INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

October 9, 2001

Number: **200203014**
Release Date: 1/18/2002
Index (UIL) No.: 7805.05-00; 42.04-00
CASE MIS No.: TAM-132020-01/CC:PSI:B5

Industry Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer =

Project =

City =

State =

Agency =

Developer 2 =

x =

y =

ISSUE:

Whether Taxpayer's requested relief under § 7805(b)(8) of the Internal Revenue Code should be granted and TAM 200043017 (July 14, 2000) (TAM) be applied without retroactive effect.

CONCLUSION:

Taxpayer's requested relief under § 7805(b)(8) is denied.

FACTS:

Taxpayer is a State limited partnership that owns the Project, a City low-income housing project that contains x residential rental units. The Project, for which the initial developer was replaced by another, was constructed in y. Taxpayer received from the Agency an allocation of low-income housing credits under § 42. Taxpayer included certain partnership syndication and formation costs, land preparation costs, developer fees, construction loan costs, and rent-up costs in the Project's eligible basis under § 42(d)(1). Technical advice was requested on whether these costs were includable in eligible basis for the low-income housing credit.

The TAM concludes that–

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.

With respect to specific partnership syndication and formation costs, land preparation costs, developer fees, construction loan costs, and rent-up costs considered, the TAM concludes that–

(1) if Developer 2 engaged in organizational or syndication activities relating to and on behalf of the Taxpayer, then the corresponding percentage of the developer fees paid by the Taxpayer should be treated as nondeductible expenses incurred in either the organization or syndication of the partnership under § 709(a), and would not be includable in eligible basis under § 42(d)(1);

(2) 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;

(3) amounts paid to developers for services in acquiring the land should not be includable in eligible basis. The principles relating to the land preparation fees in the conclusion above are applicable. Therefore, to the extent the costs relate to the land, the costs are not includable in eligible basis under § 42(d)(1);

(4) 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); and

(5) rent-up costs are not related to the construction of the buildings, but for the securing of tenants. Consequently, these costs do not establish or add to the basis of depreciable property subject to § 168. Thus, rent-up costs are not includable in eligible basis under § 42(d)(1).

Taxpayer has requested that relief under § 7805(b)(8) be extended to it and that the TAM be applied without retroactive effect. Taxpayer asserts that it should be granted § 7805(b)(8) relief because it relied upon Agency's award of credits pursuant to § 42(h) that included the costs at issue. Taxpayer states that it and its partners relied on the Agency's credit allocation, based upon an analysis of the financial feasibility of the Project, to proceed with development and investment in the Project. Taxpayer states that it followed the past practices of the developer and others in the industry in treating the costs, which treatment was certified by an international accounting firm. Retroactive application the TAM would cause irreparable damage and jeopardize the viability of the Project.

In addition, Taxpayer alleges that the conclusions in the TAM are the equivalent of regulatory rules, and because rules issued under the rule-making procedures normally apply prospectively, the TAM should also be prospective.

LAW AND ANALYSIS:

Section 7805(b)(8) provides an administrative procedure for prescribing the extent to which any ruling or regulation relating to the internal revenue laws shall be applied without retroactive effect.

Section 18.01 of Revenue Procedure 2001-2, 2001-1 I.R.B. 79, 105, permits a § 7805(b)(8) request on a technical advice memorandum subsequent to its issuance. A request to limit the retroactive effect of a technical advice memorandum must explain the reasons and arguments in support of the relief sought and include a discussion of the five items enumerated in § 17.06 of Rev. Proc. 2001-2 as they relate to the taxpayer's situation. Section 18.03(3) of Rev. Proc. 2001-2, at 106. These five items are the conditions for nonretroactive application of a technical advice memorandum that modifies or revokes a letter ruling or another technical advice memorandum.

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, Taxpayer concludes that once the Agency has verified and accepted Taxpayer's costs, the Service is bound by the Agency's determination.

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.

Taxpayer asserts that the conclusions in the TAM are equivalent to interpretative rules, and in keeping with the procedures on rule-making, the TAM should be applied prospectively. Technical advice is advice or guidance furnished, upon request, in response to any technical or procedural question that develops during any proceeding, such as the examination of a taxpayer's return, on the interpretation and proper application of the tax law, tax treaties, or regulations, revenue rulings, notices, or other precedents published by the national office to a specific set of facts. Technical advice helps Service personnel close cases and also helps establish and maintain consistent holdings throughout the Service. Section 2 of Rev. Proc. 2001-2, 2001-1 I.R.B. at 84. The TAM is not to be used for precedential purposes in other cases under § 6110(k)(3). The position of the Service is not established by a technical advice memorandum, rather, it is restricted to those interpretations that have been adopted as position of the Service by publication in the Internal Revenue Bulletin. Chief Counsel's Directive Manual (39)1.5.1; also see 2001-1 I.R.B. Introduction.

In the present case, Taxpayer did not rely on any income tax regulation, revenue ruling, notice, or revenue procedure explicitly addressing whether the costs under the facts presented in the TAM are includable in eligible basis under § 42(d). Taxpayer did

not rely on a previously issued private letter ruling or technical advice memorandum covering the issues which might form a basis for § 7805(b)(8) relief. See § 17 of Rev. Proc. 2001-2, 2001-1 I.R.B. 79, 104. Taxpayer relied on its own interpretation of the law in determining its eligible basis. A taxpayer's erroneous interpretation of the law is not a basis for relief under § 7805(b)(8).

Accordingly, Taxpayer's arguments do not support nonretroactive application of the TAM under § 7805(b)(8).

CAVEATS

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.