Private Letter Ruling
Number: 9601005
Internal Revenue Service
SEP. 26, 1995

Internal Revenue Service
Department of the Treasury
PO. Box 7604
Ben Franklin Station
Washington, DC 20044

This letter responds to your letter dated April 6, 1995, on behalf of Taxpayer as its authorized representative, requesting a ruling under § 42 of the Internal Revenue Code. You request a ruling that a buildings to be newly constructed and P existing buildings to be rehabilitated (such rehabilitation expenditures qualifying as a separate new building under § 42(e)) will not be treated as federally subsidized buildings under § 42(i)(2)(A) by reason of Taxpayer's assumption of an existing project debt that is sourced in tax-exempt bond proceeds. The relevant facts as represented in your letter are set forth below.

FACTS:
Taxpayer is a State M limited partnership whose mailing address is Address. Taxpayer's annual accounting period is the calendar year, and its over-all method of accounting is the accrual method. The District Office having examination jurisdiction is City N, State M.

Taxpayer is proposing to acquire Project, a low-income elderly housing complex consisting of c units located in h buildings on d acres of land (Existing Units). Taxpayer also will acquire e adjacent vacant parcels of land consisting of f acres. Taxpayer intends to rehabilitate the Existing Units and construct an additional g units in a buildings (New Units). Of the a newly constructed buildings, h will be situated among the buildings housing the Existing Units. The other newly constructed building will be situated on the vacant land that is now separate from Project.

Taxpayer was formed pursuant to an Agreement and Certificate of Limited Partnership executed on t2. The general partner of Taxpayer is Corporation, a State M corporation, whose president and sole shareholder is officer. The original limited partners of Taxpayer are Limited Partner 1, Limited Partner 2, Limited Partner 3, and Officer. The current allocation of Taxpayer ownership is i to Corporation and i to the limited partners. Taxpayer intends to admit additional investor limited partners) at the time of the acquisition of Project resulting in an allocation of Taxpayer ownership of k to the investor limited partner(s) and 1 to Corporation. The existing limited partners will withdraw from Taxpayer.

Project will be sold to Taxpayer by Seller, a State M limited partnership. Seller was formed pursuant to an Agreement and Certificate of Limited Partnership executed on t3.

The general partner of Seller is Seller GP (owning a 1 interest in Seller). The limited partnership interests are owned as follows: m by investors unrelated to Seller GP and n by individuals related to the Seller GP. One of the now vacant adjacent parcels will be sold to Taxpayer by Limited Partner 3 who is related to Seller GP. The other vacant parcel will be purchased from an unrelated party.

The Existing Units were originally financed by Agency in t4 utilizing the proceeds of a tax-exempt bond issue. Interest on the bonds is excludible from gross income for federal income tax purposes pursuant to §103 of the Code. On t5, Seller entered into a Housing Assistant Payment contract with the United States Department of Housing and Urban Development, which provides Section 8 rental assistance subsidies to o of the p units in the project for p years. The Existing Units are located in g r-unit buildings, a s-unit building and a community building all of which is located on approximately d acres of land. Each existing residential unit is approximately t square feet with one bedroom, one bathroom, living room, dining area and kitchen. The existing community building contains administrative offices, a small library, laundry facilities, a small kitchen facility and a meeting room.

Taxpayer will acquire the Existing Units for approximately $u. The purchase price will be supported by an independent third-party appraisal for the benefit of Agency and is one of prerequisites to Agency's consenting to the transfer. The purchase price will be comprised of (1) Taxpayer's assumption of the outstanding balance on a mortgage note dated t6, given by Seller to Agency with an original principal amount of $v and an estimated current outstanding principal balance of $w, (2) a purchase money mortgage from Taxpayer to Seller of approximately $x (which will provide for interest payments at no less than the applicable federal rate), and (3) cash of approximately $y. Pursuant to the terms of the mortgage note (which terms have not been materially modified since t4), the mortgage is enforceable against the d acres of land on which Project is currently located as well as all buildings and improvements situated thereon. Accordingly, the mortgage will continue to be enforceable against the presently existing buildings (which house the Existing Units) which are to be rehabilitated, and will be enforceable against the buildings which are to be constructed on the subject land (which will house z of the New Units).

Taxpayer proposes to rehabilitate each of the Existing Units, construct g New Units and improve and expand the community facilities. The cost of rehabilitating the Existing Units will be approximately $aa. Each of the buildings containing Existing Units will qualify as a separate new building under § 42 (e)(1). Construction costs of the New Units will be approximately $bb. The cost for the vacant land parcels will be approximately $cc. No tax-exempt obligations nor "below-market Federal loans" will be used to finance the construction of the New Units or the rehabilitation of the Existing Units (or the acquisition of the vacant parcels).

The New Units will be contained in e building types. z of the units will be situated in h s-unit buildings interspersed among the existing residential structures. Each of these buildings will be dd story in height and contain e e-bedroom units and e dd-bedroom units. The balance of the units (1) will be located in cued e-story building located on land that is currently vacant.

The investor limited partners will contribute $ee to Taxpayer. The debt financing for the rehabilitation of the Existing Units, the construction of the New Units and the acquisition of the vacant land parcels will include a new taxable bond financed mortgage also to be issued by Agency for the necessary balance of funds.

Taxpayer will request an allocation of approximately $ff in low-income housing tax credits from Agency. This allocation request will be based upon utilization of the 30% present value low-income housing credit for the acquisition of Existing Units, and the 70% present value low-income housing credit for estimated rehabilitation costs of $aa for the Existing Units and construction costs for the New Units of approximately $bb.

Section 42(a) of the Internal Revenue Code provides a tax credit for investment in low-income housing buildings placed in service after December 31, 1986. For any taxable year in a ten - year credit period, the amount of credit is equal to the applicable percentage of the qualified basis of each qualified low-income building.

In the case of any qualified low-income building placed in service by the taxpayer after 1987, § 42(b) provides, in part, that the term "applicable percentage" means the appropriate percentage prescribed by the Secretary for the month applicable under § 42 (b) (2) (A) (i) or (ii). Section 42 (b) (2) (B) provides that the percentages prescribed by the Secretary for any month shall be percentages that will yield over a 10-year period amounts of credit that have a present value equal to: (i) 70 percent of the qualified basis of new buildings that are not federally subsidized for the taxable year (70-percent present value credit), and (ii) 30 percent of the qualified basis of existing buildings, and of new buildings that are federally subsidized for the taxable year (30-percent present value credit).

Section 42 (c) provides that the qualified basis of any qualified low-income building for any taxable year is an amount equal to the applicable fraction (defined in § 42(c)(1)(B)) of the eligible basis of such building. In general, under § 42(d) the eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period.

Section 42(i)(2)(A) provides that except as otherwise provided in this paragraph, for purposes of subsection (b)(1), new building shall be treated as federally subsidized for any taxable year if, at any time during such taxable year or any prior taxable year, there is or was outstanding any obligation the interest on which is exempt from tax under § 103, or any below-market Federal loan, the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof.

The legislative history to § 42 provides that if any portion of the eligible basis attributable to new construction or the eligible basis attributable to rehabilitation expenditures is financed with Federal subsidies, the qualified basis is eligible only for the 30-percent present value credit, unless such Federal subsidies are excluded from eligible basis. The legislative history also provides that the determination of whether rehabilitation expenditures are federally subsidized is made without regard to the source of financing for the construction or acquisition of the building to which the rehabilitation expenditures are made. For example, a Federal loan or tax-exempt bond financing that is continued or assumed upon purchase of existing housing is disregarded for purposes of the credit on rehabilitation expenditures. See H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-91 (1986), 1986-3 (Vol. 4) C.B. 91.

In the present case, no portion of the eligible basis attributable to new construction or the eligible basis attributable to rehabilitation expenditures will be financed with a federal subsidy. Seller used the proceeds of the tax-exempt bond issued in t4 as partial financing for the construction of the existing buildings. The eligible basis of Taxpayer attributable to its acquisition of the b existing buildings will include assumption of the remaining liability under that bond. Pursuant to § 42(b)(2)(B), Taxpayer seeks to claim a 30-percent present value credit on the qualified basis of the existing buildings.

There will be no material modifications to the terms of the mortgage note relating to the existing federally subsidized debt. Thus, the facts present a clear case where a federal subsidy is continued or assumed, basically unchanged, upon purchase of existing housing. Accordingly, the existing federally subsidized debt assumed by Taxpayer to acquire the b existing buildings will be disregarded for purposes of determining the applicable percentage of the rehabilitation expenditures made to the b existing buildings. Furthermore, not withstanding that the mortgage note will be enforceable against h of the a buildings to be newly constructed (the terms of the t4 mortgage note require that the note is to be secured by any improvements to the property), the existing federally subsidized debt will likewise be disregarded for purposes of determining the applicable percentage of these newly constructed buildings.

The assumed federally subsidized mortgage is the only federal subsidy involved in the overall financing of Project. Thus, the inquiry of whether any newly constructed building or substantially rehabilitated building is federally subsidized is, under a theory of cross collateralization, limited to the effect this assumed federally subsidized debt has on these buildings. Under these facts, the assumption by Taxpayer of this existing federally subsidized debt will not, in and of itself, operate to characterize as federally subsidized (under a theory of cross collateralization) the a buildings to be newly constructed or the b new buildings represented by the substantially rehabilitated costs.

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

The a buildings to be newly constructed and b existing buildings to be rehabilitated (such rehabilitation expenditures qualifying as a separate new building under § 42(e)) will not be treated as federally subsidized buildings under § 42(i)(2)(A) by reason of Taxpayer's assumption of the existing project debt that is sourced in tax-exempt bond proceeds.

Under the power of attorney on file, we are sending a copy of this ruling to the first and second representatives listed on the power of attorney.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. Nor is any opinion expressed or implied regarding whether Project otherwise qualifies for the low-income housing credit under § 42. We specifically offer no opinion on whether Taxpayer satisfies the requirements of § 42(d)(2)(B)(i) and (iii), regarding the eligibility for qualifying Project for an acquisition credit under § 42 (d) (2) .

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
JAMES RANSON
Chief, Branch 5
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

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