

Private Letter Ruling 9805018, IRC Section 42

UIL No. 0042.04-08

Headnote:

Reference(s): Code Sec. 42;

The Service has ruled that the transfer of a partnership's bare legal title in low-income housing credit property to the partnership's general partner will not trigger recapture of the low- income housing credit.

Full Text:

Date: October 30, 1997

In Reference to: CC:DOM:P&SI:5 PLR-113090-97

LEGEND:

Taxpayer = ***

General Partner = ***

Limited Partner = ***

State = ***

County = ***

City = ***

a = ***

b = ***

c = ***

e = ***

f = ***

g = ***

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Dear ***

This letter responds to your letter dated a, 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 regarding the application of section 42(j) to a proposed transfer of bare legal title to certain real property owned by Taxpayer to General Partner.

The relevant facts as represented in your submissions are set forth below.

FACTS:

Taxpayer, a State limited partnership, was organized under the provisions of the State revised uniform limited partnership act, as amended. Operations of Taxpayer commenced on b, for the purpose of constructing and operating an apartment complex in County that qualifies for low-income housing tax credits under section 42. Taxpayer will terminate on c, or sooner, in accordance with the terms of the limited partnership agreement. On b, Taxpayer entered into a subscription agreement with General Partner and Limited Partner whereby General Partner contributed title to all land and construction costs incurred for the apartment complex to Taxpayer, and Limited Partner became the sole investment limited partner. As sole investment limited partner, Limited Partner contributed \$e for each \$f of aggregate tax credits projected to be earned by Taxpayer during a ten year tax credit period. In g, Limited Partner contributed \$h.

The phase 1 property comprises Taxpayer's qualified basis in i low-income housing buildings. The qualified basis of the phase 1 property is \$j, which, based upon its annual accelerated credit percentage of u%, results in a annual credit of \$k. Taxpayer's compliance period began the year that the buildings were placed in service, fiscal year ended l. The buildings continue to qualify as part of a low-income housing project and meet the statutory requirements of section 42. Subject to a favorable ruling request,

Taxpayer will contribute bare legal title to its phase 1 property to General Partner.

The District of the Internal Revenue Service having examination jurisdiction over Taxpayer's returns is located in City. Taxpayer files its audited financial statements and federal income tax returns on a p year-end, conforming to Limited Partner's fiscal year end. Taxpayer reports items of income and expense on the accrual basis of accounting for both book and tax purposes.

General Partner is a State not-for-profit corporation. As a section 501(c)(3) organization, its purpose is (a) to provide a safe, adequate and affordable housing complex for low-income individuals and families needing assistance in achieving economic self sufficiency; (b) to assist parents by providing dependable quality child care in a licensed day care facility or a family care home; and (c) to provide assistance to individuals in improving their education, skills, and work experience so that they can move from

dependency to become economically self-reliant. General Partner charges a management fee totaling m% of gross monthly rental payments received by Taxpayer. Subject to the receipt of a favorable ruling, General Partner will become the holder of bare legal title to the phase 1 property of Taxpayer.

The District Director of the Service having examination jurisdiction over General Partner's returns is also located in City. General Partner files its audited financial statements and federal income tax returns on a g year-end. General Partner reports items of income and expense on the accrual basis of accounting for both book and tax purposes.

Limited Partner, a C corporation, is the sole limited partner of Taxpayer holding a n% profit and loss sharing interest. Limited Partner prepares its audited financial statements and federal income tax return on a p year-end. Limited Partner reports items of income and expense on the accrual basis of accounting for both book and tax purposes.

Title to the phase 1 property will be transferred by a quitclaim deed to General Partner. Concurrently, Taxpayer will execute a claim of interest in County. This claim of interest will assert Taxpayer's interest pursuant to r of the State statutes. Also concurrently, General Partner and Limited Partner will enter into a memorandum of understanding whereby they will each acknowledge that all rights and obligations associated with ownership of the phase 1 property, including the right to receive all income from the

operations and sale of the property and the obligation to pay all costs and expenses associated with the ownership, operation and sale of the property will remain with Taxpayer and that the transfer of the phase 1 property will not result in a sale or exchange (i.e., change in ownership) of the property for federal income tax purposes. The transfer of bare legal title is not intended to alter the rights and obligations of the partners under the limited partnership agreement, and Taxpayer will continue to operate as though title to the phase 1 property were held in the name of Taxpayer.

The proposed transaction will not result in a transfer of the benefits and burdens of ownership (for federal and state income tax purposes) and will not constitute a sale or exchange (for federal and state income tax purposes) of the phase 1 property.

The primary business purpose for the proposed transaction is to transfer bare legal title of the phase 1 property to an exempt entity to receive an exemption from State ad valorem taxes pursuant to s of the State statutes that states:

All property owned by an exempt entity and used exclusively for exempt purposes shall be totally exempt from ad valorem taxation.

The proposed transaction has been described in detail to senior officials in the County's tax assessor's office and such officials have advised General Partner, in its capacity as general partner, that the property would be exempt from property taxes upon a transfer of

bare legal title in the manner described above. At present, the ad valorem taxes paid by Taxpayer for the most recent tax year were approximately \$0.

Based upon projected cash flows that include outflows for the recurring payment of ad valorem taxes, if Taxpayer does not receive this tax exemption, its ability to fund operating expenses from the government-regulated income streams is highly unlikely. All current residents participate in a federally subsidized rental assistance program administered by the County housing authority. Taxpayer has reduced its staff by 60% of previous maximum employment levels and is at the point of risking the quality of the services to the tenants. Absent a favorable ruling, Limited Partner will not consent to the

transaction. This consent is required to effect the transaction pursuant to t of the limited partnership agreement and to allow Taxpayer to receive the ad valorem exemption essential to its financial existence. Accordingly, Taxpayer contends that the receipt of a favorable ruling is a required event necessary to ensure its continued financial feasibility.

RULING REQUESTED:

Based on the foregoing, which assumes that under these facts the transfer of bare legal title to the phase 1 property from Taxpayer to General Partner is not a sale or exchange (for federal and state income tax purposes), or causes a shift in the benefits and burdens of ownership (for federal and state income tax purposes), a ruling is respectfully requested to provide that:

The section 42(j) recapture provisions are not applicable to the proposed transfer of bare legal title to the phase 1 property by Taxpayer to General Partner.

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)(1)(A) 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)(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.

Section 42(j) provides rules concerning the recapture of low-income housing tax credits. Section 42(j)(1) provides that if as of the close of any taxable year in the compliance period, the qualified basis of any building with respect to the taxpayer is less than the amount of qualified basis as of the close of the preceding taxable year, the taxpayer's tax for the taxable year shall be increased by the credit recapture amount. The credit recapture amount for a recapture event occurring during any year in the credit period

(as defined in section 42(f)(1)) is one-third of all credits claimed (assuming no prior recapture amount has been paid) plus interest at the overpayment rate under section 6621, beginning with the date the recaptured amount was claimed. The legislative history to section 42 provides that generally, any change in ownership during the compliance period is a recapture event and that all dispositions of ownership interests in buildings are treated as transfers for purposes of recapture. See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., II-96 and II-102 (1986), 1986-3 (Vol. 4) C.B. 1, 96, 102. However, under section 42(j)(6), in the case of a disposition of a building or an interest therein, a taxpayer can avoid recapture liability for the disposition if the taxpayer posts a satisfactory bond utilizing Form 8693, Low-Income Housing Credit Disposition Bond, and it is reasonably expected that the building will continue to be operated as a qualified low-income building for the remaining compliance period of the building.

Taxpayer represents in the above facts that the transfer of bare legal title from Taxpayer to General Partner is not a sale or exchange for federal and state income tax purposes and will not result in a shift of the benefits and burdens of ownership for federal and state income tax purposes from Taxpayer to General Partner. This representation is a material fact in this case. Therefore, the issue being considered in this case is not whether a sale or exchange or a transfer of the burdens and benefits of ownership is, for federal income tax purposes, a recapture event under section 42, but whether the transfer of bare legal title under the above facts is a disposition or change in ownership contemplated by the section 42 legislative history to result in a recapture event.

The transfer of bare legal title under the above circumstances would not be made for the evasion or avoidance of federal income tax. Further, the federal tax treatment of the proposed transaction has been fully disclosed to the local taxing authority. Taxpayer represents that all indicia of ownership of the phase 1 property (other than bare legal title), and each partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) would remain unchanged. Consequently, the transfer of bare legal title in this case is not a disposition or change in ownership contemplated by the section 42 legislative history to result in a recapture event.

Accordingly, based solely upon the representations and the relevant law set forth above, we rule as follows:

The transfer of bare legal title to the phase 1 property by Taxpayer to General Partner will not, under these facts, result in recapture under section 42(j).

Under the power of attorney on file, we are sending a copy of this ruling to the second representative listed on the power of attorney and to Taxpayer.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. Particularly, no opinion is expressed or implied regarding whether the transfer of bare legal title to the phase 1 property from Taxpayer to General Partner is a sale or exchange (for federal or state income tax purposes), or causes a shift in the benefits and burdens of ownership (for federal and state income tax purposes). Nor is any opinion expressed or implied regarding whether the phase 1 property 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,

Kathleen Reed
Assistant to the Branch Chief, Branch 5
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)