

ing is located is \$11.8 million. Partnership earned \$300,000 in investment earnings from investing the original \$5.7 million of proceeds of the bonds. The sum of these amounts, \$6 million, was expended on construction of the building.

LAW AND ANALYSIS

Section 42(a) provides for a tax credit for investment in qualified low-income residential rental buildings placed in service after December 31, 1986.

Section 42(h)(1)(A) provides that the amount of credit determined under § 42 for any taxable year with respect to any building shall not exceed the housing credit dollar amount allocated to the building under § 42(h).

Section 42(h)(4)(A) provides that § 42(h)(1) does not apply to any portion of the credit otherwise allowable under § 42(a) which is attributable to eligible basis financed by any obligation the interest on which is exempt from tax under § 103 if—

(i) the obligation is taken into account under § 146, and

(ii) principal payments on the financing are applied within a reasonable period to redeem obligations the proceeds of which were used to provide the financing.

Section 42(h)(4)(B) provides that, if 50 percent or more of the aggregate basis of any building and the land on which the building is located is financed with tax-exempt obligations specified in § 42(h)(4)(A), § 42(h)(1) does not apply to any portion of the low-income housing credit allowable under § 42(a) with respect to the building.

Section 1.42-1T(f)(1) of the temporary Income Tax Regulations provides that no housing credit allocation is required in order to claim a credit under § 42 with respect to the entire qualified basis (as defined in § 42(c)) of a qualified low-income building if 70 percent or more of the aggregate basis of the building and the land on which the building is located is financed with the proceeds of tax-exempt bonds which are taken into account for purposes of the volume cap under § 146. The reference to 70 percent in § 1.42-1T(f)(1) has been superseded by an amendment to § 42(h)(4)(B), which

changed 70 percent to 50 percent. Revenue Reconciliation Act of 1989, P.L. 101-239, § 7108(j).

Except as otherwise provided, § 103 provides that gross income does not include interest on any state or local bond. An exception under § 103(b)(1) is that interest on a private activity bond is included in gross income unless it is a qualified bond within the meaning of § 141. Generally, § 141(e)(2) requires that a qualified bond meet the volume cap requirements of § 146.

Section 146(a) provides that a private activity bond issued as part of an issue meets the volume cap requirements if the aggregate face amount of the private activity bonds issued pursuant to the issue, when added to the aggregate face amount of tax-exempt private activity bonds previously issued by the issuing authority during the calendar year, does not exceed the authority's volume cap for the calendar year.

Proceeds is not specifically defined for purposes of § 1.42-1T(f)(1). However, for other purposes of the Code, tax-exempt bond proceeds are generally defined to include amounts received from investing proceeds. See § 1.148-1(b) of the Income Tax Regulations. Accordingly, given the similarity of purposes for determining bond proceeds under § 1.42-1T(f)(1) and the tax-exempt bond provisions of the Code, it is appropriate to treat proceeds for purposes of § 1.42-1T(f)(1) to include amounts received from investing proceeds.

In the present situation, Partnership properly includes the \$300,000 amount from investing proceeds to determine if it met the 50-percent aggregate basis test in § 42(h)(4)(B). Because \$6 million (\$5,700,000 plus \$300,000) is greater than 50 percent of the aggregate basis of the building and the land (\$11,800,000), Partnership satisfies the 50-percent test in § 42(h)(4)(B).

HOLDING

Amounts received from investing proceeds of tax-exempt bonds are counted toward satisfying the 50-percent aggregate basis test under § 42(h)(4)(B).

Section 42.—Low-Income Housing Credit

26 CFR 1.42-1T: Limitation on low-income housing credit allowed with respect to qualified low-income buildings receiving housing credit allocations from a state or local housing credit agency (temporary). (Also §§ 103, 146.)

Low-income housing credit; tax-exempt bond financing. Amounts received from investing proceeds of tax-exempt bonds are counted toward satisfying the 50-percent aggregate basis test under section 42(h)(4)(B) of the Code.

Rev. Rul. 2002-21

ISSUE

Are amounts received from investing proceeds of tax-exempt bonds counted toward satisfying the 50-percent aggregate basis test under § 42(h)(4)(B) of the Internal Revenue Code?

FACTS

Partnership was formed to develop and operate in State X a low-income housing building in accordance with § 42. In December 1999, the State X bond-issuing authority (Issuer) issued at par \$5.7 million of tax-exempt housing bonds, and loaned the \$5.7 million to Partnership to finance a portion of the construction of the low-income housing project. Issuer received an allocation of § 146 volume cap in the amount of \$5.7 million for the bonds. Principal payments on this financing are to be applied within a reasonable period to redeem the bonds.

Partnership's aggregate basis for the building and the land on which the build-

DRAFTING INFORMATION

The principal author of this revenue ruling is Jack Malgeri of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Malgeri at (202) 622-3040 (not a toll-free number).

Section 103.—Interest on State and Local Bonds

26 CFR 1.103-1: Interest upon obligations of a state, territory, etc.

Are amounts received from investing proceeds of tax-exempt bonds counted toward satisfying the 50-percent aggregate basis test under § 42(h)(4)(B) of the Internal Revenue Code? See Rev. Rul. 2002-21, page 793.

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. See Rev. Proc. 2002-24, page 798.

Section 143.—Mortgage Revenue Bonds: Qualified Mortgage Bond and Qualified Veterans' Mortgage Bond

26 CFR 6a.103A-2: Qualified mortgage bond.

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. See Rev. Proc. 2002-24, page 798.

Section 146.—Volume Cap

Are amounts received from investing proceeds of tax-exempt bonds counted toward satisfying the 50-percent aggregate basis test under § 42(h)(4)(B) of the Internal Revenue Code? See Rev. Rul. 2002-21, page 793.

Section 167.—Depreciation

If a taxpayer has a depreciable interest in a qualifying vehicle and chooses to account for the cost of original and replacement tires under the original tire capitalization method, are the qualifying vehicle's tires treated as part of the vehicle for depreciation purposes? See Rev. Proc. 2002-27, page 802.

Section 168.—Accelerated Cost Recovery System

Under the original tire capitalization method, what is the applicable depreciation method, recovery period, and convention for the cost of a qualifying vehicle's original tires for purposes of § 168 of the Internal Revenue Code? See Rev. Proc. 2002-27, page 802.

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446.1: General rule for methods of accounting.

If a taxpayer changes its treatment of the cost of a qualifying vehicle's original and replacement tires to the original tire capitalization method, is this change a change in method of accounting under § 446(e) of the Internal Revenue Code? See Rev. Proc. 2002-27, page 802.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481-1: Adjustments in general.

If a taxpayer changes its treatment of the cost of a qualifying vehicle's original and replacement tires to the original tire capitalization method, is an adjustment under § 481 of the Internal Revenue Code taken into account in computing taxable income? See Rev. Proc. 2002-27, page 802.

Section 664.—Charitable Remainder Trusts

26 CFR 1.664-3: Charitable remainder unitrust.

Charitable remainder trusts; qualified charitable remainder unitrusts; recipient trusts. This ruling provides that, in three situations, a charitable remainder unitrust may pay the unitrust amounts to a second trust for the life of an individual, who is financially disabled

as defined in section 6511(h)(2)(A) of the Code. In each situation, the use of the unitrust amounts by the second trust is consistent with the manner in which the individual's own assets would be used, and the individual is, therefore, considered to have received the unitrust amounts directly from the charitable remainder unitrust for purposes of section 664(d)(2)(A).

Rev. Rul. 2002-20

ISSUE

May a trust qualify as a charitable remainder unitrust under § 664 of the Internal Revenue Code, if the unitrust amounts are paid to a separate trust for the life of an individual who is "financially disabled," as defined in § 6511(h)(2)(A)?

FACTS

An individual concurrently creates Trust A, a trust that otherwise qualifies as a charitable remainder unitrust, and a separate trust, Trust B. Under the governing instrument of Trust A, annual unitrust amounts will be paid to Trust B for the life of C. C is an individual who is financially disabled, that is, C is unable to manage C's own financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months.

Situation 1. Under the governing instrument of Trust B, a designated portion of the amount it receives from Trust A will be paid to C each month. If, at any time in the sole judgment of the trustee, the monthly payment to C is insufficient to provide adequately for the care, support, and maintenance of C, or is insufficient for the needs of C for any reason, additional amounts will be paid as needed to or on behalf of C from Trust B. Upon C's death, the balance remaining in Trust B will be distributed to C's estate.

Situation 2. Under the governing instrument of Trust B, the trustee may make distributions of income and principal, as determined in the trustee's sole and absolute discretion, for the financial aid and best interests of C in a manner