Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:5 – PLR-154953-07
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June 09, 2008

LEGEND

Taxpayer =

CDC =

Holdings =

Sub1 =

Bank 1 =

Bank 2 =

Partnership =

State =

a =

b =

c =

d =

Dear :

This responds to your letter dated February 14, 2008, and subsequent correspondence, submitted on behalf of Taxpayer, requesting a ruling that low-income housing tax credits derived through Partnership will not be subject to recapture under § 42(j) of the Internal Revenue Code as a result of (1) the proposed sale by Bank 2 of its interest in Partnership to Bank 1, and (2) the subsequent contribution by Bank 1 to CDC of Bank 1's newly acquired interest in Partnership. The relevant facts as represented in your submissions are set forth below.

FACTS

Taxpayer is a corporation organized and existing under the laws of State. Taxpayer is the common parent of an affiliated group of corporations that file a Federal consolidated tax return. Taxpayer and its subsidiaries are accrual basis, calendar-year taxpayers.

Taxpayer has more than a subsidiaries, owned directly or indirectly, that provide through its subsidiaries ("Taxpayer Subsidiaries") interests in various partnerships, limited partnerships, and limited liability companies. Some of the limited partnerships and limited liability companies (the "LIHC Partnerships") invest directly in low-income buildings, or are partners or members in other partnerships or limited liability companies that own low-income buildings (the "Project Partnerships"). Through its ownership of interests in the LIHC Partnerships and the indirect ownership of interests in the Project Partnerships, Taxpayer estimates that it has an interest in hundreds of buildings qualifying for the low-income housing tax credit. The LIHC Partnerships allocate low-income housing tax credits to Taxpayer and Taxpayer Subsidiaries on Schedule K-1 (Form 1065).

Holdings, a wholly-owned subsidiary of Taxpayer, is the majority (b percent) owner of Bank 1. The minority owners of Bank 1 are Taxpayer (c percent) and several other subsidiaries of Taxpayer. CDC is a wholly-owned subsidiary of Taxpayer. Taxpayer would like to transfer its CDC stock to Bank 1 through pro-rata contributions of d percent of the stock of CDC to the owners of Bank 1 followed by contributions of d percent of the stock of CDC from the owners of Bank 1 to Bank 1.

Bank 2 is a wholly-owned subsidiary of Sub 1, which is a wholly-owned subsidiary of Holdings. Bank 2 would like to transfer its interest in Partnership, a low-income housing credit partnership, to CDC following the contribution of CDC to Bank 1. Bank 2 has more than a 50 percent interest in Partnership.

To achieve Taxpayer's desired ownership structure, Bank 2 proposes to sell its interest in Partnership to Bank 1 at fair market value. Bank 1 proposes to then contribute its newly acquired interest in Partnership to its subsidiary, CDC.

Taxpayer makes the following representations. First, the principal business purpose of the proposed transactions is to centralize ownership of the low-income housing partnership interest in CDC to increase efficiency and reduce the current administrative burden of holding low-income housing partnerships in numerous entities. Second, CDC intends to hold the interest in Partnership for the same purposes that Bank 2 originally held it. Third, Bank 1 intends to be the sole owner of CDC. Fourth, with respect to the Partnership interests that will be sold to Bank 1 and contributed to CDC, the basis of the interest in Partnership in the hands of CDC will be determined in whole or in part by reference to the basis of the interest in the hands of Bank 1. Fifth, Bank 1, Bank 2, and CDC will be members of the same affiliated group during the consolidated return year in which the proposed transactions (and dispositions) occur. Sixth, the effect of the proposed transactions will clearly reflect the taxable income and tax liability of the group as a whole, and will not have the effect of creating, accelerating, avoiding, or deferring consolidated taxable income or consolidated tax liability. Seventh, there is no intention to dispose of an interest in a building qualifying for the § 42 credit during the compliance period under § 42, either by disposing of the interest itself or by disposing of the interest indirectly (e.g., by disposing of an interest in an entity that, directly or indirectly, owns the interest). Eighth, The mere change in form requirements of conducting a trade or business under § 1.47-3(f)(1) will be satisfied with respect to any section 38 property that is subject to recapture due to its being held by partnerships that will technically terminate under § 708(b)(1)(B) as a result of the contemplated sale by Bank 2 and contribution by Bank 1.

RULING REQUESTED

Taxpayer requests a ruling that (1) the proposed sale by Bank 2 of its interest in Partnership to Bank 1, and (2) the subsequent contribution by Bank 1 to CDC of Bank 1's newly acquired interest in Partnership, will not result in recapture under § 42(j).

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, for purposes of section 38, the amount of the low-income housing credit determined under § 42 for any taxable year in a 10-year credit period shall be 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 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, and (ii) 30 percent of the qualified basis of existing buildings, and of new buildings that are federally subsidized for the taxable year.

Section 42(c) provides that the qualified basis of any qualified low-income building for any taxable year is an amount equal to the applicable fraction (defined in § 42(c)(1)(B)) of the eligible basis of such building. In general, under § 42(d) the eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period.

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 such basis as of the close of the preceding taxable year, 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).

The legislative history to § 42 provides that, generally, any change in ownership of a low-income building during the compliance period is a recapture event and that all dispositions of ownership interests in buildings are treated as transfers for purposes of recapture. See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., II-96 and II-102 (1986), 1986-3 (Vol.4) C.B. 1, 96, 102. Under § 42(j)(6), however, no recapture will be imposed on a disposition of a low-income building (or an interest therein) 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. A taxpayer may satisfy the bond posting requirement of § 42(j)(6) by completing a portion of Form 8693, Low-Income Housing Credit Disposition Bond, and having it approved by the Internal Revenue Service.

Little guidance is available to illustrate when, under § 42(j), 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, analogous provisions concerning recapture of investment credit (ITC) property provide relevant guidance for determining recapture under § 42(j).

Under § 50(a)(1), if during any taxable year ITC property is disposed of or otherwise ceases to be ITC property with respect to the taxpayer before the close of the recapture period, the tax for such taxable year shall be increased. Currently, there are no regulations under § 50. However, for property placed in service before January 1, 1991, former § 47(a)(1) (and the regulations thereunder) contained a similar ITC recapture rule. The regulations under former § 47 (which are still effective) mirror the general recapture rule of former § 47 that a disposition or cessation of ITC property before the close of the estimated useful life of the property that was taken into account in computing the taxpayer's qualified investment will result in ITC recapture. However, there are a number of exceptions to the general rule concerning the recapture of ITC property. For example, § 1.47-6(a)(2) of the Income Tax Regulations provides a de minimis rule that permits a partner to dispose of up to 33-1/3 percent of its proportionate interests in the general profits of a partnership (or in a particular item of section 38 property) before ITC recapture applies.

Rev. Rul. 90-60, 1990-2 C.B. 6, adopts a similar de minimis rule for purposes of § 42(j) whereby no bond is required to avoid or defer recapture for a disposition by a partner of its interest in a low-income building held through a partnership (to which § 42(j)(5)(B) does not apply) until the partner has disposed of more than 33-1/3 percent of its greatest total interest in the building held through the partnership.

Also regulation § 1.47-3(f)(1) (reflected now, in part, in § 50(a)(4)) provides an exception to ITC recapture in the case of a mere change in form of conducting a trade or business. To qualify for the § 1.47-3(f)(1) exception, the following requirements must be met:

(1) the ITC property must be retained as ITC property in the same trade or business;

(2) the transferor (or in the case where the transferor is a partnership, the partner) of the ITC property must retain a substantial interest in the trade or business,

(3) substantially all the assets (whether or not ITC property) necessary to operate the trade or business must be transferred to the transferee to whom the ITC property is transferred, and

(4) the basis of the ITC property in the hands of the transferee is determined in whole or in part by reference to the basis of the ITC property in the hands of the transferor.

Regulation § 1.47-3(f)(2) provides that a transferor is considered as having retained a substantial interest in a trade or business only if, after the change in form, the 'transferor's retained interest in the trade or business is substantial in relation to the total interest of all persons or is equal to or greater than the transferor's interest prior to the change in form.

Section 351(a) provides that no gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in the corporation and immediately after the exchange the person or persons are in control (as defined in § 368(c)) of the corporation. Under § 368(c), the term "control" means the ownership of stock possessing at least 80 percent of the total number of shares of all other classes of stock of a corporation. Section 362(a) provides that if property is acquired by a corporation in connection with a transaction to which § 351 applies, the basis of the property is the same as it was in the hands of the transferor, increased by the amount of any gain recognized by the transferor on the transfer.

Rev. Rul. 64-155, 1964-1 C.B. 138, provides, in part, that a contribution of property by a corporation to a wholly owned subsidiary, although not resulting in the issuance of additional stock to the contributing corporation, is an exchange of property for stock under § 351 of the Code.

Rev. Rul. 81-38, 1981-1 C.B. 386, provides, in part, that the transfer of a 50-percent interest in a partnership to a wholly owned corporation in a transaction qualifying under § 351 of the Code is an exchange terminating the partnership under § 708(b)(1)(B).

Regulation § 1.1502-3(f)(2)(i) provides generally that during a consolidated return year a transfer of section 38 property (which includes ITC property) from one member of an affiliated group to another member of the group during a consolidated return year is not treated as a disposition within the meaning of former § 47(a)(1).

Rev. Rul. 75-245, 1975-1 C.B. 6 involves the sale of a corporate partner's partnership interest to a member of the corporate partner's affiliated group during a consolidated return year. The revenue ruling relies on regulation § 1.1502-3(f)(2)(i) in finding an exception to the recapture provisions of former § 47(a)(1). The revenue ruling concludes that § 1.1502-3(f)(2)(i) was intended to prevent recapture for transfers of section 38 property between members of an affiliated group, and that no recapture occurred under the circumstances.

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)(4) provides, in part, 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 it 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. Under § 723, the new partnership takes a basis in the old partnership's property equal to the adjusted basis such property had in the hands of the old partnership (i.e., carryover basis).

For a partnership to which § 42(j)(5)(B) does not apply, a § 42 recapture event can occur at the partnership level and also at the partner level. A recapture event can occur at the partnership level, for example, if a partnership disposes of a building upon which a § 42 credit has been allowed. Recapture liability (if any) would be the responsibility of the partners in the partnership at the time of the disposition. A recapture event can apply at the partner level, for example, if a partner disposes of more than 33-1/3 percent of its greatest total interest in any § 42 buildings held through the partnership.

Proposed sale by Bank 2 to Bank 1

In the present case, the proposed sale of Bank 2's entire interest in Partnership to Bank 1 is a disposition of more than 33-1/3 percent of Bank 2's greatest total interest in any § 42 buildings held through Partnership, and thus a recapture event.

Taxpayer has represented that Bank 1, Bank 2, and CDC will be members of the same affiliated group during the consolidated return year in which the dispositions will occur and that there is no intent to dispose of an interest in a building qualifying for the § 42 credit during the compliance period under § 42, either by disposing of the interest itself or by disposing of the interest indirectly (e.g., by disposing of an interest in an entity that, directly or indirectly, owns the interest).

Based on the analogous recapture provision under former § 47(a) and the analogous application of § 1.1502-3(f)(2)(i) of the regulations, which is intended to prevent recapture of ITCs for transfers of section 38 property between members of an affiliated group, the proposed sale of Bank 2's entire interest in Partnership (and underlying § 42 property held by Partnership) to Bank 1 will not be treated as a disposition of § 42 property resulting in recapture of § 42 credits under § 42(j).

Bank 2's sale of its interest in Partnership to Bank 1 will also result in a § 708(b)(1)(B) technical termination of Partnership. A technical termination of a partnership is a disposition under § 42 and thus, a recapture event. However, Bank 2's sale of its entire interest in Partnership to Bank 1 will occur prior to the technical termination of Partnership. Thus, any recapture consequences resulting from the technical termination of Partnership do not apply to Bank 2. However, recapture consequences may apply to Bank 1 because Bank 1 is a member of Partnership immediately prior to Partnership's technical termination.

The potential recapture consequences under § 42 resulting from the technical termination of Partnership occur from two, almost simultaneous dispositions. The first disposition is the contribution by Partnership of its assets and liabilities to a new partnership resulting from the technical termination. The second disposition is the subsequent liquidation by Partnership of its partnership interests in the new partnership to its partners, which include Bank 1. While the contribution of Partnership's assets and liabilities to the new partnership is one disposition, and the subsequent liquidation by Partnership of its partnership interest in new partnership is another disposition, because they occur almost simultaneously, they will be treated as one disposition for purposes of this ruling.

Taxpayer has represented that the mere change in form requirements of conducting a trade or business under regulation §1.47-3(f)(1) will be satisfied with respect to any section 38 property that is subject to recapture due to the technical termination of Partnership resulting from the contemplated sale of Bank 2's interest in Partnership to Bank 1. Assuming the requirements of § 1.47-3(f) are met, no ITC recapture liability to Partnership will result from the disposition of section 38 property resulting from the § 708(b)(1)(B) technical termination of Partnership, and Bank 1, who is a partner in Partnership at the time of the disposition, will also not be subject to ITC recapture. We believe it appropriate in this case to analogize the § 1.47-3(f) exception for ITC recapture to the determination of recapture under § 42(j). Therefore, based on the analogous application of § 1.47-3(f), no recapture liability under § 42(j) will apply to Partnership and Bank 1 as a result of the disposition of § 42 property occasioned by the § 708(b)(1)(B) technical termination of Partnership.

Proposed contribution by Bank 1 to CDC

The analysis that applies to the proposed sale of Bank 2's interest in Partnership to Bank 1 also applies to the proposed contribution of Bank 1's entire interest in Partnership (as continued under § 708(a)—hereinafter referred to as "New Partnership

1") to CDC. Bank 1's contribution is a disposition of more than 33-1/3 percent of Bank 1's greatest total interest in any § 42 buildings held through New Partnership 1, and thus a recapture event.

Taxpayer has represented that Bank 1, Bank 2, and CDC will be members of the same affiliated group during the consolidated return year in which the dispositions will occur and that there is no intent to dispose of an interest in a building qualifying for the § 42 credit during the compliance period under § 42, either by disposing of the interest itself or by disposing of the interest indirectly (e.g., by disposing of an interest in an entity that, directly or indirectly, owns the interest).

Based on the analogous recapture provision under former § 47(a) and the analogous application of § 1.1502-3(f)(2)(i) of the regulations, the proposed contribution of Bank 1's entire interest in New Partnership 1 (and underlying § 42 property held by New Partnership 1) to CDC will not be treated as a disposition of § 42 property resulting in recapture of § 42 credits under § 42(j).

Bank 1's contribution of its interest in New Partnership 1 to CDC will also result in a § 708(b)(1)(B) technical termination of New Partnership 1. A technical termination of a partnership is a disposition under § 42 and thus, a recapture event. However, Bank 1's contribution of its entire interest in New Partnership 1 to CDC will occur prior to the technical termination of New Partnership 1. Thus, any recapture consequences resulting from the technical termination of New Partnership 1 do not apply to Bank 1. However, recapture consequences may apply to CDC because CDC is a member of New Partnership 1 immediately prior to New Partnership 1's technical termination.

The potential recapture consequences resulting from the technical termination of New Partnership 1 occur from two, almost simultaneous dispositions. The first disposition is the contribution by New Partnership 1 of its assets and liabilities to a new partnership (hereinafter referred to as "New Partnership 2") resulting from the technical termination. The second disposition is the subsequent liquidation by New Partnership 1 of its partnership interest in New Partnership 2 to its partners, which include CDC. While the contribution of New Partnership 1's assets and liabilities to New Partnership 2 is one disposition, and the subsequent liquidation by New Partnership 1 of its partnership interest in New Partnership 2 is another disposition, because they occur almost simultaneously, they will be treated as one disposition for purposes of this ruling.

Taxpayer has represented that the mere change in form requirements of conducting a trade or business under regulation §1.47-3(f)(1) will be satisfied with respect to any section 38 property that is subject to recapture due to the technical termination of New Partnership 1 resulting from the contemplated contribution of Bank 1's interest in New Partnership 1 to CDC. Assuming the requirements of § 1.47-3(f) are met, no recapture liability to New Partnership 1 will result from the disposition of section 38 property resulting from the § 708(b)(1)(B) technical termination of New Partnership 1, and CDC, who is a partner in New Partnership 1 at the time of the disposition, will also not be subject to ITC recapture. We believe it appropriate in this case to analogize the § 1.47-3(f) exception for ITC recapture to the determination of recapture under § 42(j). Therefore, based on the analogous application of § 1.47-3(f), no recapture liability under § 42(j) will apply to New Partnership 1 and CDC as a result of the disposition of § 42 property occasioned by the § 708(b)(1)(B) technical termination of New Partnership 1.

Accordingly, based solely on the representations and relevant law as set forth above, we rule that the dispositions occasioned by the (1) proposed sale by Bank 2 of its interest in Partnership to Bank 1, and (2) subsequent contribution by Bank 1 to CDC of Bank 1's newly acquired interest in Partnership, will not result in recapture under § 42(j).

Except as specifically set forth above, no opinion is expressed concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations. Specifically, no opinion is expressed or implied regarding the application of §§ 50, 708, and 1502, or whether Taxpayer or any partnership owning § 42 property in which the Taxpayer owns a direct or indirect interest (either before or after the proposed transactions) qualifies for the low-income housing credit under § 42, or whether any other requirement of § 42 is met. In addition, we express no opinion whether Taxpayer's specific representations concerning whether the conditions set forth in § 1.47-3(f) for dispositions of section 38 property are met or whether the exception for early dispositions of section 38 property set forth in § 1.1502-3(f)(2) are met.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Taxpayer's authorized representative.

Sincerely,

/s/

Christopher J. Wilson
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: