Private Letter Ruling 8945036, IRC Section 42

August 15, 1989

This is in response to a letter dated September 10, 1987, and subsequent correspondence, submitted on behalf of Taxpayer. Rulings are requested regarding whether Taxpayer's proposed project is a qualified low-income housing project eligible for the low-income housing credit under section 42 of the Internal Revenue Code. The represented facts as submitted are set forth below.

Taxpayer was organized in *** and is incorporated as a nonprofit corporation under the laws of the State X. The City Y District Office has examination jurisdiction over the corporation's Federal tax returns. Taxpayer represents that it is an exempt charitable organization under section 501(c)(3) of the Code.

Taxpayer is organized and operated to maintain a residence and other facilities that provide services to elderly persons. Taxpayer's principal charitable activities are providing residential alternative care facilities and intermediate care nursing facilities for the elderly and providing housing for low-income elderly persons.

Taxpayer intends to form a limited partnership to construct a new residential facility for the needy elderly in City Y. Taxpayer will manage and operate the facility under a management contract with the limited partnership. Taxpayer anticipates that it or a wholly- owned subsidiary will be the general partner of the limited partnership. Funds for the facility will be raised through equity contributions to the limited partnership, together with loan proceeds. The precise terms of the equity and debt structure have not been determined at this time.

The residential facility will consist of a new building to be constructed on land presently owned by Taxpayer. When completed, the facility will consist of approximately *** residential units, each of which will be similarly constructed and will have the same quality standards.

At present, Taxpayer owns and operates a residential facility in which *** elderly persons live. The building which houses the residential facility also contains a separate *** bed intermediate care nursing facility. As part of the project, the existing building will be substantially modified and rehabilitated such that what is in effect a new building will be constructed behind the existing historical facade.

Taxpayer represents that the new building will be built in two distinct phases. First, a new *** story building will be built adjacent to the existing building ("Phase One"). On the *** floor of the new building will be a residential facility for the elderly. On the *** floor of the new building will be a separate *** bed intermediate care nursing facility. Upon completion of the new building, the residents of the existing building will move to the *** floor of the new building and the intermediate care nursing patients in the existing building will be moved to the *** floor of the new building. Taxpayer anticipates that the

building will be condominiumized, such that the limited partnership will own the residential facilities and Taxpayer will own the intermediate care nursing facility. Thus, Phase One will be divided into *** full- floor condominium units and the existing structure will consist of *** condominium unit. Taxpayer represents that there will only be *** units because it will simplify the ownership structure for the project. Taxpayer states that each residential unit in the project will not be a separate condominium unit. Taxpayer acknowledges that the *** floor intermediate care nursing facility portion of the new building will not qualify for the section 42 credit because it will not be residential rental property. Taxpayer represents that the residential portion of the project and the intermediate care nursing portion of the project serve separate and distinct functions and separate and distinct populations.

After Phase One is completed, the existing structure will be substantially rehabilitated and expanded ("Phase Two"). When Phase Two is completed, the Phase One building and the expanded structure will be contiguous and will constitute a single building. The historic façade and a very small portion of the existing structure will be saved; otherwise, the Phase Two construction will result in a new building. The partnership will own the Phase Two building.

The Phase Two construction will consist entirely of residential facilities for the elderly, together with common areas and cooking and dining facilities which will serve both the residential facilities of Phase One and the residential facilities of Phase Two. The Phase Two construction will not include additional intermediate care nursing facilities and Taxpayer represents that the residential facilities and the intermediate care facilities will be separate and distinct and will serve different populations.

When Phase Two is completed, the residential facility will contain *** separate living units, together with common areas and cooking and dining facilities serving the residential units. The *** floor of the Phase Two building and the *** floor of the Phase One building will form a single level, with the intermediate care nursing facility below such level and the residential floor of the phase two building above such level.

Each resident will occupy his or her own apartment unit which will contain living and sleeping facilities and, except for cooking and dining, will be self-contained. Each residential unit will contain a bathroom and shower. Although units will not contain kitchens or kitchen-type appliances, residents will be permitted to install such appliances as mini-refrigerators and microwave ovens. Rooms will not be furnished, and residents will provide their own furniture.

The residential facility will contain common areas and amenities, including without limitation the following, common cooking and eating areas, card and game room, reading room, television room, crafts room, lounges and other communal activity areas. Taxpayer represents that the purpose of the residential facility is to provide living arrangements for the elderly which permit them to maintain their independent status to the fullest extent possible while providing the living assistance required by virtue of their age. Taxpayer emphasizes that the apartments in the facility will be the permanent residences of the

residents and that the residents will not be transient. For example, the average time of residence in the present facility is *** years and several residents have lived at the facility for more than *** years.

In addition to living areas and common areas provided to residents in exchange for rental payments, Taxpayer will contract with residents to provide the following services: three meals per day in a common dining area, housekeeping services, laundry services, assistance in bathing and dressing, if needed, assistance with the taking of medication, if needed, and general supervision to assure that residents do not meet with accidents or other conditions which might require medical or nursing care. Taxpayer represents that the meals and board (consisting of other services listed above) will be provided to residents under separate contract, which will be OPTIONAL and will not be a condition of occupancy. Taxpayer will also provide a van which will provide local transportation for residents to go to town to shop, visit their doctors and the like. These services will be provided under separate contract from the rental of the apartment unit.

The residential facility will not provide professional nursing care. Residents will have private arrangements with their own doctors. Although some residents may subsequently decide to move into the intermediate care facility if their health so requires, residents may use other facilities of their choice to provide nursing and health services. If a resident decides to use the intermediate care facility owned by Taxpayer, he or she will be charged independently for such use. Residents may, at their option and expense, use the medical services provided by the nursing facility.

In the past, residents have come from the metropolitan City Y area; and Taxpayer anticipates that this will continue to be the case. All elderly persons who need living assistance will be eligible to become residents of the facility and Taxpayer will not discriminate on the basis of sex, color or national or religious affiliation with respect to residency eligibility.

The purpose for the planned transaction is to further Taxpayer's charitable goals through the provision of a residential alternative care facility for the needy elderly. In order to raise equity financing for the project, Taxpayer claims that it is critical that the low-income housing credit be available for use by investors.

For purposes of these rulings, Taxpayer makes the following additional representations:

1. The project will meet either the "20-50 test" of section 42(g)(1)(A) of the Code or the "40-60 test" of section 42(g)(1)(B) and will meet the requirements of such sections within the time period provided by section 42(g)(3).

2. The condominiums will receive an allocation from the appropriate housing credit agency in accordance with the requirements of section 42(h) of the Code, unless an allocation is not required pursuant to section 42(h)(4).

3. The condominiums will receive a *** carryover allocation under section 42(h)(1)(E) of the Code and will constitute "qualified buildings."

4. It is anticipated that Phase One of the project will be placed in service in *** and that Phase Two will be placed in service in *** .

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, as added by section 252 of the Tax Reform Act of 1986 (the "1986 Act"), 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."

The first ruling that Taxpayer requests concerns whether the project will meet the "public use" requirement set forth in the legislative history to section 42 of the Code. 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. 2 H.R. Conf . Rep. No. 841, 99th Cong., 2d Sess. II-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 any 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 *** residential rental units may give preference to the elderly provided that they comply with HUD's policies on nondiscrimination 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.) Taxpayer's proposed residential facility must also comply with HUD regulations implementing the

1988 amendments to the Fair Housing Act regarding discrimination against families with children.

In the instant case, the restriction of the residential facility to the elderly does not violate the public use requirement as set forth in the legislative history of section 42, provided such restriction complies with the HUD nondiscrimination provisions as stated above.

The second ruling concerns whether the furnishing of services other than housing will disqualify the residential facility as residential rental property under section 42(g) of the Code.

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 minimum set-aside requirements of section 42(g)(1)(A) or (B), whichever the taxpayer elects. The election is irrevocable. Section 42(g)(2)(A) 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 limits that section 42(g)(1) imposes upon the occupants.

The Joint Committee on Taxation Staff's explanation of section 42 of the Code which provides 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 further 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.

Under the represented facts, meal preparation, dining and other services will be provided on an optional basis. Further, no medical or nursing services will be provided to those residents of the residential rental project. Thus, assuming Taxpayer's gross rent limitation is otherwise satisfied, the residential rental facility may qualify as a low-income project.

The third requested ruling concerns whether the residential facility will be a "qualified low-income building" pursuant to section 42(c)(2) of the Code and will be entitled to a low-income housing credit determined under section 42(a).

Section 42(c)(2) and (i)(1) of the Code define the term "qualified low-income building" as any building which at all times during the compliance period (a period of 15 years beginning on the first day of the first taxable year in which the credit is claimed) is part of a qualified low-income housing project, and to which the amendments made by section 201(a) of the 1986 Act apply.

Section 42(g)(3)(B)(i) of the Code provides that in determining whether a building (the "prior building") is a qualified low-income building, the taxpayer may take into account 1 or more additional buildings placed in service during the 12-month period described in section 42(g)(3)(A) with respect to the prior building only if the taxpayer elects to apply section 42(g)(3)(B)(ii) with respect to each additional building taken into account. Section 42(g)(3)(B)(ii) provides that in the case of a building which the taxpayer elects to take into account under section 42(g)(3)(B)(i), the period under section 42(g)(3)(A) for such building shall end at the close of the 12-month period applicable to the prior building.

The legislative history to section 42 of the Code provides that a low-income unit includes any unit in a qualified low-income building if the individuals occupying such unit meet the income limitation elected for the project for purposes of the minimum set- aside requirement and if the unit meets the gross rent limitation, as well as all other requirements applicable to units satisfying the minimum set-aside requirement.

Further, certain single room occupancy housing used on a non- transient basis may qualify for the credit, even though such housing may provide eating, cooking, and sanitation facilities on a shared basis. An example of housing that may qualify for the credit is a residential hotel used on a non-transient basis that is available to all members of the public. The residential units in such building may share bathrooms and have a common dining area. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-94-95 (1986), 1986-3 (Vol. 4) C.B. 94, 95.

Notice 88-91, 1988-36 I.R.B. 28, states 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. Thus, each condominium consisting of the low-income units described above will be considered a qualified low-income building that is

part of a qualified low- income housing project under section 42(c)(2) and 42(g)(3)(B)(i) of the Code.

Therefore, based upon the above representations of facts, provided, Taxpayer's restriction of its residential facility to the elderly does not violate the HUD policies prohibiting discrimination on the basis of class membership, membership in the sponsoring organization, or handicap; and such a restriction complies with the HUD regulations implementing the 1988 amendments to the Fair Housing Act; and provided that each residential condominium satisfies the minimum set-aside requirements under section 42(g)(1) of the Code and that each residential unit otherwise is rent restricted and satisfies the gross rent limitation under section 42(g)(2), we rule as follows:

1. The residential rental condominiums satisfy the "public use" requirement set forth in the legislative history to section 42 of the Code.

2. For purposes of section 42 of the Code, the optional meals and other services will not prevent the condominiums from qualifying as residential rental property under section 42(g) of the Code.

3. Each residential condominium will be considered a "qualified low-income building" pursuant to section 42(c)(2) of the Code.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations or to whether Property 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 you this letter as Taxpayer's authorized representative.

Sincerely yours,

Susan Reaman

Assistant to the Chief, Branch 5

Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)