September 7, 1989

Dear ***:

This is in response to a letter dated September 9, 1988, and subsequent correspondence submitted on behalf of Taxpayer requesting a ruling that Taxpayer's newly constructed housing development (the "Project") would be eligible for the 70-percent present value low- income housing credit allocation for newly constructed non-Federally subsidized buildings under section 42 of the Internal Revenue Code. Although the Project received a tax-exempt bond financed construction loan, Taxpayer represents that such loan was repaid before the Project was placed in service. The represented facts as submitted are set forth below.

The Project is a c-unit newly constructed housing development for the elderly located in a redevelopment area (the "Redevelopment Area") at Site 1. The Project was placed in service on d and will serve exclusively low-income households.

The Project was developed by Taxpayer. Taxpayer is a public body, corporate and politic, created by the City G City Council in e pursuant to the State F Housing Authorities Law. Its governing body is the City G City Council and its Chairman is the Mayor of City G. The specific purpose of Taxpayer is to develop housing for low-income households in City G.

In the Spring of h, after construction of the Project was well under way, Taxpayer decided to syndicate the Project to take advantage of the federal and State F low-income housing tax credits. Taxpayer plans to use the revenues raised from the syndication to provide Project development costs not covered by mortgage proceeds, to provide certain programs to elderly residents of Taxpayer's i central City elderly housing developments, and to construct additional low-income housing. Accordingly, Taxpayer has entered into a Purchase and Sale Agreement with Partnership, a State F limited partnership, pursuant to which Taxpayer has agreed to sell the Project to Partnership for j dollars. Taxpayer will retain title to the land on which the Project is situated and will lease the land to the Partnership for a term of k years.

The general partner of Partnership is a nonprofit corporation that is controlled by Taxpayer. The By-laws of the corporate general partner provide that the Executive Director of Taxpayer appoints the directors of the corporation. The general partner has a t percent interest in Partnership profits, losses and credits and intends to syndicate limited partnership interests to individual and/or corporate investors. Taxpayer, as the initial limited partner, will withdraw from the Partnership when the investor limited partners are admitted.

The Partnership acquired title to the Project shortly before the Project was placed in service on d. The Partnership will operate all of the residential units in the Project in accordance with the household income limitations and rent restrictions set forth in section 42(g) of the Code for the 15-year federal compliance period.

The development costs for the Project have been financed with funds from federal, State, and local sources as follows:

m dollars -- loan from the State F Rental Housing Construction Program.

n dollars -- Housing Development Action Grant ("HoDAG") loan from City G.

o dollars -- Community Development Block Grant funds.

p dollars -- Construction loan from City G's Redevelopment Agency.

The Partnership will assume the State loan, the HoDAG loan and the Redevelopment Agency loan. City G has approved the transfer of the Project by the Taxpayer to the Partnership on the condition that the Block Grant funds be treated as a loan to the Partnership. The two loans of federal funds, the Block Grant loan and the HoDAG loan, will bear interest at the applicable federal rate in effect under section 1274(d)(1) of the Code as of the date on which each loan is made. In addition, those two loans will be required to be paid currently to the extent of surplus cash.

The construction loan from the Redevelopment Agency of City G (the "Agency") was initially funded using a portion of the proceeds of Tax Allocation Bonds issued by the Agency (the "Bonds"). Interest on the Bonds is excludable from gross income for federal income tax purposes pursuant to section 103 of the Code.

Repayment of principal and interest on the Bonds is secured by a pledge of certain "tax increment revenue" generated within the Redevelopment Area. Tax increment revenue consists of general property tax revenue attributable to increases in assessed valuation of property in the Redevelopment Area above the assessed valuation in effect in the years in which various portions of the Redevelopment Area were established and designated for redevelopment pursuant to the provisions of the State F Community Redevelopment Law (the State F Health and Safety Code Section q et seq.) The Agency receives the proceeds generated by increased property taxes attributable to redevelopment activities in the Redevelopment Area. These tax increment revenues are then available to repay debt or finance additional redevelopment activities.

Pursuant to the State F Community Redevelopment Law and the Agency adopted redevelopment plans, tax increment revenue allocated and paid to the Agency may be pledged by the Agency for repayment of indebtedness, such as the Bonds, incurred for the purposes of redevelopment in the Redevelopment Area. Repayment of principal and interest on the Bonds is not secured in any way by revenues that may be received by the Agency from projects or improvements that are funded with Bond proceeds. There is no provision for early redemption of the Bonds in the case of availability of revenues generated by specific financed projects. Instead, the principal amount of the Bonds may not be redeemed until a specified date.

Bond proceeds were not designated for a specific project and are to be expended for the purpose of financing the redevelopment of the Redevelopment Area. Within this purpose is a wide range of activities, the public components of which may be financed with Bond proceeds. The Agency presently has outstanding r dollars of tax allocation bonds for the downtown Redevelopment Area.

The Agency used p dollars of Bond proceeds to provide an interim loan to Taxpayer to finance part of the construction of the Project (the "Loan"). The Loan was viewed as an interim use of Bond proceeds, with the ultimate use of such funds, upon repayment of the Loan, earmarked for expansion of City G's central public library.

In August of h, before the Project was placed in service on d, the Agency made a second loan to Taxpayer in the amount of p dollars, the source of which was unencumbered tax increment revenue. Taxpayer used the proceeds from the second loan to repay the Agency's first loan in the amount that had been funded with Bond proceeds. Thus, Taxpayer represents that the Bond-financed construction loan for the Project was repaid by Taxpayer before the Project was placed in service. Therefore, Taxpayer requests a ruling that the Project will not be treated as federally subsidized under section 42(i)(2) of the Code because the Agency's initial loan, financed with Bond proceeds, was repaid before the Project was placed in service.

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 (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 taxable year in the credit period shall be an amount equal to the "applicable percentage" of the qualified basis of each qualified low-income building.

In the case of any qualified low-income building placed in service by the taxpayer after 1987, section 42(b)(2) of the Code, as amended by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) (Pub. L. 100-647) provides, in part, that the term "applicable percentage" means the appropriate percentage prescribed by the Secretary for the month applicable under section 42(b)(2)(A)(i) or (ii). Section 42(b)(2)(B) provides that the percentages prescribed by the Secretary for any month shall be percentages that will yield over a 10-year period amounts of credit that have a present value equal to: (i) 70 percent of the qualified basis of new buildings that are not federally subsidized for the taxable year (70 percent present value credit), and (ii) 30 percent of the qualified basis of existing buildings, and of new buildings that are federally subsidized for the taxable year (30 percent present value credit).

Section 42(i)(2)(A) of the Code provides, in general, that a new building shall be treated as federally subsidized for any taxable year if, at any time during such taxable year or any prior taxable year, there is or was outstanding any obligation the interest on which is exempt from tax under section 103, or any below market Federal loan, the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof. Section 42(i)(2)(D) defines "below market Federal loan" as any loan funded in whole or in part with Federal funds if the interest rate payable on such loan is less than the applicable Federal rate in effect under section 1274(d)(1) (as of the date on which the loan was made).

Section 42(i)(2)(C) of the Code was added by TAMRA to provide an exception to the rule in section 42(i)(2)(A) for any tax-exempt obligation or below market Federal loan used to provide construction financing for any building if --

(i) such obligation or loan (when issued or made) identified the building for which the proceeds of such obligation or loan would be used, and

(ii) such obligation is redeemed, and such loan is repaid, before such building is placed in service.

We believe that the Congressional intent behind section 42(i)(2)(C) of the Code was to ensure that a building did not receive the benefit of a federal subsidy while also receiving the benefit of the higher 70 percent present value credit for qualified low-income housing buildings. Although in the instant case the Bonds remain outstanding, the Bonds were not earmarked specifically for the Project, but rather for the entire Redevelopment Area. Furthermore, Taxpayer has represented that the p dollars of Bond proceeds used by the Agency to provide the interim Loan to Taxpayer were repaid before the Project was placed in service.

Therefore, based upon the above facts and representations, we rule as follows:

The Project will not be treated as federally subsidized under section 42(i)(2) of the Code with respect to the interim Loan made by the Agency to finance part of the construction of the Project.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations or to whether Property will otherwise qualify 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 the taxpayer.

Sincerely yours,

James Ranson

Chief, Branch 5

Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)