

Private Letter Ruling 9737006, IRC Sec(s). 42

UIL No. 0042.10-00

Date: June 11, 1997

LEGEND:

Parent = ***

Sub = ***

b = ***

c = ***

d = ***

e = ***

Dear ***

This responds to a letter submitted on behalf of Parent, dated June 25, 1996, and subsequent correspondence, requesting a ruling that certain transfers of partnership interests from Parent to Sub will not result in the recapture of low-income housing tax credits under section 42(j) of the Internal Revenue Code.

Facts

Parent and Sub are engaged in the production and sale of packaged foods. Parent is the parent of a consolidated group of corporations filing a consolidated return that includes Parent and Sub. The business of Parent primarily is to hold, administer, and market all intellectual property rights relating to the products and businesses of the consolidated group. The business of Sub, a wholly-owned subsidiary of Parent, primarily is to conduct direct sales activities in all the geographic markets of the consolidated group.

Between b and c, Parent acquired limited partnership interests in six limited partnerships having fewer than 35 partners in each partnership (the "Partnerships"). The Partnerships invest directly in low-income buildings, or become limited partners in limited partnerships that own low-income buildings (the "Project Partnerships"). Through its ownership of interests in the Partnerships and the indirect ownership of interests in the Project Partnerships, Parent estimates that it has an interest in hundreds of buildings qualifying for the low-income housing tax credit.

Parent assigned all of its interests in the Partnerships to Sub on d, which was the first day of the consolidated group's e taxable year (the "Assignments"). The Assignments were made as a contribution to capital. Parent received no additional shares in Sub or other consideration for the Assignments. Sub intends to hold these interests and Parent intends that Sub will remain a member of the affiliated group.

The assigned interests did not exceed twenty percent of the profits or capital of any Partnership.

The Assignments were made as part of a general corporate restructuring (including the formation of Sub and two other subsidiaries of Taxpayer) intended to:

- 1) facilitate the integration of diverse manufacturing operations;
- 2) reduce the business risks relating to potential third party liabilities of the respective business operations of the group; and
- 3) provide greater flexibility in the management of new and existing business operations.

More specifically, the interests in the Partnerships were assigned to Sub for two reasons. First, most of the personnel responsible for overseeing the investments in the low-income buildings are employees of Sub.

Also, Sub has business operations in all states where Project Partnerships own low-income buildings.

Parent has made the following additional representations. First, Sub intends to hold the interests in the Partnerships for the same purposes that Parent held them. Second, Parent owns and expects to continue to own 100 percent of the capital stock of Sub. Third, substantially all of the assets necessary for the operation of the interests in the Partnerships were transferred to Sub. Fourth, the basis of the interests in the Partnerships in the hands of Sub is determined in whole or in part by reference to the basis of the interests in the hands of Parent. Last, the transfer of the interests in Partnership from Parent to Sub was not a transaction to which section 381 applies.

Parent requests a ruling that it will not be liable for any credit recapture amount under section 42(j) solely as a result of the Assignments.

Law and Analysis

Section 38(a) provides as a credit against the tax imposed for the taxable year an amount equal to the sum of the business credit carryforwards carried to the taxable year, the amount of the current year business credit, and the business credit carrybacks carried to the taxable year. Section 38(b)(5) includes the low-income housing tax credit determined under section 42(a) as a part of the current year business tax credit.

Section 42(a) provides that for purposes of section 38, the amount of the low-income housing credit 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.

Under section 42(j)(1), if at the close of any taxable year in the compliance period, the amount of the qualified basis of any building with respect to the taxpayer is less than the amount of such basis as of the close of the preceding taxable year, then the taxpayer's tax

for the taxable year will be increased by the credit recapture amount. The credit recapture amount is determined under section 42(j)(2) and section 42(j)(3).

Generally, under section 42(j)(1), any disposition by a taxpayer of a building subject to the compliance period is a recapture event. Under section 42(j)(6), however, no recapture will be imposed on disposition of a low-income building if the taxpayer furnishes to the Secretary a bond, and it is reasonably expected that the building will continue to be operated as a qualified low-income building through the end of the compliance period.

No regulations or rulings under section 42(j) illustrate when a reduction in qualified basis of a building "with respect to the taxpayer" has occurred or when there has been a disposition that requires the taxpayer to post a bond to avoid recapture. However, analogous provisions concerning recapture of investment credit provide relevant guidance.

Under section 50(a)(1), if during any taxable year investment credit property is disposed of or otherwise ceases to be section 38 property with respect to the taxpayer before the close of the recapture period, the tax for such taxable year shall be increased. For property placed in service before January 1, 1991, former section 47(a)(1) contained an identical investment credit recapture rule.

Section 1.1502-3(f)(2)(i) generally provides that during a consolidated return year a transfer of investment credit property from one member of an affiliated group to another is not treated as a disposition within the meaning of former section 47(a)(1).

Rev. Rul. 75-245, 1975-1 C.B. 6 involves the sale of a corporate partner's partnership interest to a member of the corporate partner's affiliated group during a consolidated return year. The revenue ruling relies on section 1.1502-3(f)(2)(i) in finding an exception to the recapture provisions of former section 47(a)(1). The revenue ruling concludes that section 1.1502-3(f)(2)(i) was intended to prevent recapture for transfers of section 38 property between members of an affiliated group, and that no recapture occurred under the circumstances.

We believe that the same result is warranted here. Therefore, we conclude that Parent has made no disposition of an interest in any of the assigned low-income buildings under section 42(j)(6) that results in a reduction of qualified basis, or that requires Parent to post a bond to avoid recapture. Accordingly, we rule that Parent shall not be subject to recapture of low-income housing credit under section 42(j)(1) as a result of the Assignments.

No opinion is expressed or implied regarding the application of any other provision of the Code or regulations.

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

Pursuant to the power of attorney on file with this office, we are forwarding a copy of this letter to your authorized representative.

Sincerely yours,

Walter H. Woo
Senior Technician Reviewer
Branch 5
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)