

Private Letter Ruling 9611010, IRC Section 42

The Service has ruled that a limited partnership's use of Federal Emergency Management Agency funds to repair flood-damaged units in a housing project will not result in a reduction of the eligible basis of the project's buildings under section 42(d)(5).

Full Text:

Date: December 7, 1995

Dear ***

This letter responds to your letter dated May 25, 1995, and subsequent submissions, on behalf of Taxpayer as its authorized representative, requesting a ruling under section 42 of the Internal Revenue Code. You request a ruling that Taxpayer's use of Federal Emergency Management Agency (FEMA) grant funds to repair flood-damaged units in Taxpayer's low-income housing project will not result in a reduction of the existing eligible basis of the project buildings under section 42(d)(5). The relevant facts as represented in your submissions are set forth below.

FACTS:

Taxpayer is a State 1 limited partnership organized under Act and is presently comprised of General Partner, a State 1 nonprofit public benefit corporation, with an a percent interest, and Limited Partner, a State 2 limited partnership, as the investor limited partner with a b percent interest.

Taxpayer has developed and is operating a c-unit, d building affordable housing project (Project) located on Project Site. The Project buildings are newly constructed buildings and were placed in service in Date 1. Of the Project buildings, e are residential and one is a community building. The e residential buildings were fully occupied by Date 2. The Project received a carryover allocation of low-income housing tax credits (Credits) from Agency 1. The eligible basis of each building in the Project was determined as of Date 2, the close of the first taxable year of the credit period. At that time, no part of the basis of the buildings had been paid for with a grant of funds.

The c units in the Project serve households at 50 and 60 percent of median income. After funding operating and replacement reserves as required by Agency 2 under the terms of its loan, the Taxpayer has generated, on average, over the last three years, little to no annual cash flow.

Throughout the winter of Year 2, State 1 was plagued by incessant rain. The total rainfall was record setting in many areas, with rivers overflowing their banks causing extensive flooding. In Date 3, the River overflowed, causing significant damage to nearby properties, including the Project. County was one of many counties in State 1 declared a federal disaster area in Date 4 and again in Date 3. All f of the residential units on the

first floor of the Project buildings suffered water damage and the tenants of those units had to be temporarily relocated while the units were repaired. Taxpayer estimates the cost to repair the units to be \$g and has contracted for the work which has begun.

Project is not located in a designated flood zone, and therefore did not have flood insurance. To help defray the cost of the repairs, General Partner is applying to FEMA for a grant. General Partner would contribute these funds to Taxpayer which would use them to pay the cost of repairs to the damaged units, which amounts would not be added to the basis of the Project buildings. In addition, the costs of the repairs would not increase the amount of annual low-income housing tax credits for which the Project is eligible.

The location of the District Office of the Internal Revenue Service that has examination jurisdiction over all returns filed by Taxpayer is *** State 1.

LAW AND ANALYSIS:

Section 42(a) 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, section 42(b) provides, in part, that the term "applicable percentage" means the appropriate percentage prescribed by the Secretary for the month applicable under section 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 section 42(c)(1)(B)) of the eligible basis of such building.

Under section 42(d)(1), the eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period. However, section 42(d)(5) provides that if, during any taxable year of the compliance period, a grant is made with respect to any building or the operation thereof and any portion of such grant is funded with Federal funds (whether or not includible in gross income), the eligible basis of the building for such taxable year and all succeeding taxable years shall be reduced by the federally funded portion of the grant. Section 42(d)(5) is designed to prevent a taxpayer from replacing debt financing with a federal grant after eligible basis is determined at the close of the first year of the credit period. Replacing a project's debt financing with a federal

grant after the first year of the credit period would, absent section 42(d)(5), over subsidize the project because no mechanism would exist for adjusting eligible basis downward to accommodate the grant.

FEMA assistance can include a grant or a loan and is available only if other government assistance, private charities, and insurance are not available. Section 5172 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. sections 5121-5204) allows the director of FEMA to make a contribution to an owner of a private nonprofit facility damaged or destroyed by a major disaster. The contribution is limited to the "net eligible cost" of repairing, restoring, reconstructing, or replacing the facility and for "associated expenses" incurred. The net eligible cost is the cost of repairing, restoring, reconstructing, or replacing the facility to its immediate pre-casualty condition. Associated expenses are necessary costs of requesting, obtaining, and administering federal assistance that is limited by a percentage of the net eligible cost.

Because FEMA assistance is allowed only to the extent that repair, restoration, reconstruction, or replacement costs bring an affected building back to its pre-casualty condition, the eligible basis of the building is unaffected by these costs and the over subsidization concern of section 42(d)(5) is not present.

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

That Taxpayer's use of Federal Emergency Management Agency (FEMA) grant funds to repair flood damaged units in the Project will not result in a reduction of the existing eligible basis of the Project buildings under section 42(d)(5).

Under the power of attorney on file, we are sending a copy of this ruling to the first representative 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 the Project otherwise qualifies for the low-income housing credit under section 42.

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,

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Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)

