

Private Letter Ruling 9801028, IRC Sec(s). 42

UIL No. 0042.10-00

Headnote:

Reference(s): Code Sec. 42;

The Service has ruled that the transfer of low-income housing limited partnership interests on a spouse's death to a trust, and then on to another trust for benefit of the surviving spouse, will not trigger recapture of the low-income housing credit.

Full Text:

Date: September 30, 1997

Refer Reply to: CC:DOM:P&SI:5 - PLR-252462-96

LEGEND:

State A = \*\*\*

State B = \*\*\*

District C = \*\*\*

H = \*\*\*

W = \*\*\*

G = \*\*\*

Trust A = \*\*\*

Trust B = \*\*\*

Trust C = \*\*\*

LP1 = \*\*\*

LP2 = \*\*\*

LP3 = \*\*\*

LP4 = \*\*\*

LP5 = \*\*\*

LP6 = \*\*\*

LP7 = \*\*\*

LP8 = \*\*\*

LP9 = \*\*\*

LP10 = \*\*\*

LP11 = \*\*\*

LP12 = \*\*\*

b = \*\*\*

c = \*\*\*

d = \*\*\*

e = \*\*\*

f = \*\*\*

j = \*\*\*  
h = \*\*\*  
m = \*\*\*  
n = \*\*\*  
o = \*\*\*  
p = \*\*\*  
r = \*\*\*  
s = \*\*\*

Dear \*\*\*

This responds to your letter dated October 31, 1996, requesting a ruling that there is no recapture of low-income housing credits under section 42(j)(1) of the Internal Revenue Code claimed by H by reason of transfers at his death of certain limited partnership interests in low-income housing partnerships under the terms of H's estate plan documents.

The facts as you have represented are as follows. H died on b. H employed the cash method of accounting for federal income tax purposes with the calendar year as his taxable year. The Internal Revenue Service District that has examination jurisdiction over the federal income tax forms filed by H is District C. At the time of his death, all of H's assets either were owned by Trust A or passed to it outside of H's will. H has no personal representative as his will is not being probated. The trustees of Trust A are administering the estate of H pursuant to the terms of the trust.

W filed a joint tax return with H for calendar years c through e. W will file a joint tax return for h, which includes the income deductions, gains, losses, and credits of H for the period in the calendar year through b. On f, H created Trust A, a revocable trust subject to the grantor trust provisions under sections 671 through 677 of the Code. Upon H's death, Trust A became irrevocable and subject to the provisions of sections 641 through 667. The initial Trustees of Trust A were H and W. Upon the death of H, G became the successor Trustee to H.

On j, H created Trust B, a revocable trust, which became irrevocable and subject to the provisions of sections 641 through 667 upon H's death. The initial Trustees of Trust B were H and W. Upon the death of H, G became the successor Trustee to H. Also on j, H created Trust C, a revocable trust, which became irrevocable and subject to the provisions of sections 641 through 667 Upon H's death. The initial Trustees of Trust C were H and W. Upon the death of H, G became the successor Trustee to H.

During c and d, H entered into twelve limited partnership agreements as a limited partner in LP1 through LP12 (the "Limited Partnerships"). Through the Limited Partnerships, H invested \$m in twelve low-income housing projects qualifying for the low-income housing credit under section 42. Each of the Limited Partnerships constructed new low-income buildings qualifying for the low-income housing credit. All of the projects are located in State A, except for the project owned by LP10, which is located in State B. H's

operating profit and loss interests in each of the Limited Partnerships was n percent. His residual interest was o percent.

State A became a community property state effective r. On p, H and W entered into a marital property agreement to continue treating their property as individually owned, rather than subjecting it to the provisions of State A community property law. On s, H and W amended their marital property agreement to provide that on H's death, H's interest in any assets that would otherwise be subject to probate would pass immediately without probate to the Trustees of Trust A.

Under the terms of Trust A, the Trustees are to administer H's estate and distribute all of the assets of Trust A to Trust B as soon as possible. W is the sole beneficiary of Trust B during her life, and is entitled to all of its income and discretionary principal distributions during her life. Upon the death of W, all of the assets of Trust B after payment of estate taxes are to be distributed to Trust C, whose beneficiaries are all of the issue of H and W.

When H died, H's entire interest in the Limited Partnerships passed to Trust A without probate. Under the agreements relating to the Limited Partnerships the death of a limited partner does not terminate the partnership. The general partners of the Limited Partnerships consented to the transfer of the Limited Partnership interests to Trust A, the substitution of Trust A for H as the limited partner in each of the Limited Partnerships, the transfer of the Limited Partnership interests to Trust B, and substitution of Trust B for Trust A as the limited partner in each of the Limited Partnerships.

You have requested the following rulings:

- 1) The transfer of each of the limited partnership interests in the Limited Partnerships by reason of H's death to Trust A did not result in credit recapture to H under section 42(j)(1);
- 2) The transfer of the interests in the Limited Partnerships pursuant to the terms of Trust A to Trust B will not result in credit recapture to Trust A under section 42(j)(1)
- 3) The low-income housing tax credits from the interests in the Limited Partnerships for the calendar year h may be claimed by Trust A, and are not prorated between H and Trust A according to the number of days of ownership interests in the Limited Partnerships by H and Trust A during h;
- 4) During the period when Trust A owns the interests in the Limited Partnerships, Trust A will be entitled, subject to section 42(i)(6) to the amount of low-income housing credits to which H would have been entitled had H not died, and;
- 5) During the period when Trust B owns the interests in the Limited Partnerships, Trust B will be entitled, subject to section 42(i)(6) to the amount of low-income housing credits to which Trust A would have been entitled had Trust A not distributed the interests to Trust B.

## Law and Analysis:

Section 38(a) provides a credit against the tax imposed for the taxable year in 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. The amount of the current year business tax credit includes, under section 38(b)(5), the low-income housing tax credit determined under section 42(a).

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).

Under section 42(f)(4), if a building (or an interest in the building) is disposed of during any year for which low-income housing tax credit is allowable, the credit is allocated between the parties on the basis of the number of days during the year the building (or interest) was held by each party. Generally, any change in ownership of a low-income building within the compliance period is a disposition under section 42. See, H.R. Conf. Rep. No. 481, 99th Cong., 2d Sess. II 96 (1986).

While section 42 and its legislative history is silent concerning dispositions upon death, the investment tax credit also under section 38, in effect for property placed in service before January 1, 1991, did provide rules for dispositions upon death. Under section 1.47-3(b)(1) of the Income Tax Regulations, no investment tax credit recapture occurred upon the death of a taxpayer. This section further provided that no recapture occurred upon the transfer of a partner's interest in a partnership by reason of the death of the partner. Similarly, we believe that no recapture event occurs upon the transfer of a particular interest in a low-income housing project by reason of the death of the taxpayer.

No specific rule exists under section 42 for allocation of credits from low-income buildings held by a partnership. However, we believe Congress intended that partnerships be treated as if they were taxpayers where appropriate to carry out the objectives of the credit. For example, where a partner's interest changes during a taxable year, each partner's distributive share of the tax credit should be determined under general partnership allocation rules, i.e., by using a method prescribed in the regulations that takes into account the varying interests of the partners in the partnership during such taxable year. See, Staff of the Joint Committee on Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986, 154, n.3 (Comm. Print 1987).

Section 706(a) provides that in computing the taxable income of a partner for a taxable year, the inclusions required by section 702 (including items of deduction or credit) and section 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.

Section 706(c) provides, in part, that except in the case of a termination of a partnership, retirement of a partner, complete liquidation of a partner's interest, or a sale or exchange of an entire partnership interest, the taxable year of a partnership does not close as the result of the death of a partner. Similarly, section 1.706-1(c)(1) of the Income tax regulations provides, in part, that the taxable year of a partnership does not close as the result of the death of a partner, except in the case of a termination of the partnership.

Section 1.706-1(c)(3)(i) provides that when a partner dies, the partnership taxable year does not close with respect to such partner prior to the end of the partnership taxable year. The partnership taxable year continues both for the remaining partners and the decedent partner. Where the death of a partner results in the termination of the partnership, the partnership taxable year closes for all partners on the date of such termination under section 708(b)(1)(A). However, if the decedent's estate or other successor sells or exchanges its entire interest in the partnership, or if its entire interest is liquidated, the partnership taxable year with respect to the estate or other successor in interest closes on the date of such sale or exchange, or the date of completion of the liquidation.

Section 1.706-1(c)(3)(ii) provides that the last return of a decedent partner shall include only his share of partnership taxable income for any partnership taxable year or years ending within or with the last taxable year for such decedent partner (i.e., the year ending with the date of his death). The distributive share of partnership taxable income for a partnership taxable year ending after the decedent's last taxable year is includable in the return of his estate or other successor in interest. If the estate or other successor in interest of a partnership continues to share in the profits or losses of the partnership business, the distributive share thereof is includable in the taxable year of the estate or other successor in interest within or with which the taxable year of the partnership ends. Where the estate or other successor in interest receives distributions, any gain or loss on such distributions is includable in its gross income for its taxable year in which the distribution is made.

Section 1.706-1(c)(3)(iii) provides that if a partner, in accordance with the terms of the partnership agreement, designates a person to succeed to his interest in the partnership after his death, such designated person shall be regarded as a successor in interest of the deceased for purposes of chapter 1 of the Code. Thus, where the partner designates his widow as the successor in interest, her distributive share of income for the taxable year of the partnership ending within or with her taxable year may be included in a joint return.

Section 1.706-1(c)(3)(v) provides that to the extent any part of a distributive share of partnership income of the estate or other successor in interest of a deceased partner is attributable to the decedent for the period ending with the date of his death, such part of the distributive share is income in respect of a decedent under section 691.

Section 708(b)(1)(B) provides that a partnership is considered terminated only if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital or profits.

Section 1.708-1(b)(1)(i)(a) provides that upon the death of one partner in a 2-member partnership, the partnership is not considered to be terminated if the estate or other successor in interest of the deceased partner continues to share in the profits or losses of the partnership business.

Section 1.708-1(b)(1)(ii) provides that, a partnership terminates when 50 percent or more of the total interest in partnership capital and profits is sold or exchanged within a period of twelve consecutive months, including a sale or exchange to another member of the partnership.

However, a disposition of a partnership interest by gift (including assignment to a successor in interest), bequest, or inheritance, or the liquidation of a partnership interest, is not a sale or exchange for purposes of this rule.

In Rev. Rul. 68-215, 1968-1 C.B. 312, the Service addressed the reporting requirements of the successor in interest to a decedent partner's partnership interest when the decedent partner had received a partial distribution of the distributive share of income prior to death. The Service concluded that the successor does not reduce the distributive share reported on the successor's tax return for the year of death by the amount of the prior distribution to the decedent. The successor must include the decedent's entire distributive share of partnership income in its return for the year of death.

In the present case, H's death did not cause a termination of any of the limited partnerships. Therefore, the partnerships' taxable years did not close under section 706 on the date of H's death with respect to any of the partners, including the decedent. As H's successor in interest, Trust A will report on its return its distributive share of partnership taxable income for the entire tax year that ends after H's death. As H's successor in interest, Trust A also will include on its return its distributive share of the low-income housing tax credit for the entire taxable year that ends after H's death.

Accordingly, based solely upon the above facts and the representations submitted, we rule that:

1) The transfer of each of the limited partner interests in the Limited Partnerships to Trust A upon H's death did not result in credit recapture to H under section 42(j)(1)

2) The transfer of the interests in the Limited Partnerships to Trust B pursuant to the terms of Trust A will not result in credit recapture to H under section 42(j)(1);

3) The entire amount of low-income housing tax credits from the interests in the Limited

Partnerships for the tax year ending after H's death may be claimed by Trust A, and are not pro rated between H and Trust A according to the number of days of ownership interests in the Limited Partnerships by H and Trust A during h;

4) During the period in which Trust A is the owner of interests in the Limited Partnerships, Trust A will be entitled, subject to section 42(i)(6) to the amount of low-income housing credits to which H would have been entitled had H not died; and

5) In the taxable year in which Trust A distributes the interests in the Limited Partnerships to Trust B, the amount of low- income housing credits shall be apportioned between Trust A and Trust B pursuant to section 42(i)(6) on the basis of the income allocable to each trust.

No opinion is expressed or implied regarding the application of any other provision of the Code or regulations. In particular, no opinion is expressed as to whether the projects held by the Limited Partnerships qualify for the low-income housing tax credit under section 42.

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 W.

Sincerely yours,

Susan J. Reaman  
Chief, Branch 5  
Office of the Assistant  
Chief Counsel  
(Passthroughs and Special Industries)