Private Letter Ruling 9120021, IRC Section 42

Unsold condominiums qualify as new, separate buildings.

Full Text:

Date: February 19, 1991

Dear ***

This is in response to your July 15, 1990, letter and subsequent correspondence submitted on behalf of Partnership. In your correspondence you requested rulings concerning the placed in service date for the Condominium for purposes of section 42 of the Internal Revenue Code. The facts as represented in your correspondence are set forth below.

Partnership is a State A partnership maintaining its principal place of business in City B. Partnership files its federal income tax returns with the Internal Revenue Service Center, City C, and is under the audit jurisdiction of the District Director, City B.

Partnership's activities include developing and operating low- income housing both inside and outside the Northeast. Partnership intends, either directly or through a related partnership of which it or an affiliate will be a general partner, to acquire the Condominium and to convert it to low-income rental use. Partnership also intends to own and to manage the Condominium so that it will qualify for the low-income housing credit under section 42 of the Code.

The Condominium was originally developed by Developer for sale as individual condominium units. Construction of the Condominium was completed in t1, and a Certificate of Occupancy for the building was issued by the City D Department and dated t2. The Condominium was established by a master deed dated t3, while individual unit Certificates of Occupancy were issued in t4.

Beginning in t5 and after completion of the Condominium, Developer advertised units for sale in various newspapers in the metropolitan City B area. Units were offered for outright sale.

Developer's sales efforts continued up to t6, at which time sales agreements had been entered into for the Sold Units. Title for each of the Sold Units was transferred to the purchasers.

In addition, Developer engaged in rental activity with respect to the Rented Units. Developer placed four of the Rented Units in a local Housing Program for rental purposes. Under this program, the units were leased to qualified buyers with an option to purchase, with portions of rents paid credited toward the purchase prices. Developer rented out 1 of the Rented Units under a tenancy at will.

Due to a weak real estate market, Developer was not able to meet its sales projections. Consequently, Developer was not able to satisfy its obligations to its construction lender, Bank. During discussions between Developer and Bank, the parties determined it likely both that Developer could not complete its sales program

and that Bank would initiate foreclosure proceedings. To avert foreclosure, Developer transferred the Condominium to an affiliate of Bank in lieu of foreclosure.

In late t7, Bank entered into negotiations with Partnership for the sale of the Condominium. Based on the advice of tax counsel, Partnership intends to enter into a purchase and sale agreement contingent upon the receipt of a favorable ruling from the Service that the Project Units (the Condominium less both the Rented Units and the Sold Units constitutes the Project Units) have not been placed in service under section 42 of the Code.

Partnership represents that to the best of its knowledge:

(1) Developer developed the Project Units for sale and not for rental.

(2) Developer did not claim any allowance for depreciation with respect to the Project Units.

(3) After taking title to the Project Units by deed in lieu of foreclosure, Bank did not hold out the Project Units for rental.

(4) After taking title to the Project Units, Bank did not claim any allowance for depreciation with respect to the Project Units.

Section 38(a) of the Code provides for a general business credit against the tax imposed by chapter 1 for the tax year that includes the amount of the current year business credit. The amount of the current year business credit includes, under section 38(b)(5), the low-income housing credit determined under section 42(a).

Section 42(a) of the Code provides that the amount of the low- income housing credit shall be an amount equal to the applicable percentage of the qualified basis of each qualified low-income building. Section 42(b)(2)(A) provides that the term applicable percentage, for any qualified low-income building placed in service by the taxpayer after 1987, means the appropriate percentage prescribed by the Secretary for the earlier of (i) the month in which the building is placed in service, or (ii) at the election of the taxpayer (1) the month in which the taxpayer and housing credit agency enter into an agreement with respect to such building (which is binding on such agency, the taxpayer, and all successors in interest) as to the housing credit dollar amount to be allocated to such building, or (ii) in the case of any building to which section 42(h)(4)(B) applies, the month in which the tax-exempt obligations are issued. Additionally, a month may be elected under clause (ii) only if the election is made not later than the 5th day after the close of such month. Such an election, once made, shall be irrevocable.

Section 42(h)(1)(A) of the Code provides that the amount of the credit determined under section 42 for any building for any tax year shall not exceed the housing credit dollar amount allocated to such building. A taxpayer is required to receive a housing credit dollar amount allocation from the appropriate State housing credit agency. The general timing for receiving a housing credit dollar amount allocation is linked, with exceptions, to the year a building is placed in service. Thus, section 42(h)(1)(B) provides that except in the case of an allocation that meets the requirements of subparagraphs (C), (D), and (E) of section 42(h)(1), an allocation shall be taken into

account under section 4(h)(1)(A) only if it is made not later than the close of the calendar year in which the building is placed in service.

Section 42(i)(4) of the Code provides that the term "new building" means a building the original use of which begins with the taxpayer.

The Service issued guidance on what constitutes a qualified low- income building in IRS Notice 88-91, 1988-26 I.R.B. 28. Notice 88-91 states that final regulations will provide that the term "qualified low-income building" includes residential rental property that is either an apartment building, a single family dwelling, a townhouse, a rowhouse, a duplex, or a condominium. Accordingly, each condominium unit meeting the requirements of section 42 of the Code constitutes a separate qualified low-income building with its separate placed-in-service date.

The Service also issued guidance on what constitutes placing a building in service in IRS Notice 88-116, 1988-2 C.B. 449. Notice 88- 116 provides that the term "placed in service" has two definitions -- one for buildings and one for rehabilitation expenditures that are treated as a separate new building (section 42(e)(4)(A)). 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. In general, a transfer of the building results in a new placed-in-service date if, on the date of transfer, the building is occupied or ready for occupancy.

For further guidance on the term "placed in service" for purposes of section 42 of the Code, the Service looks to the placed- in-service rules in sections 1.167 and 1.46-3(d) of the Income Tax Regulations.

Section 1.167(a)-2 of the regulations provides that the depreciation allowance in the case of tangible property applies only to that part of the property that is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence. The allowance does not apply to inventories or stock in trade, or to land apart from the improvements of physical development added to it.

Section 1.167(a)-11(e)(1)(i) of the regulations provides that the term "first placed in service" refers to the time the property is first placed in service. Property is first placed in service when first placed in a condition or state of readiness and availability for a specifically assigned function, whether in a trade or business, in the production of income, in a tax-exempt activity, or in a personal activity.

Similarly, under section 1.46-3(d) of the regulations, property is first placed in service for purposes of the investment credit in the earlier of (i) the tax year in which, under the taxpayer's depreciation method, the period for depreciation with respect to the property begins, or (ii) the taxable year in which the property is placed in a condition or state of readiness and availability for a specifically assigned function, whether in a trade or business, in the production of income, in a tax-exempt activity, or in a personal activity.

Regulations stipulate that only depreciable property may be placed in service for purposes of claiming depreciation deductions. Under section 1.167(a)-1(a) of the regulations, depreciable tangible property is property used in the trade or business of

a taxpayer or property held by a taxpayer for the production of income. Property held either as inventory or primarily for sale to customers in the ordinary course of a taxpayer's trade or business is not property for which depreciation deductions are allowed pursuant to section 1.167(a)-2 of the regulations.

In this case, Developer attempted to sell the Project Units, but engaged in no rental activity on the Project Units during the sales period. Partnership represents that Developer held the Projects Units for sale. Partnership also represents that Developer claimed no depreciation deductions for the Project Units. Therefore, we assume that the Project Units held by Developer were not property for which depreciation deductions were allowed under section 167 of the Code.

Developer transferred, by deed in lieu of foreclosure, the Project Units to Bank in order to avert foreclosure proceedings. Bank then entered into negotiations with Partnership for the sale of the Project Units. Partnership represents that Bank did not hold out for rental the Project Units after taking title in lieu of foreclosure. Partnership also represents that Bank claimed no depreciation deductions for the Project Units after taking title in lieu of foreclosure. Therefore, we assume that the Project Units held by Bank were not property for which depreciation deductions were allowed under section 167 of the Code.

As indicated above, the Service looks to section 1.167 of the regulations for guidance on placement in service as it pertains to section 42. Under the regulations, residential rental property is placed in service when ready and available for its specifically assigned function. The Certificates of Occupancy issued by Department to Developer for the Condominium and its units evidence availability for occupancy under local law, but are not alone determinative under the facts of whether the Project Units were placed in service under section 42. Presumably, Developer and Bank were holding the Project Units for purposes for which no depreciation allowances were allowed. Therefore, under the foregoing facts and assumptions we conclude that neither Developer nor Bank placed in service the Project Units for purpose section 42.

Under section 42(i)(4) of the Code, a "new building" is a building the original use of which begins with the taxpayer. Because we conclude that the Project Units were not placed in service by either Developer or Bank, each of the Project Units will constitute a separate new building under section 42(i)(4) when originally placed in service by Partnership.

Based upon the above facts and assumptions, we rule as follows:

Under section 42 of the Code, the Project Units are not considered placed in service by either Developer or Bank and will be considered new buildings when acquired by Partnership.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the foregoing facts under any other provisions of the Code and regulations.

We direct this ruling only to the taxpayer on whose behalf it was requested. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in

this ruling letter have not been adopted. Therefore, this ruling may be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion herein. See section 11.04 of Rev. Proc. 91-1, 1991-1 I.R.B. 9, 30. However, when the criteria in section 11.05 of Rev. Proc. 91-1 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 year in which the transaction is consummated.

Sincerely yours,

James Ranson

Chief, Branch 5

Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)