management agreement until h.

At the same time Agency was negotiating with E, it formed Taxpayer as a limited partnership. Agency is Taxpayer's general partner and Agency holds a t percent interest in Taxpayer. E holds a u percent limited partnership interest in Taxpayer. E intends to sell

its limited partnership interest to investors who may claim-the section 42 low-income housing credit.

Pursuant to the direction of Agency, C prepared a limited partnership agreement, a ground lease between Agency and Taxpayer, and other documents necessary to facilitate Agency's transfer of the Project to Taxpayer before tenants occupied the Project. C transmitted the documents to Agency on i.

Although Agency had initially contemplated transferring the Project by the end of the year, certain statutory requirements delayed the transfer for a week. Because Agency owned the Project, the proposed sale of the Project and the ground lease by Agency required City A legislative approval after a public hearing.

Notice of the public hearing had to be published for *** consecutive weeks pursuant to section m of the State D Health & Safety Code. The publication requirements and the impending holiday season caused Agency and City A to delay approval of the sale of the Project and the lease of the land to Taxpayer until early in the next year on k. Agency completed the transfer of the Project to Taxpayer on j.

Agency Board of Directors and its staff were aware that it had to transfer the Project before placing it in service in order for the Partnership to be able to apply to State D for a low-income housing credit allocation. They also believed that tenants should not occupy the Project until they transferred it to the Partnership. Agency originally intended to allow tenants to move into the Project the first week of g. Because final approval of the sale would not occur until after the City A City Council and Agency Board of Directors met on k, tenants had to postpone occupying the Project until the following week. Accordingly, Agency notified E that tenants could not move into the Project until Agency notified E that it had transferred the Project to Taxpayer.

Within two weeks after receipt by E of the above directive from Agency, an employee of E, acting without authorization from E, Taxpayer, or Agency, allowed tenants to occupy o units in the Project on 1 (one week prior to City A's issuance of the Project's certificate of occupancy). F, a City A building inspector, made his final inspection of the Project on x (one day after the actual occupancy of tenants). F determined that H, the construction company that constructed the Project, had completed the necessary work to issue the building a final certificate of occupancy. It was during this final inspection that F discovered tenants began illegally occupying o units in the Project on the previous day. G, who also is a City A building inspector, notified E on k (four days after the actual occupancy) that the City A had not yet issued the Project a certificate of occupancy as of k, and that the tenants were occupying the Project in violation of the City A Code.

E notified Agency on K that o units in the Project had been occupied since 1, and Agency informed E in writing on j (five days after the actual occupancy of tenants) that E had acted without authorization by moving tenants into the Project. Agency required E to immediately notify each of the o families in writing that it was occupying the Project in violation of the City A's Code.

The Department of Planning and Community Development agreed to release a temporary certificate of occupancy to the Project with the understanding, in writing, that tenants would not be allowed to occupy the Project until it issued the Project a final certificate of occupancy. City A may issue a temporary certificate for use of a portion of a building prior to its completion for use of buildings that are undergoing repair, rehabilitation, construction and/or alteration. Taxpayer represents that in practice, however, the temporary certificate is issued only once electricity has been connected in order to test all of the systems, and not to permit occupancy or residential use.

The City A Code states in section v of Ordinance w that no building shall be occupied or used until the City A has issued a certificate of occupancy and no such certificate shall be issued where it is ascertained that there is a violation of, or conflict with, any laws, rule, ordinance or regulation of the City A.

Once City A officials have conducted a final inspection, a final release form is usually sent to the Department of Building and Safety and a City A official contacts the contractor/developer to indicate that tenants may occupy the building. The act of the City A official contacting the contractor/developer constitutes issuing the certificate of occupancy.

F verbally notified H on p that all health and safety items were satisfactorily completed under the City A Code. The verbal notification served as the Project's final certificate of occupancy.

Agency required E to return to the occupants any rent and security deposits E had collected from them prior to p. Although the occupants were not required to move out of the Project, they did not pay rent during their one week unauthorized occupancy and were permitted to leave the Project.

After City A verbally issued the Project a certificate of occupancy on p, it notified E that the Project was available for occupancy. After City A notified E that the Project was available for occupancy, tenants who moved in without appropriate authorization and who chose to remain in the Project executed leases and began to pay rent as of p. Approximately three months later, Taxpayer entered into a formal property management agreement for the Project with E on h.

Section 38(b)(5) of the Code provides for a low-income housing credit. Section 42(a) provides that for purposes of section 38, the amount of the low-income housing credit determined under this section for any taxable year in the credit period shall be an amount equal to -- (1) the applicable percentage of (2) the qualified basis of each qualified low-income building. Section 42(b)(1) provides that in the case of any qualified low income building placed in service by the taxpayer during 1987, the term 'applicable percentage' means -- (A) 9 percent for new buildings which are not federally subsidized. Section 42(i)(4) defines a new building as a building, the original use of which begins with the taxpayer.

Notice 88-116, 1988-44 I.R.B. 22, provides that the placed in service date for a new or existing building used as residential rental property is the date on which the building is ready and available for its specifically assigned function, i.e., the date on which the first unit in the building is certified as being suitable for occupancy in accordance with state or local law. Under Notice 88- 116, a building may be placed in service even if the rental units in the building are not currently occupied by low-income tenants. Taxpayer represents that E was without authority when moving tenants into the Project prior to the issuance of the certificate of occupancy and was not an ostensible agent of the Agency or Taxpayer at that time under State D law.

Based on the facts and representations in the letter from Taxpayer's representative and, in particular, assuming the representations regarding the interpretation of State D's agency law are correct, we rule that Taxpayer placed the Project in service after j, and was the first owner of the Project to place it in service. Thus, Taxpayer placed a "new building" within the meaning of section 42(i)(4) of the Code in service after J.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. No opinion is expressed whether the Project otherwise qualifies 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 the issues addressed in this ruling have not been adopted. This ruling is issued under the authority of Rev. Proc. 88-18, 1988-20 I.R.B. 32, that enables the Service to issue rulings for Code sections enacted or amended by the Tax Reform Act of 1986 or the Revenue Act of 1987. Therefore, this ruling may be modified or revoked by the Service. However, when the criteria in section 16.05 of Rev. Proc. 89-1, 1989- 1 I.R.B. 20 are satisfied, a ruling is not modified or revoked retroactively except in rare or unusual circumstances.

In accordance with the power of attorney on file, a copy of this letter is being sent to you as Taxpayer's authorized representative.

A copy of this letter should be attached to the income tax return of Taxpayer for the taxable year in which Taxpayer placed the building in service.

Sincerely yours,

Susan Reaman

Assistant to the Chief, Branch 5

Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)