Private Letter Ruling 9538012, IRC Section 42

Date: June 15, 1995

Dear ***

This letter responds to your letter of May 8, 1995, requesting a private letter ruling that low-income housing credit will not be precluded under section 42 of the Internal Revenue code because the lessee of an apartment complex is a cooperative housing corporation, assuming compliance with all of the other provisions of section 42. This request is being submitted by Partnership C. The general partner is Partner D. The limited partner is Partner E. You have provided the following representations.

Partnership C was formed for the purpose of rehabilitating, developing, owning, and operating a b unit apartment complex known as Project F. One hundred percent (100%) of the units in Project F are to be leased to low-income tenants and Project F will be operated as a low-income housing project qualified for the low-income housing tax credit (the "Credit") allowed by section 42 of the Code. Pursuant to the terms of the first amended and restated agreement of limited partnership of the Partnership, all income, losses, deductions and credits of the Partnership will be allocated ninety-nine percent (99%) to the Limited Partner and one percent (1%) to the General Partner.

An application for 1991 Credits was made in March 1991 to Agency G. Agency G issued a 1991 Notice of Low-Income Housing Credit Reservation reserving Credits in the amount of c on d, a Carryover Allocation of 1991 Tax Credit Authority in the amount of e on f, and a Carryover Allocation of 1992 Tax Credit Authority in the additional amount of g on h.

Partnership C will lease Project F to Cooperative H. Partnership C asserts that Cooperative H will operate Project F as a limited equity cooperative throughout the lease term.

Partnership C represents that Cooperative H will not contribute funds toward the acquisition or rehabilitation of Project F and will not have funds at risk in Project F. Further, Cooperative H will not be liable to third parties with respect to any of Project F's operating expenses, including, without limitation, insurance and real estate taxes. Neither Cooperative H nor any of its Members is an obligor on any debt financing secured by Project F or will have any obligation to any of the Project F lenders with respect to the repayment thereof.

At the end of the initial sixteen-year lease period, Cooperative H will have a right of first refusal to purchase Project F for an amount equal to the sum of (i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of sale) and (ii) all Federal, State, and local taxes attributable to such sale (i.e., the "minimum purchase price" as defined in section 42(i) (7) (B) of the Code).

Partnership C represents that Cooperative H, as the lessee under the Master Lease, will not be allocated any Credits, net profits, net losses or other tax benefits from the Project. Further, Partnership C is fully liable to third parties and Project lenders with respect to payment of operating expenses and debt service, respectively. The partners of the Partnership are entitled to receive all the net income from the operation of the Project and are subject to all risk of loss with respect to such operation.

Under the terms of the Master Lease, Cooperative H will be required to rent each of the dwelling units in Project F to an individual who will satisfy the applicable income limitations under section 42 of the Code. Partnership C asserts that the rents charged with respect to the dwelling units are intended to be kept at a level that will satisfy the applicable rent restrictions under section 42 of the Code. The tenant also would be required to become a member of Cooperative H as a condition of such tenant's right to occupy a dwelling unit pursuant to the rental agreement between the tenant and the Cooperative. Upon the termination or expiration of the rental agreement, the tenant will be required to terminate his or her membership in Cooperative H and surrender his or her membership certificate.

Each member of the Cooperative (collectively, the "Members") will be required to enter into an occupancy agreement with the Cooperative (the "Occupancy Agreements"). Pursuant to the terms of the Occupancy Agreements, each Member will be charged monthly rent. The total rent paid by each tenant will not exceed the maximum rent permitted under section 42 of the Code. Cooperative H, in turn, will be required to pay to Partnership C a monthly master lease payment (the "Master Lease Payment"). The Master Lease Payment will be an amount equal to the sum of all Partnership operating expenses, debt service and deposits to reserves plus an annual rental payment. Based on projections of the rental income and expenses of Project F, Partnership C anticipates that the amount of the annual rental payment will be approximately equal to the amount of profit generated by the operation of Project F.

We note that you have withdrawn an earlier ruling request including the issue of whether Partnership C could impose on Cooperative H a twelve percent assessment on any shortages existing between lease payments made by Cooperative H and required payments paid by Partnership C on behalf of Project F.

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)(5)). 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).

Section 42(c)(2)(A) of the Code defines the term "qualified low- income building" as any building that is part of a qualified low- income housing project at all times during the period beginning on the 1st day in the compliance period on which such building is part of such a project, and ending on the last day of the compliance period with respect to such building.

Section 42(g)(1) of the Code defines the term "qualified low- income housing project" as any project for residential rental property if the project meets the requirements of subparagraph (A) or (B), whichever the taxpayer elects. The election is irrevocable. Section 42(g)(1)(A) states that the project meets the requirements of subparagraph (A) if 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income. Section 42(g)(1)(B) states that the project meets the requirements of subparagraph (B) if 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income.

Section 42(g)(2)(A) of the Code provides that a residential unit is rent-restricted if the gross rent (defined in section 42(g)(2)(B)) that is paid for the unit does not exceed 30 percent of the income limitation that section 42(g)(1) imposes upon the occupants of such unit.

Section 42(i)(7)(A) of the Code provides that "No Federal income tax benefit shall fail to be allowable to the taxpayer with respect to any qualified low-income building merely by reason of a right of 1st refusal held by the tenants (in cooperative form or otherwise) … to purchase the property after the close of the compliance period for a price which is not less than the minimum purchase price determined under subparagraph (B)." Subparagraph (B) of section 42(i)(7) defines the minimum purchase price as an amount equal to the sum of (i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants), and (ii) all Federal, State, and local taxes attributable to such sale. Except in the case of Federal income taxes, there shall not be taken into account under clause (ii) any additional tax attributable to the application of clause (ii).

Section 216(b)(1) of the Code defines a "cooperative housing corporation" as a corporation – (A) having one and only one class of stock outstanding, (B) each of the

stockholders of which is entitled, solely by reason of their ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation, (C) no stockholder of which is entitled (either conditionally or unconditionally) to receive any distribution not out of earnings and profits of the corporation except on a complete or partial liquidation of the corporation, and (D) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest described in section 216(a) are paid or incurred is derived from tenant stockholders.

Section 216(b)(2) defines a "tenant-stockholder" as a person who is a stockholder in a cooperative housing corporation, and whose stock is fully paid-up in an amount not less than an amount shown to the satisfaction of the Secretary as bearing a reasonable relationship to the portion of the value of the corporation's equity in the houses or apartment building and the land on which situated that is attributable to the house or apartment that such person is entitled to occupy.

Notice 88-91 (1988-2 C.B. 414) indicates that final regulations under section 42 of the Code will provide that the term "qualified low-income building" includes residential rental property that is an apartment building, a single family dwelling, a townhouse, a rowhouse, a duplex, or a condominium. The Notice also indicates that a qualified low-income building does not include residential rental property owned or leased by a cooperative housing corporation or tenant-stockholder, as those terms are defined under section 216(b)(1) and (2) of the Code.

Since the publication of Notice 88-91, the Internal Revenue Service has decided that a qualified low-income building can include residential rental property owned or leased by a cooperative housing corporation or a tenant-stockholder.

Therefore, based upon the above representations, we conclude that Partnership C is not precluded from claiming low-income housing credits merely because the lessee of Project F, Cooperative H, is a cooperative housing corporation, assuming all other requirements of section 42 are satisfied.

No opinion is expressed or implied regarding whether Cooperative H is a cooperative housing corporation for purposes of section 216 of the Internal Revenue Code nor whether the members of the cooperative are tenant-stockholders for purposes of section 216.

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. This ruling does not address the application of any other provision of the Code or regulations to the transaction, other than those specifically mentioned above.

Sincerely yours,

WALTER H. WOO

Senior Technician Reviewer

Branch 5

Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)