Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Refer Reply To:
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Date: September 30, 2004

LEGEND

Taxpayer =

Buyer =

Building =

City =

General Partner =

GP1 =

GP2 =

Limited Partner =

LP1 =

LP2 =

LP3 =

Original Buyer =

a =

b =

State 1

c =

d =

e =

f =

g =

State 2 =

h =

x =

xx =

xxx =

i =

j =

Year 1 =

k =

Month 1

L =

m =

xxxx =

n =

o =

s =

p =

q =

r =

t =

State 3 =

u =

v =

w =

y =

z =

Year 2 =

State 4 =

Dear :

This letter responds to your letter dated May 17, 2004, and subsequent submission on behalf of Taxpayer requesting a ruling that, for purposes of § 42(d)(2)(B)(ii) of the Internal Revenue Code, there is a period of 10 years between the date on which Building is expected to be acquired and the date Building was last placed in service. The Internal Revenue Service Office that will have examination jurisdiction over Taxpayer is located in City.

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

FACTS

On a, Taxpayer and Original Buyer entered into a purchase and sale agreement in which Taxpayer agreed to sell and Original Buyer agreed to buy all right, title and interest of Taxpayer in Building, subject to certain terms and conditions. On b, Original Buyer assigned to Buyer all of Original Buyer's rights, title and interest to and under the sale agreement.

Buyer intends to convert Building into a low-income housing project, and to rehabilitate, own and manage Building so that it will qualify for low-income housing credits under § 42. Consequently, Buyer agreed to consummate the purchase of Building contingent upon Taxpayer receiving a favorable ruling from the Internal Revenue Service that, for purposes of § 42(d)(2)(B)(ii), there is a period of at least 10

years between the date Building is expected to be acquired by Buyer and the date Building was last placed in service.

Taxpayer is a State 1 limited partnership formed for the purpose of developing, owning and operating Building. At least since c, Taxpayer has owned Building in fee simple absolute, and operates and rents Building's d apartments to various tenants for rental income.

On e, GP1 and GP2 each held a .5-percent partnership interest in Taxpayer, and served as Taxpayer's co-general partners. GP1 also was designated as Taxpayer's tax matters partner.

On f, GP1 and GP2 formed General Partner and became its only shareholders and two of its three directors. Among the assets that GP1 and GP2 transferred to General Partner at the time of formation was their aggregate 1 percent of general partnership interest in Taxpayer. Consequently, on g, GP1 and GP2 withdrew from serving as co-general partners of Taxpayer, and General Partner was appointed as the sole general partner and tax matters partner of Taxpayer. Thus, since g, General Partner has been the general partner and tax matters partner of Taxpayer.

The remaining 99 percent of partnership interest in Taxpayer was held, on e, by LP1 as a limited partner. LP1 was a State 2 limited partnership formed for the purpose of acquiring, among other things, all of the limited partnership interest in Taxpayer. By purchase agreement dated h, LP1 agreed to purchase all of the limited partnership interest in Taxpayer for $x.

At the time of the closing of the h purchase agreement, and in consideration for the 99-percent limited partnership interest in Taxpayer, LP1 paid $xx, and issued to all prior holders of the limited partnership interest in Taxpayer a non-recourse negotiable note in the principal amount of $xxx. Payments of principal and interest under the note were secured, in part, by LP1's newly acquired 99-percent limited partnership interest in Taxpayer. The note's original maturity date was i. However, the note's maturity date was extended twice, ultimately to j. In addition, the note was amended to name GP1 and GP2 as the note's sole payees.

In Year 1, GP1 and GP2 formed Limited Partner and became its only shareholders and directors. Pursuant to a consolidation agreement dated as of k, among the assets that GP1 and GP2 transferred to Limited Partner was the note for $xxx. Thus, as of k, Limited Partner became the note's sole payee.

In Month 1, in an initial public offering of its common stock, Limited Partner sold to the public L shares of its common stock. At the same time, GP1 and GP2 also sold a cumulative m shares of Limited Partner's common stock. The net proceeds, after deducting for all offering expenses that Limited Partner received as a result of this offering was approximately $xxxx. Upon the completion of the offering, GP1 and GP2

remained the owners, in the aggregate, of an approximately n percent interest of Limited Partner's then outstanding stock, and the shares of Limited Partner were traded on the NASDAQ National Market.

On j, when the note for $xxx matured, LP1 defaulted on its payment obligation under the note. Consequently, Limited Partner foreclosed on the note, and, in full satisfaction thereof, took possession of LP1's 99-percent limited partnership interest in Taxpayer, effective as of o. Immediately thereafter, on the same day, Limited Partner sold and assigned to LP2 the 99-percent limited partnership interest in Taxpayer.

Pursuant to a sale and assignment agreement between LP2 and Limited Partner dated as of o, in addition to acquiring from Limited Partner the 99-percent limited partnership interest in Taxpayer, LP2 acquired from Limited Partner various interests in seven other partnerships otherwise unrelated to Taxpayer for a total aggregate purchase price of $s. Thus, as of o, LP2 owned a 99-percent limited partnership interest in, and was the sole limited partner of, Taxpayer. On its Form 1065, U.S. Return of Partnership Income, for the taxable year ended p, Taxpayer made an election under § 754 and § 1.754-1 of the Income Tax Regulations to adjust the basis of its property pursuant to §§ 734(b) and 743(b).

At the time that LP2 acquired from Limited Partner the 99-percent limited partnership interest in Taxpayer, LP2 was a shareholder in Limited Partner, owning less than a q percent interest of Limited Partner's then outstanding stock. LP2 also held various debt instruments issued by Limited Partner in an aggregate amount exceeding $r, was in a joint venture with Limited Partner in connection with the ownership of t senior living communities located in State 3, and was a limited partner (directly or by attribution) in various other partnerships organized by Limited Partner or predecessors of Limited Partner.

On u, Limited Partner filed with the United States Bankruptcy Court for the District of State 2 a voluntary petition for protection under Chapter 11 of Title 11 of the United States Code. This bankruptcy case lasted almost 3 years, during which Limited Partner entered into settlement agreements with various claim holders. Some of the settlement agreements were intended to minimize significant additional professional fees and delays in Limited Partner's ability to make distributions to its creditors, and various agreements were placed under seal by an order of the United States Bankruptcy Court.

Subsequent to its bankruptcy filing, Limited Partner started to negotiate with LP2 the terms of a settlement agreement between them. Upon the death of LP2, on v, the negotiations continued with LP3, the estate of LP2. On w, Limited Partner and LP3 reached a settlement agreement that was approved by the United States Bankruptcy Court on y. Under the settlement agreement, LP3 agreed, among other things, to transfer to Limited Partner the 99-percent limited partnership interest in Taxpayer. The actual transfer was consummated as of z, when LP3 transferred the 99-percent limited

partnership interest in Taxpayer to a wholly-owned second tier limited liability company of Limited Partner that is disregarded as an entity separate from its owner pursuant to § 301.7701-3. Thus, as of z, Limited Partner has been, for federal income tax purposes, the sole limited partner of Taxpayer.

Taxpayer also makes the following representations concerning Building:

1) Buyer intends to acquire Building from Taxpayer by a "purchase" as defined in §179(d)(2);

2) Taxpayer is not a person whose relationship to Original Buyer and/or Buyer would result, pursuant to § 179(d)(2)(A), in the disallowance of losses under § 267;

3) Neither Original Buyer nor Buyer are members with Taxpayer in the "same controlled group" within the meaning of § 179(d)(2)(B);

4) Building was not previously placed in service by either Original Buyer or Buyer or by any person who was a related person with respect to Original Buyer or Buyer as of the time previously placed in service;

5) Buyer intends to incur rehabilitation expenditures, within the meaning of § 42(e)(1), in an amount that exceeds the minimum rehabilitation threshold with respect to Building;

6) There has been no transfer other than the transfers described in the above facts;

7) Building has been continuously occupied and used in a trade or business at all times at least since Year 2;

8) Building has not been the subject of "non qualified substantial improvement" within the meaning of § 42(d)(2)(D)(i);

9) Buyer has applied to the State 4 Housing Finance Authority for an allocation of low-income housing tax credits with respect to Building; and

10) Within the last 11 years, Taxpayer's partnership agreement has not been amended to change the relative interest of the partners in the partnership.

RULING REQUESTED

Taxpayer requests the Service to rule that, for purposes of § 42(d)(2)(B)(ii), there is a period of at least 10 years between the date that Building is expected to be acquired by Buyer and the date Building was last placed in service.

LAW AND ANALYSIS

Section 38(a) provides for a general business credit against tax that includes the amount of the current year business credit. 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 the amount of the low-income housing credit for any taxable year in a 10-year compliance period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

Section 42(b) provides, in part, that the term “applicable percentage” means the appropriate percentage prescribed by the Secretary for the month applicable under § 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 the 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 new buildings that are federally subsidized for the taxable year and existing buildings (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 (i) applicable fraction (determined as of the close of the taxable year) of (ii) the eligible basis of the building (determined under § 42(d)).

Section 42(d)(2)(A) provides that the eligible basis of an existing building is (i) in the case of a building that meets the requirements of § 42(d)(2)(B), its adjusted basis as of the close of the first year of the credit period, and (ii) zero in any other case. Section 42(d)(2)(B) provides that a building meets the requirements of § 42(d)(2)(B) if (i) the building is acquired by purchase (as defined in § 179(d)(2)), (ii) there is a period of at least 10 years between the date of its acquisition by the taxpayer and the later of (I) the date the building was last placed in service, or (II) the date of the most recent nonqualified substantial improvement of the building, (iii) the building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service, and (iv) except as provided in § 42(f)(5), a credit is allowable under § 42(a) by reason of § 42(e) with respect to the building.

Section 42(d)(2)(D)(ii)(I) provides that, for purposes of determining when a building was last placed in service under § 42(d)(2)(B)(ii), there shall not be taken into account any placement in service in connection with the acquisition of the building in a transaction in which the basis of the building in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such building in the hands of the person from whom acquired.

Section 708(a) provides that a partnership shall be considered as continuing if it is not terminated. Section 708(b)(1)(B) provides that, for purposes of § 708(a), a partnership shall be considered terminated if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

Section 1.708-1(b)(1)(i) provides that upon the death of one partner in a 2-member partnership, the partnership shall not be considered as terminated if the estate or other successor in interest of the deceased partner continues to share in the profits or losses of the partnership business.

Section 1.708-1(b)(4) provides that if a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership, either for the continuation of the business by the new partnership or for its dissolution and winding up.

Section 1.708-1(b)(5) provides that if a partnership is terminated by a sale or exchange of an interest in the partnership, a § 754 election (including a § 754 election made by the terminated partnership on its final return) that is in effect for the taxable year of the terminated partnership in which the sale occurs, applies with respect to the incoming partner. Therefore, the bases of partnership assets are adjusted pursuant to §§ 743 and 755 prior to their deemed contribution to the new partnership.

Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time.

Section 754 provides that if a partnership files an election in accordance with regulations prescribed by the Secretary, the basis of partnership property is adjusted, in the case of a distribution of property, in the manner provided in § 734, and, in the case of a transfer of partnership interest, in the manner provided in § 743. Such an election shall apply with respect to all distributions of property by the partnership and to all transfers of interest in the partnership during the taxable year with respect to which the election was filed and all subsequent taxable years.

Section 743(b) provides that, in the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which an election under § 754 is in effect shall (1) increase the adjusted basis of the partnership property by the excess of the basis to the transferee partner of the transferee partner's interest in the partnership over the transferee partner's

proportionate share of the adjusted basis of the partnership property, or (2) decrease the adjusted basis of the partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of the transferee partner's interest in the partnership.

Specified Transfers

Under the preceding described facts, there are four specified transfers of 99-percent limited partnership interests that Taxpayer seeks to assure will not be taken into account for purposes of determining under § 42(d)(2)(B)(ii) when Building was last placed into service. The four specified transfers include; (1) the o transfer from LP1 to Limited Partner, (2) the o transfer (via sale) by Limited Partner to LP2, (3) the transfer by LP2 to LP3 following the death of LP2, and (4) the transfer by LP3 to Limited Partner pursuant to the settlement agreement approved by the United States Bankruptcy Court.

On o, Limited Partner acquired LP1's 99-percent limited partnership interest in Taxpayer by means of foreclosure. This resulted in a technical termination of Taxpayer under § 708(b)(1)(B). As a result, and pursuant to § 1.708-1(b)(4), Taxpayer was deemed to have contributed Building to a new partnership (i.e., New Partnership 1) in exchange for an interest in New Partnership 1, and, immediately thereafter, distributed its interest in New Partnership 1 to General Partner and Limited Partner in proportion to their respective interests in Taxpayer in liquidation of Taxpayer for the continuation of Building's operation by New Partnership 1. In addition, pursuant to § 1.708-1(b)(5), because an election was in effect under § 754 with respect to the o transfer from LP1 to Limited Partner of LP1's 99-percent limited partnership interest in Taxpayer, the adjusted basis of Building was adjusted under § 743 while still in the hands of LP1 and prior to the deemed contribution by Taxpayer of Building to New Partnership 1. As a result of Taxpayer's deemed contribution of Building to New Partnership 1, under § 723, the adjusted basis of Building in the hands of New Partnership 1 was the same (carryover basis) as the adjusted basis of Building in the hands of Taxpayer. This satisfies the exception of § 42(d)(2)(D)(ii)(I) with the result that the transfer of LP1's 99-percent limited partnership interest in Taxpayer to Limited Partner is not taken into account for purposes of determining under § 42(d)(2)(B)(ii) when Building was last placed into service.

Immediately following the above transfer that resulted in the § 708(b)(1)(B) termination of Taxpayer, and also on o, Limited Partner sold its 99-percent limited partnership interest in New Partnership 1 to LP2. This resulted in a technical termination of New Partnership 1 under § 708(b)(1)(B). As a result, and pursuant to § 1.708-1(b)(4), New Partnership 1 was deemed to have contributed Building to a new partnership (i.e., New Partnership 2) in exchange for an interest in New Partnership 2, and, immediately thereafter, distributed its interest in New Partnership 2 to General Partner and LP2 in proportion to their respective interests in New Partnership 1 in liquidation of New Partnership 1 for the continuation of Building's operation by New Partnership 2. In addition, pursuant to § 1.708-1(b)(5), because an election was in

effect under § 754 with respect to the o transfer from Limited Partner to LP2 of the 99-percent limited partnership interest in New Partnership 1, the adjusted basis of Building was adjusted, under § 743, while still in the hands of New Partnership 1 and prior to the deemed contribution by New Partnership 1 of Building to New Partnership 2. As a result of New Partnership 1's contribution of Building to New Partnership 2, under § 723, the adjusted basis of Building in the hands of New Partnership 2 was the same (carryover basis) as the adjusted basis of Building in the hands of New Partnership 1. This satisfies the exception of § 42(d)(2)(D)(ii)(I) with the result that the sale by Limited Partner to LP2 of its 99-percent limited partnership interest in New Partnership 1 is not taken into account for purposes of determining under § 42(d)(2)(B)(ii) when Building was last placed into service.

On v, LP2 died. LP2's 99-percent limited partnership interest in New Partnership 2 was transferred to LP2's estate, LP3. LP3 continued to share in the profits and/or losses of New Partnership 2 with a 99-percent limited partnership interest, while General Partner continued to maintain a 1 percent interest in New Partnership 2. Under § 1.708-1(b)(1)(i), New Partnership 2 is not considered as terminated as a result of the transfer from LP2 to LP3 of its 99-percent limited partnership interest in New Partnership 2. Also, the transfer of LP2 to LP3 of its 99-percent limited partnership interest in New Partnership 2 is not a sale or exchange for purposes of § 1.708-1(b)(2). Accordingly, the transfer of the 99-percent limited partnership interest is not taken into account for purposes of determining under § 42(d)(2)(B)(ii) when Building was last placed into service.

On z, pursuant to a settlement agreement approved by the United States Bankruptcy Court, LP3 transferred its 99-percent limited partnership interest in New Partnership 2 to a wholly-owned second tier limited liability company of Limited Partner that Taxpayer represents is disregarded as an entity separate from its owner pursuant to § 301.7701-3. Thus, as of z, Limited Partner became, for federal income tax purposes, the sole limited partner of New Partnership 2. This resulted in a technical termination of New Partnership 2 under § 708(b)(1)(B). As a result, and pursuant to § 1.708-1(b)(4), New Partnership 2 was deemed to have contributed Building to a new partnership (i.e., New Partnership 3) in exchange for an interest in New Partnership 3, and, immediately thereafter, distributed its interest in New Partnership 3 to General Partner and Limited Partner in proportion to their respective interests in New Partnership 2 in liquidation of New Partnership 2 for the continuation of Building's operation by New Partnership 3. As a result, under § 723, the adjusted basis of Building in the hands of New Partnership 3 was the same (carryover basis) as the adjusted basis of Building in the hands of New Partnership 2. This satisfies the exception of § 42(d)(2)(D)(ii)(I) with the result that the transfer by LP3 to Limited Partner of its 99-percent limited partnership interest in New Partnership 2 is not taken into account for purposes of determining under § 42(d)(2)(B)(ii) when Building was last placed into service.

Based solely upon the above facts and Taxpayer's representations we rule that, as regards the four specified transfers described above, for purposes of § 42(d)(2)(B)(ii), there is a period of at least 10 years between the date that Building is expected to be acquired by Buyer and the date Building was last placed in service.

No opinion is expressed or implied regarding the application of any other provision in the Code or regulations. Specifically, no opinion is expressed or implied regarding whether Taxpayer's costs of acquisition and rehabilitation of the Building will otherwise qualify for the low-income housing credit under § 42.

This ruling is directed only to the Taxpayer which requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter should be filed with the federal income tax return for Taxpayer and its partners for the first taxable year in which the low-income housing credit for Building is claimed.

Sincerely yours,

/s/ Susan Reaman

Susan Reaman
Chief, Branch 5
Office of Associate
Chief Counsel
(Passthroughs and Special
Industries)

Enclosure:
6110 copy

cc: