Private Letter Ruling 9146017, IRC Section 42

Date: August 12, 1991

Dear ***

This is in response to your letter dated June 12, 1991, and subsequent correspondence submitted on behalf of Taxpayer in which you request a ruling concerning the placed in service date of the Project for purposes of section 42 of the Internal Revenue Code. The facts as represented in your correspondence are set forth below.

Taxpayer is a limited partnership formed under the laws of State A by a Limited partnership Agreement and a Certificate of Limited Partnership dated as of a. The Certificate of Limited Partnership of Taxpayer was filed with the State A Secretary of State on b. The general partners of Taxpayer are the General Partners.

Taxpayer was formed for the sole purpose of acquiring a parcel of real estate located in Town B and constructing the Project. The Project is intended for qualified elderly tenants pursuant to the United States Farmers' Home Administration ("FmHA") rural rental housing program under section 515 of the Housing Act of 1949. Town B is a town of less than d in population located in northern State A near the border with Country C.

On e, Taxpayer applied to FmHA for a rural rental housing loan and rental assistance. By reply dated f, Taxpayer was notified that its application was approved and the requested financing and rental assistance would be provided. The approval was "subject to [FmHA] regulations applicable to this type of assistance."

On g, Taxpayer acquired the site. Construction took place over the summer and fall of h. Taxpayer represents that in all of its and the General Partners' activities regarding the Project, they expected that permanent mortgage closing and occupancy of the project would occur in early j.

Taxpayer also applied to the State A State Housing Authority ("Agency") for an allocation of low-income housing credit dollar amount pursuant to section 42 of the Code. Under the laws of State A, the Agency is the authority designated for the purpose of allocating the low-income housing tax credit dollar amounts. By letter dated i, Taxpayer received a conditional reservation of $k of the low-income housing credit ("Conditional Reservation"). Paragraph 4 of the Conditional Reservation illustrates the fact that Taxpayer and the Agency were expecting the Project to be completed in early j. That paragraph imposes a l deadline for closing on permanent financing and the issuance of a local certificate of occupancy, and a m deadline for the application to the Agency for issuance of an Internal Revenue Service Form 8609.

As a condition of receiving the allocation of the low-income housing credit dollar amount, Taxpayer executed an Extended Low- Income Housing Commitment Agreement ("Extended Agreement"), which obligates Taxpayer to certain criteria regarding the

income levels of tenants to whom the units in the project are rented. The obligations of Taxpayer extend for a period of 15 years with respect to requirements imposed under section 42 of the Code and 30 years for certain other requirements imposed by the Agency. Under section 6 of the Extended Agreement, the 15 and 30-year periods "commence with the first day in the Project period in which any building which is part of the Project is placed in service." The Extended Agreement was signed by Taxpayer on n, and by the Agency on the day following. The Agency informed Taxpayer that the Extended Agreement will be recorded in the County D Registry of Deeds when a Form 8609 is issued by the Agency.

Taxpayer represents that under applicable FmHA regulations loans are only closed effective as of the first day of the calendar month. See 7 C.F.R. section 1944.236(c)(2). If the first day of the month is a holiday (as in the case for Taxpayer), the loan closing meeting is the last business day of the preceding month, and closing documents are filed the first business day of the month after the closing. For FmHA purposes, the loan is considered closed when the security instrument (e.g., the mortgage) is filed of record. See 7 C.F.R. section 1944.236(e)(1).

Taxpayer represents that the failure to close on the first day of a given calendar month results in a delay in closing until the first day of the next calendar month. Pursuant to FmHA requirements, all documentation showing the completed status of the project and other closing requirements must be submitted sufficiently in advance of the closing date to permit staff review of the materials. Taxpayer represents that for FmHA purposes, the loan for Taxpayer was considered closed on o.

In view of the FmHA policy, the General Partners decided to schedule a closing date with FmHA for p. In order to meet the requirements that materials be submitted sufficiently in advance of that date while allowing for delays that might arise because of the holiday season, the General Partners sought and obtained documentation in December h, showing the status of the project as substantially complete. Among other documents obtained in preparation for this closing was a local Certificate of Occupancy issued by Town B on q ("Certificate of Occupancy"). The Certificate of occupancy was conditional and referred to several matters stipulated in a decision of the Town B's Board of Appeals r decision.

Despite the issuance of the Certificate of Occupancy, Taxpayer represents that it remained legally unable to permit the occupancy of the Project prior to the January closing of its permanent financing with FmHA. Taxpayer represents that FmHA requires that the residential units not be occupied prior to the closing of the permanent financing. FmHA regulations provide that for projects receiving an interest subsidy such as the Project, occupancy prior to permanent mortgage closing is permitted only in circumstances in which the FmHA District Director has consented to occupancy in advance of the permanent mortgage closing. See 7 C.F.R. section 1944. Exhibit B(vi)(c). The FmHA District Director's consent for occupancy in advance of permanent mortgage closing was neither requested nor obtained by Taxpayer. Therefore, Taxpayer was precluded by governmental regulation from using the Project residential units for their intended purpose until p.

In December h, representatives of Taxpayer undertook leasing activity to obtain qualified tenants. Leases with qualifying tenants were signed to be effective p. Keys to the leased units were provided to the tenants at the time that the leases were signed late in the month. The purpose of providing the keys was to facilitate tenants who desired to access the premises for the purpose of taking measurements and other activities preliminary to moving in. Tenants were instructed not to commence their occupancy prior to p. Notwithstanding these instructions, Taxpayer has learned that some tenants moved personal belongings into the units and may have commenced occupancy prior to p; these activities were without authorization from Taxpayer.

Rent was charged only commencing p, and all utilities were changed from the account of Taxpayer to the accounts of the tenants on or after the first business day of January. No depreciation deductions have been claimed or will be claimed for any period prior to p.

The FmHA permanent mortgage closing occurred as of p, and the mortgage was recorded and the construction loan paid off on o. A letter from FmHA dated s, hereby incorporated by reference, indicates that FmHA views the Project as operational as of p.

Taxpayer represents that no Form 8609 was issued by the Agency for h because both the Agency and Taxpayer believed the project to be a j project for purposes of allocating the low-income housing credit. Taxpayer has applied for a j allocation of low-income housing credit and has been informed by the Agency that a Form 8609 allocating j credit will be issued when forms become available.

As of m, Partnership, a limited partnership, and Corporation were admitted to Taxpayer as new limited partners. These limited partners have, however, retained the right to withdraw from the partnership and receive a return of their capital contribution in the event that a favorable ruling is not received from the Service in response to Taxpayer's request.

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(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), (E), or (F) of section 42(h)(1), an allocation shall be taken into account under section 4(h)(l)(A) only if it is made not later than the close of the calendar year in which the building is placed in service.

The Service 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)-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.

As indicated above, the Service looks to sections 1.167 and 1.46-3(d) of the regulations for guidance on placement in service as it applies to section 42 of the Code. Under the regulations, residential rental real estate is placed in service when ready and available for its specifically assigned function. The Service looks at all the facts and circumstances for indicia of a building's readiness and availability for its specifically assigned function.

The issuance of a certificate of occupancy is one indication of a building's readiness and availability for its specifically assigned function. Thus, the Certificate of Occupancy issued by Town B to Taxpayer for the Project evidences availability for occupancy under local law; however, it is not by itself determinative under the facts of the issue of placement in service. Occupancy is another indication of a building's readiness and availability for its specifically assigned function. Taxpayer represents that some tenants occupied their units prior to p, although rent was charged beginning on p. However, Taxpayer also specifically represents that this early occupancy was without Taxpayer's authorization.

Taxpayer represents that it remained legally unable to permit the occupancy of the Project prior to closing on the permanent financing provided by FmHA. Under the FmHA rural rental housing program, the Project's specifically assigned function is to provide housing for qualified elderly tenants. With unintended relevance to the placement in service issue here, FmHA regulations prohibit, except under certain circumstances not relevant here, occupancy prior to closing on the permanent financing. As the foregoing facts show, the FmHA permanent mortgage closing did not occur until p. Therefore, the Project was not available for occupancy by elderly tenants, its specifically assigned function, until that date.

Based on the foregoing representations of fact and law, we rule as follows:

Under section 42 of the Code, the Project is considered placed in service by Taxpayer in January j, entitling Taxpayer to use j low-income housing credit dollar amount to be allocated by the Agency.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the foregoing facts under 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.

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 the issues addressed in this ruling 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 federal income tax return for the year in which the transaction is consummated.

Sincerely,

James Ranson

Chief, Branch 5

Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)