

**Technical Advice Memorandum 200044005 - IRC Section 42**

IRC Sections 42, 167, 168, 263A  
July 14, 2000  
Number: 200044005  
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CASE MIS No.: TAM-100740-00/CC:PSI:B5  
Chief, Examination Division  
Taxpayer's Name:  
Taxpayer's Address:  
Taxpayer's Identification No.:  
Tax Year Involved:  
Date of Conference:

LEGEND:  
Taxpayer =  
Project =  
Agency =  
State A =  
State B =  
State C =  
Gen Partner A =  
Gen Partner B =  
Gen Partner C =  
Ltd Partner =  
Contractor A =  
Contractor B =  
Bank =  
Lender =  
a =  
b =  
c =  
d =  
e =  
f =  
g =  
b =  
i =  
j =

ISSUE:  
What costs incurred in the construction of a low-income housing building are included in eligible basis under § 42(d)(1) of the Internal Revenue Code?

Specifically, are certain land preparation costs, costs for obtaining a construction loan, and construction contingency costs incurred by the Taxpayer in constructing Project included in eligible basis under § 42(d)(1)?

CONCLUSIONS:

### Eligible Basis

A cost incurred in the construction of a low-income housing building is includable in eligible basis under § 42(d)(1) if the cost is:

(1) included in the adjusted basis of depreciable property subject to § 168 and the property qualifies as residential rental property under § 103, or

(2) included in the adjusted basis of depreciable property subject to § 168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building.<sup>1</sup>

### Land Preparation Costs

For the cost of a land preparation to be includable in the Project's eligible basis under § 42(d)(1), the cost must be for property of a character subject to the allowance for depreciation under § 168. The cost of a land preparation is a depreciable property if the land preparation is so closely associated with a particular depreciable asset that the land preparation will be retired, abandoned, or replaced contemporaneously with that depreciable asset. Whether the land preparation will be retired, abandoned, or replaced contemporaneously with the depreciable asset is a question of fact. If it is determined, upon further factual development, that a land preparation cost is depreciable, such cost may be included in eligible basis if it is also determined as part of the adjusted basis of § 168 property that qualifies as residential rental property under § 103, or § 168 property used in a common area or provided as a comparable amenity to all residential rental units in the building.

### Construction Loan Costs

The Taxpayer's third-party costs and fees incurred in obtaining a construction loan are capitalized and amortized over the life of the loan. The Taxpayer's construction loan intangible is not subject to § 168 and therefore not includable in the Project's eligible basis. Section 263A requires the amortization deductions relating to the construction loan intangible be capitalized to the produced property during the construction period. The deductions must be reasonably allocated to all property produced. To the extent the amortization deductions are allocable under § 263A to the adjusted bases of § 168 property that qualifies as residential rental property under § 103 or § 168 property used in a common area or provided as a comparable amenity to all residential units in the building, the amortization deductions are includable in the Project's eligible basis under § 42(d)(1).

### Construction Contingency Costs

The Taxpayer has not provided any records that substantiate whether the construction contingency costs were in fact incurred. Further, there are no facts to adequately describe the nature of these costs. These questions of material fact must be resolved at the examination level before technical advice can be rendered.

### FACTS:

The Taxpayer is a State A limited partnership that was formed on a. The general partner of the Taxpayer is Gen Partner A, a State B limited partnership, with a b percent interest and the limited partner of the Taxpayer is Ltd Partner, a State C limited partnership, with a c percent interest. Gen Partner B, a State B corporation, is a general partner of Gen Partner A. The Taxpayer was formed for the sole purpose of constructing and operating the Project. The Taxpayer purchased the land for

construction of the Project on d. On e, the Taxpayer received a carryover allocation from Agency in the amount of f\_ in low-income housing credits under § 42 and began to develop the Project. The Taxpayer entered into a contract for construction of the Project, which was to consist of g units, with Contractor A. Gen Partner C is the general partner of Contractor A. Contractor A entered into a contract with Contractor B for the construction of the Project.

The Taxpayer included certain land preparation costs, costs for obtaining a construction loan, and construction contingency costs in the Project's eligible basis under § 42(d)(1).<sup>2</sup>

#### LAW AND ANALYSIS:

##### Eligible Basis

Section 42(a) provides that the amount of the low-income housing tax credit determined for any tax year in the credit period is an amount equal to the applicable percentage of the qualified basis of each low-income building. Section 42(c)(1)(A) defines the qualified basis of any qualified low-income building for any tax year as an amount equal to the applicable fraction, determined as of the close of the tax year, of the eligible basis of the building, determined under § 42(d)(5).

Section 42(c)(2) provides that the term "qualified low-income building" means, in part, any building to which the amendments made by section 201(a) of the Tax Reform Act of 1986 apply (the 1986 Act). Section 201 (a) of the 1986 Act modified property subject to the accelerated cost recovery system (ACRS) under § 168 for property placed in service after December 31, 1986, except for property covered by transition rules.

Section 42(d)(1) provides that the eligible basis of a new building is its adjusted basis as of the close of the first tax year of the credit period. Section 42(d)(4)(A) provides that, except as provided in § 42(d)(4)(B), the adjusted basis of any building is determined without regard to the adjusted basis of any property that is not residential rental property. Section 42(d)(4)(B) provides that the adjusted basis of any building includes the adjusted basis of property (of a character subject to the allowance for depreciation) used in common areas or provided as comparable amenities to all residential rental units in the building.

The legislative history of § 42 states that residential rental property, for purposes of the low-income housing credit, has the same meaning as residential rental property within § 103. The legislative history of § 42 further states that residential rental property thus includes residential rental units, facilities for use by the tenants, and other facilities reasonably required by the project. 2H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. 11-89 (1986), 1986-3 (Vol. 4) C.B. 89. Under § 1.103-8(b)(4) of the Income Tax Regulations, facilities that are functionally related and subordinate to residential rental units are considered residential rental property. Section 1.103-8(b)(4)(iii) provides that facilities that are functionally related and subordinate to residential rental units include facilities for use by the tenants, such as swimming pools and similar recreational facilities, parking areas, and other facilities reasonably required for the project. The examples given by § 1.103-8(b)(4)(iii) of facilities reasonably required for a project specifically include units for resident managers or maintenance personnel.

Based on the above, a cost is incurred in the construction of a low-income housing

building under § 42(d)(1) if it is:

(1) included in the adjusted basis of depreciable property subject to § 168 and the property qualifies as residential rental property under § 103, or

(2) included in the adjusted basis of depreciable property subject to § 168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building.

The Taxpayer contends that each state housing credit agency determines what costs are includable in eligible basis when determining the financial feasibility of a project under § 42(m)(2)(A). Consequently, the Taxpayer concludes that once Agency has verified and accepted the Taxpayer's costs, the Service is bound by the Agency's determination. We disagree.

Section 42(m)(2)(A) provides, in part, that the housing credit dollar amount allocated to a project shall not exceed the amount the housing credit agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project through the credit period. A state housing credit agency's responsibility under § 42(m)(2)(A) to determine the financial feasibility and viability of a project in no way abrogates the Service's authority and responsibility to administer the low-income housing tax credit and its various provisions.

The Taxpayer also cites Notice 88-116, 1988-2 C.B. 449, as authority for its position that all construction costs are costs includable in eligible basis. The Taxpayer's interpretation of Notice 88-116 is misplaced.

Notice 88-116, in part, provides guidance on what costs will be considered construction, reconstruction, or rehabilitation costs for the limited purpose of qualifying certain buildings for post-1989 credits after the (then) § 42(n) statutory sunset of a state's authority to allocate post-1989 credit. For this limited purpose, the notice provides that certain costs would satisfy the definition of construction, reconstruction or rehabilitation costs- but only if these costs are included in the eligible basis of the building. In other words, under the notice, a condition to qualifying a new building for post-1989 credit was that construction costs must also be included in eligible basis. The notice does not define what costs are included in eligible basis nor, as the Taxpayer proposes, does it stand for the proposition that all construction-related costs are included in eligible basis.

#### Land Preparation Costs

The Taxpayer incurred a variety of land preparation costs when constructing the Project which the Taxpayer included in the Project's eligible basis under § 42(d)(1). These costs included the following land surveys: boundary, topographic, mortgage, tree, architectural, ALTA, and recordation of the final plat. The Taxpayer also incurred costs for the following environmental surveys: percolation tests, soil borings, geotechnical investigations, contamination studies, suitability study, wetland reviews, mapping of wetland, inspection of wetland, wetland characterization, and groundwater investigation. Additionally, the Taxpayer incurred costs for soil and erosion control, earthwork and sitework, clearing and grubbing, fill dirt, and staking. Further, the Taxpayer incurred costs for the following engineering services: detailed construction drawing, erosion control plan, grading plan, utility plans, general details, easement descriptions, sewer and sanitary plans, and traffic engineering.

The following is a general discussion of when land preparation costs are depreciable and consequently may qualify for inclusion in eligible basis. Whether the Taxpayer's specific costs are includable in eligible basis will depend upon further factual development by the revenue agent.

Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business of the taxpayer, or of property held for the production of income.

Section 1.167(a)-2 provides that the depreciation allowance in the case of tangible property applies only to that part of the property which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence. The allowance does not apply to land apart from the improvements of physical development added to it.

Generally, the depreciation deduction provided by § 167(a) for tangible property is determined under § 168 by using the applicable depreciation method, the applicable recovery period, and the applicable convention. In the case of residential rental property, the applicable depreciation method is the straight line method (§ 168(b)(3)(B)), the applicable recovery period is 27.5 years (§ 168(c)), and the applicable convention is the mid-month convention (§ 168(d)(2)(B)). Land improvements, whether § 1245 property or § 1250 property, are included in asset class 00.3, Land Improvements, of Rev. Proc. 87-56, 1987-2 C.B. 674, 67:7, and have a class life of 15 years for the general depreciation system. Thus, for land improvements the applicable depreciation method is the 150 percent declining balance method (§ 168(b)(2)(A)), the applicable recovery period is 15 years (§ 168(c)), and the applicable convention is the half-year convention (§ 168(d)(1)).

The grading of land involves moving soil for the purpose of changing the ground surface. It produces a more level surface and generally provides an improvement that adds value to the land. Rev. Rul. 65-265, 1965-2 C.B. 52, clarified by Rev. Rul. 68-193, 1968-1 C.B. 79, holds that such expenditures are inextricably associated with the land and, therefore, fall within the rule that land is a nondepreciable asset. Rev. Rul. 65-265 further holds that excavating, grading, and removal costs directly associated with the construction of buildings and paved roadways are not inextricably associated with the land and should be included in the depreciable basis of the buildings and roadways. Accordingly, the costs attributable to the general grading of the land, not done to provide a proper setting for a building or a paved roadway, become a part of the cost basis of the land and, therefore, are not subject to a depreciation allowance. See *Algernon Blair, Inc. v. Commissioner*, 29 T.C. 1205 (1958), acq., 1958-2 C.B. 4. As such, the costs are not includable in eligible basis under § 42(d)(1).

Rev. Rul. 74-265, 1974-1 C.B. 56, involves the issue of whether landscaping for an apartment complex is depreciable property. The area surrounding the apartment complex was landscaped according to an architect's plan to conform it to the general design of the apartment complex. The expenditures for landscaping included the cost of top soil, seeding, clearing and grading, and planting of perennial shrubbery and ornamental trees around the perimeter of the tract of land and also immediately adjacent to the buildings. The replacement of these apartment buildings will destroy the immediately adjacent landscaping, consisting of perennial shrubbery and

ornamental trees.

This revenue ruling held that land preparation costs may be subject to a depreciation allowance if such costs are so closely associated with a depreciable asset so that it is possible to establish a determinable period over which the preparation will be useful in a particular trade or business. A useful life for land preparation is established if it will be replaced contemporaneously with the related depreciable asset. Whether land preparation will be replaced contemporaneously with the related depreciable asset is necessarily a question of fact, but if the replacement of the depreciable asset will require the physical destruction of the land preparation, this test will be considered satisfied. Accordingly, landscaping consisting of the perennial shrubbery and ornamental trees immediately adjacent to the apartment buildings is depreciable property because the replacement of the buildings will destroy the landscaping. However, the balance of the landscaping, including the necessary clearing and general grading, top soil, seeding, finish grading, and planting of perennial shrubbery and ornamental trees around the perimeter of the tract of land, is general land improvements that will be unaffected by the replacement of the apartment buildings and, therefore, will not be replaced contemporaneously therewith. Accordingly, these types of property are not depreciable property but rather are considered inextricably associated with the land and as such are not includable in eligible basis under § 42(d)(1).

Rev. Rul. 80-93, 1980-1 C.B. 50, involves the issue of whether a taxpayer is allowed to take a depreciation deduction for costs incurred in the construction of electrical and natural gas distribution systems and for land preparation costs incurred in connection with the development of a mobile home park. Regarding the distribution systems, the taxpayer made expenditures for the distribution systems, but the utility company retained full ownership of them and would repair and replace the systems as necessary. The taxpayer also incurred costs for the clearing, grubbing, cutting, filling, and rough grading necessary to bring the land to a suitable grade. In addition, the land preparation costs incurred in the digging and the rough and finish grading necessary to construct certain depreciable assets will not be repeated when the depreciable assets are replaced. However, the excavation and backfilling required for the construction of the laundry facilities and the storm sewer system are so closely associated with those depreciable assets that replacement of the depreciable assets will require the physical destruction of that land preparation.

This revenue ruling held that the land preparation costs (clearing, grubbing, cutting, filling, rough and finish grading, and digging) that are unaffected by replacement of the components of the mobile home park and will not be replaced contemporaneously therewith are nonrecurring general land improvement costs and, therefore, are considered to be inextricably associated with the land and are added to the taxpayer's cost basis in the land. These land preparation costs are not depreciable and, therefore, not includable in eligible basis under § 42(d)(1). However, the land preparation costs that are so closely associated with depreciable assets (laundry facilities and storm sewer system) such that the land preparation will be retired, abandoned, or replaced contemporaneously with those depreciable assets are capitalized and depreciated over the estimated useful lives of the assets with which they are associated. The amounts paid to the utility for the electrical and natural gas distribution systems are nonrecurring costs for betterments that increase the value of the land and are includable in the taxpayer's cost basis of the land. These costs likewise are not depreciable and not includable in eligible basis under § 42(d)(1).

In *Eastwood Mall, Inc. v. U.S.*, 95-1 USTC ¶50,236 (N.D. Ohio 1995), *aff'd* by unpublished disposition, 59 F.3d 170 (6th Cir. 1995), the issue before the court was whether the taxpayer, a developer, should depreciate the cost of reshaping land as part of the cost of a building. The court stated that costs for land preparation may or may not be depreciable depending on whether the costs incurred are inextricably associated with the land (nondepreciable) or with the buildings constructed thereon (depreciable). It further asserted that the key test for determining whether land preparation costs are associated with nondepreciable land or the depreciable building thereon is whether these costs will be reincurred if the building were replaced or rebuilt. Land preparation costs for improvements that will continue to be useful when the existing building is replaced or rebuilt are considered inextricably associated with the land and, therefore, are to be added to the taxpayer's cost basis in the land and are not depreciable. On the other hand, land preparation costs for improvements that are so closely associated with a particular building that they necessarily will be retired, abandoned, or replaced contemporaneously with the building are considered associated with the building and, therefore, are added to the taxpayer's cost basis in the building and are depreciable.

The cost of a land preparation inextricably associated with the land is added to a taxpayer's cost basis in the land and is not depreciable property. See Rev. Rul. 65-265; *Algernon Blair*; *Eastwood Mall*. Land preparation costs that are nonrecurring or that will continue to be useful when the related depreciable asset is replaced or rebuilt are considered to be inextricably associated with the land. See Rev. Rul. 80-93; *Eastwood Mall*. However, the cost of a land preparation inextricably associated with a particular depreciable asset (for example, an apartment building) is added to a taxpayer's cost basis in that depreciable asset and is depreciable property. The cost of a land preparation that is so closely associated with a particular depreciable asset that the land preparation will be retired, abandoned, or replaced contemporaneously with that depreciable asset is considered inextricably associated with the depreciable asset. See Rev. Rul. 74-265; Rev. Rul. 80-93; *Eastwood Mall*.

In applying this standard, the issue of whether a land preparation will be retired, abandoned, or replaced contemporaneously with a particular depreciable asset is a question of fact.

In the present case, further factual development is needed to determine whether each land preparation cost at issue is so closely associated with a particular depreciable asset (for example, building) that the land preparation will be retired, abandoned, or replaced contemporaneously with that depreciable asset. This test is satisfied if it is reasonable to assume the replacement of the depreciable asset will require the actual physical destruction of the land preparation. See Rev. Rul. 74-265. It is irrelevant that a state housing credit agency may require a taxpayer to incur a particular land preparation cost (for example, the planting of trees on the perimeter of the tract of land). Similarly, it is irrelevant that an ordinance may require a taxpayer to incur a particular land preparation cost (for example, tree preservation or endangered species survey).

Under these guidelines, the costs of clearing, grubbing, and general grading to prepare a site suitable for any type of structure are inextricably associated with the land and are added to the cost of land and, therefore, are not depreciable. Similarly, costs incurred for fill dirt that is used to raise the level of the site are considered to be inextricably associated with the land and, therefore, are not depreciable.

Therefore, the costs are not includable in eligible basis under § 42(d)(1). However, earth-moving costs incurred for digging spaces and trenches for a building's foundation and utilities generally are considered to be inextricably associated with the building and are added to the cost of the building and, therefore, are depreciable. Similarly, costs incurred for fill dirt that is used to set the foundation of a depreciable asset generally are considered to be inextricably associated with the related depreciable asset and, therefore, are depreciable.

Land and environmental surveys are generally conducted over the entire property of the development, not just where the buildings and improvements will specifically be placed. Some surveys, such as boundary or mortgage surveys, help to define the property whereas other surveys, such as percolation tests and contamination studies, are used to determine if the improvements can properly be built on the site. Costs incurred for the former type of survey are clearly related to the land itself and are inextricably associated thereto and, therefore, are not depreciable and not includable in eligible basis under § 42(d)(1). The latter type of survey is performed on the land to determine its suitability for supporting the improvements to be constructed thereon. If this type of survey will not necessarily need to be redone contemporaneously when the depreciable improvement is replaced, the costs incurred for the survey are inextricably associated with the land and, therefore, are not depreciable and not includable in eligible basis under § 42(d)(1). A survey is considered to be redone contemporaneously with the replacement of the depreciable improvement if the physical replacement of the depreciable improvement mandates a reperformance of the survey. Although an ordinance may require reperformance of the survey, such requirement is irrelevant as to whether the physical replacement of a depreciable improvement necessarily mandates a reperformance of the survey.

If a cost of land preparation is associated with both nondepreciable property (for example, land) and depreciable property (for example, building), the cost should be allocated among the nondepreciable property and depreciable property using any reasonable method. For example, if staking costs are incurred to demarcate a variety of items related to the development of the project and such items may be depreciable improvements (for example, sidewalks) and nondepreciable improvements (for example, landscaping not immediately adjacent to a building), the staking costs should be allocated among the depreciable and nondepreciable assets. Similarly, if engineering services are performed partly for nondepreciable assets and partly for depreciable assets, the cost of such services should be allocated among the nondepreciable and depreciable assets.

The Taxpayer's main argument as to why the land preparation costs should be depreciable property is that without construction of the buildings and other infrastructure for the project, none of these expenses would have been incurred. However, the court in *Eastwood Mall* specifically denounced this argument as being incorrect. The court noted that in almost every instance, some costs—whether it be the cost of moving a single tree or the larger costs of raising a site—will be incurred in preparing the land for the construction of the building. The court further noted that under the taxpayer's argument, all costs incurred in preparing a site are depreciable and that the only situation where land preparation costs would not be depreciable is where nothing is constructed on the land. The court stated that "[t]his interpretation is illogical and contrary to the law." *Eastwood Mall*, at para. 9. Juxtaposing the Taxpayer's main argument with the argument made by the taxpayer in *Eastwood Mall*, the arguments are the same. Thus, the Taxpayer's main argument is without merit.

The Taxpayer further asserts that some of the land preparation costs may need to be redone if the building was replaced due to possible changes in applicable ordinances. The court in *Eastwood Mall* stated that "land preparation costs for improvements that are so closely associated with a particular building that they necessarily will be retired, abandoned, or replaced contemporaneously with the building are considered associated with the building." *Eastwood Mall*, at para. 12. See also Rev. Rul. 74-265 and Rev. Rul. 80-93. The Taxpayer's argument, however, does not satisfy the test that the costs necessarily will be replaced contemporaneously with the building. The fact that an ordinance may require a taxpayer to incur a particular land preparation cost does not mean that it thereby is considered to be inextricably associated with a building.

Based upon the above, once a land preparation cost is determined to be depreciable, that cost may be included in eligible basis to the extent it is treated as part of the adjusted basis of § 168 property that qualifies as residential rental property under § 103, or § 168 property used in a common area or provided as a comparable amenity to all residential rental units in the building.

#### Construction Loan Costs

The Taxpayer incurred two separate and distinct loans in connection with the Project. The first loan was a construction loan which was closed with Bank on h. The costs associated with the loan include closing costs, service charges, professional fees, title costs, loan origination, interest rate lock-in, commitment, mortgage taxes, documentary stamps, title insurance, and endorsement costs. The proceeds of the loan were used for the construction of the Project. The Taxpayer included the costs in the Project's eligible basis under § 42(d)(1). The second loan occurred in i with Lender. This permanent financing occurred after the completion of the Project. None of the costs associated with the permanent loan were included in the Project's eligible basis under § 42(d)(1).

Costs incurred in obtaining a loan are capitalized and amortized over the life of the loan. See *Enoch v. Commissioner*, 57 T.C. 781, 794-5 (1972), aeq. on this issue, 1974-2 C.B. 2. See also Rev. Rul. 70-360, 1970-2 C.B. 103, Rev. Rul. 75-172, 1975-1 C.B. 145, and Rev. Rul. 81-160, 1981-1 C.B. 312. Accordingly, the Taxpayer's third-party costs and fees incurred in obtaining a construction loan for the Project are not capitalized to depreciable property, but are treated as an amortizable §167 intangible.

Only property subject to §168 is included in eligible basis under §42(d)(1). However, to the extent some of the amortization deductions relating to the construction loan are capitalized under §263A to the produced property and the produced property is subject to § 168, some of the amortization deductions indirectly may qualify for inclusion in the Project's eligible basis.

Section 263A generally requires direct costs and an allocable portion of indirect costs of real or tangible personal property produced by a taxpayer to be capitalized to the property produced.

Costs subject to § 263A capitalization are discussed in § 1.263A-1(e). In § 1.263A-1(e)(3)(i) indirect costs are defined as all costs that are not direct costs (in the case of produced property). All such costs must be capitalized under § 263A if the costs

are properly allocable to the produced property. Costs are properly allocable when the costs directly benefit or are incurred by reason of the performance of production activities. A nonexclusive list of indirect costs to be capitalized is provided in § 1.263A-1(e)(3)(ii) and included in this list are depreciation, amortization, and cost recovery allowances on equipment and facilities. Section 1.263A-1(e)(3)(ii)(I).

Section 1.263A-1 (f) discusses various cost allocation methods that can be used to allocate direct and indirect costs to produced property. For example, a taxpayer can use the specific identification method (Section 1.263A-1 (f)(2)), the burden rate and standard cost methods (Section 1.263A-1(f)(3)(i) and (ii)) and any other reasonable method (Section 1.263A-1 (f)(4)). Whichever method is used to allocate costs to the produced property, the method selected must satisfy the requirements of § 1.263A-1 (f)(4).

Section 263A(g) defines produce as including constructing, building, installing, manufacturing, developing, or improving. See also § 1.263A-2(a)(1)(i).

The Taxpayer is producing real property within the meaning of § 263A. The Taxpayer owns the underlying land and constructs on the land the housing areas as well as common areas. Further, the Taxpayer improves the land by installing items such as sidewalks and curbs and by landscaping.

The Taxpayer's intangible asset consists of third-party costs and fees incurred in obtaining a loan that was used to fund construction activities. These costs would not have been incurred by the Taxpayer but for its housing construction activities. Thus, the costs were incurred by reason of the production of property and are properly allocable to the property as indirect costs.

Section 263A requires that the costs that are capitalized be reasonably allocated to the property produced. Section 1.263A-1 (f)(4) describes when an allocation method will be judged reasonable. The Taxpayer has capitalized all of its costs to the buildings in the Project it constructed and has failed to allocate any of these costs to the other property it was producing. Whether the Taxpayer's method is reasonable depends on the Taxpayer's facts and circumstances and thus, this decision is best left for the revenue agent. However, the costs for obtaining a construction loan relate to the land acquired as well as the land improvements, in addition to the buildings. Further, the property being produced includes land, land improvements, and the buildings. Thus, a reasonable allocation method would allocate the amortization deductions among all of the produced property using some reasonable basis. To the extent the amortization deductions are allocable under § 263A to the adjusted bases of § 168 property that qualifies as residential rental property under § 103 or § 168 property used in a common area or provided as a comparable amenity to all residential units in the building, the amortization deductions are includable in the Project's eligible basis under § 42(d)(1).

#### Construction Contingency Costs

The Taxpayer included j in the final cost certification to the Agency for construction contingency. According to the revenue agent, this figure is an estimate and relates to possible construction overruns. The Taxpayer has not provided any records that substantiate costs for this estimate demonstrating that they were in fact incurred. Further, there are no facts to adequately describe the nature of these costs. The Taxpayer included the amount in the Project's eligible basis under § 42(d)(1).

Consequently, this issue lacks sufficient factual development to determine whether such costs are includable in eligible basis under § 42(d)(1).

CAVEAT:

No opinion is expressed as to whether the Project otherwise qualifies for the low-income housing tax credit under § 42. A copy of this technical advice memorandum is to be given to the Taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.

\*\*\*\*\*1. This test does not exclude the application of other requirements that affect eligible basis under § 42. For example, the cost for constructing a parking area would qualify under this test. However, this cost would not be permitted in eligible basis if a separate fee were charged for use of the area. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. 11-90 (1986), 1986-3 (Vol. 4) C.B. 90.\*\*\*\*\*

\*\*\*\*\*2. The facts relevant to these issues are subject to disagreement between the Taxpayer and the District Director's office. Pursuant to § 10.03 of Rev. Proc. 2000-1, I.R.B. 73, 86, the national office, if it chooses to issue technical advice, will base that advice on facts provided by the district office.\*\*\*\*\*