IRC §42, Low-Income Housing Credit - Part IX Appendix

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Appendix A

Glossary of Terms

-A-

Accelerated Portion of the Credit: The excess of the aggregate allowable credit during the 10-year credit period under IRC §42 over the aggregate credit that would have been allowable ratably over the 15-year compliance period. IRC §42(j)(3).

Additions to Qualified Basis: Refers to increases in qualified basis after the end of the first year of the credit period because more residential rental units qualify as low-income units. If, as of the close of any table year in the 15 year compliance period (after the first year), the qualified basis of a low-income building exceeds the qualified basis as of the end of the first year of the credit period, then the applicable percentage used to compute the credit for the increase in qualified basis is two-thirds of the applicable percentage which would otherwise be applied. A rule similar to the special rule for the computation of the applicable fraction for the first year of the credit period is also applied. IRC §42(f)(3).

Annual Report by Taxpayer to the State Agency: See "Certification to State Agency."

Applicable Fraction: The portion of rental units that are qualified low-income units; determined as the smaller of the unit fraction or square footage fraction. IRC §§42(c) & 42(f). See "Unit Fraction" and "Floor Space Fraction."

Applicable Fraction, Special Rule First Year of the Credit Period: The applicable fraction for the first taxable year of the credit period is the sum of the applicable fractions as of the end of each full month of the first taxable year that the building was placed in service divided by 12.

Any credit not allowable for the first year of the credit period because of the special rule is allowable for the first year following the credit period; i.e., year 11 of the 15-year compliance period. IRC §42(f)(2).

Applicable Percentage: The percentage that will yield the amount of credit equal to the present value of either 70% or 30% of the qualified basis, depending on the characteristics of the housing. The discount factor is known as the applicable percentage and is based on interest rates. IRC §42(b).

Area Gross Median Income: Area median gross income (adjusted for family size) for IRC §42 purposes is consistent with the determination of estimates for median family income under section 8 of the United States Housing Act of 1937 (HUD section 8). Estimates are based on definitions of income that include some items of income that are not included in a taxpayer's gross income for purposes of computing federal income tax liability. Beginning in 2010, to accommodate the IRC §142(d)(2)(e) hold harmless rule when determining the area median gross income, HUD now refers to qualified residential rental projects under IRC §142(d) and qualified low-income housing projects under IRC §42 collectively as "Multi-family Tax Subsidy Projects" (MTSP) provides separate tables with income limits specifically calculated for MTSPs. Notice 1988-80, CCA 201046014, and IRC §42(g)(1).

Available Unit Rule: If the income of an existing tenant rises above a specified amount, the next available comparable unit in the building must be rented to an income-qualified tenant. Otherwise, the "over-income" unit ceases to be a low-income unit. IRC §42(g)(2)(D) and Treas. Reg. §1.42-15.

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Binding Commitment: A commitment by a state agency to allocate a specified credit amount beginning in a specified later year. The commitment must be made no later than the close of the calendar year in which the building is placed in service. IRC §42(h)(1)(C).

Building: A discrete edifice or other man-made construction consisting of an independent foundation, outer walls, and roof. A single unit which is not an entire building but is merely a part of a building is not a building or structure…as such, while single townhouses are not buildings if their foundation, outer walls, and roof are not independent, detached houses and row houses are buildings." Treas. Reg. §1.103-8(b)(8)(iv).

Building, Existing: Any building which is not a new building. IRC §42(i)(5).

Building Identification Number: A Building Identification Number (BIN) is assigned by the state agency to every building receiving an allocation of IRC §42 credit, or, as described in IRC §42(h) (4), financed with tax exempt bonds subject to the volume cap under IRC §146. BINs consists of a two character state designation (the postal state abbreviation) followed by a two digit designation identifying the year the credit is allocated, and a five digit numbering designation. The BIN is unique to the building and must be used for all allocations of credit. Notice 1988-91.

Building, Mixed Use: A building including (1) low-income and market rate residential rent units, (2) low-income residential rental units and commercial property, or (3) low-income and market-rate residential rental units, and commercial property.

Building, New: A building for which original use begins with the taxpayer. IRC §42(i)(4).

Building, Rehabilitated: The expenditures associated with rehabilitating an existing building. The expenditures are treated as a new building and do not include the cost of acquiring the building. IRC §42(e)(1) and (2).

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Carry-Over Allocation: An allocation of credit with respect to a qualified building which is placed in service not later than the close of the second calendar year following the calendar year in which the allocation is made. IRC §42(h)(1)(E) and Treas. Reg. §1.42-6.

Certificate of Occupancy: Document providing a description of the property and identifying the date the property is placed in service. In some locations it also describes zoning and the type of units.

Certification, Annual Report by Taxpayer to the IRS: Taxpayers file Form 8609-A, Annual Statement for Low-Income Housing Credit, Part I, with their tax returns for each year of the 15-year compliance period. IRC §42(l)(2)

Certification, First Year: Taxpayers are required to complete a certification with respect to the first year of the credit period. The certification is made by completing Part II of the Form(s) 8609 executed by the state agency to document the allocation of low-income housing credits. IRC §42(l)(1).

Certification to State Agency: The taxpayer is required to certify at least annually to the state agency that the project met specified requirements. Treas. Reg. §1.42-5(c).

Common Areas: Property in a residential rental project subject to depreciation and (1) used in common areas or (2) to provide comparable amenities to all the residential rental units in the building(s). IRC §42(d)(4)(B).

Community Service Facility: A qualified low-income project located in a qualified census tract, as defined in IRC §42(d)(5)(B)(ii), may include a community service facility designed to service primarily nonresident individuals whose income is 60% or less of the area median income. The facility must be subject to depreciation, the cost includable in eligible basis is limited to a percentage of the total eligible basis, and the facility must be used throughout the year as a community service facility. IRC §42(d)(4)(C).

Compliance Monitoring: A procedure used by state agencies to monitor qualified low-income buildings for noncompliance with IRC §42 requirements and reporting noncompliance to the IRS. IRC §42(m)(1)(B)(iii) and Treas. Reg. §1.42-5.

Compliance Period: To qualify for the credit, the taxpayer must provide low-income housing for fifteen years, which is known as the compliance period, beginning with the first taxable year of the credit period with respect to the building. IRC §42(i)(1).

Credit Ceiling: See Housing Credit Ceiling.

Credit Period: In exchange for the investment in low-income housing, the taxpayer will receive tax credits for each of ten years, which is known as the credit period. The credit period begins with the taxable year in which the building is placed in service or, at the election of the taxpayer (which is irrevocable), the succeeding taxable year, but only if the building is a qualified low-income building as of the close of the first year of such period. IRC §42(f)(1).

Credit Recapture Amount: See "Recapture Amount."

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Depreciation: A reasonable allowance for the exhaustion, wear and tear (including obsolescence) of property used in the trade of business of a taxpayer, or of property held for the production of income. IRC §§ 167, 168, and 179(d)(9).

Difficult to Develop Area: A subset of "high cost area." Any area designated by HUD as having high construction, land and utility costs relative to area median gross income. IRC §42(d)(5)(B)(iii)(I). Also, buildings designated by state agencies can be treated as located in a difficult to develop area as long as the building is not financed with tax-exempt bonds. IRC §42(d)(5)(B)(v).

Disproportionate Standards of Units: Generally, a low-income building's eligible basis is reduced by the portion attributed to residential rental units in the building that (1) are not low-income units and (2) are above the average quality standard of the low-income units. However, this reduction of eligible basis can be avoided under certain circumstance. IRC §42(d)(3).

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Extended Low-Income Housing Commitment ("Extended Use Agreement"): No credit is allowable for a taxable year unless the agreement is in effect as of the last day of such taxable year. The agreement is a contract entered into by the taxpayer (and binding on all subsequent owners) and the state agency, recorded in the land records, and enforceable under state law. The agreement must meet certain requirements under IRC §4(h)(6). The agreement is also commonly referred to an "extended use agreement" or "land use restriction agreement." IRC §42(h)(6).

Extended Use Period: The period of time that an extended low-income housing commitment is in effect, beginning on the first day in the compliance period and ending on the later of the date specified by the state agency in the commitment or the date which is 15 years after the close of the compliance period. There are exceptions if the building is acquired by foreclosure (or instrument in lieu of foreclosure) or if no buyer is willing to maintain the low-income status. Both exceptions are subject to certain restrictions. IRC §42(h) (6) (D) and (E).

Eligible Basis: The total costs (adjusted basis) associated with the depreciable residential rental property qualifying for the credit at the end of the first year of the credit period and without regard to any deduction for depreciation. If the building is located in a high cost area, the eligible basis may be increased to as much as 130% of the actual costs. IRC §§42(d) and 42(e).

Eviction: The act or process of legally dispossessing a person of land or rental property. A taxpayer owning an IRC §42 project and wishing to evict a tenant must comply with applicable state and/or local laws governing evictions. See also, Good Cause eviction and Lease, Nonrenewal. IRC §42(h)(6)(B)(i) and Rev. Rul. 2004-82, Q&A #5.

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Facility, Functionally Related: Facilities that are functionally related, and subordinate to, residential rental projects; e.g., swimming pools, parking lots and other facilities reasonably required for the project such as a resident manager's unit. Treas. Reg. §1.103-8(b)(4)(iii).

Federally Subsidized: A new building is treated as federally subsidized under IRC §42(b)(1) if, at any time during the taxable year or any prior taxable year, there is or was outstanding any obligation the interest on which is exempt from tax under IRC §103, the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof. IRC §42(i)(2). For new buildings placed in service before July 31, 2008, a "federally subsidized" building includes any below market Federal loan; i.e., any loan funded in whole or in part with federal funds if the interest rate payable on such loan is less than the applicable federal rate as of the date on which the loan was made. IRC §42(i)(2) prior to amendment by the Housing Assistance Tax Act of 2008.

Final Cost Certification: To ensure that the credit allocated to a project does not exceed the amount necessary to assure its feasibility and long-term viability, the state agency must evaluate the taxpayer's sources and uses of funds and the total financing planned for the project, the proceeds (capital contributions) expected to be generated by the tax benefits, the percentage of the housing credit dollar amount used for project costs other than the cost of intermediaries, and the reasonableness of the developmental and operational costs of the project. The evaluation is completed when the taxpayer applies for the credit, when the credit is allocated (usually a credit carryforward allocation) and again when the project is placed in service. This last evaluation is commonly referred to as the Final Cost Certification and is based on actual costs incurred through the end of the first year of the credit period IRC §42(m)(2) and Treas. Reg. §1.42-17(a)(5).

First Year Certification: See "Certification, First Year."

Floor Space Fraction: Method for computing the applicable fraction; i.e., the fraction for which the numerator is the total floor space of the low-income units in the building and the denominator of which is the total floor space of the residential rental units (whether or not occupied) in such building. IRC §42(c)(1)(D). See "Applicable Fraction."

Form 8610, Annual Low-Income Housing Credit Agencies Report: Annual report by each state agency to (1) transmit Forms 8609 issued during the year, reconcile the state's credit ceiling, and report completion of compliance monitoring requirements. IRC §42(l)(3)

Forms 8609, Low-Income Housing Credit Allocation and Certification: Part I is completed by state agencies to document the allocation of credit for a qualified low-income building. A copy is sent to the IRS with the state agency's annual report on Form 8610 and the original is sent to the building owner. The owner completes Part II of the form received from the state agency (with Part I executed) to document certain information and elections, and then makes a one-time filing to the IRS to complete the certification for the first year of the credit period. IRC §42(l)(1).

Form 8609-A, Annual Statement for Low-Income Housing Credit: Filed each year of the 15-year compliance period with the tax return for the taxpayer owning a low-income building. Part I satisfies the annual reporting requirement under IRC §42(l)(2) and Part II documents the computation of the allowable credit for the year. A separate Form 8609-A is filed for each allocation of credit; i.e., there is a one-to-one match of Forms 8609 issued by the state agency and Forms 8609-A filed by the taxpayer. IRC §42(l)(2).

Form 8610, Schedule A, Carryover Allocation of Low-Income Housing Credit: Documents the amount of credit allocated if the building(s) will be placed in service not later than the close of the second calendar year following the calendar year in which the allocation is made, or if the credit allocation is made on a project basis. IRC §42(h)(1)(E) and (F).

Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition: Submitted to the IRS by state agency to report noncompliance with IRC §42 requirements or dispositions of property (or interests therein). Treas. Reg. §1.42-5(e)(3).

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General Public Use: Rental units must be available for use by the general public, which includes rental in a manner consistent with fair housing policy governing nondiscrimination. A determination that a taxpayer violated fair housing policy governing nondiscrimination may result in the loss of credit. IRC §42(g)(9) and Treas. Reg. §1.42-9.

Good Cause Eviction: Determined by state or local law. Examples may include nonpayment of rent, violations of the lease or rental agreement, destruction or damage to the property, interference with other tenants or creating a nuisance, or using the property for an unlawful purpose. See "Eviction."

Grant, Federal: A low-income building's eligible basis cannot include any costs financed with the proceeds of a federally funded grant. IRC §42(d)(5)(A).

Gross Rent: The rent charged before required adjustments. IRC §42(g)(2)(B).

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High Cost Area: For any new building located in a qualified census tract or difficult to developer area, the eligible basis can be increased by up to 130% of the eligible basis otherwise determined. The same holds true for rehabilitation expenses treated as a new building under IRC §42(e). IRC §42(d)(5)(B).

Household, Low-Income: A household whose combined income is less than or equal to the percentage of area median gross income elected by the taxpayer for purposes of the minimum set-aside requirement. A household is composed of all the occupants of a residential rental unit unless specifically excluded, whether or not legally related. A household's income is compared to the appropriate percentage of the median family income for a family with the same number of members. Rev. Rul. 90-89 and IRC §42(g)(1).

Household, Student: A household composed entirely of full-time students is not considered a qualified low-income household unless the household is "excepted" by satisfying certain conditions. IRC §42(i)(3)(D).

Housing Credit Agency: Any state (or local) agency authorized to carry out IRC §42. "State" includes possessions of the United States. IRC §42(h)(8).

Housing Credit Ceiling: The IRC §42 credit available to a state for allocation by its housing agencies to qualified low-income buildings within the state. IRC §42(h)(3). Buildings financed by tax-exempt bonds are eligible for IRC §42 credit under specified conditions, but are not allocations that reduce the housing credit ceiling. IRC §42(h)(4).

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Imputed Income Limit: For purposes of restricting the rents under IRC §42(g)(2), an imputed income limitation is used. It is based on the number of bedrooms in the unit and uses the income limit that would apply if each separate bedroom was occupied by 1.5 individuals. For a unit that does not have a separate bedroom, one person is deemed to occupy the unit. IRC §42(g)(2)(C).

Income-Qualified Household: See Household, Low Income

Inspections by State Agency: Tenant records and the project are subject to physical inspection by the state agency. Treas. Reg. §1.42-5(c)(2).

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Lease, Nonrenewal: A taxpayer is not obligated to renew a lease or enter into a new lease with an existing low-income tenant, and failure to do so does not, per se, constitute an eviction without good cause. However, the taxpayer must provide timely notice that the lease will not be renewed as required under state law and be prepared to demonstrate, if challenged in state court, that the nonrenewal of a lease is not a "termination of tenancy" for other than good cause under IRC §42.

Low-Income Household: See "Household, Low Income."

Low-Income Housing Project: See "Project."

Low-Income Unit: Any unit in the building if the unit is rent-restricted, the individuals occupying the unit meet the income limitation applicable under IRC §42(g)(1), the unit is suitable for occupancy, and the unit is not used on a transient basis. IRC §42(i)(3).

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Market Study: A comprehensive market study of the housing needs of low-income individuals in the area to be served by a proposed IRC §42 project is conducted before the credit allocation. Generally, the developer pays for the study, which is completed by a disinterested party approved by the state agency. IRC §42(m)(1)(A)(iii).

Material Participation of Qualified Nonprofit Organizations: If the taxpayer received a credit allocation from the nonprofit set-aside, then the qualified nonprofit organization must materially participate in both the development and operation of the project throughout the 15-year compliance period. IRC 469(h) defines material participation as activity that is regular, continuous, and substantial. IRC §42(h)(5)(B). See "Nonprofit Set-Aside."

Maximum Qualified Basis: Credit allocated to buildings is not to exceed the amount necessary to ensure financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period. The state agency can limit the credit by specifying a "maximum qualified basis" less than the qualified basis that would otherwise be allowable on Form 8609 line 3a. Alternatively, the state agency can lower the applicable percentage, which is reflected on Form 8609 line 2. IRC §42(m)(2)(A).

Minimum Set-Aside: The housing project will not qualify for any credit unless it includes a minimum number of qualified low-income rental units. IRC §42(g)(1)

Mixed-Use Project: See Project, Mixed Use

Multifamily Tax Subsidy Projects (MTSP): HUD's designation for qualified residential rental projects under IRC §142(d) and qualified low-income housing projects under IRC §42 collectively. See also "Area Median Gross Income."

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National Pool: A state's unused housing credit carryover for any calendar year that is assigned to the IRS for reallocation among qualified states for the succeeding year. IRC §42(h)(3)(D) and Treas. Reg. §1.42-14(h)(2)(i).

Next Available Unit Rule: See Available Unit Rule.

Nonprofit Set-Aside: The portion of the state's housing credit ceiling set aside for projects involving qualified nonprofit organizations so that not more than 90 percent of the state's credit ceiling is allocated to projects not involving qualified nonprofit organizations. IRC §42(h)(5).

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Owner Certification: See "Certification to State Agency."

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Placed-in-Service Date: The placed-in-service date for a new or existing low-income building is the date on which the first unit in the building is certified as being suitable for occupancy in accordance with state or local law. Generally, this date is documented on the certificates of occupancy. The placed-in-service date for rehabilitation expenditures treated as a separate new building under IRC §42(e)(4)(A) is at the close of any 24-month period, over which such expenditures are aggregated. This placed-in-service date applies even if the building is occupied during the rehabilitation period. Notice 88-116.

Project: Each qualified low-income building is considered a separate project unless a taxpayer elects to treat the building as part of a multi-building project. The election is documented on Form 8609, Line 8b, with an attachment identifying all the buildings to be included in the project. Two or more qualified low-income buildings can be included in a project only if the buildings are: (1) located on the same tract of land, unless all of the dwelling units in all the buildings are low-income units (see IRC §42(g)(7)), (2) are owned by the entity for federal tax purposes, (3) are financed under a common plan of financing, and (4) have similarly constructed housing units. IRC §42(g)(3)(D) and Treas. Reg. §1.103-8(b)(4)(ii).

Project Based Allocation: An allocation of credit to a project without specifying the amount of credit allocated to specific qualified buildings within the project. IRC §42(h)(1)(F).

Project, Deep Rent Skewed: A low-income project financed with tax-exempt bonds and for which the taxpayer has elected

- 15% or more of the low-income units are occupied by individuals whose income is 40% or less of area median gross income,
- the gross rent for each low-income unit does not exceed 30% of the applicable income limit, and
- the gross rent for each low-income unit does not exceed one half of the average gross rent of units of comparable size which are not occupied by individuals who meet the applicable income limit. IRC §142(d)(4)(B).

Project, Mixed Use: A project composed of (1) low-income and market rate residential rent units, (2) low-income residential rental units and commercial property, or (3) low-income and market-rate residential rental units, and commercial property.

Project, Scattered Site: Buildings which would, but for their lack of proximity, be treated as a project shall be treated as a project if all the dwelling units in all the buildings are rent-restricted residential rental units. IRC §42(g)(7).

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Qualified Allocation Plan (QAP): State agencies are required to have a QAP in place for determining which housing projects should receive allocations of IRC §42 credits. The QAP must (1) identify the selection criteria to be used for determining housing priorities that are appropriate to local conditions, (2) give preference to projects serving the lowest income tenants, for the longest periods, and located in qualified census tracts and which will contribute to a concerted community revitalization plan, and (3) provide procedures that the agency or an agent or other private contractor of such agency) will follow in monitoring for noncompliance with IRC §42 through regular site visits and in notifying the IRS of such noncompliance. IRC §42(m)(1)(B) and Treas. Reg. §1.42-5.

Qualified Basis: The qualified basis of any qualified low-income building for any taxable year is an amount equal to the applicable fraction (determined at the end of such taxable year) of the eligible basis of such building. IRC §42(c)(1).

Qualified Basis, Increases in: See "Additions to Qualified Basis."

Qualified Census Tract: A subset of "high cost area." Any census tract designated by HUD and, for the most recent year for which census data are available on household income in such tract, for which either (1) 50% or more of the households have an income which is less than 60% of the area median gross income for such year or (2) has a poverty rate of at least 25%. IRC §42(d)(5)(B)(ii)(I). See "High Cost Area."

Qualified Contract: A bona fide contract to acquire (within a reasonable period after the contract is entered into) the building(s), both the non-low-income and low-income portions, after the end of the 15-year compliance period of the building(s) for an agreed upon purchase priced that meets prescribed requirements. IRC §42(h)(6)(F) and Treas. Reg. §1.42-18.

Qualified Low-Income Building: Any building which is part of a qualified low-income housing project at all times during the period beginning on the first day in the 15-year compliance period of which such building is part of the project and ending on the last day of the 15-year compliance period with respect to such building and the building is subject to depreciation under IRC §168. IRC §42(c)(2).

Qualified Nonprofit Organization: Any tax exempt organization qualified to receive a credit allocation from the nonprofit set-aside. IRC §42(h)(5)(C).

Qualified Low-Income Project: Any project for residential rental property if, as irrevocably elected by the taxpayer, (1) 20% or more of the residential rental units in the project are both rent restricted and occupied by individuals whose income is 50% or less of area median gross income, or (2) 40% or more of the residential rental units in the project are both rent restricted and occupied by individuals whose income is 60% or less of areas median gross income. See "Minimum Set-Aside." IRC §42(g)(1).

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Recapture Amount: The portion of the accelerated credit recaptured from each prior year of the 15-year compliance period plus interest at the overpayment rate (IRC 6621) on the recaptured accelerated credit. The interest portion of the recapture amount is computed for each prior year beginning on the due date for filing such tax return to the due date for filing the tax return for the year in which the recapture provisions were triggered. IRC §42(j)(2).

Recapture Percentage: The portion of credit allowable in prior years of the 15-year compliance period subject to recapture if the recapture provisions are triggered. The recapture percentage is 33.3% for years 2 through 11, 26.7% for year 12, 20.0% for year 13, 13.3% for year 14, and 6.7% for year 15. IRC §42(j)(2)(A) and General Explanation of the Tax Reform Act of 1986, H.R. 3838, 99th Congress; Public Law 99-514.

Records, Keeping and Retention: Taxpayers are subject to recordkeeping and record retention provisions specific to IRC §42. The records must be retained for at least six years after the due date (with extensions) for filing the federal income tax return for that year. The records for the first year of the credit period must be retained for at least six years beyond the due date (with extensions) for filing the federal income tax return for the last year of the compliance period of the building. Treas. Reg. §1.42-5(b) and Rev. Rul. 2004-82, Q&A #6. See Appendix E.

Rehabilitation Expenses: Amounts chargeable to capital account and incurred for property (or additions or improvements to property) of a character subject to depreciation in connection with the rehabilitation of a building. IRC §42(e)(2).

Rent Restricted: The rent paid by low-income households must be restricted; i.e., the rent cannot exceed 30 percent of the imputed income limit for that unit. IRC §42(g)(2).

Resident Manager's Unit: Residential rental unit occupied by a full-time resident manager and treated as a functionally related facility. The adjustment basis of a resident manager's unit is included in eligible basis, but the unit is excluded from the determination of the applicable fraction and the minimum set-aside. Treas. Reg. §1.103-8(b)(4)(iii) and Rev. Rul. 92-61.

Residential Rental Property: Generally, a residential rental project is a building or structure, together with any functionally related and subordinate facilities, containing one or more similarly constructed units. IRC §168(e)(2)(A) and Treas. Reg. §1.103-8(b)(4)(i).

Residential Rental Unit: Any accommodation containing separate and complete facilities for living, sleeping, eating, cooking, and sanitation. Such accommodations may be served by centrally located equipment, such as air conditioning or heating. Certain single-room occupancy units also qualify as residential rental units even though such housing may provide eating, cooking and sanitation facilities on a shared basis. Treas. Reg. §1.103-8(b)(4)(i) and IRC §42(i)(3)(B)(iv).

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Single Room Occupancy Unit (SRO): Residential rental units providing eating, cooking and sanitation facilities on a shared basis. SROs can qualify as low-income units. Treas. Reg. §1.103-8(b)(8)(i) and IRC §42(i)(3)(B)(iv).

State Housing Credit Agency: See "Housing Credit Agency."

Suitable for Occupancy: The housing must be suitable for occupancy. Consideration is given to the site, building exterior, building systems, dwelling units, and common areas. All areas and components of the housing must be free of health and safety hazards. IRC § 42(i)(3)(B), Treas. Reg. §1.42-5(d)(2), Instructions for Form 8823, and CCA 201042025.

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Tax Benefit Rule: The increase in tax under IRC §42(j)(1) for the credit recapture amount is increased only with respect to credits under IRC §42 which were used to reduce tax liability. Otherwise, the carry-forwards and carrybacks are appropriately adjusted. IRC §42(j)(4)(A).

Tax-Exempt Bond Project: A low-income housing project financed with loans financed through private activity bonds issued under IRC §146, and for which interest earned by the lender is exempt from federal taxation. IRC §142(d).

Termination of Tenancy: See "Eviction."

Transitional Housing for the Homeless: A unit is considered to be used other than on a transient basis if the unit contains sleeping accommodations and kitchen and bathroom facilities and is located in a building which is used exclusively to facilitate the transition of homeless individuals to independent living within 24 months, and in which a government entity or qualified nonprofit organization provides individuals with temporary housing and supportive services. IRC §§ 42(i)(3)(B)(iii) and 42(c)(1)(E).

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Unit Fraction: Method for computing the applicable fraction; i.e., the fraction for which the numerator is the number of low-income units in the building and the denominator of which is the number of residential rental units (whether or not occupied) in the building. IRC §42(c)(1)(C).

Unit, Low-Income: See "Low-Income Unit."

Unit, Market Rate: A residential rent unit for which the rent is not restricted.

Utility Allowance: A portion of the gross rent. If the tenant pays the utility cost directly to the utility provider, gross rent must include an allowance for the utility. IRC §42(g)(2)(B)(ii) and Treas. Reg. §1.42-10.

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Vacant Unit Rule: If a low-income unit becomes vacant, the taxpayer must make reasonable attempts to rent the unit before renting any units to tenants who are not income-qualified. Treas. Reg. §1.42-5(c)(1)(ix).

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Exhibit B References

Audit Technique Guides

Guide for Completing Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition - Training 23092-001 (Rev. 01-2011)

Chief Counsel Advisories

CCA 200134006. Treatment of Casualty Losses Under IRC §42(j)(4)(E). Chief Counsel addressed three points: (1) the meaning of "casualty loss" under IRC §42(j)(4)(E) should be consistent with generally accepted tax principles under IRC §165, (2) state housing credit agencies must, as required by Treas. Reg. §1.42-5(e)(3), report to the Service via Form 8823 any casualty loss that takes low-income property in whole or in part out of service and results in a reduction in qualified basis, and (3) there is no support for allowing property owners to continue to claim credits on units while the units are not in service because of a casualty event.

CCA 200137044. Clarifications of IRC §42(l)(1), Certification With Respect to 1st Year of Credit Period. Chief Counsel responded to five questions: (1) When is a building placed in service and how can this be documented? (2) Once a Form 8609 is first issued by an applicable allocating authority, can the taxpayer file an amended return to claim credits for taxable years in a building's compliance period prior to the issuance of the Form 8609? (3) If a taxpayer has claimed IRC §42 credits for any year prior to the issuance of the Form 8609, can all credits claimed prior to the issuance of the Form 8609 be disallowed? (4) Can a taxpayer satisfy the certification requirements of IRC §42(l) during the examination process? (5) If a revenue agent finds that the first year certification requirements of IRC §42(l)(1) have not been met, can the entire credit amount for the first and all successive years be disallowed?

CCA 200812023. Allocation of IRC §42 Tax Credits. The IRC §42 credit must be allocated among a partnership's partners in the same proportion as the actual allocations of the related depreciation deductions giving rise to the credit for the year.

CCA 200913012. Chief Counsel Advice regarding three casualty loss issues under IRC §42(j)(4)(E). (1) IRC §42(j)(4)(E) only provides recapture relief for casualty events; it does not provide the allowance of credits during the period of time that the building is being restored. (2) Regarding the relief provided in Rev. Proc. 95-28 and Rev. Proc. 2007-54, if the statute of limitations is closed, whether for the casualty event or credits claimed during the restoration period, and the taxpayer fails to restore the building, then the taxpayer's first open taxable year in the compliance period should be treated as the year of the taxpayer's reduction in qualified basis. (3) If a building is damaged by a casualty and fully restored and rented to low-income tenants within the same taxable year, or initiated continual and verifiable measures to rent restored vacant units to low-income tenants, then there is no recapture and no loss of credits.

CCA201042025. Suitability for Occupancy. (1) The suitable for occupancy requirement under IRC §42(i)(3)(B) does not have to be determined on a unit-by-unit basis if the facts exist that the condition of the exterior components of the building (e.g., wall, roof, etc.) are so poor as to lead to a factual determination that all the units in a building are not suitable for occupancy. (2) A violation of the HUD physical condition standard alone is sufficient for a violation of §42(i)(3)(B). However, a taxpayer, in response to the IRS finding a violation, may raise an affirmative defense by proving that local health, safety, or building codes address the specific point in question, and after application of the facts, local law reaches a taxpayer favorable result whereas the HUD standard does not reach a taxpayer favorable result.

CCA 201046014. Income Limits. Chief Counsel confirmed that the published 50% and 60% income limitations for the HUD section 8 program should be used to determine whether households are qualifying low-income households. IRC §142(d)(2)(B)(i), through IRC §42(g)(4), controls income limits for IRC §42(g)(1) purposes and the Secretary of Treasury (not the Secretary of HUD) that makes the determination of what income limitations control for IRC §42 purposes in a manner consistent with determinations of lower income limits under HUD section 8.

CCA 201106008. Treatment of TCAP Funds. Chief Counsel concluded that the TCAP grants are includible in a recipient's gross income for federal income tax purposes.

CCA 201136023. Application of Recapture Provisions of IRC §42(j)(1), considering Bentley Court II Limited Partnership v. Commissioner, T.C. Memo 2006-113 (Bentley). The recapture provisions of IRC §42(j)(1) apply if the Service's adjustment of a building's eligible basis under IRC §42(d) as a result of an audit of a taxable year subsequent to a closed taxable year results in a decrease in the qualified basis used to compute the credit. The Service may rely on the qualified basis as reported in a closed taxable year when applying the recapture provisions of IRC §42(j) (1).The Service may also recalculate the qualified basis in a closed taxable year in appropriate circumstances.

CCA 201146016. Foreclosure and Recapture. The termination of a building's extended use period under IRC §42(h)(6)(E)(i)(I) upon foreclosure (or instrument in lieu of foreclosure) does not result in automatic recapture of credits under IRC §42(j).

CCA 201352009. The failure to comply with the requirement of IRC §42(h)(5)(B) to maintain the involvement of a qualified nonprofit organization in the development and operation of the project (as of the close of a taxable year) is the disallowance of the credit for that taxable year. However, noncompliance with IRC §42(h)(5)(B) does not, in and of itself, result in an actual (or an imputed) decrease in the qualified basis of a building that results in recapture under IRC §42(j)(1). The taxpayer may claim the credit for the taxable year that the violation is corrected (assuming the taxpayer is otherwise eligible to claim credit for that taxable year).

Chief Counsel Advice dated June 2, 2014 (POSTN-111812-14). Charging resident managers, maintenance personnel, or security officers rents, utilities, or both for units in a qualified low-income building does not make the units residential rental units and not facilities reasonably required for the project under Treas. Reg. §1.103-8(b)(4)(iii). Whether or not the owner of the project charges rents, utilities, or both for the units are not relevant for treating the units as facilities that are reasonably required for the project. In other words, charging rents, utilities, or both for units occupied by resident managers, maintenance personnel, or security officers in a qualified low-income building does not make such units residential rental units for purposes of the applicable fraction. The character and size of the project are, among other things, relevant in determining whether any property, including an employee-occupied unit, is functionally related and subordinate to the project, as indicated by Treas. Reg. §1.103-8(a)(3).

Court Cases

Bentley - *Bentley Court II*, T.C. Memo 2006-113. See Appendix H.

Boyle – *United States v. Boyle, Executor of the Estate of Boyle,* 469 U.S. 241. See Appendix F.

Carp & Zuckerman – *Richard E. Carp and Minda G. Carp, and Franklin D. and Lois Zuckerman,*

Petitioners v. Commissioner of Internal Revenue, Respondent, T.C. Memo 1991-436. See Appendix I.

Corbin West – *Corbin West Limited Partnership, CDC Equity Corporation, Tax Matter Partner,*

Petitioner v. Commissioner of Internal Revenue, Respondent, T.C. Memo 1999-7. See Appendix G.

Eastwood Mall – Eastwood Mall, Inc. v. U.S., 95-1 USTC Paragraph 50,236 (N.D. Ohio 1995), aff'd by unpublished disposition, 59 F.3d 170 (Table) (6th Cir. 1995), the issue was whether the taxpayer, a developer, could 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 (non-depreciable) or with the buildings constructed thereon (depreciable).

It further asserted that the key test for determining whether land preparation costs are associated with non-depreciable land or the depreciable building thereon is whether these costs will be re-incurred 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. See Southern Natural Gas Co. v. United States [69–2 ustc ¶ 9473], 412 F.2d 1222, 1231 (Ct.Cl.1969); Rev. Rul. 74–265, 1974–1 C.B. 56; see also, A. Duda & Sons, Inc. v. United States [77–2 ustc ¶ 9678], 560 F.2d 669, 679 & n. 15 (5th Cir.1977); Rudolph Investment Corp. v. Commissioner [CCH Dec. 31,421(M)], 31 T.C.M. (CCH) 573, 578 (1972); 1 B. Bittker & L. Lokken, Federal Taxation of Income, Estates and Gifts, ¶ 23.2.5 at 23–34 (2d ed. 1989).

Housing Pioneers – Housing Pioneers, Inc. v. Commissioner, 58 F.3d 401 (9th Cir. 1995). See Appendix J. Von-Lusk – Von-Lusk v. Commissioner, 104 T.C. 207 (1995). The Court held that certain expenses incurred by a real estate developer before actual physical work began on undeveloped land are subject to IRC §263A. The Court found that the developer's activities, such as obtaining building permits and zoning variances, negotiating permit fees, and similar activities, represent the "first steps of the development of the property." The Court noted that the pursuit of building permits and zoning variances, negotiating permit fees, and similar activities "are ancillary to actual physical work on the land and are as much a part of a development project as digging a foundation or completing a structure's frame. The project cannot move forward if these steps are not taken."

Field Service Advisories

FSA 200125014 – Chief Counsel advised that IRC §6222(a) provides that a partner shall, on the partner's return, treat a partnership item in a manner which is consistent with the treatment of the partnership item on the partnership return. Under IRC §6222(c), if a partnership item is treated inconsistently on the partner's return, the IRS may assess any resulting deficiency without regard to the restriction on an assessment attributable to a partnership item under IRC §6225. A "true-up" under IRC §6222(a) is a type of computational adjustment. Because the provisions of IRC §6225 and 6211 do not apply, a true-up may be immediately assessed by the IRS.

Law and Legislative History

- Tax Reform Act of 1986 (P.L. 990154, 100 Stat. 100). Included enactment of IRC §42
- General Explanation of the Tax Reform Act of 1986, H.R. 3838, 99th Congress; Public Law 99-514. Commonly referred to as the "Blue Book," this document provides an in-depth discussion of the original implementation of IRC §42.

Notices

Notice 88-80; 1988-30 I.R.B. 28. Determination of Income for Purposes of IRC §42(g)(1). Income of individuals and area median gross income are made in a manner consistent with the determination of annual income and the estimates for median family income under section 8 of the United States Housing Act of 1937 (HUD section 8) and are not made by reference to items of income used in determining gross income for purposes of computing Federal income tax liabilities.

Notice 88-91; 1988-2 C.B. 414; 1988-36 I.R.B. 28. Additional Certification Requirements. Low-income buildings that have or will be allocated a low-income housing tax credit under IRC §42 must be assigned a building identification number (BIN) consisting of a two character state designation (identical to a postal state abbreviation) followed by a two digit designation representing the year the credit is allocated, and a five digit numbering designation.

Notice 88-116; 1988-2 C.B. 449; 1988-44 I.R.B. 22. Carryover of 1989 Credits for Certain Projects in Progress, Description of Construction, Reconstruction of Rehabilitation, Placed in Service. Notice discusses (1) what costs will be considered construction, reconstruction, or rehabilitation costs; (2) when such costs will be considered to be incurred, and (3) when a building will be considered to be placed in service for IRC §42 purposes.

Notice 94-47; 1994-1 C.B. 25. Debt/Equity Issues in Recent Financing Tractions. Upon examination, the Service will scrutinize instruments designed to be treated as debt for federal income tax purposes but as equity for regulatory, rating agency, or financial accounting purposes to determine if their purported status as debt for federal income tax purposes is appropriate. Of particular interest to the Service are instruments that contain a variety of equity features, including an unreasonably long maturity or an ability to repay the instrument's principal with the issuer's stock. Analysis of these instruments must take into account the cumulative effect of these features and other equity features.

Notice 2008-79; 2008 I.R.B. 726.Tax-Exempt Housing Bonds and 2008 Housing Legislation. Section 6 of the Notice provides list of military basis affected by §3005 of the 2008 Housing Act, which amends IRC §142(d)(2) to disregard basic housing allowance payments to military members at certain military basis for purposes of determining whether a household is income-qualified under IRC §§ 42 and 142.

Notice 2008-106; 2008-2 C.B. 1239; 2008-49 I.R.B. 1239. Applicable Percentage under Section 3002(A)(1) of the Housing Assistance Tax Act of 2008. Clarifies that the 9% applicable percentage floor for non-Federally subsidized new buildings that are placed in service after July 30, 2008, and before December 31, 2013, enacted pursuant to section 3002 of the Housing Assistance Tax Act of 2008, applies notwithstanding an irrevocable election by the taxpayer under former IRC §42(b)(2)(A)(ii) (now IRC §42(b)(1)(A)(ii), as amended by the Act) made on or before July 30, 2008.

Notice 2009-44; 2009-21 I.R.B. 1037. Low-Income Housing Credit. Clarifies that, under Treas. Reg. §1.42-10, the utility allowance regulations, utility costs paid by a tenant based on actual consumption in a sub-metered rent-restricted unit are treated as paid directly by the tenant for purposes of IRC §42(g)(2)(B)(ii).

Notice 2010-18; 2010-14 I.R.B. 525. American Recovery and Reinvestment Tax Act of 2009 Clarifications. Among the topics, the Notice clarifies that subawards of grants under §1602(c) of the American Recovery and Reinvestment Tax Act of 2009 are excluded from the gross income of recipients and are exempt from taxation. Neither the depreciable basis nor eligible basis of a qualified building is reduced by any §1602 grant.

Notice 2010-62; 2010-40 I.R.B. 411. Interim Guidance under the Codification of the Economic Substance Doctrine and Related Provisions of the Health Care and Education Reconciliation Act of 2010. Provides interim guidance regarding the economic substance doctrine under IRC §7701(o) and the related amendments to the penalties under IRC §§ 6662, 6662A, 6664, and 6676 by §1409 of the Health Care and Education Reconciliation Act of 2010 (Act), Pub. L. No. 111-152. The notice applies with respect to transactions entered into on or after March 31, 2010, which is the effective date for the amendments made by section 1409 of the Act.

Private Letter Rulings

PLR 200703024. As part of the ruling, it was concluded that the right of first refusal granted to tenants as part of a condominium home ownership plan to purchase their units after the close of the compliance period applicable to each unit satisfied the requirements of IRC §42(i)(7)(A).

PLR 200916007. Ruling that the taxpayer's costs for infrastructure improvements for a project were dedicated improvements within the meaning of IRC §263A and Treas. Reg. §1.263A-4(d)(8)(iv) and, therefore, not capitalizable as amounts paid to create an intangible under Treas. Reg. §1.263(a)-4(d)(8)(i). The costs to construct the dedicated infrastructure improvements were indirect costs within the meaning of Treas. Reg. §1.263A-1(e)(3)(i) for purposes of IRC §263A and were capitalizable to the bases of the project's residential rental buildings, using a reasonable allocation method under Treas. Reg. §1.263A-1(f) to allocate the costs amount the residential rental buildings. Assuming that the project's residential rental buildings would be depreciated as residential rental property under IRC §168, the ruling concluded the eligible basis of the project's residential rental buildings under IRC §42(d)(1) includes the cost of the infrastructure improvements. The PLR cites Rev. Rul. 2002-9 as part of its analysis.

PLR 201049018. Ruling concluded, based on the taxpayer's representations and relevant law, that the redemption of all or any portion of the bonds used to satisfy the 50% test of IRC §42(h)(4)(B) after the project has been placed in service and after the 50% test has been met (taking into account bond proceeds expended after the project has been placed in service), but before the end of the first year in the credit period, will not, in and of itself, result in a determination that project was not financed with tax-exempt bonds under IRC §42(h)(4)(B).

Regulations

Treas. Reg. §1.42-1. Limitation on low-income housing credit allowed with respect to qualified low-income buildings receiving housing credit allocations from a State or local housing credit agency.

Treas. Reg. §1.42-1T. Limitation on low-income housing credit allowed with respect to qualified low-income buildings receiving housing credit allocations from a State or local housing credit agency.

Treas. Reg. §1.42-2. Waiver of requirement that an existing building eligible for the low-income housing credit was last placed in service more than 10 years prior to acquisition by the taxpayer.

Treas. Reg. §1.42-3. Treatment of buildings financed with proceeds from a loan under an Affordable Housing Program established pursuant to section 721 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).

Treas. Reg. §1.42-4. Application of not-for-profit rules of section 183 to low-income housing credit activities.

Treas. Reg. §1.42-5. Monitoring compliance with low-income housing credit requirements.

Treas. Reg. §1.42-6. Buildings qualifying for carryover allocations.

Treas. Reg. §1.42-7. Substantially bond-financed buildings (reserved).

Treas. Reg. §1.42-8. Election of appropriate percentage month.

Treas. Reg. §1.42-9. For use by the general public.

Treas. Reg. §1.42-10. Utility allowances.

Treas. Reg. §1.42-11. Provision of services

Treas. Reg. §1.42-12. Effective dates and transitional rules.

Treas. Reg. §1.42-13. Rules necessary and appropriate; housing credit agencies correction of administrative errors and omissions.

Treas. Reg. §1.42-14. Allocation rules for post-2000 State housing credit ceiling amounts.

Treas. Reg. §1.42-15. Available unit rule.

Treas. Reg. §1.42-16. Eligible basis reduced by federal grants.

Treas. Reg. §1.42-17. Qualified allocation plan.

Treas. Reg. §1.42-18. Qualified contracts.

Revenue Procedures

Rev. Proc. 87-56, 1987-2 C.B. 674, 677. This revenue procedure specifies class lives and recovery periods for property subject to depreciation under the general depreciation system provided in IRC §168(a) or the alternative depreciation system provided in IRC §168(g).

Rev. Proc. 94-9, 1994-1 C.B. 555; 1994-2 I.R.B. 25. Instructions for making the election provided by §13142(c)(1) of the Revenue Reconciliation Act of 1993. The election is available to owners of low-income buildings not covered by §7108(e)(1) of the Revenue Reconciliation Act of 1989 and allows these owners to determine the gross rent limitation for rent-restricted units using the number of bedrooms method under IRC §42(g)(2)(C).

Rev. Proc. 94-57, 1994-2 C.B. 744; 1994-37 I.R.B. 6. Except for a low-income building financed with tax-exempt bonds, the IRS will treat the gross rent floor in IRC §42(g)(2)(A) as taking effect on the date a state agency initially allocates a housing credit dollar amount to the building under IRC §42(h)(1) unless the owner designates the date that the building was placed in service as the date on which the gross rent floor will take effect for the building. An owner must make this designation to use the placed in service date and inform the state agency that made the allocation to the building no later than the date on which the building is placed in service. For a bond-financed building, the IRS will treat the gross rent floor in IRC §42(g)(2)(A) as taking effect on the date a state agency initially issues a determination letter to the building unless the owner designates the date that the building was placed in service as the date on which the gross rent floor will take effect for the building. The owner must make this designation to use the placed in service date and inform the agency that issues the determination letter to the building no later than the date on which the building is placed in service.

Rev. Proc. 94-64, 1994-2 C.B. 797. Procedures for obtaining the waiver of the annual income recertification referenced in IRC §42(g)(8)(B). Note: Superseded by Rev. Proc. 2004-38. The waiver was entirely obsolete beginning July 31, 2008, because, under IRC §142(d)(3)(A), if all the low-income buildings in the project are 100% low-income buildings, owners are not required to complete annual tenant income re-certifications. IRC §142(d)(3)(A) was amended by section 3010 of the Housing Assistance Tax Act of 2008 and is effective for taxable years ending after July 30, 2008. IRC §142(d)(3)(A) is made applicable to IRC §42 low-income projects in IRC §42(g)(4).

Rev. Proc. 94-65, 1994-2 CB 798. Procedures for when a signed, sworn statement by a low-income tenant will satisfy the documentation requirements of Treas. Reg. §1.42-5(b)(1)(vii).

Rev. Proc. 95-28, 1995-1 C.B. 704. Provides procedures for granting temporary relief from certain IRC §42 provisions to owners of low-income housing projects and state agencies in major disaster areas. Note: superseded by Rev. Proc. 2007-54.

Rev. Proc. 96-32, 1996-1 C.B. 717. Guidance on qualification for tax exemption under IRC §501(c)(3) is provided for organizations that provide low-income housing. The guidance includes a safe harbor procedure to determine qualification.

Rev. Proc. 97-22, 1997-1 C.B. 652. Guidance to taxpayers that maintain books and records by using an electronic storage system that either images their hardcopy (paper) books and records or transfers their computerized books and records to an electronic storage media, such as an optical disk. Records maintained in an electronic storage system that complies with the requirements of this revenue procedure will constitute records within the meaning of IRC §6001.

Rev. Proc. 98-25, 1998-1 C.B.689. Specifies the basic requirements that the IRS considers essential when a taxpayer's records are maintained within an Automatic Data Processing system (ADP). This revenue procedure updates and supersedes Rev. Proc. 91-59.

Rev. Proc. 99-11 1999-1 C.B. 275. Procedures for providing a Treasury Direct Account as an alternative to providing a surety bond to avoid or defer recapture of low-income housing tax credits under IRC §42(j)(6). Under this program, taxpayers were able to establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security. These procedures are no longer in effect due to amendment of IRC §42(j)(6) in 2008. See Rev. Proc. 2008-60.

Rev. Proc. 2003-82, 2003-47 I.R.B. 1097. Provides safe harbors under which the IRS will treat a residential unit in a building as a low-income unit under IRC §42(i)(3)(A) if the incomes of the individuals occupying the unit are at or below the applicable income limitation under IRC §42(g)(1) or §142(d)(4)(B)(i) before the beginning of the first taxable year of the building's credit period, but their incomes exceed the applicable income limitation at the beginning of the first taxable year of the building's credit period.

Rev. Proc. 2004-38, 2004-27 I.R.B. 10. Instructions for obtaining the waiver from the IRS of the annual recertification of tenant income provided in IRC §42(g)(8)(B). Note: Supersedes Rev. Proc. 94-64. The waiver was entirely obsolete beginning July 31, 2008. See explanation for Rev. Proc. 94-64.

Rev. Proc. 2005-37, 2005-28 I.R.B. 79. Establishes a safe harbor under which housing credit agencies and project owners may meet the requirements of IRC §42(h)(6)(B)(i) as described in Rev. Rul. 2004-82, Q&A #5 regarding extended use agreements

Rev. Proc. 2007-20, 2007-7 I.R.B. 517. Provides that certain transactions with contractual protection are not reportable transactions for purposes of the disclosure rules under Treas. Reg. §1.6011-4(b)(4). However, these transactions may be reportable transactions for purposes of the disclosure rules under Treas. Reg. §1.6011-4(b)(2),(b)(3), (b)(5), (b)(6), or (b)(7). Paragraph 4.02(4) specifies "transactions in which the refundable or contingent fee is related to the low-income housing credit under IRC §42(a)."

Rev. Proc. 2007-54, 2007-31 I.R.B. 293. Procedures for temporary relief from certain IRC §42 requirements for owners of low-income housing buildings and housing credit agencies of states or possessions of the United States in major disaster areas declared by the President. This revenue procedure is effective for a major disaster declaration issued by the President under the Stafford Act on or after July 2, 2007, and before August 21, 2014. This revenue procedure superseded the relief provisions of Rev. Proc. 95-28 and was superseded by Rev. Proc. 2014-49.

Rev. Proc. 2008-60, 2008-2 C.B. 1006. Procedures for taxpayers maintaining surety bonds or Treasury Direct Accounts (TDA) to follow when making the election under §3004(i)(2)(B)(ii) of the Housing Assistance Tax Act of 2008 (Pub. L. 110-289) to no longer maintain a surety bond or a TDA to avoid recapture.

Rev. Proc. 2012-27, 2012-21 I.R.B. 940. Procedures for notifying the IRS, under IRC §42(j)(6)(B)(i), of any increase in tax resulting from a reduction in the qualified basis of a low-income housing tax credit building in order to begin the 3-year statutory period for assessing a deficiency with respect to that taxpayer.

Rev. Proc. 2014-49, I.R.B. 2014-37. Procedures for temporary relief from certain IRC §42 requirements for owners of low-income housing buildings and housing credit agencies of states or possessions of the United States in major disaster areas declared by the President. This revenue procedure is effective for major disasters declared on or after August 21, 2014. This revenue procedure supersedes the relief provisions of Re. Proc. 2007-54.

Revenue Rulings

Rev. Rul. 65-265, 1965-2 C.B. 52, clarified by Rev. Rul. 68-193, 1968-1 C.B. 79. Provides that the costs attributable to general grading of the land are capital expenditures and become a part of the cost basis of the land, which is not subject to depreciation allowances. The costs attributable to excavation, grading, and removing soil necessary for the proper setting of the building and paving of the roadways are part of the cost of those assets and should be included in the depreciable basis for the buildings and roadways.

Rev. Rul. 68-193, 1968-1 C.B., clarifies Rev. Rul. 65-265, 1965-2 C.B. 52. Costs attributable to general grading of the land are capital expenditures and are generally not subject to depreciation allowances. However, the cost of grading for roadways may be depreciable where it can be established that the grading is associated with a depreciable asset and that the grading will be retired, abandoned, or replaced contemporaneously with the asset.

Rev. Rul. 74-265, 1974-1 C.B. 56. Landscaping consisting of perennial shrubbery and ornamental trees immediately adjacent to the buildings in a newly constructed apartment complex is property depreciable over the life of the buildings if the replacement of the buildings at the expiration of their useful lives will destroy the landscaping; other landscaping on the grounds of the complex is considered general land improvements, the costs of which is to be added to the taxpayer's basis in the land.

Rev. Rul. 80-93, 1980-1 C.B. 50. Amounts paid by the developer of a mobile home park to the public utility for underground electric and gas distribution systems are capital expenditures that are included in the developer's cost basis of the land. Examples illustrate which land preparation costs may be depreciated by the developer and which must be included in the basis of the land. Excavation and backfilling required for the construction of a laundry facility and storm sewer system were so closely associated with those depreciable assets that replacement of the depreciable assets will require the physical destruction of the land preparation. However, the land preparation costs (clearing, grubbing, cutting, filling and rough grading) are unaffected by replacement of the depreciable assets and will not be replaced contemporaneously. Therefore, they are nonrecurring general land improvement costs that are inextricably associated with the land. The amounts paid for electrical and natural gas distribution systems are nonrecurring costs for betterments that increase the value of the land and are also includible in the taxpayer's cost basis of the land. The taxpayer pays for the distribution system, but the utility company retained full ownership and repairs/replaces the systems as needed.

Rev. Rul. 85-32, 1985-1 C.B. 186. Syndication costs incurred in connection with the sale of limited partnership interests are chargeable by the partnership to a capital account and cannot be amortized.

Rev. Rul. 89-24, 1989-1 C.B. 24. Provides instructions for computing the income limits applicable both to exempt facility bonds issued to provide for qualified residential rental projects under IRC §142 and to low-income housing credits under IRC §42. The income limits are required to be made in a manner consistent with determinations of lower income families under section 8 of the United States Housing Act of 1932. With respect to the 20-50 requirement of IRC §§ 142(d)(1)(A) and 42(g)(1)(A), 20% or more of the applicable units must be occupied by individuals or families having incomes equal to or less than the income limit for a "very low-income" family of the same size. With respect to the 40-60 requirement of §§ 142(d)(1)(B) and 42(g)(1)(B), 40 percent of the applicable units must be occupied by individuals or families having incomes equal to 120% or less of the income limit for a very low-income family of the same size. With respect to certain deep rent skewed projects, as described in IRC §142(d)(4), the determination of whether 15% of the low-income units are occupied by individuals having incomes equal to 40% or less of the area median gross income shall be made by determining whether 15% of such units are occupied by individuals or families having incomes equal to or less than 80% of the income limit for a very low-income family of the same size. See Rev. Rul. 94-57, which later modified and superseded this revenue ruling.

Rev. Rul. 90-60, 1990-2 C.B.4. Guidance for determining the amount of bond considered satisfactory by the Secretary and the period of the bond required under former IRC §42(j)(6). Note: Applicable only to dispositions of low-income buildings (or interests therein) on or before July 30, 2008.

Rev. Rul. 90-89, 1990-2 C.B. 8. For purposes of determining whether a building meets the minimum set-aside requirements of IRC §42(g)(1),the combined income of all occupants of a residential rental unit, whether or not legally related, is compared to the appropriate percentage of the median family income for a family with the same number of members.

Rev. Rul. 91-38, 1991-2 C.B. 3. This ruling answers 12 frequently asked questions about the low-income housing credit.

Rev. Rul. 91-38, 1991-2 C.B. 3, Q&A #5. A building's credit period is determined by reference to the tax year (at the time of placement in service) of the owner who placed the building in service, and is not affected by differing tax years of succeeding owners. However, the amount of credit that a particular owner may claim on a return for a tax year is determined on the last day of that owner's tax year. For purposes of IRC §42(f)(4), the owner who has held the property for the longest period during the month in which a transfer occurs is deemed to have held the property for the entire month and may claim a credit accordingly. In cases in which the transferor and transferee have held the property for the same amount of time during the month of the transfer, the transferor is deemed to have held the property for the entire month and the transferee's ownership of the property is deemed to begin the first day of the following month.

Rev. Rul. 92-61, 1992-2 C.B. 7. The adjusted basis of a unit occupied by a full-time resident manager is included in the eligible basis of a qualified low-income building under IRC §42(d)(1), but the unit is excluded from the applicable fraction under IRC §42(c)(1)(B) for purposes of determining the building's qualified basis.

Rev. Rul. 94-57, 1994-2 C.B. 5. This ruling modifies and supersedes Rev. Rul. 89-24 referenced above. This ruling concludes that (1) the income limitation used to initially qualify tenants in a low-income unit fluctuates with changes in area median gross income, and (2) owners must use the current area median gross income to determine when the available unit rule of IRC §42(g)(2)(ii) applies. Rev. Rul. 89-24 modified and superseded. Taxpayers may rely on a list of income limits released by HUD until 45 days after HUD releases a new list of income limits, or until HUD's effective date for this new list, whichever is later.

Rev. Rul. 95-49, 1995-2 C.B. 7. This ruling concludes that an extended use agreement satisfies IRC §42(h)(6) even though its provisions may be suspended or terminated after the compliance period when a tenant exercises a right of first refusal to purchase a low-income unit.

Rev. Rul. 96-35, 1996-2 C.B. 4. Below market loan provided by the Federal Emergency Management Agency (FEMA) to the owner of a qualified low-income building damaged by a disaster to repair, reconstruct, or restore the building to its pre-casualty condition does not result in a reduction in characterizing the building as federally subsidized under IRC §42(i)(2). A grant provided by FEMA to the owner of a qualified low-income building damaged by a disaster does not cause a reduction of the building's eligible basis under IRC §42(d)(5) to the extent that the grant funds are used to repair, reconstruct, or restore the building to its pre-casualty condition.

Rev. Rul. 98-49, 1998-2 C.B. 453. Under Treas, Reg. §1.42-16(b)(3), the IRS determined that payments made to a building owner on behalf or in respect of a tenant under the Section 8 Assistance For Single-Room Occupancy Dwellings Program (42 U.S.C. 11301, 11401-11402) or under the Shelter Plus Care Program (42 U.S.C. 11301, 11403-11407b) are not grants made with respect to a building or its operation under IRC §42(d)(5).

Rev. Rul. 2002-9, 2002-1 C.B. 614. "Impact fees" incurred by a taxpayer in connection with the construction of a new residential rental building are capitalized costs allocable to the building under IRC §§ 263(a) and 263A.

Rev. Rul. 2003-77, 2003-29 I.R.B. 75. The issue was whether a described facility qualified as a community service facility under IRC §42(d)(4)(C)(iii). The ruling found the requirement that a community service facility must be designed to serve primarily individuals whose income is 60 percent or less of area median gross income (AMGI) was satisfied for the following reasons: (1) the services provided at the facility improved the quality of life for community residents, (2) the taxpayer demonstrated (market study) that the services provided at the facility will be appropriate and helpful to individuals in the area of the project whose income is 60 percent or less of AMGI, (3) the facility must be located within the building, and (4) the services provided at the Facility were affordable to individuals whose income is 60 percent or less of AMGI.

Rev. Rul. 2004-82, 2004-35 I.R.B. 350. Generally, this revenue ruling is presented in a "Q&A" format and provides guidance for the following topics: (A) Eligible Basis and Qualified Basis Issues, (B) First Year Low-Income Unit Issue, (C) Extended Low-Income Housing Commitment Issue, (D) Home Investment Partnership Act Loan Issues, (E) Vacant Unit Rule Issues, and (F) Recordkeeping and Record Retention Issues. The following Q&As are specifically referenced in the ATG:

- Q&A #2 provides an example of a qualifying community service facility under IRC §42(d)(4)(C)(iii).
- Q&A #3 explains that credit application and allocation fees assessed by a state agency are not includable in eligible basis.
- Q&A #5 explains that IRC §42(h)(6)(B)(i) requires that an extended use commitment include a prohibition during the extended use period against (1) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit (no-cause eviction protection) and (2) any increase in the gross rent with respect to the unit not otherwise permitted under IRC §42.
- Q&A #6 explains that IRC §42(i)(2)(E)(i) generally provides that assistance provided under the HOME Investment Partnerships Act (HOME) or the Native American Housing and Assistance and Self-Determination Act (NAHASDA) of 1996 with respect to any building will not be treated as a below market Federal loan if 40 percent or more of the residential units in the building are occupied by individuals whose income is 50 percent or less of the Average Median Gross Income (AMGI). However, the rent restrictions for restriction for all the low-income units in the building, including the units used to satisfy the rules under IRC §42(i)(2)(E)(i), is based on the applicable income limitation under IRC §42(g). Applies to buildings placed in service on or before July 20, 2008.
- Q&A #9 explains that an owner of an IRC §42 project must use reasonable attempts to rent a vacant low-income unit or the next available unit of comparable or smaller size to tenants having a qualifying income before any units in the project are rented to tenants not having a qualifying income. What constitutes reasonable attempts to rent a vacant unit is based on facts and circumstances. Examples included in the ruling.
- Q&A #11 explains that a taxpayer can comply with the recordkeeping and record retention provisions under Teas. Reg. §1.42-5(b) using an electronic storage system instead of maintaining hardcopy (paper) books and records, provided that the electronic storage system satisfies the requirements of Rev. Proc. 97-22. However, complying with the recordkeeping and record retention requirements of the Service does not exempt an owner from having to satisfy any additional recordkeeping and record retention requirements of the monitoring procedure adopted by the housing credit agency. For example, the housing credit agency may require the taxpayer to maintain hardcopy books and records. For additional information, see Rev. Proc. 98-25, 1998-1 C.B. 689.

- Rev. Rul. 2008-6 , 2008-3 I.R.B. 271. Pursuant to Treas. Reg. §1.42-16(b)(3), the IRS determined that certain rental assistance payments made to a building owner on behalf of a tenant under the Indian Housing Block Grant Program authorized by the Native American Housing Assistance and Self-Determination Act of 1996, 25 U.S.C.S. 4101 et seq., are not grants made with respect to a building or its operation under IRC §42(d)(5). The rental assistance payments were provided under 24 C.F.R. 1000.103(b).

Technical Advice Memoranda

TAM 200021509. Costs includable in eligible basis under IRC §42(d)(1). Specifically, is the amount of a "Developer Fee Note," provided in part payment for services rendered for the taxpayer by the developer includable in eligible basis?

TAM 200021510. Costs includable in eligible basis under IRC §42(d)(1). 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 section 42(d)(1)?

TAM 200043015. Costs includable in eligible basis under IRC §42(d)(1). Specifically, are certain land preparation costs and bond issuance costs includable in eligible basis?

TAM 200043017. Costs includable in eligible basis under IRC §42(d)(1). Specifically addresses certain partnership syndication and formation costs, land preparation costs, developer fees, construction loan costs, construction contingency and rent-up costs incurred by the taxpayer. NOTE: information on the treatment of impact fees should be disregarded; superseded by Rev. Proc. 2002-9 and PLR 200916007.

TAM 200044004. Costs includable in eligible basis under IRC §42(d)(1). Specifically addresses the amount of a "Developer Fee Note" provided in part payment for services rendered for the Taxpayer by the Developer.

TAM 200044005. Costs includable in eligible basis under IRC §42(d)(1). Specifically addresses certain land preparation costs, costs for obtaining a construction loan, and construction contingency costs incurred by the taxpayer.

TAM 200203014. Involves a taxpayer request that IRC §7805(b) be applied to taxpayer's situation so that the conclusions of TAM 200043017 could be applied without retroactive effect. The taxpayer asserted that it should be granted IRC §7805(b)(8) relief because it relied upon Agency's award of credits pursuant to IRC §42(h) that included the costs at issue. However, a state housing credit agency's responsibility under IRC §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.

TAM 200523023. Chief Counsel responded to question regarding purported loans of HOME Investment Partnerships Act (HOME) funds and Affordable Housing Program (AHP) funds between General Partner and Taxpayer. The purported loan of HOME funds between General

Partner and Taxpayer was treated for purposes of IRC §42 as a below market federal loan under IRC §42(i)(2)(D) and the purported loan of AHP funds between General Partner and Taxpayer was treated for purposes of IRC §42 as a below market loan under Treas. Reg. §1.42-3(a), and not as a below market federal loan under IRC §42(i)(2)(D).

Appendix C Treatment of Assets/Costs for IRC §42 Purposes

Introduction

This appendix provides a list of the types of costs taxpayers typically incur when developing low-income housing and how the cost should be treated for IRC §42 purposes. The list is not exclusive.

- Assets/Costs Associated with Low-Income Buildings
- Assets/Costs Associated with Land
- Costs Associated with Land Improvements
- Financing Costs
- Costs Excluded from Eligible Basis
- Miscellaneous

Assets/Costs Associated with Low-Income Buildings

Developer Fees

Developer fees are paid for services provided to develop the project from its initial inception to its completion when the project is placed in service. Only the portion of the developer fee paid/accrued for providing services associated with the low-income buildings is includable in eligible basis.

Building Permits

These costs are usually associated with payments to local governments for construction plan reviews and building inspections needed to ensure conformance with local building codes and requirements.

Consulting Fees

Fees paid to consultants for development-related services may be included in eligible basis if the service is associated with the low-income building.

Accounting Costs

Costs incurred during the construction period to account for the costs of construction are indirect costs that directly benefit, or are incurred by reason of, the taxpayer's improvement and, therefore, are capitalized to the basis of the property improved under IRC §§ 263(a) and 263A. The accounting costs should be allocated among the property improved, and to the extent the cost of the improved property is includible in eligible basis, the improved property's allocated share of the accounting costs are also includible in eligible basis. Accounting costs include, for example, accounting for costs according to the construction contract, securing advances from a construction loan or submitting documentation to HUD for reimbursement.

Land Preparation

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. However, costs attributable to grading land that is done to provide a proper setting for a building become a part of the cost basis of the building. See Algernon Blair, Inc. v. Commissioner, 29 T.C. 1205 (1958), acq., 1958-2 C.B. 4, and Rev. Rul. 65-265, 1965-2 C.B. 52, clarified by Rev. Rul. 68-193. 1968-1 C.B. 79.

Foundations and Utilities - Excavating, Backfilling, Removal Costs

Earth-moving costs incurred for digging spaces and trenches for a building's foundation and utilities are generally considered to be inextricably associated with the building, are added to the cost of the building and, therefore, are depreciable. Similarly, costs incurred for fill dirt used to set the foundation of a depreciable asset are generally considered to be inextricably associated with the depreciable asset and are depreciable. Rev. Rul. 65-265, as clarified by Rev. Rul. 68-193, holds that excavating, grading, and removal costs directly associated with the construction of buildings and paved roadways are not inextricable associated with the land and should be included in the depreciable basis of the buildings and roadways.

Utilities: Tap Fee

Fees paid to a local government for the right to tap into an existing local utility are usually building-specific and capitalized to the building.

Impact Fees and Dedicated Improvements

Impact Fees: Impact fees are one-time charges imposed by a state or local government against new development or expansion of existing development to finance specific off-site capital improvements for general public use that are needed because of the new or expanded development. Taxpayers are required to pay impact fees to compensate the government entity for the financial impact of the taxpayer's development. The fees, for example, could be used to build a new school or expand a sewage system.

Rev. Rul. 2002-9 provides guidance for including impact fees for determining the eligible basis. Impact fees are assessed because of the taxpayer's plans to construct a new residential building. Impact fees are indirect costs under IRC §263A because they directly benefit, and are incurred by reason of, the construction of the project. Under Treas. Reg. 1.263A-1(e)(3)(i), the taxpayer must allocate the impact fees to the property produced. Because impact fees are calculated based upon the characteristics of the building and the impact fees are generally refundable if the building is not constructed as planned, the fees are 100% allocable to the building.

Dedicated Improvements: Similar to the treatment of impact fees, costs to construct dedicated infrastructure improvements are indirect costs under IRC §263A because they directly benefit, or are incurred by reason of, the construction of the project. Infrastructure improvements include, for example, streets, curbs, sidewalks, and storm water drainage required by the local government and constructed according to the local government's specifications. To qualify, the improvements must be dedicated to the state or local government for public use after completion. Upon acceptance of the dedication, the state or local government will own and maintain the infrastructure assets. Treas. Reg. §1.263(a)-4(d)(8)(iv). See PLR 200916007. Under Treas. Reg. §1.263A-1(e)(3)(i), the taxpayer must allocate the costs to the property produced. If the project encompasses multiple buildings, the costs must be allocated among the buildings constructed using a reasonable method of allocation under Treas. Reg. §1.263A-1(f). See PLR 200916007

Personal Property - Fixtures, Furniture, Appliances

Personal property (e.g., fixtures, furniture and appliances) may be included in eligible basis. Treas. Reg. §1.103-8(b)(4)(iii).

Assets/Costs Associated with Land

Expenses related to acquiring the land are excluded from eligible basis. These costs are capitalized under IRC§§ 1016 and 263.

Land Acquisition - Developer Activities, Finders Fees, Brokerage Fees, Legal Fees, Professional Fees, Assumed Liabilities

Generally, land acquisition involves the purchase of unimproved land for the construction of IRC §42 projects.

Activities normally performed by a developer and associated with the acquisition of land, which should be capitalized to the land, include (but are not limited to):

- Analysis of the Qualified Allocation Plan (QAP) for targeted areas within a state;
- Identification of potential land sites;
- Analysis of population demographics for potential sites;
- Analysis of a site's economy and forecast future growth potential;
- Determining a site's zoning status and possible rezoning actions;
- Contacting local government officials concerning access to utilities, public transportation, impact fees and local ordinances;
- Performing environmental tests on selected sites; and
- Negotiating the purchase of the land and its related financing.

The list above is not meant to be comprehensive and each activity may have underlying tasks.

Finders fees and brokerage fees paid for assistance in acquiring title to a property are also included in land basis and excluded from eligible basis. See M. A. Mathiasen, 20 T.C.M. 1681, Dec. 25,155(M), T.C. Memo., 1961-325, 63-1 USTC 9153; J.H. Vestal, CA-8, 74-1 USTC 9407, 498 F.2d 487.

Legal and professional fees related to the acquisition of land are also included in land basis and excluded from eligible basis. See: P.W. Havener, 23 T.C.M. 539, Dec. 26,735(M), T.C. Memo. 1964-91; Expenditures as attorneys' fees paid for services rendered in connection with the acquisition of the …estate, the cost of constructing roads on the property, the cost of drilling two water wells, the payment of delinquent real estate taxes …, interest paid to mortgage participation holders at the time of acquisition in 1938, etc. These expenditures may be added to his cost basis in the property.

J.M. Haddock, 57 T.C.M. 274, Dec. 45,654(M), T.C. Memo. 1989-200; [The legal fee] was incurred in connection with improvements to a capital asset, the 41 lots. The costs associated with construction of the roads include the legal fee incurred in defending the road contractor's lawsuit. Thus the fee of $1,265 must be capitalized and added to petitioners' cost basis in the lots.

P.W. Davis, Est., 79 T.C. 503, Dec. 39,361; Petitioner's legal fees thus were not incurred in the conservation of property she "held," within the meaning of IRC §212. They were, rather, incurred in an effort to establish her right to, or perfect her title to, assets, and the expenditures are not deductible under IRC §212. They must be capitalized as part of her basis for any property she ultimately acquires or to which her title is finally perfected. Boagni v. Commissioner, 59 T.C. 708, 712 (1973).

V.M. Cramer, 55 T.C. 1125, Dec. 30,697; The legal fees constitute amounts "paid….in connection with the reacquisition" of property within the meaning of IRC §1038 and, therefore, are not deductible but are added to petitioner's basis in the reacquired property.

Interests in Land - Air rights, Zoning Variances

Treas. Reg. §1.197-2(c)(3), Interests in Land, provides that IRC §197 intangibles do not include an interest in land. An interest in land includes a fee interest, life interest, remainder, easement, mineral right, timber right, grazing right, riparian right, air right, zoning variance, and any other similar right, such as a farm allotment, quota for farm commodities, or crop acreage base.

Land Acquisition - Assumed Liabilities

Unpaid real estate taxes and similarly assumed costs are added to the land's basis. See P. W. Havener, 23 T.C.M. 539, Dec. 26,735(M), T.C. Memo. 1964-91.

Demolition & Tenant Relocation

IRC §280B states that in the case of the demolition of any structure, no deduction is allowed to the owner or lessee of such structure for any amount expended for the demolition, or any loss sustained on account of the demolition. The costs should be added to the capital account for the land on which the demolished structure was located. Therefore, these costs are excluded from eligible basis.

The costs of relocating tenants out of an acquired building that will be demolished may be associated with the demolition and, if so, are capitalized to the land.

Land Preparation Costs - Clearing, Grubbing, Cutting, Filling, Rough Grading

Rev. Rul. 80-93 addresses whether a taxpayer is allowed to take a depreciation deduction for costs incurred for the clearing, grubbing, cutting, filling and rough and finish grading necessary to bring the land to a suitable grade for constructing certain depreciable assets. These costs will not be repeated when the depreciable asset is replaced. This revenue ruling holds that the land preparation costs are unaffected by replacement of the depreciable assets and will not be replaced contemporaneously. Therefore, they are nonrecurring general land improvement costs that are inextricably associated with the land and are to be added to the taxpayer's cost basis in the land. These land preparation costs are not depreciable and, therefore, are excluded from eligible basis.

Land Preparation Costs - Grading

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, clarified by Rev. Rul. 68-193, holds that such expenditures are inextricably associated with the land and, therefore, fall within the rule that land is a non-depreciable asset. 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 IRC §42(d)(1).

Land Surveys - Boundary, Mortgage

Land and environmental surveys are generally conducted over the entire property of the development, not just where the buildings and improvements will be specifically placed. Some surveys, such as boundary or mortgage surveys help to define the property. Costs incurred for these types of survey are inextricably associated with the land, are not depreciable, and are excluded from eligible basis. See TAM 200043017.

Environmental Surveys - Percolation Tests, Contamination Studies, Soil Borings, Geotechnical Inspections, Wetland Studies, Groundwater Investigations

Environment surveys such as percolation tests and contamination studies are used to determine if the land is suitable for the construction of the contemplated improvements. Other similar surveys include soil borings, geotechnical investigations, suitability studies, wetland reviews, mapping of wetland, and inspections of wetland, wetland characterization, and groundwater investigations. 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 are not depreciable and are excluded from eligible basis. A survey is considered to be redone contemporaneously with the replacement of the depreciable improvement if the physical replacement of the depreciable improvement (which is included in eligible basis) mandates a re-performance of the survey. Although an ordinance may require re-performance of the survey, such requirement is irrelevant as to whether the physical replacement of a depreciable improvement necessarily mandates a re-performance of the survey.

If necessary, the cost should be allocated between non-depreciable property (for example, land) and depreciable property (for example, buildings) using any reasonable method. For example, if staking costs are incurred to demarcate sidewalks (depreciable) and landscaping not immediately adjacent to buildings (non-depreciable), the staking costs should be allocated between the sidewalks and the landscaping.

See TAM 200043017

Costs Associated with Land Improvements

Generally, land preparation and improvement costs are excluded from eligible basis. For a land cost to be included in eligible basis, it must be so closely associated with a particular depreciable asset includable in eligible basis that the land improvement will be retired, abandoned, or replaced contemporaneously with that depreciable asset; i.e., the cost will be re-incurred if the depreciable asset is replaced or rebuilt. Whether a specific land cost will be retired, abandoned, or replaced contemporaneously with the depreciable asset is a question of fact. Eastwood Mall, Inc. v. U.S., 95-1 USTC 50,236 (N.D. Ohio 1995), aff'd without published opinion, 59 F.3d 170 (6th Cir. 1995).

Water Retention Ponds

Costs incurred by a taxpayer to haul dirt and fill to an area to raise the level of the land surrounding a creek to make the area useful as an industrial site is an improvement to the land itself and must be capitalized to land basis. Coors v. Commissioner, 60 T.C. 368, (1973).

The costs incurred in construction of steel cellular revetments and a stable slope berm outward from a lake shoreline, as part of a project to enclose and fill in an area of the lake to provide additional land for industrial facilities, and the costs of filling in the enclosed area are non-depreciable land acquisition costs and, therefore, are excluded from eligible basis. Rev. Rul. 77-270, 1977-2 C.B. 79.

Landscaping - Clearing, General Grading, Top soil, Seeding, Finish Grading, Planting of Perennial Shrubbery and Trees

Landscaping immediately adjacent to a low-income building is depreciable property if the replacement of the building will destroy the landscaping. In such a case, these costs are considered inextricably associated with the building and, therefore, are a depreciable land improvement. These costs are included in eligible basis. Otherwise, landscaping that will be unaffected by the replacement of the low-income building and, therefore, will not be replaced contemporaneously, is a non-depreciable land improvement. These costs are excluded from eligible basis. See Rev. Rul. 74-265.

Engineering and Architectural Services

Engineering and architectural services may include (but are not limited to) the preparation of erosion control plan, grading plan, utility plans, general details, easement descriptions, sewer and sanitary plans, and traffic engineering. Such services associated with non-depreciable land are excluded from eligible basis.

The services associated with a tangible depreciable asset includable in eligible basis, such as detailed construction drawings, are includable in eligible basis.

While it is a case-by-case factual determination, engineering and architectural services should be characterized consistently with the subject of the service. Services that may be associated with both non-depreciable property (e.g., land) and depreciable property should be allocated among the non-depreciable property and the depreciable property using a reasonable method.

Financing Costs

Fee, Cash Flow Guarantee

A "cash flow guarantee fee" paid by a partnership to secure agreement that its general partner would make loans to the partnership to fund any operating deficits is excluded from eligible basis. See Appendix G, Corbin West Limited Partnership v. Commissioner.

Fee, Tax Credit Guarantee

A "tax credit guarantee fee" paid to ensure that the project is operated in compliance with IRC §42 and guarantee that the taxpayer is entitled to claim the IRC §42 credit is excluded from eligible basis. See Appendix G, Corbin West Limited Partnership v. Commissioner.

Tax-Exempt Bonds - Issuance Costs

Notwithstanding the general rule of IRC §263A, bond issuance costs are excluded from eligible basis under the specific requirements of IRC §42(d)(1). The legislative history of IRC §142 provides that bond issuance costs cannot be paid from the 95% portion of the issue. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-686, 729 (1986), 1986-3 (Vol. 4) C.B. 868, 729. Since bond issuance costs are not costs included in the 95% used for qualified residential rental projects, the bond issuance costs are not residential rental property or costs used to provide residential rental property within the meaning of IRC §§142 or 42.

Characterizing a certain portion of bond issuance costs as includable in eligible basis under IRC §263A is directly contrary to this specific congressional determination. Permitting an IRC §263A characterization of the bond issuance costs for purposes of IRC §42 would result in the disparate treatment of the term residential rental property between IRC §§42 and 142. This result is contrary to the statutory and legislative history construct governing IRC §42 that requires that residential rental property have the same meaning for purposes of both sections.

Accordingly, notwithstanding the general rule under IRC §263A, no portion of bond issuance costs are included in eligible basis. See TAM 200043015.

Loans - Origination Fees, Legal Fees, Closing Costs, Title Searches, Recordation Fees

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), acq. 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. The cost of securing financing includes costs such as origination fees, legal fees, closing costs, title searches and recordation fees.

Construction Loans: The costs and fees incurred in obtaining a construction loan are not capitalized to depreciable property, but are treated as an amortizable IRC §167 intangible. The costs for obtaining a construction loan relate to the land acquired as well as the land improvements, in addition to the buildings. IRC §263A requires the amortization deductions relating to the construction loan be capitalized to the produced property during the construction period. The deductions must be reasonably allocated to all property produced. See TAM 200044005.

Permanent Financing: The cost of securing permanent financing is excluded from eligible basis, but to the extent the loan is associated with the building, capitalization of the amortization during the construction period may be required under IRC §263A. However, permanent financing is not usually in place during the construction period. Bridge loans are treated the same way.

Loans: Reserves and Escrows Required by Lender

Funds held in escrow accounts or required by a lender to be held in reserve are not depreciated and are excluded from eligible basis.

Construction Contingency Amounts

Amounts in a construction contingency account created for unexpected construction overruns are excluded from eligible basis because no cost was incurred.

Loans: Interest Paid or Incurred

Interest paid or incurred during the "production" period of a low-income building that is allocable to the production expenditures of the building is capitalized to the building under IRC §263A(f) and includable in eligible basis. Generally, the production period begins when physical activity on the site begins and ends when the produced property is placed in service. Physical production excludes planning and architectural design, soil testing, or securing permits. Treas.

Reg. §1.263A-12(f). The determination of whether interest is allocable to the production of the building is made using the "avoided cost" method. See Treas. Reg. §1.263A-8(a).

Interest attributable to a completed low-income building that is paid or incurred after the production period for the building for purposes of IRC §263A(f) has ended, is expensed as an ordinary and necessary business expense.

If dwelling units within a low-income building are separately placed in service, interest attributable to these dwelling units that is paid or incurred after the production period for the dwelling units for purposes of IRC §263A(f) has ended, is expensed as an ordinary and necessary business expense. However, if the dwelling units are separately placed in service before the development of the low-income building or construction of the improvement to the low-income building has been completed for purposes of IRC §266, a taxpayer may elect under IRC §266 and Treas. Reg. §1.266-1(b)(1)(ii) to capitalize to the building the interest attributable to these dwelling units that is incurred after the production period for the dwelling units for purposes of IRC §263A(f) has ended but before the development of the low-income building or construction of the improvement to the low-income building has been completed for purposes of IRC §266. See Treas. Reg. §1.266-(1)(a)(2).

Costs Excluded from Eligible Basis

IRC §42 Credit: Application & Allocation Fees

A state agency may charge a fee for submitting and processing the application for an allocation of IRC §42 credit, and if successful, may impose an allocation fee. These fees are excluded from eligible basis because the fees are not able to be capitalized into the adjusted basis of the building. See IRC §§263 and 263A. However, depending on the facts and circumstances, all or a portion of these fees may be required to be capitalized as amounts paid to create an intangible asset. See Treas. Reg. §1.263(a)-4. Any portion of these fees not required to be capitalized under Treas. Reg. §1.263(a)-4 may be deductible as an ordinary and necessary expense under IRC §§162 or 212, provided the taxpayer satisfies the requirements of those sections. Rev. Rul. 2004-82.

IRC §42 Credit: Cost Certifications

Under IRC §42(m)(2), the credit allocated by a state agency is not to exceed amount necessary to assure project feasibility and viability as a qualified low-income housing project throughout the credit period. To make sure only the credit necessary is allocated, the state agencies perform evaluations of the sources and uses of funds at three critical points of the development process: (1) when the taxpayer applies for the credit, (2) when the credit allocation is made, and (3) when the building is placed in service. The cost of preparing the cost certifications is excluded from eligible basis because this cost is incurred to secure an allocation of the IRC §42 credit and, therefore, is not capitalized to the basis of the building under IRC §263(a) or IRC §263A. The cost of preparing cost certifications may be associated with the creation of an intangible asset. See Treas. Reg. §1.263(a)-4. Any portion of these fees not required to be capitalized under Treas.

Reg. §1.263(a)-4 may be deductible as an ordinary and necessary expense under IRC §§162 or 212, provided the taxpayer satisfies the requirements of those sections.

Compliance Monitoring

State agencies may charge taxpayers a fee to offset the cost of compliance monitoring under Treas. Reg. §1.42-5. The fees are an ordinary and necessary business expense under IRC §162 in the year the fee is incurred or paid. The cost is not depreciable and, therefore, is excluded from eligible basis.

Management Fee

"Rental management" is the continuing day-to-day management of the property, including all dealings with the tenants, leasing and renewal of current leases, procurement of new tenants for any vacancies, etc. Rental management fees are usually a set amount plus a percentage for any lease renewals and incentives for new tenants obtained to fill vacancies. Amounts paid for the original leasing of the units and continued management of the project should be expensed on a yearly basis and matched against current rental income. These fees are excluded from eligible basis.

Partnership Organizational Costs

The cost of organizing a partnership may be amortized over a period of time not less than 60 months under IRC §709(b). These costs are not included in adjusted basis for depreciation purposes and are, therefore, excluded from eligible basis.

Treas. Reg. §1.709-2(a) defines "organizational expenses" as expenses that are: (1) incident to the creation of the partnership; (2) chargeable to capital account; and (3) of a character that, if expended incident to the creation of a partnership having an ascertainable life, would (but for IRC §709(a)) be amortized over that life. An expenditure that fails to meet one or more of the three tests does not qualify as an organizational expense for purposes of IRC §709(b) and Treas. Reg. §1.709-2(a).

Examples of organizational expenses include legal fees for services incident to the organization of the partnership, such as negotiation and preparation of a partnership agreement; accounting fees for services incident to the organization of the partnership; and filing fees. Examples of expenses that are not organizational expenses include costs to acquire assets for the partnership or transferring assets to the partnership; expenses connected with the admission or removal of partners other than at the time the partnership is first organized; expenses connected with a contract relating to the operation of the partnership trade or business (even where the contract is between the partnership and one of its members); and syndication expenses.

See TAM 200043017.

Partnership Syndication Costs

Treas. Reg. §1.709-2(b) defines "syndication expenses" as expenses connected with the issuing and marketing of interests in the partnership. Examples of syndication expenses are brokerage fees; registration fees; legal fees of the underwriter or placement agent and the issuer (the general partner or the partnership) for securities advice and for advice pertaining to the adequacy of tax disclosures in the prospectus or placement memorandum for securities law purposes; accounting fees for preparation of representations to be included in the offering materials; and printing costs of the prospectus, placement memorandum, and other selling and promotional material.

These expenses are not subject to the election under IRC §709(b) and must be capitalized, and are not includable in adjusted basis for depreciation purposes. Therefore, partnership syndication costs are excluded from eligible basis. Rev. Rul. 85-32 explains that syndication costs incurred in connection with the sale of limited partnership interests are chargeable by the partnership to a capital account and cannot be amortized. See TAM 200043017.

Acquiring Occupied Building: Tenant Relocation Costs

Cost Incurred to Permanently Relocate Non-qualifying Tenants: A determination may be made that an existing tenant is not a qualified low-income household. In which case, the taxpayer may decide to move the tenant out of the unit permanently. In some cases, the taxpayer may rehabilitate the vacant unit. The costs attributable to moving out the tenant permanently (e.g.; legal costs, tenant moving expenses, and compensation paid to the tenant) are expensed as an ordinary and necessary business expense under IRC §162, even if the vacated unit is rehabilitated.

Costs Incurred to Temporarily Relocate Qualifying Tenants During the Rehabilitation: A determination may be made that an existing tenant is a qualified low-income household. In which case, the taxpayer will move the tenant and provide temporary housing while the tenant's unit is being rehabilitated. The temporary housing may be another unit within the project or off-site. The tenant is expected to occupy the rehabilitated unit after the rehabilitation is completed. The costs attributable to moving the tenant and providing temporary housing for the tenant during the rehabilitation (e.g.; legal costs, tenant moving expenses, costs for temporarily storing a tenant's property, and temporary housing costs) are expensed as ordinary and necessary business expenses under IRC §162.

"Rent-Up" Marketing and Advertising Costs

"Rent up" or "lease up" costs are the costs necessary to initially rent out a newly placed in service low-income housing building or project. Costs may include advertising, maintaining a model unit, providing housing for on-site rental managers and staff, and any other costs to fully rent out the buildings. Rent-up costs are not related to the construction of the buildings, but for securing tenants. These costs do not establish or add to the basis of depreciable property and are excluded from eligible basis. See TAM 200043017.

Miscellaneous Costs

Real Estate Taxes

Assumed Liability: Delinquent real estate taxes assumed at acquisition are included in the basis of the land. P.W. Havener, 23 T.C.M. 539, Dec. 26,735(M), T.C. Memo. 1964-91. Therefore, the cost of delinquent real estate taxes assumed at acquisition is excluded from eligible basis.

Incurred During Pre-Production Period: When real property is acquired with the intent to develop it, real estate taxes paid are required to be capitalized under IRC §263A, even if no positive steps to begin developing the property has occurred. Reichel v. Commissioner, 112 T.C. 14 (1999).

Incurred During Construction Period: Real estate taxes incurred during the construction period and capitalizable to the low-income buildings under IRC §263A are included in eligible basis.

Incurred After Buildings are Placed in Service: Real estate taxes incurred after the buildings are placed in service are expensed as ordinary and necessary business expenses and are excluded from eligible basis.

Carrying Charges Other Than Interest

IRC §266 permits taxpayers to elect to capitalize certain otherwise deductible carrying charges paid or incurred with respect to improved but unproductive real property. A low-income building that has been placed in service may contain vacant units that have been rehabilitated and are available for rent but have not yet been rented out. A taxpayer may pay or incur payroll and utility costs attributable to those vacant units during the first year of the credit period. Under Rev. Rul. 71-475, 1971-2 C.B. 304, advertising expenses attributable to unproductive property, and maintenance and upkeep costs attributable to improved and unproductive real property, are not carrying charges chargeable to a capital account under IRC §266. Thus, payroll and utility costs attributable to those vacant units are not carrying charges for purposes of IRC §266.

However, carrying charges (other than interest) that are attributable to vacant units that have been rehabilitated for which the production period for purposes of IRC S263A(f) has ended, that are available for rent but have not yet been rented out, and are located in a low-income building that has been placed in service are capitalized to the building under IRC §263A as post-production costs. See Treas. Reg. §1.263A-2(a)(3)(iii).

Appendix D Treas. Reg. §1.103-8(b), Residential Rental Property

§ 1.103-8(b) Residential Rental Property

(b) Residential rental property -- (1) General rule for obligations issued after April 24, 1979. Section 103(b)(1) [26 USCS § 103(b)(1)] shall not apply to any obligation which is issued after April 24, 1979, and is part of an issue substantially all of the proceeds of which are to be used to provide a residential rental project in which 20 percent or more of the units are to be occupied by individuals or families of low or moderate income (as defined in paragraph (b)(8)(v) of this section). In the case of a targeted area project, the minimum percentage of units which are to be occupied by individuals of low or moderate income is 15 percent. See generally § 1.103-7 for rules relating to refunding issues.

(2) Registration requirement. Any obligation (including any refunding obligation) issued after December 31, 1981, to provide a residential rental project must be issued as part of an issue, each obligation of which is in registered form (as defined in paragraph (b)(8)(ii) of this section).

(3) Transitional rule. For purposes of this section, obligations issued after April 24, 1979, may be treated as issued before April 25, 1979, if the transitional requirements of section 1104 of the Mortgage Subsidy Bond Tax Act of 1980 (94 Stat. 2670) are satisfied.

(4) Residential rental project. (i) In general. A residential rental project is a building or structure, together with any functionally related and subordinate facilities, containing one or more similarly constructed units --

(a) Which are used on other than a transient basis, and

(b) Which satisfy the requirements of paragraph (b) (5) (i) of this section and are available to members of the general public in accordance with the requirement of paragraph (a) (2) of this section.

Substantially all of each project must contain such units and functionally related and subordinate facilities. Hotels, motels, dormitories, fraternity and sorority houses, rooming houses, hospitals, nursing homes, sanitariums, rest homes, and trailer parks and courts for use on a transient basis are not residential rental projects.

(ii) Multiple buildings. (a) Proximate buildings or structures (hereinafter "buildings") which have similarly constructed units are treated as part of the same project if they are owned for Federal tax purposes by the same person and if the buildings are financed pursuant to a common plan.

(b) Buildings are proximate if they are located on a single tract of land. The term "tract" means any parcel or parcels of land which are contiguous except for the interposition of a road, street, stream or similar property. Otherwise, parcels are contiguous if their boundaries meet at one or more points.

(c) A common plan of financing exists if, for example, all such buildings are provided by the same issue or several issues subject to a common indenture.

(iii) **Functionally related and subordinate facilities.** Under paragraph (a)(3) of this section, facilities that are functionally related and subordinate to residential rental projects include facilities for use by the tenants, for example, swimming pools, other recreational facilities, parking areas, and other facilities which are reasonably required for the project, for example, heating and cooling equipment, trash disposal equipment or units for resident managers or maintenance personnel.

(iv) Owner-occupied residences. For purposes of section 103 (b)(4)(A) [26 USCS § 103(b)(4)(A)] and this paragraph (b), the term "residential rental project" does not include any building or structure which contains fewer than five units, one unit of which is occupied by an owner of the units.

(5) Requirement must be continuously satisfied -- (i) Rental requirement. Once available for occupancy, each unit (as defined in paragraph (b)(8)(i) of this section) in a residential rental project must be rented or available for rental on a continuous basis during the longer of --

(a) The remaining term of the obligation, or

(b) The qualified project period (as defined in paragraph (b)(7) of this section).

(ii) Low or moderate income occupancy requirement. Individuals or families of low or moderate income must occupy that percentage of completed units in such project applicable to the project under paragraph (b)(1) of this section continuously during the qualified project period. For this purpose, a unit occupied by an individual or family who at the commencement of the occupancy is of low or moderate income is treated as occupied by such an individual or family during their tenancy in such unit, even though they subsequently cease to be of low or moderate income. Moreover, such unit is treated as occupied by an individual or family of low or moderate income until reoccupied, other than for a temporary period, at which time the character of the unit shall be re-determined. In no event shall such temporary period exceed 31 days (6) Effect of post-issuance noncompliance –

(i) In general. Unless corrected within a reasonable period, noncompliance with the requirements of this paragraph (b) shall cause the project to be treated as other than a project described in section 103 (b)(4)(A) [26 USCS § 103(b)(4)(A)] and this paragraph (b) as of the date of issue. After an issue to provide such project ceases to qualify, subsequent conformity with the requirements will not alter the taxable status of such issue.

(ii) Correction of noncompliance. If the issuer corrects any noncompliance arising from events occurring after the issuance of the obligation within a reasonable period, such noncompliance (e.g., an unauthorized sublease) shall not cause the project to be a project not described in this paragraph (b). A reasonable period is at least 60 days after such error is first discovered or would have been discovered by the exercise of reasonable diligence.

(iii) Involuntary loss. (a) The requirements of paragraph (b) shall cease to apply to a project in the event of involuntary noncompliance caused by fire, seizure, requisition, foreclosure, transfer of title by deed in lieu of foreclosure, change in a Federal law or an action of a Federal agency after the date of issue which prevents an issuer from enforcing the requirements of this paragraph, or condemnation or similar event but only if, within a reasonable period, either the obligation used to provide such project is retired or amounts received as a consequence of such event are used to provide a project which meets the requirement of section 103 (b)(4)(A) [26 USCS § 103(b)(4)(A)] and this paragraph (b).

(b) The provisions of paragraph (b)(6)(iii)(a) of this section shall cease to apply to a project subject to foreclosure, transfer of title by deed in lieu of foreclosure or similar event if, at any time during that part of the qualified project period subsequent to such event, the obligor on the acquired purpose obligation (as defined in § 1.103-13(b)(4)(iv)(a)) or a related person (as defined in § 1.103-10(e)) obtains an ownership interest in such project for tax purposes

.. (7) Qualified project period. The term "qualified project period" means --

(i) For obligations issued after April 24, 1979, and prior to September 4, 1982, a period of 20 years commencing on the later of the date that the project becomes available for occupancy or the date of issue of the obligations. The requirement of paragraph (b)(5)(ii) of this section shall be deemed met if the owner of the project contracts with a Federal or state agency to maintain at least 20 percent (or 15 percent in the case of targeted areas) of the units for low or moderate income individuals or families (as defined in paragraph (b)(8)(v) of this section) for 20 years in consideration for rent subsidies for such individuals or families for such period.

(ii) For obligations issued after September 3, 1982, a period beginning on the later of the first day on which at least 10 percent of the units in the project are first occupied or the date of issue of an obligation described in section 103(b)(4)(A) [26 USCS § 103(b)(4)(A)] and this paragraph and ending on the later of the date --

(a) Which is 10 years after the date on which at least 50 percent of the units in the project are first occupied,

(b) Which is a qualified number of days after the date on which any of the units in the project is first occupied, or

(c) On which any assistance provided with respect to the project under section 8 of the United States Housing Act of 1937 terminates.

For purposes of this paragraph (b)(7)(ii), the term "qualified number of days" means 50 percent of the total number of days comprising the term of the obligation with the longest maturity in the issue used to provide the project. In the case of a refunding of such an issue, the longest maturity is equal to the sum of the period the prior issue was outstanding and the longest term of any refunding obligations.

(8) Other definitions. For purposes of this paragraph --

(i) Unit. The term "unit" means any accommodation containing separate and complete facilities for living, sleeping, eating, cooking, and sanitation. Such accommodations may be served by centrally located equipment, such as air conditioning or heating. Thus, for example, an apartment containing a living area, a sleeping area, bathing and sanitation facilities, and cooking facilities equipped with a cooking range, refrigerator, and sink, all of which are separate and distinct from other apartments, would constitute a unit.

(ii) In registered form. The term "in registered form" has the same meaning as in section 6049 [26USCS § 6049]. With respect to obligations issued after December 31, 1982, such term shall have the same meaning as prescribed in section 103(j) [26 USCS § 103(j)] (including the regulations thereunder).

(iii) Targeted area project. The term "targeted area project" means a project located in a qualified census tract (as defined in § 6a.103A-2(b)(4)) or an area of chronic economic distress (as defined in §6a.103A-2(b)(5)).

(iv) Building or structure. The term "building or structure" generally means a discrete edifice or other man-made construction consisting of an independent foundation, outer walls, and roof. A single unit which is not an entire building but is merely a part of a building is not a building or structure within the meaning of this section. As such, while single townhouses are not buildings if their foundation, outer walls, and roof are not independent, detached houses and rowhouses are buildings.

(v) Low or moderate income. Individuals and families of low or moderate income shall be determined in a manner consistent with determinations of lower income families under section 8 of the United States Housing Act of 1937, as amended, except that the percentage of median gross income which qualifies as low or moderate income shall be 80 percent. Therefore, occupants of a unit are considered individuals or families of low or moderate income only if their adjusted income (computed in the manner prescribed with § 1.167(k)-3(b)(3)) does not exceed 80 percent of the median gross income for the area. Notwithstanding the foregoing, the occupants of a unit shall not be considered to be of low or moderate income if all the occupants are students (as defined in section 151(e)(4) [26 USCS § 151(e)(4)]), no one of whom is entitled to file a joint return under section 6013 [26 USCS § 6013]. The method of determining low or moderate income in effect on the date of issue will be determinative for such issue, even if such method is subsequently changed. In the event programs under § 8(f) of the Housing Act of 1937, as amended, are terminated prior to the date of issue, the applicable method shall be that in effect immediately prior to the date of such termination.

(9) Examples. The following examples illustrate the application of this paragraph (b).

Example (1). In August 1982, City X issues $ 10 million of registered bonds with a term of 20 years to be used to finance the construction of an apartment building to be available to members of the general public. X loans the proceeds of the bonds to Corporation M, the tax owner of the project. The loan is secured by a promissory note from M and a mortgage on the project. The mortgage requires annual payments sufficient to amortize the principal and interest on the bonds. Corporation M maintains 20 percent of the units in the project for low or moderate income individuals and meets all of the requirements of this section until 2002, at which time M converts the project to offices. The bonds are industrial development bonds, but because the proceeds are used for construction of residential rental property, which is an exempt facility under section 103(b)(4)(A) [26 USCS § 103(b)(4)(A)] and paragraph (b) of this section, section 103(b)(1) [26 USCS § 103(b)(1)] does not apply.

Example (2). The facts are the same as in example (1), except that the building is constructed adjacent to a factory, and the factory employees are to be given preference in selecting tenants. The bonds are industrial development bonds and the facility is not an exempt facility under section 103(b)(4)(A) [26USCS § 103(b)(4)(A)] and paragraph (b) of this section because it is not a facility constructed for use by the general public.

Example (3). The facts are the same as in example (1), except that the proceeds of the obligation are provided to N, a cooperative housing corporation, to finance the construction of a cooperative housing project. N sells stock in such cooperative to shareholders, some of whom occupy the units in the cooperative and some of whom rent the units to other persons. Such project is not a residential rental project within the meaning of section 103(b)(4)(A) [26 USCS § 103(b)(4)(A)] and § 1.103-8(b) because less than all of the units in the building are used for rental. Further, the bonds are mortgage subsidy bonds under section 103A [26 USCS § 103A] because more than a significant portion of the proceeds are used to provide financing for residences, some of which are owner-occupied and some of which are used in the trade or business of rental.

Example (4). On February 1, 1984, County Z issues registered obligations with a term of 3 years and loans the proceeds to Corporation V to construct a garden apartment project for tenants who are 65 years or older. The mortgage on the project secures the loan. At the end of 3 years, V obtains permanent financing for the project from a commercial lender. The project is not a targeted area project. V has not contracted with any Federal or state agency to provide rental assistance under section 8 of the United States Housing Act of 1937. As a condition for providing financing for construction, Z requires that the deed to the project contain a covenant that requires the project be used for elderly tenants and restricts occupancy of 20 percent of the units in the project to individuals or families of low or moderate income. Further, the deed provides that "Such covenant shall run with and bind the land, from the date that ten percent of the units in the project are first occupied until ten years after the date that at least half the units are first occupied. The right to enforce these restrictions is vested in County Z." In 1990, however, less than 20 percent of the units are occupied by families or individuals of low or moderate incomes, and three months after learning of this condition County Z had not commenced enforcement of the covenant. Although on the date of issue the proceeds of the obligation were used to provide a residential rental project, the obligation will not be treated as providing a residential rental project within the meaning of section 103(b)(4)(A) [26USCS § 103(b)(4)(A)] as of February 1, 1984, because the project did not meet the requirements of this paragraph for at least 10 years after at least 50 percent of the units are first occupied.

Example (5). On January 15, 1983, State X issues registered obligations with a term of 15 years, the proceeds of which are loaned to Corporation P to construct an apartment building. The project will be a "targeted area project", within the meaning of § 1.103-8(b)(8)(iii). Corporation P intends to rent all the units to individuals for their residences, maintaining 15 percent of the units in the project for individuals having low or moderate incomes, for 15 years. In 1988, however, Corporation P converts 80 percent of the units to condominiums. Corporation P repays the loan to State X which, in turn, redeems the obligations. The obligations are not used to provide a residential rental project within the meaning of section 103(b)(4)(A) [26 USCS § 103(b)(4)(A)], and all the interest paid or to be paid on such obligations will be includable in gross income.

Example (6). On January 15, 1984, State Z issues registered obligations with a term of 15 years the proceeds of which will be used to acquire and renovate a residential apartment building. Z sells the project to Corporation U and receives a 30-year mortgage. On June 1, 1985, the first occupants of the project commence their tenancies. At least 50 percent of the units in the project are occupied on July 1, 1985. On January 15, 1988, Z issues 35-year refunding bonds the proceeds of which are used to retire the obligations issued in 1984. The prior issue will be discharged by March 15, 1988. In order to meet the requirement of § 1.103-8(b)(5)(ii), at least 20 percent of such units must be occupied by individuals of low or moderate income until January 1, 2005.

Example (7). The facts are the same as in example (6) except that in 1987, the apartment building is substantially destroyed by fire. The building was insured at its fair market value. U does not intend to reconstruct the building but uses a portion of the insurance proceeds to repay the unpaid balance of the mortgage. Z uses this amount to redeem the outstanding bonds at the first available call date. Since the project was substantially destroyed by fire and the outstanding bonds are retired at the first available call date, the requirements of section 103(b)(4)(A) [26 USCS § 103(b)(4)(A)] and this paragraph (b) are satisfied with respect to the obligations.

Example (8). The facts are the same as in example (6) except that in 1987 U defaults on the mortgage, and Z obtains title to the project without instituting foreclosure proceedings. Z sells the project to S and uses the proceeds to retire the outstanding bonds. Since S did not obtain the project with obligations described in section 103(b)(4) [26 USCS § 103(b)(4)], S is not required to meet the requirements of section 103(b)(4)(A) [26 USCS § 103(b)(4)(A)] and this paragraph. Further, the 1984 obligations are obligations described in section 103(b)(4)(A) [26 USCS § 103(b)(4)(A)].

Example (9). In September 1983, State W issues $ 10 million of registered bonds with a term of 3 years, the proceeds of which are to be loaned to Corporation V to finance the construction of an apartment building in a rural community. At the end of 3 years, V obtains permanent financing from Federal Agency T. Agency T will not allow the deed to contain any restrictive covenant relating to the use of the project. Under Federal law, however, T requires that V maintain all of the units in the project for rental to low-income farm workers for the term of the mortgage, which is 20 years. Further, the mortgage between T and V provides that if T determines that low-income housing is no longer required in the community in which the project is constructed then the repayment of the mortgage may be accelerated. T determines as of the date of issue that low-income housing will be needed in the community for at least 20 years. In 1987, the project fails to meet the requirements of section 1.103-8(b)(5)(ii), relating to occupancy by individuals or families of low or moderate income. Further, T does not require V to correct the failure. Based on the foregoing, the bonds issued by W will be treated as described in section 103(b)(4)(A) [26 USCS § 103(b)(4)(A)].

Example (10). The facts are the same as in example (9) except that in 1987, the Federal law is amended to provide that Agency T may not enforce its low-income occupancy requirement. The result is the same.

Example (11). The facts are the same as in example (9) except that in 1987 Agency T determines that due to a change in circumstances in the community in which the project is located low-income rental housing is no longer required. As such, T requires V to repay the mortgage. Since the obligations have been repaid, W has no legal right to enforce the requirements of paragraph (b) with respect to the project. Subsequent nonconformity of the project with the requirements of § 1.103-8(b) under these circumstances will not cause the obligations issued by W to be industrial development bonds within the meaning of section 103(b)(1) [26 USCS § 103(b)(1)].

(10) Obligations issued before April 25, 1979 -- (i) General rules. Section 103(b)(1) [26 USCS §103(b)(1)] shall not apply to obligations issued before April 25, 1979, which are part of an issue substantially all of the proceeds of which are to be used to provide residential real property for family units. In order to qualify under this paragraph (b) as an exempt facility, the facility must satisfy the public use requirement of paragraph (a)(2) of this section by being available for use by members of the general public.

(ii) Family units defined. For purposes of this paragraph (b) the term "family unit" means a building or any portion thereof which contains complete living facilities which are to be used on other than a transient basis by one or more persons, and facilities functionally related and subordinate thereto. Thus, an apartment which is to be used on other than a transient basis as a residence by a single person or by a family and which contains complete facilities for living, sleeping, eating, cooking, and sanitation, constitutes a family unit. Such a unit may be served by centrally located machinery and equipment as in a typical apartment building. To qualify as a family unit, the living facilities must be a separate, self-contained building or constitute one unit in a building substantially all of which consists of similar units, together with functionally related and subordinate facilities and areas. Hotels, motels, dormitories, fraternity and sorority houses, rooming houses, hospitals, sanitariums, rest homes, and trailer parks and courts for use on a transient basis do not constitute residential real property for family units.

(iii) Functionally related and subordinate facilities. Under paragraph (a)(3) of this section, facilities which are functionally related and subordinate to residential real property actually used for family units include, for example, facilities for use by the occupants such as a swimming pool, a parking area, and recreational facilities.

Appendix E Recordation and Documentation Requirements

This appendix provides an overview of recordation and documentation requirements applicable to taxpayers owning IRC §42 projects.

General Documentation Requirement

IRC §6001

IRC §6001 reads:

Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax under this title…."

Treas. Reg. §1.6001-1(a)

Treas. Reg. §1.6001-1(a) clarifies that, generally, "…any person subject to tax under Subtitle A of the Code…or any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information." Paragraph (c) further explains that the taxpayer's books and records shall be:

- Kept at all times available for inspection by authorized internal revenue officers or employees, and
- Retained so long as the contents thereof may become material in the administration of any internal revenue law.

IRC §42 Documentation Requirements

Treas. Reg. §1.42-5

The IRS has also provided guideline for retaining records specific to claiming IRC §42 credit in Treas. Reg. §1.425(b)(1). The owner of a low income housing project must be required to keep records for each qualified low-income building in the project that show for each year in the 15-year compliance period:

- The total number of residential rental units in the building (including the number of bedrooms and the size in square feet of each residential rental unit);
- The percentage of residential rental units in the building that are low-income units;
- The rent charged on each residential rental unit in the building (including any utility allowances);
- The number of occupants in each low-income unit, but only if rent is determined by the number of occupants in each unit under IRC §42(g)(2) (as in effect before the amendments made by the Omnibus Budget Reconciliation Act of 1989);
- The low-income unit vacancies in the building and information that shows when, and to whom, the next available units were rented;
- The annual income certification of each low-income tenant per unit. There is an exception to this requirement under IRC §42(g)(8)(B), which provides a special rule for a 100% low-income building. Note: For tax year ending before July 31, 2008, an owner may have received a waiver from this requirement under Rev. Proc. 2004-38 or Rev. Proc. 94-64, but only if the low-income housing project consisted entirely of 100% low-income buildings. For tax years ending after July 30, 2008, owners are not required to complete annual tenant income recertifications if all the low-income buildings in the project are 100% low-income buildings.

- Documentation to support each low-income tenant's income certification (for example, a copy of the tenant's federal income tax return, Forms W-2, or verifications of income from third parties such as employers or state agencies paying unemployment compensation). For an exception to this requirement, see IRC §42(g)(8)(B) and the note for (6) above. In the case of a tenant receiving housing assistance payments under section 8 of the United States Housing Act of 1937, the documentation requirement is satisfied if the public housing authority provides a statement to the building owner declaring that the tenant's income does not exceed the applicable income limit.
- The eligible basis and qualified basis of the building at the end of the first year of the credit period; and
- The character and use of the nonresidential portion of the building included in the building's eligible basis under IRC §42(d) (e.g., tenant facilities that are available on a comparable basis to all tenants and for which no separate fee is charged for use of the facilities, facilities reasonably required by the project, or community service facilities.

Record Retention

Treas. Reg. §1.42-5(b)(2) is the record retention provision under which a taxpayer owning a low-income housing project must be required to retain the records described above for at least 6 years after the due date (with extensions) for filing the federal income tax return for that year. The records for the first year of the credit period, however, must be retained for at least 6 years beyond the due date (with extensions) for filing the federal income tax return for the last year of the compliance period of the building.

Under Treas. Reg. §1.42-5(b)(3), taxpayers are subject to an inspection record retention provision. The owner of a low-income housing project is required to retain the original local health, safety, or building code violation reports or notices that were issued by the State or local government unit for the Agency's inspection. Retention of the original violation reports or notices is not required once the Agency reviews the violation reports or notices and completes its inspection, unless the violation remains uncorrected.

Utility Allowances

Specific to the computation of utilities allowance, Treas. Reg. §1.4210(d) explains that owners must retain any utility consumption estimates and supporting data as part of the taxpayer's records for purposes of Treas. Reg. §1.6001-1(a).

Electronic Records

Storing Records Electronically

The IRS has also addressed the feasibility of using electronic storage options. In Rev. Rul. 2004-82, Q&A #11 (immediately below), the IRS provided guidance on recordkeeping and record retention requirements for purpose of IRC §6001 and the associated regulations.

Q-11: May a taxpayer comply with the recordkeeping and record retention provisions under Treas. Reg. §1.42-5(b) by using an electronic storage system instead of maintaining hardcopy (paper) books and records?

A-11: Yes, provided that the electronic storage system satisfies the requirements of Rev. Proc. 97-22, 1997-1 C.B. 652. This revenue procedure provides guidance to taxpayers that maintain books and records by using an electronic storage system that either images their hardcopy (paper) books and records or transfers their computerized books and records to an electronic storage media, such as an optical disk. Rev. Proc. 97-22 provides that records maintained in an electronic storage system that complies with the requirements of this revenue procedure will constitute records within the meaning of IRC §6001.

However, complying with the Service's recordkeeping and record retention requirements does not exempt a taxpayer from having to satisfy any additional recordkeeping and record retention requirements of the monitoring procedure adopted by the state agency. For example, the housing credit agency may require the taxpayer to maintain hardcopy books and records. For the basic requirements of maintaining records in an automated data processing system, including electronic storage systems, see Rev. Proc. 98-25, 1998-1 C.B. 689.

Sources of Information

Alternative Sources of Information

In cases where a taxpayer does not have its own books and records created concurrently with a transaction, consideration should be given to using alternative sources of information, accepting credible oral testimony, or relying on documentation from third parties. Examiners should evaluate whether the source of the information is credible, as well as whether the facts and information gathered from alternative sources make sense and are sufficient.

Accountant's Workpapers

For audits of IRC §42 issues, there is one credit-specific source of information which an examiner may, under very limited circumstances, want to consider. Under IRC §42(m)(2)(C)(i)(III), the state agency performs a final evaluation of the sources and uses of funds when the low-income building(s) are placed in service. As described in Treas. Reg. §1.42-17(a)(5), the taxpayer must submit a schedule of project costs. This final cost certification details the project's total costs as well as those costs that qualify as eligible basis.

Treas. Reg. §1.42-17(a)(5) also requires that for projects with more than 10 units, the schedule of project costs must be accompanied by a Certified Public Accountant's audit report on the schedule. For projects with less than 11 units, the state agency may require an audited schedule of project costs. If a certified audit was performed, the accountant's audit workpapers may provide additional information needed to resolve tax issues involving the eligible basis.

However, the accountant's workpapers may be unavailable or simply not include information about the issue being considered. Further, the accountant's audit workpapers may not be sufficient for all purposes. For example, the workpapers will describe the accountant's audit procedures and may include a summary of the verified construction costs which are sufficiently detailed. On the other hand, the audit workpapers will probably not be sufficient to resolve issues involving a developer fee; i.e., what services were provided, when were the services provided, and were development costs properly allocated between land, land improvements, and the low-income buildings.

Appendix F Supreme Court of the United States United States v. Boyle, Executor of the Estate of Boyle 469 U.S. 241

Summary and Relevance

This case involves the failure to timely file an estate tax return. Under IRC §6075(a) the deadline for all estate tax returns is within 9 months of the decedent's death. Late filing incurs a penalty. To escape the penalty, the taxpayer bears the burden of proving under IRC §6651(a)(1) both (1) that the failure did not result from willful neglect, and (2) that the failure was due to reasonable cause.

The United States Supreme Court granted certiorari to this case to resolve a conflict among the Circuits. The Supreme Court ultimately reversed the United States Court of Appeals for the Seventh Circuit. 710 F.2d 1251 (7th Cir. 1983), which had affirmed the decision of the United States District Court for the Central District of Illinois granting a summary judgment to the taxpayer. In the Supreme Court's majority opinion, it was held that a taxpayer's reliance on an attorney to prepare and file a tax return does not constitute "reasonable cause" under IRC §6651(a)(1) which will excuse the taxpayer from payment of a penalty for late filing.

This case is relevant in the IRC §42 context because the same principle applies when considering a taxpayer's filing requirement under IRC §42(l)(1); i.e., the First-Year Certification. See Chapter 4. The flush language following IRC §42(l)(1)(E) reads:

In the case of a failure to make the certification required by the preceding sentence on the date prescribed therefore, unless it is shown that such failure is due to reasonable cause and not to willful neglect, no credit shall be allowable by reason of subsection (a) with respect to such building for any taxable year ending before such certification is made.

Majority Opinion

We granted certiorari to resolve a conflict among the Circuits on whether a taxpayer's reliance on an attorney to prepare and file a tax return constitutes "reasonable cause" under IRC §6651(a)(1), so as to defeat a statutory penalty incurred because of a late filing.

Respondent, Robert W. Boyle, was appointed executor of the will of his mother, Myra Boyle, who died on September 14, 1978; respondent retained Ronald Keyser to serve as attorney for the estate. Keyser informed respondent that the estate must file a federal estate tax return, but he did not mention the deadline for filing this return. Under IRC §6075(a), the return was due within nine months of the decedent's death; i.e., not later than June 14, 1979.

Although a businessman, respondent was not experienced in the field of federal estate taxation, other than having been executor of his father's will 20 years earlier. It is undisputed that he relied on Keyser for instruction and guidance. He cooperated fully with his attorney and provided Keyser with all relevant information and records. Respondent and his wife contacted Keyser a number of times during the spring and summer of 1979 to inquire about the progress of the proceedings and the preparation of the tax return; they were assured that they would be notified when the return was due and that the return would be filed "in plenty of time." When respondent called Keyser on September 6, 1979, he learned for the first time that the return was by then overdue. Apparently, Keyser had overlooked the matter because of a clerical oversight in omitting the filing date from Keyser's master calendar. Respondent met with Keyser on September 11, and the return was filed on September 13, three months late.

Acting pursuant to IRC §6652(a)(1), the Internal Revenue Service assessed against the estate an additional tax of $ 17,124.45 as a penalty for the late filing, with $1,326.56 in interest. IRC 6651(a)(1) reads in pertinent part:

> "In case of failure . . . to file any return . . . on the date prescribed therefore…, *unless it is shown that such failure is due to reasonable cause and not due to willful neglect*, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate. . ." (Emphasis added.)

A Treasury Regulation provides that, to demonstrate "reasonable cause," a taxpayer filing a late return must show that he "exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time." Treas. Reg. §301.6651-1(c)(1) (1984). [See Footnote 1]

Respondent paid the penalty and filed a claim for a refund. He conceded that the assessment for interest was proper, but contended that the penalty was unjustified because his failure to file the return on time was "due to reasonable cause;" i.e., reliance on his attorney. Respondent brought suit in the United States District Court, which concluded that the claim was controlled by the Court of Appeals' holding in Rohrabaugh v. United States, 611 F.2d 211 (CA7 1979). In Rohrabaugh, the United States Court of Appeals for the Seventh Circuit held that reliance upon counsel constitutes "reasonable cause" under IRC §6651(a)(1) when: (1) the taxpayer is unfamiliar with the tax law; (2) the taxpayer makes full disclosure of all relevant facts to the attorney that he relies upon, and maintains contact with the attorney from time to time during the administration of the estate; and (3) the taxpayer has otherwise exercised ordinary business care and prudence. 611 F.2d at 215, 219.

The District Court held that, under Rohrabaugh, respondent had established "reasonable cause" for the late filing of his tax return; accordingly, it granted summary judgment for respondent and ordered refund of the penalty. A divided panel of the Seventh Circuit, with three opinions, affirmed. 710 F.2d 1251 (1983).

We granted certiorari, 466 U.S. 903 (1984), and we reverse.

Congress' purpose in the prescribed civil penalty was to ensure timely filing of tax returns to the end that tax liability will be ascertained and paid promptly. The relevant statutory deadline provision is clear; it mandates that all federal estate tax returns be filed within nine months from the decedent's death, IRC §6075(a). [See Footnote 2.] Failure to comply incurs a penalty of 5 percent of the ultimately determined tax for each month the return is late, with a maximum of 25 percent of the base tax. To escape the penalty, the taxpayer bears the heavy burden of proving both (1) that the failure did not result from "willful neglect," and (2) that the failure was "due to reasonable cause." IRC §6651(a)(1).

The meaning of these two standards has become clear over the near-70 years of their presence in the statutes. [See Footnote 3] As used here, the term "willful neglect" may be read as meaning a conscious, intentional failure or reckless indifference. See Orient Investment & Finance Co. v. Commissioner, 83 U.S. App. D.C. 74, 75, 166 F.2d 601, 602 (1948); Hatfried, Inc. v. Commissioner, 162 F.2d 628, 634 (CA3 1947); Janice Leather Imports Ltd. v. United States, 391 F. Supp. 1235, 1237 (SDNY 1974); Gemological Institute of America, Inc. v. Riddell, 149 F. Supp. 128, 131-132 (SD Cal. 1957).

Like "willful neglect," the term "reasonable cause" is not defined in the Code, but the relevant Treasury Regulation calls on the taxpayer to demonstrate that he exercised "ordinary business care and prudence" but nevertheless was "unable to file the return within the prescribed time." [See Footnote 4.] Treas. Reg. §301.6651(c)(1) (1984); accord, e.g., Fleming v. United States, 648 F.2d 1122, 1124 (CA7 1981); Ferrando v. United States, 245 F.2d 582, 587 (CA9 1957); Haywood Lumber & Mining Co. v. Commissioner, 178 F.2d 769, 770 (CA2 1950);Southeastern Finance Co. v. Commissioner, 153 F.2d 205 (CA5 1946); Girard Investment Co. v. Commissioner, 122 F.2d 843, 848 (CA3 1941); see also Footnote 1, supra. The Commissioner does not contend that respondent's failure to file the estate tax return on time was willful or reckless. The question to be resolved is whether, under the statute, reliance on an attorney in the instant circumstances is a "reasonable cause" for failure to meet the deadline.

In affirming the District Court, the Court of Appeals recognized the difficulties presented by its formulation but concluded that it was bound by Rohrabaugh v. United States, 611 F.2d 211 (CA7 1979). The Court of Appeals placed great importance on the fact that respondent engaged the services of an experienced attorney specializing in probate matters and that he duly inquired from time to time as to the progress of the proceedings. As in Rohrabaugh, see id., at 219, the Court of Appeals in this case emphasized that its holding was narrowly drawn and closely tailored to the facts before it. The court stressed that the question of "reasonable cause" was an issue to be determined on a case-by-case basis. See 710 F.2d at 1253-1254; id., at 1254 (Coffey, J., concurring).

Other Courts of Appeals have dealt with the issue of "reasonable cause" for a late filing and reached contrary conclusions. [See Footnote 5.] In Ferrando v. United States, 245 F.2d 582 (CA9

1957), the court held that taxpayers have a personal and non-delegable duty to file a return on time, and that reliance on an attorney to fulfill this obligation does not constitute "reasonable cause" for a tardy filing. Id., at 589. The Fifth Circuit has similarly held that the responsibility for ensuring a timely filing is the taxpayer's alone, and that the taxpayer's reliance on his tax advisers -- accountants or attorneys -- is not a "reasonable cause." Millette & Associates v. Commissioner, 594 F.2d 121, 124-125 (per curiam), cert. denied, 444 U.S. 899, 62 L. Ed. 2d 135, 100 S. Ct. 207 (1979); Logan Lumber Co. v. Commissioner, 365 F.2d 846, 854 (1966). The Eighth Circuit also has concluded that reliance on counsel does not constitute "reasonable cause." Smith v. United States, 702 F.2d 741, 743 (1983) (per curiam); Boeving v. United States, 650 F.2d 493, 495 (1981); Estate of Lilleheiv. Commissioner, 638 F.2d 65, 66 (1981) (per curiam).

We need not dwell on the similarities or differences in the facts presented by the conflicting holdings. The time has come for a rule with as "bright" a line as can be drawn consistent with the statute and implementing regulations. [See Footnote 6.] Deadlines are inherently arbitrary; fixed dates, however, are often essential to accomplish necessary results. The Government has millions of taxpayers to monitor, and our system of self-assessment in the initial calculation of a tax simply cannot work on any basis other than one of strict filing standards. Any less rigid standard would risk encouraging a lax attitude toward filing dates. [See Footnote 7.] Prompt payment of taxes is imperative to the Government, which should not have to assume the burden of unnecessary ad hoc determinations. [See Footnote 8.]

Congress has placed the burden of prompt filing on the executor, not on some agent or employee of the executor. The duty is fixed and clear; Congress intended to place upon the taxpayer an obligation to ascertain the statutory deadline and then to meet that deadline, except in a very narrow range of situations. Engaging an attorney to assist in the probate proceedings is plainly an exercise of the "ordinary business care and prudence" prescribed by the regulations, Treas. Reg. §301.6651-1(c)(1) (1984), but that does not provide an answer to the question we face here. To say that it was "reasonable" for the executor to assume that the attorney would comply with the statute may resolve the matter as between them, but not with respect to the executor's obligations under the statute. Congress has charged the executor with an unambiguous, precisely defined duty to file the return within nine months; extensions are granted fairly routinely. That the attorney, as the executor's agent, was expected to attend to the matter does not relieve the principal of his duty to comply with the statute.

This case is not one in which a taxpayer has relied on the erroneous advice of counsel concerning a question of law. Courts have frequently held that "reasonable cause" is established when a taxpayer shows that he reasonably relied on the advice of an accountant or attorney that it was unnecessary to file a return, even when such advice turned out to have been mistaken. See, e. g., United States v. Kroll, 547 F.2d 393, 395-396 (CA7 1977); Commissioner v. American Assn. of Engineers Employment, Inc., 204 F.2d 19, 21 (CA7 1953); Burton Swartz Land Corp. v. Commissioner, 198 F.2d 558, 560 (CA5 1952); Haywood Lumber & Mining Co. v. Commissioner, 178 F.2d at 771; Orient Investment & Finance Co. v. Commissioner, 83 U.S. App. D.C. at 75, 166 F.2d at 603; Hatfried, Inc. v. Commissioner, 162 F.2d at 633-635; Girard Investment Co. v. Commissioner, 122 F.2d at 848; Dayton Bronze Bearing Co. v. Gilligan, 281 F. 709, 712 (CA6 1922). This Court also has implied that, in such a situation, reliance on the opinion of a tax adviser may constitute reasonable cause for failure to file a return. See Commissioner v. Lane-Wells Co., 321 U.S. 219, 88 L. Ed. 684, 64 S. Ct. 511 (1944) (remanding for determination whether failure to file return was due to reasonable cause, when taxpayer was advised that filing was not required). [See Footnote 9.]

When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a "second opinion," or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place. See Haywood Lumber, supra.. "Ordinary business care and prudence" do not demand such actions.

By contrast, one does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due. In short, tax returns imply deadlines. Reliance by a lay person on a lawyer is of course common; but that reliance cannot function as a substitute for compliance with an unambiguous statute. Among the first duties of the representative of a decedent's estate is to identify and assemble the assets of the decedent and to ascertain tax obligations. Although it is common practice for an executor to engage a professional to prepare and file an estate tax return, a person experienced in business matters can perform that task personally. It is not unknown for an executor to prepare tax returns, take inventories, and carry out other significant steps in the probate of an estate. It is even not uncommon for an executor to conduct probate proceedings without counsel.

It requires no special training or effort to ascertain a deadline and make sure that it is met. The failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent, and such reliance is not "reasonable cause" for a late filing under IRC §6651(a)(1). The judgment of the Court of Appeals is reversed. It is so ordered.

Concurring Opinion

[T]he judgment must be reversed. Although the standard of taxpayer liability found in IRC §6651(a)(1) might plausibly be characterized as ambiguous, [See Footnote 10.] courts and the Internal Revenue Service have for almost 70 years interpreted the statute as imposing a standard of "ordinary business care and prudence." I agree with the Court that we should defer to this longstanding construction. [See Footnote 4.] I also agree that taxpayers in the exercise of ordinary business care and prudence must ascertain relevant filing deadlines and ensure that those deadlines are met. As the Court correctly holds, a taxpayer cannot avoid the reach of IRC §6651(a)(1) merely by delegating this duty to an attorney, accountant, or other individual. [See Footnote 11.]

I write separately, however, to underscore the importance of an issue that the Court expressly leaves open. Specifically, I believe there is a substantial argument that the "ordinary business care and prudence" standard is applicable only to the "ordinary person" -- namely, one who is physically and mentally capable of knowing, remembering, and complying with a filing deadline. In the instant case, there is no question that the respondent not only failed to exercise ordinary business care in monitoring the progress of his mother's estate, but also made no showing that he was unable to exercise the usual care and diligence required of an executor. The outcome could be different if a taxpayer were able to demonstrate that, for reasons of incompetence or infirmity, he understandably was unable to meet the standard of ordinary business care and prudence. In such circumstances, there might well be no good reason for imposing the harsh penalty of IRC §6651(a)(1) over and above the prescribed statutory interest penalty. See IRC§§ 6601(a), 6621(b).

The Court proclaims the need "for a rule with as "bright" a line as can be drawn," and it stresses that the Government "should not have to assume the burden of unnecessary ad hoc determinations." On the other hand, it notes that the "bright line" might not cover a taxpayer who is "incapable by objective standards of meeting the criteria of "ordinary business care and prudence," reasoning that "the disability alone could well be an acceptable excuse for a late filing." [See Footnote 6.]

I share the Court's reservations about the sweep of its "bright line" rule. If the Government were determined to draw a "bright line" and to avoid the "burden" of "ad hoc determinations," it would not provide for any exemptions from the penalty provision. Congress has emphasized, however, that exemptions must be made where a taxpayer demonstrates "reasonable cause." IRC §6651(a)(1). Accordingly, the IRS already allows dispensations where, for example, a taxpayer or a member of his family has been seriously ill, the taxpayer has been unavoidably absent, or the taxpayer's records have been destroyed. Internal Revenue Manual (CCH) §4350, (22) para. 22.2(2) (Mar. 20, 1980) (Audit Technique Manual for Estate Tax Examiners). Thus the Government itself has eschewed a bright-line rule and committed itself to necessarily case-by-case decision making. The gravamen of the IRS's exemptions seems to be that a taxpayer will not be penalized where he reasonably was unable to exercise ordinary business care and prudence. The IRS does not appear to interpret its enumerated exemptions as being exclusive, see id., para. 22.2(3), and it might well act arbitrarily if it purported to do otherwise. [See Footnote 12.] Thus a substantial argument can be made that the draconian penalty provision should not apply where a taxpayer convincingly demonstrates that, for whatever reason, he reasonably was unable to exercise ordinary business care.

Many executors are widows or widowers well along in years, and a penalty against the "estate" usually will be a penalty against their inheritance. Moreover, the principles we announce today will apply with full force to the personal income tax returns required of every individual who receives an annual gross income of $1,000 or more. See IRC §6651(a)(1); see also §6012. Although the overwhelming majority of taxpayers are fully capable of understanding and complying with the prescribed filing deadlines, exceptional cases necessarily will arise where taxpayers, by virtue of senility, mental retardation, or other causes, are understandably unable to attain society's norm. The Court today properly emphasizes the need for efficient tax collection and stern incentives. But it seems to me that Congress and the IRS already have made the decision that efficiency should yield to other values in appropriate circumstances.

Because the respondent here was fully capable of meeting the required standard of ordinary business care and prudence, we need not decide the issue of whether and under what circumstances a taxpayer who presents evidence that he was unable to adhere to the required standard might be entitled to relief from the penalty.

Footnotes from the Opinion

- The Internal Revenue Service has articulated eight reasons for a late filing that it considers to constitute "reasonable cause." These reasons include unavoidable postal delays, the taxpayer's timely filing of a return with the wrong IRS office, the taxpayer's reliance on the erroneous advice of an IRS officer or employee, the death or serious illness of the taxpayer or a member of his immediate family, the taxpayer's unavoidable absence, destruction by casualty of the taxpayer's records or place of business, failure of the IRS to furnish the taxpayer with the necessary forms in a timely fashion, and the inability of an IRS representative to meet with the taxpayer when the taxpayer makes a timely visit to an IRS office in an attempt to secure information or aid in the preparation of a return. Internal Revenue Manual (CCH) §4350, (22) para. 22.2(2) (Mar. 20, 1980) (Audit Technique Manual for Estate Tax Examiners). If the cause asserted by the taxpayer does not implicate any of these eight reasons, the district director determines whether the asserted cause is reasonable. "A cause for delinquency which appears to a person of ordinary prudence and intelligence as a reasonable cause for delay in filing a return and which clearly negatives willful neglect will be accepted as reasonable." Id., para. 22.2(3).
- IRC 6081(a) authorizes the IRS to grant "a reasonable extension of time," generally no longer than six months, for filing any return.
- Congress added the relevant language to the tax statutes in 1916. For many years before that, IRC §3176 mandated a 50 percent penalty "in case of a refusal or neglect, except in cases of sickness or absence, to make a list or return, or to verify the same. . . ." Rev. Stat. §3176 (emphasis added). The Revenue Act of 1916 amended this provision to require the 50 percent penalty for failure to file a return within the prescribed time, "except that, when a return is voluntarily and without notice from the collector filed after such time and it is shown that the failure to file it was due to a reasonable cause and not due to willful neglect, no such addition shall be made to the tax." Revenue Act of 1916, ch. 463, §16, 39 Stat. 756, 775 (emphasis added). No committee reports or congressional hearings or debates discuss the change in language. It would be logical to assume that Congress intended "willful neglect" to replace "refusal" - - both expressions implying intentional failure -- and "[absence of] reasonable cause" to replace "neglect" -- both expressions implying carelessness.
- Respondent contends that the statute must be construed to apply a standard of willfulness only, and that the Treasury Regulation is incompatible with this construction of the statute. He argues that the Regulation converts the statute into a test of "ordinary business care," because a taxpayer who demonstrates ordinary business care can never be guilty of "willful neglect." By construing "reasonable cause" as the equivalent of "ordinary business care," respondent urges, the IRS has removed from consideration any question of willfulness. We cannot accept this reasoning. Congress obviously intended to make absence of fault a prerequisite to avoidance of the late-filing penalty. [See Footnote 3, supra.] A taxpayer seeking a refund must therefore prove that his failure to file on time was the result neither of carelessness, reckless indifference, nor intentional failure. Thus,

the Service's correlation of "reasonable cause" with "ordinary business care and prudence" is consistent with Congress' intent, and over 40 years of case law as well. That interpretation merits deference. See, e.g., Chevron U. S. A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844, 81 L. Ed. 2d 694, 104 S. Ct. 2778, and n. 14 (1984).

- Although at one point the Court of Appeals for the Sixth Circuit held that reliance on counsel could constitute reasonable cause, see In re Fisk's Estate, 203 F.2d 358, 360 (1953), the Sixth Circuit appears now to be following those courts that have held that the taxpayer has a nondelegable duty to ascertain the deadline for a return and ensure that the return is filed by that deadline. See Estate of Geraci v. Commissioner, 1973 T.C. Memo 94, 32 T.C.M. (CCH) 424, 425 (1973), aff'd, 502 F.2d 1148 (CA6 1974), cert. denied, 420 U.S. 992, 43 L. Ed. 2d 673, 95 S. Ct. 1428 (1975); Estate of Duttenhofer v. Commissioner, 49 T.C. 200, 205 (1967), aff'd, 410 F.2d 302 (CA6 1969) (per curiam).
- The administrative regulations and practices exempt late filings from the penalty when the tardiness results from postal delays, illness, and other factors largely beyond the taxpayer's control. [See Footnote 1.] The principle underlying the IRS regulations and practices -- that a taxpayer should not be penalized for circumstances beyond his control -- already recognizes a range of exceptions which there is no reason for us to pass on today. This principle might well cover a filing default by a taxpayer who relied on an attorney or accountant because the taxpayer was, for some reason, incapable by objective standards of meeting the criteria of "ordinary business care and prudence." In that situation, however, the disability alone could well be an acceptable excuse for a late filing. But this case does not involve the effect of a taxpayer's disability; it involves the effect of a taxpayer's reliance on an agent employed by the taxpayer, and our holding necessarily is limited to that issue rather than the wide range of issues that might arise in future cases under the statute and regulations. Those potential future cases are purely hypothetical at the moment and simply have no bearing on the issue now before us. The concurring opinion seems to agree in part. After four pages of discussion, it concludes: "Because the respondent here was fully capable of meeting the required standard of ordinary business care and prudence, we need not decide the issue of whether and under what circumstances a taxpayer who presents evidence that he was unable to adhere to the required standard might be entitled to relief from the penalty." This conclusion is unquestionably correct. See also, e.g., Reed v. Ross, 468 U.S. 1, 8, n. 5, 82 L. Ed. 2d 1, 104 S. Ct. 2901 (1984); Heckler v. Day, 467 U.S. 104, 119, 81 L. Ed. 2d 88, 104 S. Ct. 2249, nn. 33 and 34 (1984); Kosak v. United States, 465 U.S. 848, 853, n. 8, 79 L. Ed. 2d 860, 104 S. Ct. 1519 (1984); Bell v. New Jersey, 461 U.S. 773, 779, n. 4, 76 L. Ed. 2d 312, 103 S. Ct. 2187 (1983).
- Many systems that do not collect taxes on a self-assessment basis have experienced difficulties in administering tax collection. See J. Wagner, France's Soak-the-Rich Tax, Congressional Quarterly (Editorial Research Reports), Oct. 12, 1982; Dodging Taxes in the Old World, Time, Mar. 28, 1983, p. 32.
- A number of courts have indicated that "reasonable cause" is a question of fact, to be determined only from the particular situation presented in each particular case. See, e.g., Estate of Mayer v. Commissioner, 351 F.2d 617 (CA2 1965) (per curiam), cert. denied, 383 U.S. 935, 15 L. Ed. 2d 852, 86 S. Ct. 1065 (1966); Coates v. Commissioner, 234 F.2d 459, 462 (CA8 1956). This view is not entirely correct. Whether the elements that

constitute "reasonable cause" are present in a given situation is a question of fact, but what elements must be present to constitute "reasonable cause" is a question of law. See, e.g., Haywood Lumber & Mining Co. v. Commissioner, 178 F.2d 769, 772 (CA2 1950); Daley v. United States, 480 F. Supp. 808, 811 (ND 1979). When faced with a recurring situation, such as that presented by the instant case, the courts of appeals should not be reluctant to formulate a clear rule of law to deal with that situation.

- Courts have differed over whether a taxpayer demonstrates "reasonable cause" when, in reliance on the advice of his accountant or attorney, the taxpayer files a return after the actual due date but within the time the adviser erroneously told him was available. Compare Sanderling, Inc. v. Commissioner, 571 F.2d 174, 178-179 (CA3 1978) (finding "reasonable cause" in such a situation); Estate of Rapelje v. Commissioner, 73 T.C. 82, 90, n. 9 (1979) (same); Estate of DiPalma v. Commissioner, 71 T.C. 324, 327 (1978) (same), acq., 1979-1 Cum. Bull. 1; Estate of Bradley v. Commissioner, 1974 T.C. Memo 17, 33 T.C.M. (CCH) 70, 72-73 (1974) (same), aff'd, 511 F.2d 527 (CA6 1975), with Estate of Kerber v. United States, 717 F.2d 454, 454-455, and n. 1 (CA8 1983) (per curiam) (no "reasonable cause"), cert. pending, No. 83-1038; Smith v. United States, 702 F.2d 741, 742 (CA8 1983) (same); Sarto v. United States, 563 F. Supp. 476, 478 (ND Cal. 1983) (same). We need not and do not address ourselves to this issue.
- For each month or fraction of a month that a tax return is overdue, IRC §6651(a)(1) provides for a mandatory penalty of 5% of the tax (up to a maximum of 25%) "…unless it is shown that [the failure to file on time] is due to reasonable cause and not due to willful neglect." As Judge Posner observed in his dissent below, "in making "willful neglect" the opposite of "reasonable cause" the statute might seem to have modified the ordinary meaning of "reasonable"..." 710 F.2d 1251, 1256 (CA7 1983).
- As the Court emphasizes, this principle of nondelegation does not extend to situations in which a taxpayer reasonably relies on expert advice concerning substantive questions of tax law, such as whether a liability exists in the first instance.
- It is difficult to perceive a material distinction, for example, between a filing delay that results from a serious illness in the taxpayer's immediate family or a taxpayer's unavoidable absence -- situations in which the IRS excuses the delay -- and a filing delay that comes about because the taxpayer is infirm or incompetent. The common thread running through all these unfortunate situations is that the taxpayer, for reasons beyond his control, has been unable to exercise ordinary business care and prudence.

Appendix G Tax Court Case Corbin West Limited Partnership v. Commissioner T.C. Memo 1999-7

Summary and Relevance

In Corbin West, the Tax Court analyzed the treatment of a variety of costs included by Corbin West in adjusted basis for purposes of depreciation and eligible basis under IRC §42 credit. The court focused on the economic substance behind the transactions generating the costs, examined the parties' practices, and evaluated the partnership's justifications under the Internal Revenue Code for each specific cost included in basis. The Court held as follows:

- The note at issue lacks economic substance and is not includable in the property's basis. Corbin West is not entitled to depreciation deductions or IRC §42 credit related to the note;
- Corbin West is not entitled to interest deductions associated with the note;
- The Court allowed the partnership to capitalize an acquisition fee and developer's fee based on its finding that these costs were incident to the partnership's acquisition of the property. The court noted a number of services performed in return for the fee, including the evaluation of zoning and environmental requirements and the securing of an option to acquire the property;
- The Court held that the partnership was not entitled to capitalize a $90,000 tax credit guarantee fee into the property's basis. The Court did not allow the taxpayer to capitalize the fee to the property's basis because the partnership failed to demonstrate that this cost was associated with the acquisition of the property, citing Treas. Reg. §1.263(a)-2.
- Similar to the treatment of tax guarantee fees, the Court held that the partnership was not entitled to capitalize a cash flow guarantee fee to the basis of the property. The fee was paid to the general partner in return for agreeing to make loans to the partnership to fund any operating deficits. Again, the Court cited the absence of a specific rationale and support in the Code.

Facts

Corbin West (a TEFRA partnership) consisted of one general partner, CDC Equity Corp. (CDC), and 29 limited partners. CDC, the tax matters partner, was the wholly owned subsidiary of CDC Financial Corp. (Financial). Corbin West was formed to purchase, manage, and syndicate the Corbin West Apartments (the property).

I. Acquisition of the Property

- From approximately March 17, 1970, until December 23, 1988, Norman Associates (Norman) owned the property.
- On December 8, 1987, Corbin West entered into an option agreement (the first option) with Norman to purchase the property for $1,760,000.
- On or about December 9, 1987, CDC, acting on behalf of Corbin West, applied for a reservation of a federal low-income housing tax credit relating to the property with the Connecticut Housing Finance Authority (CHFA application). The CHFA application reflected a total acquisition cost of $1,760,000 plus estimated development and/or rehabilitation costs of $1,698,315.

Corbin West was unable to obtain the financing required for rehabilitation of the property and allowed the first option to lapse on April 1, 1988. The taxpayer remained interested in obtaining the property and devised a new plan to acquire the property. Under the plan,

- Norman would sell the property to a charitable organization for a price below an alleged fair market value and take a charitable contribution deduction for the difference between the sale price and the alleged fair market value.

- The charitable organization in turn would sell the property to Corbin West. Corbin West would reimburse the charitable organization for the cash paid to Norman to acquire the property and execute a promissory note for the difference between the alleged fair market value and the cash paid (the same amount as Norman's charitable contribution deduction).

The bargain sale would be advantageous to Norman because it would provide him with, in addition to the proceeds from the sale of the property, a large charitable contribution deduction. The bargain sale would provide Corbin West a high basis in the property.

On or about November 30, 1988, Financial (CDC's parent) approached the New Britain Housing Authority (NBHA) and asked if NBHA would participate in Corbin West's bargain sale plan. NBHA officials believed this was a strange request but nonetheless agreed to participate. NBHA requested that Financial indemnify NBHA against any and all loss, cost, claim, demand, or damage arising out of or in connection with NBHA's purchase of the property (hold harmless agreement). Financial provided the request indemnifications.

On or about December 23, 1988, NBHA entered into an agreement with Norman to purchase the property for $1,808,500. Norman took a charitable contribution deduction for the difference between the alleged fair market value of $ 3,150,000 and the sale price of $1,808,500 (i.e., $1,341,500). The IRS denied Norman's charitable contribution deduction, and Norman never challenged respondent's determination in court.

On or about December 23, 1988, NBHA entered into an option agreement (the second option) with Corbin West under which Corbin West acquired the right to purchase the property. Corbin West exercised the second option and purchased the property from Norman pursuant to the option with NBHA for $1,808,500. Corbin West paid the $1,808,500 by assuming the existing first mortgage of $873,000, obtaining a second mortgage of $920,000, and paying the balance from the limited partners' contributions. Corbin West also gave NBHA a promissory note (the note) for $1,341,500, the difference between the alleged fair market value of $3,150,000 and the $1,808,500 already paid. NBHA did not record the note as an asset on its financial statements.

The terms of the note were particularly favorable to the taxpayer.

- The note was recourse against Corbin West but not against the general partner or any of the limited partners.
- The note was not secured by the property.
- Interest and principal on the note were not payable until the earlier of the sale of the property or January 1, 2011.
- The note was subordinated to repayment of the first and second mortgages, repayment of loans from the general partner plus interest, and repayment of the limited partners' capital contributions and loans plus 8% interest.

On its federal income tax returns for 1990, 1991, 1992, and 1993, Corbin West included the note in the property's basis for purposes of determining its depreciation deductions and low-income housing credits. Corbin West also claimed accrued interest deductions related to the note of $135,000, $147,492, $160,719, and $175,323, respectively.

II. Fees Paid

Corbin West paid CDC substantial fees related to the property. The fees included (1) an "acquisition fee" of $157,000, (2) a "developer fee" of $87,213, (3) a "tax credit guarantee fee" of $90,000, and (4) a "no negative cash flow guarantee fee" of $35,000.

Corbin West paid the "tax credit guarantee fee" for CDC's guaranty that the property would be operated in a manner which would comply with the requirements of IRC §42 and ensure the availability of the IRC §42 credit. CDC guaranteed that if the property failed to qualify for the IRC §42 credit, then CDC would advance Corbin West an amount equal to any loss of credit. To date, CDC has not made any payments under this provision.

On its federal income tax returns for 1990, 1991, 1992, and 1993, Corbin West included the "acquisition fee," the "developer's fee," and the "tax credit guarantee fee" in the property's basis.

Corbin West paid CDC the "no negative cash flow guarantee fee" for CDC's promise to make loans up to $250,000 to Corbin West to fund any operating deficits that might arise through December 31, 2995. On the same tax returns described above, Corbin West capitalized the fee and claimed the amortization deductions related to that fee of $7,571, $7,571, and $7,574.

IRS Position as to the Note

The IRS argued that the $1,341,500 note lacks economic substance; therefore, Corbin West should not include the note in the property's basis for purposes of computing depreciation deductions or low-income housing credits.

Court's Opinion

In determining whether there is a likelihood of repayment, courts look at the facts and circumstances of each case. In this case:

1. The purchase price greatly exceeded the fair market value of property. Corbin West reported the purchase price of the property as $3,150,000. The IRS argued that the fair market value of the property at the time of Corbin West's acquisition was only $1,808,500; therefore, the purchase price greatly exceeds the fair market value.

In this case, the most significant indicator of the fair market value of the property is the first option entered into by Corbin West and Norman one year before the acquisition of the property through the bargain sale. The first option allowed Corbin West to purchase the property for $1,760,000. The evidence suggests that this price was negotiated at arm's length. Therefore, it appears that the purchase price greatly exceeded the fair market value of the property at the time of Corbin West's acquisition, and the note was unlikely to be repaid from its inception.

2. The repayment of the note was subordinate to repayment of loans totaling $3,257,500, which included:

- The existing first mortgage of approximately $873,000,
- the second mortgage of $920,000,
- the limited partners' loans of $705,600 at 8% interest,
- the limited partners' capital contributions of $258,900, and
- the general partners' loans of $500,000 plus interest.

3. The preexisting debt on the property and the obligations to the partners already exceeded by a large amount the fair market value of the property at the time of Corbin West's purchase, and, as noted above, the repayment of the note was subordinate to repayment of that debt and those partner obligations. Therefore, there was no reasonable likelihood that the note would be repaid.

4. The property was the sole asset held by Corbin West; therefore, even if Corbin West decided to pay off the note, it is unlikely that Corbin West would have the financial ability to pay off the note and the interest thereon when due.

The Court also considered the nature of the dealings between the parties and concluded that NBHA did not expect the note to be repaid and never treated the note as genuine debt.

- NBHA was chosen by Corbin West to execute its bargain sale plan and NBHA was not a negotiating party in the transaction.
- There was no evidence that NBHA made any independent analysis concerning the fair market value of the property or the likelihood of repayment of the note by Corbin West.
- NBHA had nothing at risk in the transaction because Financial gave NBHA a hold harmless agreement. NBHA received the note for allowing itself to be used by Corbin West and Norman in their attempt to ensure advantageous tax positions.
- NBHA did not treat the note as genuine debt. There is no evidence that the NBHA considered the credit rating of Corbin West before agreeing to accept the note and NBHA never recorded the note as an asset on its financial statements. At the time of trial, NBHA could not locate the note. In total, the facts indicate that NBHA did not expect the note to be repaid.

Appendix H Tax Court Case Bentley Court II Limited Partnerships, B.F. Bentley, Inc., Tax Matters Partner, Petitioner v. Commissioner of Internal Revenue, Respondent T.C. Memo 2006-113

Summary and Relevance

In Bentley Court II L.P., the issue was whether a taxpayer must recapture credits under IRC §42(j). The taxpayer agreed that the credit claimed for the years under audit was not allowable, but disagreed that the IRC §42(j) credit provisions were applicable. The taxpayer contended that it was not entitled to the credit taken in closed taxable years, and because the units never qualified as low-income units, there was no difference in qualified basis in the first-open taxable year and the prior closed taxable year (i.e., qualified basis was always zero). The Court found that the duty of consistency applied to the taxpayer and held that the IRC §42(j) recapture provisions did apply.

CCA 201136023 addresses the application of the recapture provisions of IRC §42(j)(1) considering this case.

Facts

The taxpayer received an allocation of credit and constructed the housing during 1990 and 1991. The taxpayer claimed IRC §42 credits for six years, 1990-1995, as follows:

Year	**Credits**
1990	$28,508
1991	$699,780
1992	$859,543
1993	$918,155
1994	$926,819
1995	$927,606

The tax returns for 1993, 1994, and 1995 were audited. The revenue agent determined that the taxpayer had falsified documents, including changing income amounts and indicating that certain tenants were not students when, in fact, they were. A review of the tenant files by the state agency revealed that 90% of the tenants in the apartment complex were students.

The revenue agent concluded that the apartment complex did not qualify for the IRC §42 credit because the households occupying the units were not qualified and disallowed the entire credit for all three years under audit. In addition, the revenue agent applied the recapture rules under IRC §42(j) to recapture 1/3 of the credits claimed in 1990, 1991 and 1992; $9,493, $233,027 and $286,228 respectively.

Although the taxpayer originally alleged errors in the IRS' determination, the taxpayer eventually conceded all the low-income housing credit for 1993, 1994, and 1995 during settlement negotiations.

The taxpayer's general partner was sentenced to 30 months in prison based on his guilty pleas to 1 of 22 counts of obstructing and impeding the administration of the internal revenue law "by losing and concealing specified tenant files.

The taxpayer did not concede the recapture of one third of the credits claimed in 1990, 1991, and 1992.

Issue

The sole issue before the Court in Bentley Court II was whether the taxpayer, under IRC §42(j) must recapture in 1993, $528,747 in low-income housing credits claimed in prior years.

IRC §42(j)(1) states that if, as of 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, then the taxpayer's tax …for the taxable year shall be increased by the credit recapture amount.

The taxpayer argued that not only was it not entitled to the credits for 1993, 1994, and 1995, but that the same fact pattern existed in earlier years. Therefore, even though the tax years were barred from examination by the expiration of the statutes of limitation, the actually qualified basis in those years is also zero. Because there is no difference in the qualified basis between 1992 and 1993, the credit recapture rules cannot be applied. Bentley Court argued that the Government was overreaching or maneuvering by determining deficiencies in open year and using the recapture provisions to circumvent the closure of years in which a deficiency would or should have been determined.

The Government responded that since the qualified basis, as determined in the audit, was less than the qualified basis of $11,537,221 reported on the taxpayer's 1992 return, the recapture rules under IRC §42(j) are applicable. The Government argued that the taxpayer:

- offered no evidence to show that the apartment complex was not a qualified low-income building for the 1990, 1991 and 1992 tax years; and
- is bound by a "duty of consistency not to take inconsistent positions; contending now that it failed to qualify or that qualified basis was zero for 1990, 1991 and 1992, when the taxpayer had previously claimed the credit and reported on the tax return that a qualified basis existed for those years.

The "Duty of Consistency" Doctrine

The Duty of Consistency doctrine is intended to prevent a taxpayer from taking a position in a earlier year and a contrary position in a later year after the limitations period has run on the first year. As noted in *Beltzer v. United States*, 495 F.2d 211, 212 (8th Cir. 1974), a duty of consistency arises where:

- the taxpayer has made a representation or reported an item for tax purposes in one year,
- the Commissioner [IRS] has acquiesced in or relied on that fact for that year, and
- the taxpayer desires to change the representation, previously made, in a later year after the statute of limitations on assessments bars adjustments for the initial year.

The Government argued that the facts of the case show that all three of the criteria had been met and that the taxpayer should be held to a duty of consistency.

Bentley Court contended that the duty of consistency is inapplicable, or if it is, it should be applied to estop the Government from recapturing the credit because (1) the taxpayer reported low-income credits in 1990 to 1995, and the government "disallowed" those credits in all years by criminally prosecuting the general partner; (2) because of the indictments against the general partner, respondent did not acquiesce to the credits claimed for 1990, 1992, and 1992; and (3) the taxpayer was compelled to change its initial representation or claim of credits due to the criminal prosecution of the general partner.

As an alternative position, Bentley Court argued that the Duty of Consistency doctrine is limited to cases involving a mistake of fact, not a mistake of law; i.e., the general partner did not understanding which types of students could qualify as low-income individuals.

Tax Court's Decision

The Tax Court upheld the Government's position. In framing its decision, the Court addressed the three criteria presented in Beltzer.

- The taxpayer claimed credits and reported qualified basis on its 1990, 1991, and 1992 tax returns.
- The government acquiesced to and relied upon the taxpayer's representation by "accepting" the 1990, 1991 and 1992 tax returns as filed. The indictment and criminal proceeding against the general partner started after the normal 3-year statutes of limitation had expired for the taxpayer's 1990, 1991 and 1992 tax returns. Further, the audit did not extend back prior to the 1993 year. Therefore, it appears that the Government (during the audit) did not gain access to facts that would have put the Government on notice that the credit claimed for 1992 was erroneous.
- The taxpayer first represented that it qualified for the credit for the years 1990, 1991, and 1992. The taxpayer, now that the statutes of limitation have closed for those years, is claiming that the previously reported year-end qualified bases were actually zero.

As for the taxpayer's argument that the general partner made a "mistake of law," the Court stated it had no basis and was not worthy of further consideration; i.e., that "it is obvious…that the criminal matter had to do with misrepresentations and/or concealment of facts on Bentley Court's behalf by [the general partner]."

Appendix I Tax Court Case Richard E. Carp and Minda G. Carp, Petitioners v. Commissioner of Internal Revenue, Respondent; Franklin D. Zuckerman and Lois Zuckerman, Petitioners v. Commissioner of Internal Revenue, Respondent T.C. Memo 1991-436

Summary and Relevance

In Carp and Zuckerman v. Commissioner, the Court considered when an amount designated as a developer fee paid to Mr. Carp and Mr. Zuckerman constituted a qualified rehabilitation expenditure for purposes of the IRC §48, Rehabilitation Credit.

The Court found that the taxpayer failed to prove that they performed the development services specified in the development agreement.

The taxpayer bears the burden of proving that the amount constitutes a qualified rehabilitation expenditure under IRC §48. Except for the negotiation of the sales contract and the supervision of construction and renovation, the taxpayers contracted with the seller to perform the services enumerated in the development agreement.

There was no objective evidence submitted by the taxpayers to detail the time and effort spent by the taxpayers on any of the services. The Court also explained that it was inappropriate to apply the rule of Cohan v. Commissioner, 39 F.2d 540 (1930), to estimate whether part of the expenses would be deductible where the taxpayer who has "ready access" to support evidence fails to produce such evidence.

The taxpayers did not submit evidence which would allow the Court to allocate the amount to the various services specified in the development agreement, some of which are specifically excluded from the definition of qualified rehabilitation expense under IRC §48.

The analysis made in the case related to whether the amount paid was a qualified rehabilitation expenditure is similar to the analysis that should occur under IRC §42 to determine if a fee paid should be included in eligible basis.

IRS Position

The IRS argued:

- the taxpayers had not proved that the services enumerated in the development agreement had been performed,
- the services were duplicative of services of those which another person was to perform as part of the sales agreement,
- the development agreement was not a bona-fide agreement with a legitimate business purpose. Instead, the agreement was in substance for the performance of other services that would not qualify for the IRC §48 credit.
- the development fee was a cost of acquiring the building, and as such was not a qualified rehabilitation expenditure.

Taxpayer's Position

The taxpayers asserted that:

- The fee amount was intended as a development fee "for all purposes, including its legal substance and effect," as supported by its characterization in the private placement memorandum and the developers note.
- The contracts, submitted as stipulated exhibits, spoke for themselves in establishing that Mr. Carp and Mr. Zuckerman performed qualifying development services and that no further evidence was necessary.
- The taxpayers "spent many hours in meetings" regarding various aspects of the renovation and made all decisions relating to the common areas, such as selecting carpet.

Court's Decision

The Court concluded, without addressing other IRS contentions, that the taxpayers failed to prove that they performed the development services specified in the agreement. The Court explained:

1. The taxpayers bear the burden of proving that the amount constituted qualified rehabilitation expenditure.

2. Except for the negotiation of the sales contract and the supervision of construction and renovation, the taxpayers contracted with the seller to perform the services enumerated in the development agreement.

3. There was no objective evidence submitted by the taxpayers to detail the time and effort spent by the taxpayers on any of the services. The Court also explained that it was inappropriate to apply the rule of *Cohan v. Commissioner* to estimate whether part of the expenses would be deductible where the taxpayer who has "ready access" to supportive evidence fails to produce such evidence.

The "Cohan Rule" originated in the decision of *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930). In *Cohan*, the court made an exception to the rule requiring taxpayers to substantiate their business expenses. The taxpayer was disallowed a deduction for travel and business expenses because he was unable to substantiate any of the expenses. The judge wrote that "absolute certainty in such matters is usually impossible and is not necessary, the Board should make as close an approximation as it can." In general, the Tax Court has interpreted this ruling to mean that in certain situations "best estimates" are acceptable in order to approximate expenses. The Cohan Rule is a discretionary standard and can be used to support a reasonable estimate of compliance requirements.

4. The taxpayers did not submit evidence which would allow the Court to allocate the amount to the various services specified in the development agreement, some of which are specifically excluded from the definition of qualified rehabilitation expenses under IRC §48.

The Court stated:

> "Petitioners state in their brief that "There was no evidence submitted with regard to the [many hours of meetings, etc. spent by Mr. Carp and Mr. Zuckerman] because these services are typical and self-evident in any rehabilitation project, and therefore further evidence was not necessary." However, in our view such evidence is necessary, and is lacking here."

Appendix J United States Court of Appeals for the Ninth Circuit Housing Pioneers, Inc., Petitioner-Appellant, v. Commissioner, Internal Revenue Service, Respondent-Appellee. No. 93-70583, 58 F.3d 401 (9th Cir. 1995)

Summary and Relevance

This case involves the determination of whether Housing Pioneers, Inc. (Pioneers) qualifies as an IRC §501(c)(3) organization. Pioneers appealed the decision of the Tax Court denying it IRC § 501(c)(3) status and in its opinion, the Ninth Circuit Court affirms the judgment of the Tax Court.

This determination is relevant to the extent that IRC §42(h)(5) is applicable to allocation of low-income credit.

Facts

Pioneers was incorporated March 21, 1989 as a "nonprofit public benefit corporation" under California law. Its articles of incorporation announced its "specific purpose" to be "to provide innovative and affordable housing to low income and handicapped persons, including providing housing for pre-release and post-release persons who are or have been incarcerated in prisons." The articles of incorporation further declared the corporation to be organized and operated exclusively for charitable purposes "within the meaning of IRC §501(c)(3)." The incorporator was Jerry L. Harris.

Pioneers duly applied for exemption to the Internal Revenue Service (the IRS). In response to questions, Jerry L. Harris informed the IRS on January 30, 1990 that Pioneers had no facilities or office space and had published no information about itself. He added that on April 1, 1989 Pioneers had signed a joint management agreement with Grant Square Properties (Grant Square) to participate in a project by which Grant Square's property would be exempt from property tax. As part of the agreement, Grant Square had lent Pioneers $5,000 to buy an interest in Grant Square of 1% and become a general partner in Grant Square.

A subsequent letter from Harris informed the government that the Grant Square partnership was divided as follows: General partners: Towne Centre Investment, Inc. (9%) and Pioneers (1%); Limited partners: Jerry L. Harris (30%), Howard R. Harris (40%), David Harris (5%), Richard Harris (5%) and J.M. Hepps (10%). David and Richard Harris were Jerry Harris's brothers; Howard was his father; and Hepps was his grandfather. Towne Centre Investment, Inc. was wholly owned by Jerry and Howard. In addition to Jerry and Howard, the board of directors of Pioneers included nine persons not related to the Harrises and chosen for their interest in housing and social services.

Pioneers' plan of operation was keyed to the property tax exemption afforded by IRC 214(g) of the California Revenue and Taxation Code. According to S214(a), if "the managing general partner" of a partnership in property used for low-income rental housing is a nonprofit meeting the criteria set out in §214, the property is entitled to a tax exemption. Among these criteria are that at least 20% of the tenants meet certain low income requirements and that "the owner of the property is eligible for and receives low-income housing tax credits pursuant to IRC §42, as added by Public Law 99-514."

Pioneers' plan was to form partnerships in which the other partners would benefit from the property tax exemption obtained by Pioneers' participation. Part of the property tax savings would be retained by the partnership and used to keep the rents low; part of the savings would be paid to Pioneers and be used by Pioneers for its charitable purposes. In the Grant Square partnership, the first year of savings was to be divided 40% to Towne Centre Investment, Inc. for arranging the transaction, 60% to the Grant Square partnership; in subsequent years, Grant Square would keep 50% and Pioneers would receive cash from Grant Square equal to 50% of the savings. Although Pioneers was a co-general partner, its partnership duties were restricted by the agreement to assuring that the savings were applied to the reduction of the rents charged by the partnership and to assuring that the properties owned by the partnership complied with the requirements IRC §42 and California Revenue and Taxation Code §214(g).

In March 1990 Pioneers entered into an agreement with Hidden Cove Associates similar to that with Grant Square but distinguished by the absence among the Hidden Cove partners of any relative of the Harrises.

IRS Audit and Tax Court Decision

The Commissioner of Internal Revenue determined that Pioneers was not an organization described in IRC §501(c)(3). Pursuant to IRC §7428, Pioneers invoked the jurisdiction of the Tax Court and sought a declaratory judgment to the contrary.

In accordance with Rule 217(b) of the Tax Court Rules of Practice and Procedure, the case was decided on the administrative record. The Tax Court upheld the Commissioner on two grounds.

- Pioneers was disqualified because its proposed activities included at least one non-exempt purpose which was "substantial in nature." See Better Business Bureau v. United States, 326 U.S. 279, 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945) (interpreting exemption from the Social Security tax). This non-exempt purpose was to provide the benefit of both the California §214 exemption and the federal IRC §42 credit to partnerships that were not exclusively charitable.
- The benefits inured in part to private individuals; the Harrises in the case of Grant Square and the limited partners in the case of Hidden Cove. The Tax Court declared: "the California property tax reductions, even though they are to be used exclusively for the purpose of reducing the rents or otherwise maintaining the affordability of the residential units, inure indirectly at least to the benefit of the non-exempt partners in that the partnerships are thereby relieved of the necessity of maintaining rents at a level sufficient to cover operating expenses which would otherwise have to be paid out of partnership capital." The forbidden purpose and the private benefits were, the Tax Court found, "inextricably" meshed.

Pioneers appealed.

Court's Analysis

Pioneers presents an argument that is ultimately unpersuasive but is nonetheless attractive enough to deserve elaboration and powerful enough to require refutation. The argument, fully expanded, is paraphrasable as follows (quotation marks are employed not to indicate verbatim quotation but to distinguish the argument from any holding of this court):

> "Not only §214 of the California Tax and Revenue Code but federal tax law intended that in the production of low-income housing there will be collaboration between an exempt entity and for-profit partners. Specifically, IRC §42(h)(5) provides that 'not more than 90 per cent of the State housing credit ceiling for any State for any calendar year shall be allowed to projects other than qualified low-income housing projects described in subparagraph (B).' Subparagraph B describes a qualified low-income housing project as one in which 'a qualified nonprofit organization owns an interest in the project' and 'materially participates' in the development and operation of the project. To be qualified, a nonprofit must fit within IRC §501(c)(3) or (4). The statutory language implies that there will be other, for-profit partners who share with the IRC §501(c) organization in the ownership, development, and operation of the property. Fairly clearly, Congress sought to encourage low-income housing by encouraging nonprofits to join with for-profits in providing it. The inescapable corollary of such projects is that participation by the qualified nonprofit will bestow a tax credit on its for-profit partners. Indeed, once a partnership is formed by a non-profit with for-profits, one purpose - surely substantial - will be for the nonprofit to make a go of the partnership; and such purposeful endeavor will inescapably in part inure to the benefit of the private investors. If the Commissioner's position were correct, IRC §42(h)(5) would never work.
>
> "The Commissioner has not refuted Pioneers' statutory argument or its logic. So what is different about Pioneers? It is a nonprofit yoked in partnership with private parties who stand to get something out of the partnership. The benefit to the private partners as found by the Tax Court consists in relieving them 'of the necessity of maintaining rents at a level sufficient to cover operating expenses' - in other words, of allowing them to provide low-income housing cheaply; that result is what federal tax law aims in IRC §42 to achieve."
>
> "The Commissioner contends that the appropriate standard of review of the Tax Court's findings of a substantial non-exempt purpose and of activity inuring to private benefit is clear error. Under the court's precedents these findings are treated as factual and so the clear error standard applies. Church of Scientology v. Commissioner, 823 F.2d 1310, 1317 (9th Cir. 1987), cert. denied, 486 U.S. 1015, 100 L. Ed. 2d 214, 108 S. Ct. 1752 (1988). The Commissioner contends there is no clear error here. The difficulty with the Commissioner's argument is that the factual findings of the Tax Court are not enough to carry the day for the Commissioner. Under IRC §42(h) a nonprofit is expected to have a substantial purpose to benefit a non-charitable partnership and part of the savings achieved are expected to inure to individuals without destroying the IRC §501(c)(3) status of the nonprofit and making IRC §42(h) inoperable. It is the court's job to interpret the Internal Revenue Code harmoniously; so the court must recognize that as a matter of law IRC §42(h) limits the requirements of IRC §501(c)(3)."

So runs Pioneers' argument as we understand it. It might well be a successful argument but we need not, and do not, rule upon it. A crucial factual foundation is missing. Pioneers has failed to show that it qualifies as an IRC §42(h) nonprofit. To be such an entity, according to IRC §42(h)(5)(B), Pioneers has to "materially participate (within the meaning of IRC §469(h)) in the development and operation of the project." Section 469(h), setting out "the passive loss rule," defines material participation as activity that is "regular," "continuous," and "substantial." Pioneers flunks the test by all three criteria. It has shown no regular, no continuous, no substantial activity in developing or operating the projects. Moreover, under IRC §42(h)(5)(c) to qualify as an IRC §42(h) nonprofit, Pioneers had to be "determined by a State housing credit agency not to be affiliated with or controlled by a for-profit organization." Nothing in the record establishes such a determination by a State housing credit agency.

As Pioneers has not shown itself to be an IRC §42(h) nonprofit, we have no reason to decide the relation between IRC §42(h) and IRC §501(c)(3) and no need to decide if the former modifies the latter. The usual rules for applying IRC §501(c)(3) apply.

The Tax Court has found that one substantial purpose of Pioneers was a non-exempt purpose and that carrying out that purpose would inure to private benefit. We are given no reason to hold these factual findings clearly erroneous.

As Pioneers explains its argument on rehearing, it is all by way of analogy. Pioneers is not an IRC §42(h) entity and has never sought to be one; Pioneers simply points to IRC §42(h) as a sign that Congress meant some IRC §501(c)(3) entities to be yoked with for profit entities.

We need not address this contention as it is not the case presented. The case of Pioneers is governed by a single statute, IRC §501(c)(3). Pioneers invokes Plumstead Theatre Society, Inc. v. CIR, 675 F.2d 244 (9th Cir. 1982), where we held the Tax Court not to be clearly erroneous in finding a nonprofit theatre group to be operated exclusively for charitable purposes under these circumstances: outside investors put up some of the capital needed by the group to put on "First Monday in October" but the investors were not shareholders nor officers nor directors of the theatre group. Factually the case is distinct from this one where two of the partners in Grant Square were also directors of Pioneers.

Holding

The Tax Court was not clearly erroneous in its findings as to the non-exempt purpose of Pioneers. Accordingly, the judgment of the Tax Court must be affirmed.