Private Letter Ruling 9402010, IRC Section 42

The Service has ruled that the acquisition of the building by the current owner did not constitute a placement in service of the building under section 42(d)(2)(B)(ii)(I). However, the Service refused to rule on whether transfers of the building into and between land trusts constituted placement in service.

Full Text:

Date: October 6, 1993

Dear ***

This letter responds to a letter dated May 17, 1993, submitted on behalf of the Partnership requesting a private letter ruling concerning the federal income tax effect of a proposed transaction in which the Partnership, a limited partnership formed under the laws of State X, will develop a units of single room occupancy housing for low-income individuals ("Project").

I. Facts

The transaction will involve the acquisition of an existing building ("Building") and the extensive rehabilitation of the Building. A portion of the equity financing for the Project will be raised as a result of the Project's intended compliance with and qualification under the low-income housing tax credit provided for in section 42 of the Internal Revenue Code.

The Partnership was organized in t1 under the State X Revised Uniform Limited Partnership Act. The general partner of the Partnership is Corp A, a State X business corporation formed in t2. The initial limited partner of the Partnership is B, an individual. It is anticipated that, prior to or at the same time as the acquisition of the Building and the closing of construction financing, B will withdraw as limited partner in the Partnership and will be replaced by one of the established equity funds that have been formed to invest in housing development projects such as the Project. The District Director in City Y has examination jurisdiction over the Partnership's federal income tax returns. The Partnership files its returns with the City 2 Service Center.

As stated in its Agreement of Limited Partnership, the purpose of the Partnership is to "... acquire, improve, lease, operate, and manage real properties as low-income housing and to engage in any and all activities related or incidental thereto."

The Partnership intends that the Project will qualify for the rehabilitation tax credit under section 46 of the Code as well as both the 30% present value and the 70% present value tax credits for existing and new buildings, respectively, under section 42.

The Partnership will acquire the Project in t3. It is anticipated that the loan financing for the acquisition and rehabilitation of the Project will consist of a first mortgage loan from a bank or other private lender in the approximate amount of $b and a second mortgage loan from the Agency in the approximate amount of $c. The equity financing will come from one of the equity funds that have been established for the purpose of investing in low-income housing tax credit transactions. Tentative commitments have been received for all of the loan financing. The Partnership is still in negotiations with various equity sources. It is expected that the acquisition, loan, and equity closing will occur in t3 or t4.

The Partnership has not yet received a tax credit allocation for the Project but has received verbal assurances from Agency that such an allocation will be made upon the anticipated statutory extension of the Low-income housing tax credit.

The following information summarizes the ownership of the Building forming the basis for the Project for the previous ten years. This information was obtained from discussions with the Seller and from a review of the Building's tract search.

1. The Building was acquired by C pursuant to sheriff's deed dated t5.

2. At some time prior to t6, C died. The Available tract search for the Building does not indicate the date of death.

3. On t5, the Building was acquired from C's estate by D.

4. The Partnership intends to acquire the Building from D in t3 or t4.

At the current time, and at the time the Building was acquired by D, the Building was and has been unoccupied and it has not possessed a certificate of occupancy. D was unable to arrange financing for any rehabilitation of the Building, and made no improvements to the Building. D did not hold the Building out for occupancy and did not seek or accept any tenants during his period of ownership. D did not claim any depreciation with respect to the Building. The Partnership has been unable to determine at what time prior to D's acquisition of the Building that it became unoccupied and unfit for habitation. It is possible that the Building was occupied at some point in time during C's (or C's estate's) ownership of the Building.

Other than as described above, the Building has not been sold or otherwise transferred during the time period from t5 to the present. Furthermore, these has been no capital improvement to the Building during this same time period.

The Partnership requests that the Internal Revenue Service issue the following rulings:

1. The transfers of the Building into and between the land trusts, as described above, even assuming that the property was habitable at the time of such transfers, did not constitute a placement in service of the Building under section 42(d)(2)(B)(ii)(I) of the Code.

2. The acquisition of the Building by D in 1988 under the circumstances outlined above did not constitute a placement in service of the Building under section 42(d)(2)(B)(ii)(I) of the Code.

II. Law and Analysis

A. Ruling 1

We refuse to rule on whether the transfer of the Building into and between the land trusts constituted a placement in service of the Building under section 42(d)(2)(B)(ii)(I) of the Code.

B. Ruling 2

Section 42 of the Code allows a tax credit for taxpayers who develop and maintain residential housing for low-income individuals and families. Under section 42(a), such credit is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

Section 42(c)(1) of the Code provides that the qualified basis of any qualified low-income building is equal to the applicable fraction of the eligible basis of the building.

Section 42(d)(2) of the Code provides that the eligible basis for an existing building is equal to its adjusted basis as of the close of the first taxable year of the credit period provided the building meets certain requirements set forth in section 42(d)(2)(B). The eligible basis for any existing building not meeting the requirements of section 42(d)(2)(B) is zero.

One of the requirements of section 42(d)(2)(B) of the Code is that, with respect to an existing building, there be at least a 10- year period between the date of taxpayer's acquisition of the existing building and the date the building was last placed in service. See section 42(d)(2)(B)(ii)(I).

The Conference Report to the Tax Reform Act of 1986, 2 H.R. Conf. Rep. No. 99-841, 99th Cong., 2d Sess. II-85 (1986), 1986-3 (Vol. 4) C.B. 85, 90-91, provides that the cost of acquisition of an existing building may be included in eligible basis and that these costs may be included in eligible basis only if the building has not been previously placed in service within 10 years and if the building is not subject to the compliance period. Further, the Conference Report notes that a TRANSFER OF OWNERSHIP OF A BUILDING (emphasis added) where the basis of the property in the hands of the new owner is determined in whole or in part by the adjusted basis of the previous owner, is considered not to have been newly placed in service for purposes of the 10-year

requirement and that ANY OTHER TRANSFER WILL BEGIN A NEW 10-YEAR PERIOD (emphasis added).

The Service has issued specific guidance on what constitutes a placement in service for purpose of the 10-year ownership requirement for existing buildings of the low income housing tax credit. Rev. Rul. 91-38, 1991-2 C.B. 3, answers certain questions about the low- income housing credit provided for in section 42 of the Code. The revenue ruling notes that in determining when a building was last placed in service for purposes of satisfying the requirement in section 42(d)(2)(B)(ii) of the Code, section 42(d)(2)(D)(ii) provides that certain placements in service are not taken into account. The Revenue Reconciliation Act of 1990 (the "1990 Act"), provides that as of November 5, 1990 (the date of its enactment), any placement in service of a single-family residence by any individual who owned and used the residence for no other purpose than as a principal residence is not taken into account for purposes of determining whether the 10- year requirement is met. See, section 42(d)(2)(D)(ii)(V).

In discussing transfers of property during the compliance period, Rev. Rul. 91-38 states the general placement-in-service rule that is applicable to transfers of property during both the compliance period and the 10-year period of the ownership requirement for existing buildings under section 42(d)(2)(B) of the Code. The general rule is that a transfer of property results in a new placed- in-service date if, on the date of the transfer, the property is ready and available for its intended purpose. See 2 H.R. Conf. Rep. 841, at II-91.

Section E. of Rev. Rul. 91-38 lists questions and answers (i.e., Question/Answer 9,10, & 11) dealing with several issues concerning the 10-year ownership requirement for existing buildings. Under Question/Answer 9, the revenue ruling notes that except as provided in section 42(d)(2)(D)(ii) of the Code, for purposes of section 42(d)(2)(B)(ii)(I), there must be a minimum of 10 years between the date a taxpayer acquires an existing building and the date the building was last placed in service for any purpose, whether in a trade or business, in the production of income, in a tax-exempt activity, or in a personal activity.

For further guidance on the term "placed in service" for purposes of determining whether the 10-year ownership requirement for existing buildings under section 42(d)(2)(B) of the Code has been met, the Internal Revenue Service looks to the placed-in-service rules in sections 1.46-3(d) and 1.167 of the Income Tax Regulations. Language defining placed in service similar to that found at 2 H.R. Conf. Rep.841, at II-91 and in Question/Answer #9 of Rev. Rul. 91-38 can be found in sections 1.167(a)-11(e)(1)(i) and 1.46-3(d).

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 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. The term "placed in service" has consistently been construed as having the same meaning for purposes of the investment tax credit and depreciation/cost recovery deductions. See, e.g., Rev. Rul. 76-256., [sic] 1976-2 C.B. 46; Wilkison v. Commissioner, T.C.M. 1988-386, (the term "placed in Service" for cost recovery deductions under section 168 of the Code has the same meaning as it does for depreciation under section 167 and for investment credit under section 46).

Rev. Rul. 76-238, 1976-1 C.B. 55, states that an asset is considered to be placed in service when it is in a condition or state of readiness and availability. In support of this statement, the revenue ruling cites Biggs v. Commissioner, T.C.M. 1968-240, aff'd, 440 F.2d 1 (6th Cir. 1971), where the taxpayer claimed depreciation on a building for the year 1951; the court disallowed the depreciation claim because the building was not reconstructed and available for the taxpayer's use until April 1952.

In Clemente, Inc. v. Commissioner, T.C.M. 1985-367, no depreciation was allowed to the purchaser of unused commercial buildings that were in a dilapidated condition. The court determined that due to the condition of the buildings, the buildings had not been placed in service during the year at issue.

The Building, at time of acquisition by D, was unoccupied and boarded up and was not fit for habitation. At an undetermined time prior to D's acquisition of the Building, the Building became unoccupied and unfit for habitation. At the time of the acquisition of the building by D on t6, the Building, due to its physical condition, was not in a condition or state of readiness and availability. See, Rev. Rul. 76-238, Rev. Rul. 91-38 (which, for purposes of section 42(d)(2)(D) of the Code states the general placement-in-service rule), and Clemente, Inc. v. Commissioner. Accordingly, the acquisition of the Building by D on t6 under the circumstances outlined above did not constitute a placement in service of the Building under section 42(d)(2)(B)(ii)(I) of the Code.

III. Conclusions

Accordingly, based on the Partnership's representations, we rule that the acquisition of the Building by D did not constitute a placement in service of the Building under section 42(d)(2)(B)(ii)(I) of the Code. As stated above, we refuse to rule on whether the transfers of the Building into and between land trusts constituted a placement in service of the Building under section 42(d)(2)(B)(ii)(I).

Except as specifically ruled on above, we express no opinion about the federal tax consequences of any other aspect of the above- described transaction.

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 by adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in the ruling. See section 11.04 of Rev. Proc. 93-1, 1993-1 I.R.B. 7, 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 a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

JAMES RANSON

Chief, Branch 5

Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)