Private Letter Ruling 8944042, IRC Section 42

August 8, 1989

This letter is in response to a letter dated July 22, 1988, and subsequent correspondence dated January 5, 1989, submitted on behalf of Partnership regarding the application of the low-income housing credit under section 42 of the Internal Revenue Code to a "congregate housing" facility. The represented facts of the proposed project are set forth below.

Partnership, a State X limited partnership, is organized for the purpose of developing a "congregate housing" facility for the elderly in City Y. The proposed project is to be financed under the 515 Rural Rental Housing Program of the Farmers Home Administration of the United States Department of Agriculture (the "FmHA"). The general partners are in the business of developing and operating housing financed under the Farmers Home Administration Rural Rental Housing Program. Investor limited partners will be admitted as limited partners in Partnership to take advantage of federal income tax benefits, principally the low-income housing credit under section 42 of the Code. Partnership represents that if the credit is not available, the project will not be developed.

Partnership was formed on *** by the filing of a Certificate of Limited Partnership with the Secretary of State X. The Agreement of Limited Partnership was executed on ***. The purpose of Partnership is to develop a *** unit "congregate housing" facility for low and moderate income elderly families of City Y (the "Project"). The Project will consist of *** studio units, *** one bedroom units and *** two bedroom units as well as a central dining facility, indoor and outdoor recreational area, laundry facilities and other community areas. The general partners of Partnership are Partner A, a State X corporation, Partner B, and Partner C.

The Project is to be developed with federal assistance from the FmHA through 515 Rural Rental Housing Program. Under this program, the FmHA will loan up to 97 percent of the eligible project development costs (as defined by FmHA) and the remaining funds to be provided by Partnership together with sufficient working capital to cover the rent up phase.

According to Partnership, the FmHA defines "congregate housing" under FmHA Instruction 1944-E Section 1944.205(d) as:

Housing that affords an assisted independent living environment that offers the elderly, handicapped or disabled, person who may be functionally impaired or emotionally deprived, but in good health (not acutely physically ill), the residential accommodations, central dining facilities, related facilities and support service(s) required to achieve, maintain, or return to semi-independent lifestyle and prevent premature or unnecessary institutionalization as he/she grows older.

The FmHA will fund such loans only in rural areas which are generally defined as those areas of the United States outside of Standard Metropolitan Statistical Area and in cities with a population under 20,000. FmHA instruction 1944-E Section 1944.205(h) defines "elderly" as a person who is at least 62 years of age or a person who is handicapped (including a blind person at least 55 years of age) or a disabled person.

Partnership asserts that under the FmHA's rules and regulations, loans are available to construct new housing, purchase the land on which the housing will be located and develop other related facilities in connection with the housing such as storage facilities, recreation areas when the project is large enough to justify the facility (to include outdoor seating for elderly projects), central cooking and dining for congregate facilities and medical facilities, BUT ONLY for emergency care. In addition, loan funds may be used for facilities related to development of a rural rental project to include a project's office, laundry facilities and standard individual unit appliances and draperies.

Pursuant to FmHA instruction 1944-E Section 1944.212(e), an operating budget is required to be developed sufficient to cover the Project's annual operating expenses, debt services and reserve account attributable to the Project. The cost of food and other support services is not reflected in the FmHA budget and must be stated separately. However, tenants in the Project may VOLUNTARILY use the support services by paying a separate charge for such services. Such support services must be separately stated from rental charges pursuant to this FmHA requirement. Partnership anticipates that its apartments will rent for *** for studios, and *** for 1 bedroom, and *** for 2 bedrooms.

Partnership's service package will include food service in the centrally provided dining facility, weekly collection and distribution of linens and towels, assistance in the development of recreational activities among the residents, security and emergency information services (as well as emergency call buttons in each apartment), scheduled transportation services to shopping and community facilities and assistance in the development of a health consciousness program. Applicants for residency must be self motivated, ambulatory without assistance, able to self manage medications, and require no assistance in activities of daily living (except on a temporary basis). Partnership emphasizes that the Project is not designed as an institutional care facility but as housing for an independent life style per the FmHA regulation.

The FmHA regulations currently do not require that tenants purchase the support services package. Partnership represents that it will comply with the FmHA regulations and will NOT require purchase of the support services package as a condition of occupancy.

Partnership estimates the total development cost of the Project to be *** of which *** represents projected moveable equipment and miscellaneous costs. The total costs of the development exceeds that which is incurred in a typical elderly apartment financed by the FmHA. The principal reason for such increased cost is the central dining facility and kitchen. There will also be greater costs in common areas, but these costs are frequently encountered in larger (*** unit or more) apartment developments. There are no pools, cabanas or similar type amenities.

Development of the Project will begin by the purchase of the land from an unrelated entity, closing of a construction loan and the commencement of construction. The general partners will construct the Project in accordance with the FmHA's rules and regulations and upon completion of construction intend to close the FmHA permanent loan and initiate occupancy. Occupancy is estimated to commence in *** Partnership has applied for low-income housing credit through the Commission, the agency designated by State X to allocate such credit under section 42 of the Code.

Partnership plans to admit an investor limited partner who will contribute substantial capital to Partnership on the basis of Partnership's representations that the low-income housing credit will be available provided Partnership complies with the operative requirements of section 42 of the Code. In this respect Partnership represents that it will elect the 60/40 minimum set-aside requirement and will rent only to tenants who have incomes 60 percent or less of the median income for the area as adjusted for family size. Partnership also represents that the rental charges for units together with the respective utility allowances are less than 30 percent of the qualifying income for occupancy. All units will have similar design, construction quality and amenities and will be uniform throughout the Project. Partnership also represents that there will be no separate fee for the use of Project amenities except as provided in the service package.

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 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) provided 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 these 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. 11-89 (1986), 1986-3 (Vol. 4) C.B. 89.

Section 42(d)(5)(A) of the Code generally provides that 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(l)(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. Section 42(l)(4) defines "new building" as a building the original use of which begins with the taxpayer.

Residential rental units must be "for use by the general public" and all of the units in a project must be used on a non-transient basis. Residential rental units are not for use by the general public, for example, if the units are provided only for members of a social organization or provided by an employer for its employees. Generally, a unit is considered to be used on a non-transient basis if the initial lease term is six months or greater. Additionally, no hospital, nursing home, sanitarium, lifecare facility, retirement home, or trailer Park may be a qualified low-income project. See

2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess, 11-95 (1986), 1986-3 (Vol. 4) C.B. 95.

Notice 89-6, 1989-2 I.R.B. 16, states that regulations under section 42 of the Code will provide that the term "for use by the general public" shall be determined in a manner consistent with the Department of Housing and Urban Development (HUD) housing policy governing non-discrimination as evidenced by HUD rules and regulations. See HUD Handbook 4350.3 (or its successor). Accordingly, owners of residential rental units that give preferences to certain classes of tenants (e.g., the homeless, disabled and/or handicapped) will not violate the general public use requirement if such preferences would not violate and HUD policy governing non-discrimination expressed in the HUD handbook. However, if residential rental units are restricted to a class of residents that would violate HUD housing policy (e.g., residential rental units provided solely for members of a social organization or by an employer for its employees) then the building in which these units are located will be ineligible for the credit.

In a HUD opinion letter dated *** a residential rental project may give preference to the elderly provided that the project complies with HUD's policies prohibiting discrimination with respect to the named categories of sex, color or national or religious affiliation, and does not discriminate on the basis of class membership, membership in the sponsoring organization, or handicap. (See Figure 2-2 of HUD Handbook 4350.3) A project must also comply with HUD regulations implementing the 1988 amendments to the Fair Housing Act regarding discrimination against families with children.

In order to be eligible for the credit under section 42 of the Code, Partnership's congregate housing facility must be a residential rental project and not a "retirement home." See S. Rep. No. 313, 99th Cong., 2d Sess. 764 (1986), 1986-3 (Vol. 3) C.B. 764. Although not authority, the Joint Committee on Taxation Staff's explanation of section 42 states that no hospital, nursing home, sanitarium, lifecare facility, "retirement home providing significant services other than housing," dormitory, or trailer park may be a qualified low-income project. See Joint Committee on Taxation Staff, General Explanation of the Tax Reform Act of 1986, 100th Cong., 1st Sess, (1987), pp.163-164.

Notice 89-6 provides that; the furnishing to tenants of services other than housing (whether or not such services are significant) will not prevent property from qualifying as residential rental property. However, any charges for services that are not optional to low- income tenants must be included in gross rent for purposes of section 42(g)(2)(a) of the Code. A service is optional if payment for the service is not required as a condition of occupancy. Thus, in certain circumstances, a retirement-type facility may qualify under section 42 as a residential rental facility, notwithstanding that significant services other than housing are furnished to tenants. Furthermore: if continual nursing, medical, or psychiatric care is provided, it will be presumed that such services are mandatory. This is generally the case with hospitals, nursing homes, sanitariums, and lifecare facilities.

Notice 89-6 provides an example where meals and other services are provided to low-income tenants in a retirement home. Under the example, the cost of these services, when combined with rent and utility allowances, exceeds the 30 percent gross rent limitation. If any low-income tenants are required to pay for these

services as a condition of occupancy, then the units occupied by these tenants are not rent-restricted units and are not included in qualified basis. However, if payment for these services is OPTIONAL, then these units are rent-restricted units and are includible in qualified basis assuming that the gross rent limitation is otherwise satisfied. Where multiple services are provided, a building owner must decide which services are mandatory and included in the 30 percent gross rent limitation. All other services must be provided on an optional basis.

Partnership represents that the residents of the Project will have the option to receive for a fee the services package that includes meals and payment for the services is not required as a condition of occupancy. Partnership also represents that, except for emergency services, Partnership will not provide medical or nursing services to the residents. Thus, the cost of the meals will not have to be included in determining whether the 30 percent gross rent limitation of section 42(g)(2)(A) of the Code is exceeded.

Eligible basis may include the cost of amenities, including personal property, 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. 11-89-90 (1986), 1986-3 (Vol. 4) C.B. 89-90. The separate fee that Partnership charges is only for meals and other support services and not for use of the specific facilities such as the dining facilities. Thus, as long as Partnership does not prohibit the residents who do not pay for the support services from entering and using the facilities (dining, indoor recreational, laundry and other community area facilities), these facilities may be included in the Project's eligible basis under section 42(d) of the Code.

Therefore, based upon the above facts and representations, provided that restricting the Project to the elderly, handicapped, of disabled does not violate any HUD non-discrimination policy; and provided that Partnership otherwise satisfies the set-aside and gross rent limitations under section 42(g)(1) and (2) of the Code, we rule as follows:

1. Partnership's proposed congregate housing facility, which is financed and operated in accordance with the FmHA regulations, is a qualified low-income housing project for purposes of section 42(g)(1) of the Code.

2. The additional amenities that include the dining, indoor recreational, laundry and other community area facilities may be included in the Project's "eligible basis" under section 42(d) of the Code.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations or to whether the Project will otherwise qualify for the low-income housing credit under section 42 of the Code. Nor is any opinion expressed under section 42(g)(2) and 42(i)(3) regarding a unit occupied by more than one unrelated person.

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, a copy of this letter is being sent to you as the authorized representative of Partnership.

Sincerely yours,

Susan Reaman

Assistant to the Chief, Branch 5

Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)