Private Letter Ruling 9732014, IRC Section. 42

February 21, 1997

LEGEND:
Taxpayer = ***
Housing Program = ***
Federal Defendant = ***
State Defendant = ***
Freeway = ***
Court = ***
State Agency = ***
Federal Trust Fund = ***
State = ***
City = ***
a = ***
b = ***
c = ***
d = ***
e = ***
f = ***
g = ***

Dear ***

This is in response to your letter dated February 6, 1996, 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 funds lent by Taxpayer that are attributable to payments made by the Federal Defendant to the Housing Program, will not constitute federal funds within the meaning of section 42(i)(2)(D). The relevant facts as represented in your submissions are set forth below.

FACTS:

Taxpayer is a nonprofit public benefit corporation organized under the State Nonprofit Public Benefit Corporation Law for charitable purposes. The District Office of the Internal Revenue Service that has examination jurisdiction over all returns filed by Taxpayer is located in City.

In a, a class of plaintiffs (Plaintiffs) successfully enjoined the Federal Defendant and the State Defendant (collectively, the Defendants) from proceeding with the construction of the Freeway until the Defendants undertook to (i) build the Freeway with supporting transit facilities, (ii) provide for the housing needs of those living in the path of the Freeway and (iii) ensure employment opportunities for the benefit of communities impacted by the Freeway. The Plaintiffs and Defendants settled the Plaintiffs' claims pursuant to an Amended Final Consent Decree entered into on b (the Consent Decree), as

amended, interpreted and implemented by subsequent orders of the Court. Under the Consent Decree, the Defendants, for the benefit of Plaintiffs, were required to establish and fund the Housing Program. The Consent Decree designated the State Agency to be responsible for coordination and implementation of the Housing Program. Assets of the Housing Program, including cash, real property, and real property interests were irrevocably paid or committed to the Housing Program in settlement of the underlying lawsuit by the Defendants pursuant to the Consent Decree. Federal Defendant paid or committed c of the assets of the Housing Program; State Defendant paid or committed d of the assets. The amounts committed by the Federal Defendant derived from the Federal Trust Fund.

The Consent Decree required that approximately e affordable housing units be built with settlement funds provided to the Housing Program; approximately f affordable housing units have been built or are under construction or planned through the use of funds lent by or real estate purchased and rehabilitated by the Housing Program. The parties to the Consent decree projected that the Housing Program would not be able to allocate funds for additional affordable housing production and to monitor the affordability of the current units if the Housing Program continued to be administered by the State through State Agency. Plaintiffs and Defendants agreed that the Housing Program should be restructured. A Stipulation and Order Re Restructuring the Housing Program was filed in the Court on (the Order). Pursuant to the Order, the Housing Program was reorganized and restructured as the Taxpayer.

The Order requires Taxpayer to assume all obligations to the Plaintiffs and to the Court and of the Defendants that were the obligations of the State through State Agency to implement the Housing Program, as administrator of the Housing Program. Taxpayer also is required to assume title to all of the Housing Program assets, including real estate, deeds of trust and related notes, and cash. Under the Order, the Federal Defendant was dismissed with prejudice from the lawsuit and the Consent Decree.

Taxpayer intends to continue to fund the development of affordable housing projects by providing long-term, below-market interest rate financing to the projects. The funds that Taxpayer will use to develop additional affordable housing projects will include payments made by the Federal Defendant to the Housing Program pursuant to the Consent Decree. Taxpayer intends to lend these funds at below-market interest rates to affordable housing projects.

REQUESTED RULING:

Funds loaned by Taxpayer that are attributable to payments made by the Federal Defendant to the Housing Program, will not constitute federal funds within the meaning of section 42(i)(2)(D).

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. In general, under section 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), a 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 section 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.

Section 42(i)(2)(D) provides that a below-market federal loan is any loan funded in whole or in part with federal funds if the interest rate payable on the loan is less than the applicable federal rate in effect under section 1274(d)(1) (as of the date the loan was made). Below-market federal loans do not include any loan that would be a below-market federal loan solely by reason of assistance provided under section 106, 107, or 108 of the Housing and Community Development Act of 1974 (HCDA) (42 U.S.C. 5301 et seq.).

Although the term "federal funds" is not defined under section 42 or the regulations thereunder, the legislative history to section 42 provides that a federal loan under the Farmers Home Administration section 515 program is an example of a federal subsidy, as is a reduced interest rate loan attributable in part to federal grant funds lent to a building owner. A federal grant includes any grant funded in whole or in part by the federal government, to the extent funded with federal funds. Examples include grants funded by Community Development Block Grants, Urban Development Action Grants, Rental Rehabilitation Grants, and Housing Development Grants. See H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-91 (1986), 1986-3 (Vol. 4) C.B. 91.

Unlike the programs mentioned in the legislative history for which federal laws have been enacted to appropriate funds for affordable housing, the Taxpayer's loans will be funded with proceeds in settlement of a civil suit of which the Defendants are federal and state agencies. Although the source of funding to the Housing Program under the Consent Decree originated from the Federal Trust Fund, the payments of the Federal Defendant were involuntary and represent restitution to the Plaintiff. The Taxpayer's assumption of the Defendant's obligations is in pursuance of the purposes set forth in the Consent Decree and the Order and not under the directive of any federal program. Further, since the Federal Defendant has been dismissed with prejudice from the civil suit, they have no direct or indirect oversight of the Taxpayer's use of any funds attributable to Housing Program assets.

Accordingly, based solely upon the law and above facts as represented by the Taxpayer, we rule as follows:

The funds loaned by Taxpayer that are attributable to payments made by the Federal Defendant to the Housing Program will not constitute federal funds within the meaning of section 42(i)(2)(D).

Under the power of attorney on file, we are sending the original 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. Specifically, we express no opinion regarding whether funds loaned by (1) the Housing Program, or (2) the Taxpayer (other than those attributable to payments made by the Federal Defendant to the Housing Program) are federal funds within the meaning of section 42(i)(2)(D).

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. 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 the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in this ruling. See section 11.04 of Rev. Proc. 97-1, 1997-1 I.R.B. 11, 43. However, when the criteria in section 11.05 of Rev. Proc. 97-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

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,

SUSAN REAMAN

Chief, Branch 5
Office of the Assistant Chief Counsel

(Passthroughs and Special Industries)