

Private Letter Ruling 9338013, IRC Section 42

Amounts Spent by Partnership are Rehabilitation Expenditures.

The Service has ruled that the amount spent on the structure will constitute rehabilitation expenditures under section 42(e)(2) and that those expenditures will substantially benefit low-income units in the apartment complex. The Service further ruled that the low-income housing tax credit will be allowable to the partnership.

Full Text:

Date: June 23, 1993

Dear ***

This letter responds to a letter of January 28, 1993, submitted on behalf of Taxpayer, requesting rulings on various issues under section 42 of the Internal Revenue Code. In a letter of May 24, 1993, submitted on Taxpayer's behalf, the original transaction was changed and ruling request (4) was withdrawn.

Taxpayer has made the following representations.

Taxpayer owns and manages an apartment complex containing a units of housing for low-income elderly people in b buildings located in City A. The complex is known as the Village. The Village was constructed approximately 15 years ago and Taxpayer has owned and managed it since that time. The Village was financed with a mortgage from the Agency. All the units are subsidized with Section 8 rents.

At the Village, a careful effort has been made over the years to determine the best way to meet the needs of the residents. These needs have included, most importantly, the need for well-maintained, well-run affordable housing. However, over the years as the population has aged, additional needs for services and support have increased. As a result, Taxpayer added a small community building several years ago to enable the project to better serve its aging residents who are not able to travel to and from the project as easily or frequently as they once did and who, therefore, need more on-site assistance. This community building contains approximately c square feet, including a community room with approximately d square feet, a e-square foot kitchen, storage space and a circulation area. The cost of constructing this community building was approximately \$f. Neither this building nor any other improvement made to the Village within the 10 fiscal years ending June 30, 1992 constitutes a "nonqualified substantial improvement" within the meaning of section 42(d)(2)(D) of the Code.

As the population of the Village has continued to age, Taxpayer has determined that additional development is essential for it to achieve its goal of enabling older adults to

continue to live independently for as long as possible and to avoid premature institutionalization in nursing homes. As a result, it is contemplated that a soon-to-be vacant building (the Structure) located on land that is contiguous to the Village will be acquired. In fact, the buildings comprising the Village surround the Structure, which has historically shared parking lots with the Village. It is contemplated that the Structure will be rehabilitated and expanded as an assisted-living project for frail, low-income elderly.

The Structure contains a kitchen and a community hall that will be rehabilitated. The Structure will contain a larger kitchen and community hall than what is currently available in the Village, and will also contain 50 units of housing. The Structure will accommodate a number of functions and events, held by and for the residents of the Village, that are too large to be held in the current community space at the Village.

Taxpayer proposes to sell the Village to a new limited partnership to be formed for the purpose of acquiring and operating the Village (the Partnership). The Partnership will also purchase the Structure. Taxpayer or an affiliate will serve as the general partner of the Partnership, but will not have an interest of 10% or more in the capital or profits of the Partnership. The purchase price of the Village and the Structure (collectively, the Project) paid by the Partnership to Taxpayer is expected to be \$g, including the assumption of the existing mortgage from Agency, which has an outstanding balance of approximately \$h. Approximately \$i or 15% of this purchase price is expected to be allocated to land so that the adjusted basis of the Partnership in the buildings of the Village and the Structure is expected to be approximately \$j.

The Partnership expects, in addition, to spend approximately \$k to \$l on rehabilitation expenditures (the Expenditures). Approximately one-third of these expenditures will relate directly to the Village and will include items such as replacement of the roofs, replacement or upgrade of air conditioning equipment and installation of new bathroom and kitchen floors in the apartments (the Direct Expenditures). The remainder of the rehabilitation expenditures of the Partnership (the Structure Expenditures) will be contributed to the cost of rehabilitating the Structure, and to improvement of parking, curbing, sidewalk, and exterior lighting on the grounds of the Structure. The total amount of the Direct Expenditures and the Structure Expenditures, exclusive of any amounts not includable in eligible basis under sections 42(d)(3) or (4) of the Code, will exceed 10% of the aggregate basis of the Partnership in the buildings of the Village and the Structure. The total amount of the Expenditures will exceed the amount required in section 42(e)(3)(A)(ii).

At the time the rehabilitation expenditures are placed in service the Partnership will own the Structure.

The following rulings have been requested:

(1) The Structure Expenditures constitute rehabilitation expenditures under section 42(e)(2) of the Code.

(2) The Structure Expenditures substantially benefit the low-income units in the Village under section 42(e)(3)(A)(i) of the Code.

(3) A low-income housing tax credit will be allowable for the Partnership under section 42(a) of the Code for the Expenditures, provided that the amount of such expenditures, in the aggregate, meets the requirements of section 42(e)(3)(A)(ii) and all other requirements of section 42 are satisfied.

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). The low-income housing credit that may be claimed in any year is subject to the general business tax credit limitation of section 38(c).

Section 42(a) of the Code provides that, for section 38 purposes, 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.

Section 42(c)(1)(A) of the Code defines the qualified basis of any qualified low-income building for any taxable year as an amount equal to (i) the "applicable fraction" (determined as of the close of the taxable year) of (ii) the eligible basis of the building (determined under section 42(d)). Under section 42(c)(1)(B), the "applicable fraction" is the smaller of the unit fraction (the number of low-income units divided by the number of all residential rental units) or the floor space fraction (the floor space of the low-income units divided by the floor space of all residential rental units).

In general, the eligible basis of a building under section 42(d) of the Code is its adjusted basis at the close of the first taxable year of the credit period. However, a number of limitations apply. For example, under section 42(e)(5), rehabilitation expenditures that a taxpayer elects to treat as a separate new building under section 42(e) may not be considered part of the eligible basis of an existing building under section 42(d). In addition, under section 42(d)(2)(iv) the eligible basis of an existing building is zero unless a credit is allowable under section 42(e).

Section 42(d)(4)(B) of the Code provides, in part, that the adjusted basis of property (of a character subject to the allowance for depreciation) used in common areas is included in the adjusted basis of any building. 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 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 to II-90 (1986), 1986-3 (Vol. 4) C.B. II-89 to II-90.

For calendar years after 1989, rehabilitation expenditures for a building may be treated as a separate new building eligible for the credit under section 42(e)(3)(A) of the Code only if (i) the expenditures are allocable to one or more low-income units or substantially

benefit such units, and (ii) the amount of such expenditures during any 24-month period meets the greater of the following requirements: (I) the amount is not less than 10 percent of the adjusted basis of the building (determined as of the 1st day of such period and without regard to paragraphs (2) and (3) of section 1016(a)), or (II) the qualified basis attributable to such expenditures, when divided by the number of low-income units in the building, is \$3,000 or more. Under section 42(e)(2)(B), the term "rehabilitation expenditures" does not include the cost of acquisition of any building. Under section 42(e)(1) rehabilitation expenditures paid or incurred by the taxpayer for any building are treated as a new building.

Section 42(e)(4)(A) of the Code provides, in part, that expenditures treated as a separate new building under section 42(e) are considered placed in service at the close of the month period during which the expenditures were incurred. According to section 42(e)(4)(B), the applicable fraction under subsection (c)(1) for the rehabilitation expenditures is the applicable fraction for the building (without regard to paragraph (1)) for which the expenditures were incurred.

Under section 42(e)(3)(A) of the Code, a taxpayer may aggregate all rehabilitation expenditures incurred during any 24-month period to meet the minimum expenditure requirement of section 42(e)(3)(A). Rev. Rul. 91-38, 1991-2 C.B. 3, provides that if the rehabilitation is completed and the minimum expenditures requirement of section 42(e)(3)(A) is met in less than 24 months, the expenditures may be treated as placed in service at the close of that period; however, in no event may the aggregation period exceed 24 months. Therefore, rehabilitation expenditures are treated as placed in service at the close of the 24-month or shorter aggregation period in which the rehabilitation is completed and the expenditure requirement of section 42(e)(3)(A) is met.

Based solely on the facts submitted and the representations set forth above we conclude that:

(1) the Structure Expenditures constitute rehabilitation expenditures made in connection with the rehabilitation of the Village under section 42(e)(2) of the Code; (2) the Structure Expenditures substantially benefit the low-income units in the Village under section 42(e)(3)(A)(i); and (3) a low-income housing tax credit will be allowable for the Partnership under section 42(a) for the Expenditures provided that the amount of such expenditures, in the aggregate, meets the requirements of section 42(e)(3)(A)(ii) and all other requirements of section 42 are satisfied.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. Further, any portion of the Structure Expenditures attributable to commercial space, such as a kitchen that is used to prepare meals for which a fee is charged, are not includable in eligible basis under section 42(d) of the Code. Finally, the Partnership will be subject to recapture under section 42(j) to the extent of any decrease in its qualified basis in the Project by reason of the transfer by the Partnership of any portion or interest in the Structure after the Expenditures are placed in service.

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. Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion of this ruling. See section 11.04 of Rev. Proc. 93-1, 1993-1 I.R.B. 10, 39. However, when the criteria in section 11.05 of Rev. Proc. 93-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

In accordance with the power of attorney on file, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Walter H. Woo

Senior Technician Reviewer, Branch 5

Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)