

## Part III

### Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability  
(Also: Part I, Sections 47 and 704; 1.46-3, 1.704-1.)

Rev. Proc. 2014-12

#### SECTION 1. PURPOSE

This revenue procedure establishes the requirements (the Safe Harbor) under which the Internal Revenue Service (the Service) will not challenge partnership allocations of § 47 rehabilitation credits by a partnership to its partners. The Treasury Department and the Service intend for the Safe Harbor to provide partnerships and partners with more predictability regarding the allocation of § 47 rehabilitation credits to partners of partnerships that rehabilitate certified historic structures and other qualified rehabilitated buildings.

#### SECTION 2. BACKGROUND

Section 38(a) provides a credit against income taxes for certain business credits.

Business credits include the investment credit determined under § 46. Section 38(b). Section 46 provides that, for purposes of § 38, the amount of the investment credit includes the rehabilitation credit.

Section 47(a) provides that the rehabilitation credit for any taxable year is the sum of 10 percent of the qualified rehabilitation expenditures with respect to any qualified rehabilitated building other than a certified historic structure, and 20 percent of the qualified rehabilitation expenditures with respect to any certified historic structure.

Section 47(b)(1) provides that qualified rehabilitation expenditures with respect to any qualified rehabilitated building shall be taken into account for the taxable year in which the qualified rehabilitated building is placed in service.

Section 50 provides additional rules for computing the investment credit. Section 50(d)(5) makes applicable rules similar to the rule of former § 48(d) (relating to certain leased property). Accordingly, a person who is a lessor of certain property may elect with respect to the property to treat the lessee as having acquired the property if specified requirements are met, including the income inclusion requirement of former §48(d)(5).

Section 704(a) provides that a partner's distributive share of income, gain, loss, deduction, or credit shall be, except as otherwise provided in chapter 1 of subtitle A of Title 26, determined by the partnership agreement. Under § 704(b), a partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) is determined in accordance with the partner's interest in the partnership (taking into account all facts and circumstances) if (1) the partnership agreement does not provide

as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or (2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

Section 1.704-1(b)(4)(ii) provides that, with respect to the investment tax credit provided by § 38, allocations of cost or qualified investment made in accordance with § 1.46-3(f) shall be deemed to be made in accordance with the partners' interests in the partnership. Under § 1.46-3(f)(2)(i), for purposes of § 47, each partner's share of the qualified rehabilitation expenditures is determined in accordance with the ratio in which the partners divide the general profits of the partnership (that is, the taxable income of the partnership described in § 702(a)(8)) regardless of whether the partnership has a profit or loss for its taxable year during which the qualified rehabilitation building is placed in service.

In Historic Boardwalk Hall, LLC. v. Commissioner, 694 F.3d 425 (3d Cir. 2012), cert. denied, U.S., No. 12-901, May 28, 2013, the Third Circuit considered whether an investor's interest in the success or failure of a partnership that incurred qualifying rehabilitation expenditures was sufficiently meaningful for the investor to qualify as a partner in that partnership. The agreements governing the Historic Boardwalk Hall transaction ensured that the investor would receive the § 47 rehabilitation credits (or their cash equivalent) and a preferred return, with only a remote opportunity for additional sharing in profit. Both the § 47 rehabilitation credits and the preferred return were guaranteed as part of the transaction. The preferred return guarantee was funded. The Third Circuit determined that the investor's return from the partnership was

effectively fixed, and that the investor also had no meaningful downside risk because its investment was guaranteed. The Third Circuit agreed with the Commissioner's reallocation of all of the partnership's claimed losses and tax credits from the investor to the principal, holding that "because [the investor] lacked a meaningful stake in either the success or failure of [the partnership], it was not a bona fide partner." *Id.* at 463.

### SECTION 3. SCOPE

The Safe Harbor in section 4 of this revenue procedure applies in the case of a partnership that validly claims the § 47 rehabilitation credit (Partnership). The Service will not challenge a Partnership's allocations of validly claimed § 47 rehabilitation credits if the Partnership and its partners satisfy the Safe Harbor. However, taxpayers should not infer that compliance with the Safe Harbor ensures that the § 47 rehabilitation credits are otherwise valid. A Partnership and its partners that do not satisfy each of the requirements in section 4 of this revenue procedure do not qualify for the Safe Harbor.

Partners in a Partnership may include one or more managers authorized to act for the Partnership (Principals) and one or more Investors (as defined in section 4.01 of this revenue procedure). A Partnership can be structured as either a Developer Partnership or a Master Tenant Partnership. A Developer Partnership is a Partnership that owns and restores a qualified rehabilitation building or a certified historic structure (Building). A Master Tenant Partnership is a Partnership that leases a Building from a Developer Partnership (Head Lease) and for which an election is made pursuant to § 1.48-4(a)(1) to treat the Master Tenant Partnership as having acquired the Building solely for purposes of the § 47 rehabilitation credit.

This revenue procedure applies only with respect to allocations of § 47 rehabilitation credits from qualified rehabilitation expenditures. This revenue procedure does not apply to federal credits other than the § 47 rehabilitation credit or to state credit transactions. It does not indicate the circumstances under which the Service may challenge allocations of such other credits or the circumstances under which a transfer of state credits by a partnership may be treated as a disguised sale under § 707(a)(2)(B). Determinations of whether an expenditure is a qualified rehabilitation expenditure and whether a Partnership is the owner of a Building for purposes of claiming the § 47 rehabilitation credit are also outside the scope of this revenue procedure. In addition, this revenue procedure does not address how or if the tax-exempt use property rules under § 168(h) apply.

The Safe Harbor set forth in this revenue procedure is not intended to provide substantive rules and no inference should be drawn as to the validity of partnership allocations for taxpayers that fail to satisfy the Safe Harbor. Further, this revenue procedure does not address how a Partnership is required to allocate the income inclusion required by § 50(d)(5). The Treasury Department and the Service do not view the Safe Harbor as determinative of whether an Investor is a partner or acting in its capacity as a partner in an arrangement or transaction that is outside the scope of this revenue procedure. The Treasury Department and the Service do not intend the inclusion of any particular criterion in the Safe Harbor to be an indication either of our views of the significance of that criterion with respect to any other federal or state tax credit transactions, or of whether a Partnership has the requisite benefits and burdens

of ownership of a Building. The Service will not provide private letter rulings to individual taxpayers regarding the allocation of § 47 rehabilitation credits.

#### SECTION 4. SAFE HARBOR

.01 *Investors Defined.* Investors are Partnership partners (other than Principals) that hold an interest in the Partnership that is described in section 4.02(2) of this revenue procedure. An Investor may be an initial partner in the Partnership or may be a person who later becomes an Investor by purchasing a Partnership interest. If the Investor receives an allocation of § 47 rehabilitation credits from a Master Tenant Partnership, the Investor cannot also invest in the Developer Partnership other than through an indirect interest in the Developer Partnership held through the Master Tenant Partnership. This prohibition does not apply to a separately negotiated, distinct economic arrangement (e.g., a separate arm's length investment into the Developer Partnership to share in allocations of federal new markets tax credits or low income housing credits).

##### .02 *Partners' Partnership Interests.*

(1) Principal's minimum Partnership interest. The Principal must have a minimum one percent interest in each material item of Partnership income, gain, loss, deduction, and credit at all times during the existence of the Partnership.

##### (2) Investor's Partnership interest.

(a) Investor's minimum Partnership interest. The Investor must have, at all times during the period it owns an interest in the Partnership, a minimum interest in each material item of Partnership income, gain, loss, deduction, and credit equal to at least

five percent of the Investor's percentage interest in each such item for the taxable year for which the Investor's percentage share of that item is the largest (as adjusted for sales, redemptions, or dilution of the Investor's interest).

(b) Requirements regarding the Investor's Partnership interest. The Investor's Partnership interest must constitute a bona fide equity investment with a reasonably anticipated value commensurate with the Investor's overall percentage interest in the Partnership, separate from any federal, state, and local tax deductions, allowances, credits, and other tax attributes to be allocated by the Partnership to the Investor. An Investor's Partnership interest is a bona fide equity investment only if that reasonably anticipated value is contingent upon the Partnership's net income, gain, and loss, and is not substantially fixed in amount. Likewise, the Investor must not be substantially protected from losses from the Partnership's activities. The Investor must participate in the profits from the Partnership's activities in a manner that is not limited to a preferred return that is in the nature of a payment for capital.

(c) Arrangements to reduce the value of the Investor's Partnership interest. The value of the Investor's Partnership interest may not be reduced through fees (including developer, management, and incentive fees), lease terms, or other arrangements that are unreasonable as compared to fees, lease terms, or other arrangements for a real estate development project that does not qualify for § 47 rehabilitation credits, and may not be reduced by disproportionate rights to distributions or by issuances of interests in the Partnership (or rights to acquire interests in the Partnership) for less than fair market value consideration. A sublease agreement of the Building from the Master Tenant

Partnership back to the Developer Partnership or to the Principal of either the Developer Partnership or Master Tenant Partnership will be deemed unreasonable unless the sublease is mandated by a third party unrelated to the Principal. The terms of a sublease agreement of the Building by the Master Tenant Partnership to any person will be deemed unreasonable unless the duration of the sublease is shorter than the duration of the Head Lease. The Master Tenant Partnership may not terminate its lease of the Building from the Developer Partnership during the period in which the Investor remains as a partner in the Master Tenant Partnership.

*.03 Investor's Minimum Unconditional Contribution.* The Investor must contribute a minimum unconditional amount (the Investor Minimum Contribution) to the Partnership before the date that the Building is placed in service. The Investor Minimum Contribution equals 20 percent of the Investor's total expected capital contributions required under the agreements relating to the Partnership as of the date the Building is placed in service. The Investor must maintain the Investor Minimum Contribution throughout the duration of its ownership of its Partnership interest in the Partnership (and the Investor Minimum Contribution must not be protected against loss through any arrangement, directly or indirectly, by any person involved with the rehabilitation except as permitted under section 4.05(1) of this revenue procedure). Contributions of promissory notes or other obligations for which the Investor is the maker are not included in determining whether the Investor satisfies the Investor Minimum Contribution.

*.04 Contingent Consideration.* At least 75 percent of the Investor's total expected



capital contributions must be fixed in amount before the date the Building is placed in service. The Investor must reasonably expect to meet its funding obligations as they arise.

*.05 Guarantees and Loans.*

(1) Permissible guarantees.

(a) The following unfunded guarantees may be provided to the Investor--(i) Guarantees for the performance of any acts necessary to claim the § 47 rehabilitation credits;

(ii) Guarantees for the avoidance of any act (or omissions) that would cause the Partnership to fail to qualify for the § 47 rehabilitation credits or that would result in a recapture of the § 47 rehabilitation credits; and,

(iii) Guarantees that are not described as impermissible guarantees under section 4.05(2) of this revenue procedure.

(b) Examples of unfunded guarantees permitted under this section include completion guarantees, operating deficit guarantees, environmental indemnities, and financial covenants.

(c) For purposes of this section 4.05(1), a guarantee is unfunded if no money or property is set aside to fund all or any portion of the guarantee, and if neither the person making the guarantee (the guarantor) nor any person under the control of the guarantor agrees to maintain a minimum net worth in connection with the guarantee. Further, reserves in an amount less than or equal to the Partnership's reasonably projected operating expenses for a twelve-month period will not constitute an amount set aside to

fund the guaranteed amount for purposes of this section.

(2) Impermissible guarantees.

(a) No person involved in any part of the rehabilitation transaction may directly or indirectly guarantee or otherwise insure the Investor's ability to claim the § 47 rehabilitation credits, the cash equivalent of the credits, or the repayment of any portion of the Investor's contribution due to inability to claim the § 47 rehabilitation credits in the event the Service challenges all or a portion of the transactional structure of the Partnership. Further, no person involved in any part of the rehabilitation transaction may guarantee that the Investor will receive Partnership distributions or consideration in exchange for its Partnership interest (except for a fair market value sale right described in section 4.06(2)). This requirement does not prohibit the Investor from procuring insurance from persons not involved with the rehabilitation or the Partnership.

(b) No person involved in any part of the rehabilitation transaction may pay the Investor's costs or indemnify the Investor for the Investor's costs if the Service challenges the Investor's claim of the § 47 rehabilitation credits.

(c) No person involved in any part of the rehabilitation transaction may offer a guarantee described in section 4.05(1) of this revenue procedure that is not an unfunded guarantee described in section 4.05(1)(c).

(3) Loans. A Developer Partnership, a Master Tenant Partnership, or the Principal of either the Developer Partnership or the Master Tenant Partnership may not lend any Investor the funds to acquire any part of the Investor's interest in the Partnership or guarantee or otherwise insure any indebtedness incurred or created in

connection with the Investor's acquisition of its Partnership interest.

*.06 Purchase Rights and Sale Rights.*

(1) Purchase rights. Neither the Principal nor the Partnership may have a call option or other contractual right or agreement to purchase or redeem the Investor's interest at a future date (other than a contractual right or agreement for a present sale).

(2) Sale rights. The Investor may not have a contractual right or other agreement to require any person involved in any part of the rehabilitation transaction to purchase or liquidate the Investor's interest in the Partnership at a future date at a price that is more than its fair market value determined at the time of exercise of the contractual right to sell.

(3) Determination of fair market value. A determination of the fair market value of the Investor's interest in the Partnership may take into account only those contracts or other arrangements creating rights or obligations that meet the requirements of section 4.02(2)(c) of this revenue procedure and that are on arm's length terms.

(4) Payment of preferred returns, fees, and tax distributions. Nothing in this paragraph prohibits the payment of any accrued but unpaid fees, preferred returns, or tax distributions owed to the Investor.

(5) Abandonment. An Investor may not acquire its interest in the Partnership with the intent of abandoning the interest after the Partnership completes the qualified rehabilitation. If an Investor abandons its interest in the Partnership at any time, the Investor will be presumed to have acquired its interest with the intent of later abandoning it unless the facts and circumstances clearly establish that the Investor did

not acquire its interest with the intent of later abandoning it.

*.07 Allocation of § 47 Rehabilitation Credits.* Allocations under the Partnership agreement must satisfy the requirements of § 704(b) and the regulations thereunder. The § 47 rehabilitation credit must be allocated in accordance with § 1.704-1(b)(4)(ii). Solely for purposes of determining whether a Partnership meets the requirements of this section 4.07, the Partnership's allocation to its partners of the income inclusion required by § 50(d)(5) shall not be taken into account. *.08 Related Parties.* For purposes of this revenue procedure, each of the terms Principal, Partnership, Investor, and person include any related persons. For this purpose, persons are related if they bear a relationship to each other that is specified in § 267(b) or § 707(b)(1).

## SECTION 5. EXAMPLES

The following examples illustrate the application of the requirements of section 4 of the revenue procedure to a transaction in which the Investor invests in a Partnership to obtain the § 47 rehabilitation credits. The examples assume that the tax-exempt use property rules of § 168(h) do not apply. The examples also assume that the Partnership may validly claim the § 47 rehabilitation credits with respect to the rehabilitation of Building (defined below).

*.01 Example 1. (i) Transaction Structure.* The Developer Partnership is a limited liability company classified as a partnership for federal income tax purposes. The Developer Partnership is the owner for federal tax purposes of a historic commercial building (Building) that it plans to rehabilitate. The Developer Partnership is the Partnership for purposes of satisfying the requirements of this revenue procedure.

The Principal and the Investor will own Partnership. The Principal is the manager of the Partnership and authorized to act on behalf of the Partnership. The Investor is an unrelated party that will contribute money to the Partnership in exchange for an interest in the Partnership.

(ii) Investor's Contribution to Partnership. The Investor enters into an agreement with the Partnership to acquire an interest in the Partnership in exchange for an expected capital commitment of \$100x, of which \$75x is fixed. Prior to the date Building is placed in service, Investor acquires its interest in the Partnership by making an up front cash contribution of \$20x. Investor reasonably expects to contribute the remaining \$80x of its expected capital commitment upon the achievement of mutually agreed upon milestones (e.g., receiving National Park Service approvals, leasing the Building to tenants).

(iii) Partnership Interests. The Partnership is governed by a partnership agreement that satisfies the requirements of § 704(b). From the date the Investor becomes a partner until the date that is five years after the Building is placed in service (Transition Date), the Investor will be allocated 99% of the Partnership's profits and losses, as determined for federal income tax purposes. Consistent with the Partnership's allocation of profit and loss, the Investor will also be allocated, and will claim, 99% of the § 47 rehabilitation credits available to the Partnership. The Principal will be allocated 1% of the profits and losses during this period. As of the Transition Date and until the earlier of the date that the Investor is no longer a member of the Partnership and the date that the Partnership terminates, the Investor will be allocated

5% of the Partnership's profits and losses, and the Principal will be allocated 95% of the Partnership's profits and losses. The Investor has a right to receive a pro rata share of all distributions commensurate with the Investor's share of the Partnership profits. The Investor's partnership interest has a reasonably anticipated value commensurate with the Investor's overall percentage interest in the Partnership, separate from any federal, state, and local tax deductions, allowances, credits, and other tax attributes to be allocated from the Partnership to the Investor.

(iv) Partnership Operations. The Partnership will operate the Building and lease the individual units in the Building to retail businesses under terms that are consistent with lease terms for a real estate development project that does not qualify for § 47 rehabilitation credits. All fees paid by the Partnership, including any fees paid to the Principal, are reasonable and are consistent with fees commonly paid in a real estate development that does not qualify for § 47 rehabilitation credits.

(v) Guarantees. No party involved in any part of the rehabilitation has directly or indirectly provided a guarantee to the Investor regarding the Investor's ability to claim of § 47 rehabilitation credits, the cash equivalent of the credits, or the repayment of any portion of the Investor's contribution due to an inability to claim the credits in the event the Service challenges all or a portion of the transactional structure of the Partnership. Further, no party involved in any part of the rehabilitation has directly or indirectly guaranteed the Investor that it will receive distributions from the Partnership or that the Investor will receive consideration in exchange for its Partnership interest (other than the Investor's fair market value sale rights described in paragraph (vi) below). The

Partnership and the Principal have provided the Investor with unfunded guarantees commonly provided to investors in commercial real estate development transactions that do not qualify for the § 47 rehabilitation credit. In addition, the Partnership and the Principal provided an unfunded guarantee to the Investor that the Partnership and the Principal will undertake any acts necessary for the Partnership to claim the § 47 rehabilitation credit. Similarly, the Partnership and the Principal have provided an unfunded guarantee to the Investor that the Partnership and the Principal will not engage in any act that will negatively impact the Partnership's ability to claim the § 47 rehabilitation credit or that would result in the recapture of the § 47 rehabilitation credit. The Principal has also provided an unfunded guarantee requiring it to contribute additional cash to the Partnership to the extent of any Partnership operating deficit. Under the terms of the guarantee, if the Principal or the Partnership fail to meet their obligations, the Investor will be repaid all or a part of its contribution and any costs that Investor has incurred with respect to the transaction. The operating deficit guarantee does not include amounts required to fund expenses for more than twelve months of operation.

(vi) Purchase Rights and Sale Rights. Neither the Partnership nor the Principal has any contractual right to purchase the Investor's interest in the Partnership at a future date. For a period of six months beginning on the date that is six months after the Transition Date, the Investor has the right to require the Principal to purchase the Investor's interest for the fair market value of the interest. The Investor did not acquire its interest in the Partnership with the intent of abandoning its interest.

(vii) Conclusion. Under the facts of this example, because each requirement set forth in section 4 of this revenue procedure is met by the Partnership and its partners, the Service will not challenge the Partnership's allocation of 99% of the § 47 rehabilitation credits to the Investor.

.02 *Example 2.* (i) Transaction Structure. The facts are the same as in Example 1. In addition, the Master Tenant Partnership, a limited liability company classified as a partnership for federal tax purposes, will lease the Building from the Developer Partnership (Head Lease). The terms of the Head Lease are comparable to the lease terms of a real estate development project that does not qualify for § 47 rehabilitation credits. The Developer Partnership will make an election pursuant to § 1.48-4(a)(1) to treat the Master Tenant Partnership as having acquired the Building solely for purposes of the § 47 rehabilitation credits, allowing the Master Tenant Partnership to properly claim the § 47 rehabilitation credits. Therefore, the Master Tenant Partnership is the Partnership for purposes of satisfying the requirements of this revenue procedure. The Partnership will also own an interest in the Developer Partnership. The Investor does not own an interest in the Developer Partnership other than its indirect interest held through the Partnership. Further, the Partnership will sublease the Building to retail businesses as described in Example 1. The duration of these subleases will be shorter than the Head Lease.

(ii) Conclusion. Under the facts of this example, because each requirement set forth in section 4 of this revenue procedure is met by the Partnership and its partners, the Service will not challenge the Partnership's allocation of 99% of the § 47



rehabilitation credits to the Investor.

#### SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for allocations of § 47 rehabilitation credits made by a Partnership to its partners on or after December 30, 2013. If a Building was placed in service before December 30, 2013 and the Partnership and its partners satisfied all the requirements of the Safe Harbor provided in section 4 of this revenue procedure at the time the Building was placed in service and thereafter, the Service will not challenge the Partnership's allocations of § 47 rehabilitation tax credits to Investors that are in accordance with § 704(b).

#### SECTION 7. DRAFTING INFORMATION

The principal authors of this revenue procedure are Allison R. Carmody and Joseph R. Worst of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure contact Allison R. Carmody or Joseph R. Worst at (202) 317-5279 (not a toll free call).