Private Letter Ruling 9712003, IRC Section 42

Date: December 11, 1996

The Service has ruled that the adjusted basis of a low-income housing project is not entitled to an increase in basis under section 42(d)(5)(C).

Headnote:

Taxpayer-developer and state housing credit agency couldn't grandfather any increase in eligible basis for low-income housing project for tax credit ceiling on basis of Code Sec. 42(d)(5)(C) carryover allocation: project wasn't included in HUD's list of "difficult development areas for allocations that occurred after specific date." Reg. §1.42-13 allows taxpayer and credit agency to correct administrative error of creating erroneous signature block on rate lock agreement, which doesn't prevent agreement from being valid. But, potential eligible basis increase under Code Sec. 42(d)(5)(C) depends on credit agency determining that increase is necessary for financial feasibility and viability of qualified low-income housing project throughout credit period, up to 130% of depreciable basis; and HUD's difficult development area designations are effective only for allocations after list's specific date.

Refer Reply to: CC:DOM:P&SI:5-PLR-08250-96

LEGEND:
Taxpayer = ***
District A = ***
Partner B = ***
Project C = ***
City D = ***
State E Committee = ***
Title F = ***
Individual G, General Partner = ***
Signature H = ***
Partner I = ***
Partner J = ***
a = ***
b = ***
c = ***
d = ***
e = ***
f = ***
g = ***
h = ***
i = ***
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l = ***
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q = ***
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s = ***
t = ***

Dear ***

We are writing in response to your letter of March 29, 1996, submitted by your authorized representative, requesting a ruling regarding (i) the effectiveness of an election of an "applicable percentage" under section 42(b)(2)(A)(ii)(I) of the Internal Revenue Code and (ii) whether the entire adjusted basis of the project held by the taxpayer is entitled to an increase in basis under section 42(d)(5)(C). District A is the office possessing examination jurisdiction over the taxpayer's return.

Facts

The taxpayer is developing and will own and operate residential rental property known as

Project C to provide low-income housing. Project C is located in City D. Partner B initially applied for an allocation of federal low income housing tax credits ("credits") from State E. On a, Partner B received a preliminary reservation letter reserving b of credits for Project C. On c, Partner B received a d carryover allocation of credits from State E. Project C was located in a "difficult development area" in d.

Project C was the last project for which allocations were made in d and State E did not have sufficient credits to make the complete allocation of all of the low income housing credits necessary for Project C. Consequently, the d carryover allocation provided that "[t]he total amount of this allocation of federal tax credits is b with e deducted from the d ceiling. Pursuant to Title F and State E action, the remaining f has been committed to be allocated from the g tax credit ceiling."

On h, the Department of Housing and Urban Development (HUD) published the Statutorily Mandated Designation of Qualified Census Tracts and Difficult Development Areas for Section 42 of the Internal Revenue Code of 1986 and City D, where Project C is located, was not included in the list of "difficult development areas for allocations that occurred after i."

On j, Partner B received a letter from State E indicating that there was uncertainty regarding whether the credits to be allocated to Project C pursuant to the g forward commitment would qualify for a potential increase in eligible basis. As a result, State E agreed to reserve credits in the event the eligible basis adjustment was not allowed with

respect to the anticipated allocation. The taxpayer received a binding commitment letter dated k reserving l in credits. On m, the taxpayer received a carryover allocation of credits from State E.

As part of the d carryover allocation, the taxpayer executed a rate lock agreement on n, and by State E on c, with the intent of locking in the applicable percentage for determining credits at p, the rate for q.

In o, it was discovered that the d carryover allocation and the rate lock agreement had been improperly executed. The documents had been signed by Individual G, General Partner as opposed to the correct signature which should have been Signature H.

The taxpayer and State E discussed the issue and the taxpayer and State E believed that the error could be corrected as an "administrative error." On r, the taxpayer and State E corrected the administrative error. State E indicated that they still considered the "carryover allocation to be valid, effective as of c, and to have met all requirements for such allocation. Further, State E considers the rate lock agreement to be valid and effective as of the date executed, c, with the applicable percentage to be fixed at p, the applicable percentage for that month." At the same time, State E corrected the signature block for the state commitment and the conditions in the state commitment were slightly modified.

Effective s, Partner B transferred all of its interest in Project C to the taxpayer pursuant to an assignment and assumption agreement and State E consented to such assignment pursuant to a consent to assignment as of r. Effective t, Partner I was admitted as the Limited Partner and Partner J was admitted as a General Partner.

Law and Analysis

Section 42 provides that the amount of the low-income housing credit under section 38 for any taxable year in the credit period equals (i) the applicable percentage of (ii) the qualified basis of each qualified low-income building. Section 42(c)(1) provides that the qualified basis of a qualified low-income building for any taxable year equals (i) the applicable fraction (determined as of the close of such taxable year) of (ii) the eligible basis of the building (determined under section 42(d)(5)).

Section 42(b)(2)(A) provides that in the case of any qualified low-income building placed in service by the taxpayer after 1987, the term "applicable percentage" means the appropriate percentage prescribed by the Secretary for the earlier of –

(i) the month in which such building is placed in service, or

(ii) at the election of the taxpayer –

(I) the month in which the taxpayer and the housing credit agency enter into an agreement with respect to such building (which is binding on such agency, the taxpayer,

and all successors in interest) as to the housing credit dollar amount to be allocated to such building, or

(II) in the case of any building to which section 42(h)(4)(B) applies, the month in which the tax-exempt obligations are issued.

A month may be elected under clause (ii) only if the election is made not later than the 5th day after the close of such month. Such an election, once made, shall be irrevocable.

Section 1.42-8(a)(1) of the Income Tax Regulations provides: for purposes of section

42(b)(2)(A)(ii)(I), an agreement between a taxpayer and the agency as to the housing credit dollar amount to be allocated to the building is binding if it –

(i) is in writing;

(ii) is binding under state law on the Agency, the taxpayer, and all successors in interests;

(iii) specifies the type(s) of building(s) to which the housing credit dollar amount applies

(i.e., a newly constructed or existing building, or substantial rehabilitation treated as a

separate new building under section 42(e));

(iv) specifies the housing credit dollar amount to be allocated to the building(s); and

(v) is dated and signed by the taxpayer and the Agency during the month in which the requirements in paragraph (a)(1)(i) through

(iv) of this section are met.

Section 1.42-8(a)(3) of the regulations provides: an election under section 42(b)(2)(A)(ii)(I) may be made either as part of the binding agreement under paragraph (a)(1) of this section to allocate a specific housing credit dollar amount or in a separate document that references the binding agreement. In either case, the election must –

(i) be in writing;

(ii) reference section 42(b)(2)(A)(ii)(I);

(iii) be signed by the taxpayer;

(iv) if it is in a separate document, reference the binding agreement that meets the

requirements of paragraph (a)(1) of this section; and

(v) be notarized by the 5th day following the end of the month in which the binding

agreement was made.

Under section 42(n)(4) of the Code, state and local housing credit agencies may correct

administrative errors and omissions concerning allocations and recordkeeping within a

reasonable period of time after their discovery. Section 1.42- 13(b)(2) of the regulations defines an administrative error or omission as a mistake that results in a document that inaccurately reflects the intent of the Agency at the time the document is originally completed or, if the mistake affects a taxpayer, a document that inaccurately reflects the intent of the Agency and the affected taxpayer at the time the document is originally completed. Section 1.42-13(b)(1), however, provides that an administrative error or omission does not include a misinterpretation of the applicable rules and regulations under section 42.

We conclude that under the specific facts presented, the regulations under section 1.42-13

permit the agency and the taxpayer to correct this simple administrative error of creating an erroneous signature block on the rate lock agreement and that this fact does not prevent the rate lock agreement from being valid from g.

Under section 42(d)(1), the eligible basis of a new building is its adjusted basis as of the close of the 1st taxable year of the credit period. Under section 42(d)(2)(A), the eligible basis of an existing building is (i) in the case of a building which meets the requirements of section 42(d)(2)(B), its adjusted basis as of the close of the 1st taxable year of the credit period, and (ii) zero in any other case.

For any building located in a qualified census tract or difficult development area, section

42(d)(5)(C) provides that the eligible basis of a new building is 130 percent of such basis determined without regard to this subparagraph, and in the case of an existing building, the rehabilitation expenditures under section 42(e) are 130 percent of such expenditures determined without regard to this subparagraph. Section 42(d)(5)(C), as added by section

7108(g) of the Revenue Reconciliation Act of 1989, applies to allocations of housing credit dollar amounts from State housing credit ceilings for calendar years after 1989. Section 42(d)(5)(C)(iii) defines the term "difficult development areas" as any area designated by the Secretary of HUD as an area that has high construction, land, or utility costs relative to Area Median Gross Income.

Under section 42(m)(2)(A), the housing credit dollar amount allocated to a project or building may not exceed the amount the housing credit agency determines is necessary for the financial feasibility of the project and its viability as a qualified low- income housing project throughout the credit period. Therefore, the potential increase in eligible

basis under section 42(d)(5)(C) depends on the housing credit agency determining that the increase in eligible basis is necessary for the financial feasibility and viability of a qualified low-income housing project throughout the credit period, up to 130 percent of depreciable basis.

In applying the provisions of section 42(d)(5)(C) to the present case, we conclude that State E and the taxpayer cannot grandfather any increase in eligible basis for Project C for g on the basis of the d carryover allocation. The HUD calculation of difficult development area is an annual comparison of incomes and housing costs which contemplates that as data changes, designations must by necessity change as well. HUD's h designation of difficult development areas is effective only for those allocations occurring after i.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. Specifically, we express no opinion on whether Project C 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,

Barbara B. Walker
Assistant to the Chief, Branch 5
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)