

Private Letter Ruling 9846008
Internal Revenue Service
AUG. 11, 1998

Internal Revenue Service
Department of the Treasury
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Dear

This letter responds to a letter dated December 19, 1997, and subsequent correspondence, submitted on behalf of the Partnership by the Partnerships authorized representatives. In that letter, a ruling is requested regarding the renovation of buildings qualifying for the low-income housing credit under § 42 of the Internal Revenue Code.

The Partnership has made the following representations:

On a, the Partnership was organized as a State X limited partnership. The Partnership was formed to acquire, develop, and operate a low-income housing project located at City Y. The Project was approved by the Agency for b two-bedroom units in f buildings. The Partnership represents that all of the units in the project were intended for occupancy as low-income units within the meaning of § 42(i) (3).

The Partnership has one general partner, Gen Partner, and one limited partner, Ltd Partner. Gen Partner has individual partners who each own a percent interest in Gen Partner. Gen Partner has a c percent interest in the Partnership and Ltd Partner has a d percent interest in the Partnership.

According to the Partnership, in e an application was made for credit under § 42 for a project with e two-bedroom units. However, in recent years, the Project has experienced a low-occupancy rate. The Partnership believes that the low occupancy is due to the mix of units available for rent. For example, the Project has an excess of two-bedroom units available for rent, but the demand is for three-bedroom and one-bedroom units. According to the Partnership, the demand for three-bedroom units results from the requirement by the County Housing Authority that prohibits a tenant from placing two children of opposite sexes in the same bedroom when both of those children reach age . Because the population in the area consists of families with at least two dependent children of opposite sexes, two-bedroom units, are too small for these families.

Consequently, the Partnership plans to convert some of the two-bedroom units into a combination of one-bedroom and three-bedroom units. For example, two two-bedroom units will be converted into one three-bedroom unit and one one-bedroom unit.

According to the Partnership, in no event would the total number of units available for rent change. Only the mix of units, that is, one-bedroom, two-bedroom, and three-bedroom units, would change in the Project. The total number of units in the Project would remain at b.

The Partnership further represents that the Project will not be a mixed-use project, but rather will continue as a 100 percent low-income housing project. The total time for the renovation will not exceed 24 months and no tenant will be displaced or removed for the renovations. Apartment units will be renovated as vacancies occur. The Partnership has provided a letter from the Agency, dated g, stating that the changed bedroom configuration of the buildings would have met the qualifications stated in the e Low-Income Housing Tax Credit Allocation Plan and would not have adversely affected the ranking of the Project. Lastly, the Partnership represents the change in bedroom configuration will not increase the units' rent. Accordingly, the Partnership requests a ruling that the renovations will not affect the Project's eligibility for credit under § 42 and not result in the recapture under § 42(j) of any previously claimed credit.

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) provides that the amount of the current year business credit includes the low-income housing credit determined under § 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.

Section 42 (c) (1) (A) defines the qualified basis of any qualified low-income building for any taxable year to be equal to the applicable fraction (determined as of the close of the taxable year) of the eligible basis of the building (determined under § 42(d)(5)).

Section 42(c) (1) (B) defines the term "applicable fraction" as the smaller of the unit fraction or the floor space fraction. Section 42(c) (1) (C) defines the term "unit fraction" as the fraction the numerator of which is the number of low-income units in the building, and the denominator of which is the number of residential rental units (whether or not occupied) in the building. Section 42(c) (1) (D) defines the "floor space fraction" as the fraction the numerator of which is the total floor space of the low-income units in the building, and the denominator which is the total floor space of the residential rental units (whether or not occupied) in the building.

Section 42(g) (2) (A) provides that a residential unit is rent-restricted if the gross rent with respect to such unit does not exceed 30 percent of the imputed income limitation applicable to the unit. Under § 42(g) (2) (C), the imputed income limitation applicable to a unit is the income limitation which would apply under § 42(g) (1) to individuals occupying the unit if the number of individuals occupying the unit were, in the case of a

unit that does not have a separate bedroom, one individual, or, in the case of a unit that has one or more separate bedrooms, 1.5 individuals for each separate bedroom.

Under § 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 the 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 § 42(j) (2) and § 42(j) (3).

Generally, under § 42 (j) (1), any disposition by a taxpayer of a building subject to the compliance period is a recapture event. Under § 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 § 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, based on the Partnership's representations that the Project was, and will continue to be, a 100 percent low-income housing project both before and after the renovations, changes to the configuration of each building in the Project will not affect the buildings applicable fraction under § 42(c) (1) (B). Regardless of how the Project is renovated, if the units in the buildings in the Project only are rented to low-income tenants, the applicable fraction remains one. As long as the applicable fraction and eligible basis of each building remain unchanged, there is no reduction of the qualified basis under § 42(c) (1) (A). If the Project continues to meet the other requirements of § 42, the Partnership will be able to claim credit under § 42 on the renovated buildings.

Therefore, we conclude that the Partnership has made no disposition of an interest in any of buildings in the Project under § 42(j) (1) that results in a reduction of qualified basis, or that requires the Partnership to post a bond to avoid recapture. Accordingly, we rule as follows:

The Partnership's conversion of two-bedroom units into a mix of three-bedroom and one-bedroom units will not jeopardize the Partnership's eligibility for low-income housing credit under § 42, nor will the Partnership be subject to recapture of low-income housing credit under § 42(j) (1) as a result of the conversions.

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

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.

In accordance with the power of attorney on file, a copy of this letter is being sent to the Partnership's authorized legal representatives.

Sincerely yours,

SUSAN J. REAMAN
Chief, Branch 5
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
6110 copy