

**Office of Chief Counsel
Internal Revenue Service
memorandum**

CC:PSI:B05:JMalgeri
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to: Glenn DeLoriea, Program Manager, Examination Specialization & Technical
Guidance (Small Business/Self-Employed)
Attn: Grace Robertson

from: Paul F. Handleman, Senior Technician Reviewer, Branch 5, Office of the Associate
Chief Counsel (Passthroughs & Special Industries), CC:PSI:5

subject: Low-Income Buildings under § 42 Damaged by Casualty Events

This Chief Counsel Advice responds to your memorandum of September 10, 2007, requesting guidance on three casualty issues under section 42(j)(4)(E) of the Internal Revenue Code. This advice may not be used or cited as precedent.

LAW

Section 42(j)(1) provides that if (A) 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 (B) the amount of such basis as of the close of the preceding taxable year, then the taxpayer's tax under Chapter 1 for the taxable year shall be increased by the credit recapture amount.

Section 42(j)(2) provides that the credit recapture amount in section 42(j)(1) is an amount equal to the sum of (A) the aggregate decrease in the credits allowed to the taxpayer under section 38 for all prior taxable years which would have resulted if the accelerated portion of the credit allowable by reason of this section were not allowed for all prior taxable years with respect to the excess of the amount described in section 42(j)(1)(B) over the amount described in section 42(j)(1)(A), plus (B) interest at the overpayment rate established under section 6621 on the amount determined under section 42(j)(2)(A) for each prior taxable year for the period beginning on the due date for filing the return for the prior taxable year involved.

Section 42(j)(4)(E) provides that the increase in tax under section 42(j) shall not apply to a reduction in qualified basis by reason of a casualty loss to the extent such loss is

restored by reconstruction or replacement within a reasonable period established by the Secretary.

Rev. Proc. 95-28, 1995-1 C.B. 704, and Rev. Proc. 2007-54, 2007-31 I.R.B. 293, establish the process under which temporary relief will be granted from certain provisions of section 42 to owners of low-income housing projects and housing credit agencies in major disaster areas. Rev. Proc. 95-28 is effective for a major disaster declaration issued by the President under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the Stafford Act), 42 U.S.C. 5121-5206, on or after January 1, 1995. Rev. Proc. 2007-54 supersedes Rev. Proc. 95-28 and is effective for a major disaster declaration issued by the President under the Stafford Act on or after July 2, 2007.

Section 7.01 of Rev. Proc. 95-28 and section 7.01 of Rev. Proc. 2007-54 provide that an owner of a building (1) that is beyond the first year of the credit period, and (2) that, because of a disaster that caused the President to issue a major disaster declaration, has suffered a reduction in qualified basis that would cause it to be subject to recapture or loss of credit will not be subject to recapture or loss of credit if the building's qualified basis is restored within a reasonable period (or reasonable restoration period under Rev. Proc. 2007-54).

Under the revenue procedures, the housing credit agency that monitors the project for compliance with section 42 shall determine what constitutes a reasonable period (or reasonable restoration period), not to exceed 24 months after the end of the calendar year in which the President issued a major disaster declaration for the area where the building is located. Section 7.01 of Rev. Proc. 2007-54 further provides that, if the owner of the building fails to restore the building within the reasonable restoration period determined by the housing credit agency, the owner shall lose all credit claimed during the restoration period and suffer recapture for any prior years of claimed credit under the provisions of section 42(j)(1).

Section 7.02 of Rev. Proc. 95-28 and section 7.02 of Rev. Proc. 2007-54 provide that to determine the credit amount allowable during the reconstruction or replacement period (or reasonable restoration period), an owner of a building described in section 7.01 must use the building's qualified basis at the end of the taxable year that preceded the President's major disaster declaration.

QUESTIONS

Question 1: Does section 42(j)(4)(E) extend the allowance of credits during the period of time that a building suffers a reduction in qualified basis and the reconstruction period as a result of a casualty event that is not covered under Rev. Proc. 2007-54?

Answer 1: No. Section 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. Rev. Proc. 2007-54 only applies to casualty events for which the President has issued a major disaster declaration under the Stafford Act. Rev. Proc. 2007-54 was issued under § 1.42-13(a) of the Income Tax Regulations, which provides that, under section 42(n), the Secretary has authority to provide guidance through various publications in the Internal Revenue Bulletin.

Question 2: Under Rev. Proc. 95-28 and Rev. Proc. 2007-54, what is the first taxable year for credit recapture if an owner fails to restore the building within the applicable time period allowed under both revenue procedures?

Answer 2: The relief provided in Rev. Proc. 95-28 and Rev. Proc. 2007-54 applies if the building's qualified basis is restored within a reasonable period (or reasonable restoration period). If the building's qualified basis is not restored within the reasonable period (or reasonable restoration period), then the building will be subject to recapture under section 42(j)(1) in the taxable year in which the disaster occurred and the owner cannot claim credits on the building for that taxable year. The owner also will lose all credits claimed during the restoration period. Under all casualty event circumstances, section 42(j)(4)(E) provides that a taxpayer is relieved from the increase in tax under section 42(j) if the building's qualified basis is restored by reconstruction or replacement within a reasonable period. If the taxpayer does not replace or restore the building's qualified basis within the reasonable period, then the relief in section 42(j)(4)(E) does not apply to the casualty.

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. See Bentley Court II Limited Partnership v. Commissioner, T.C. Memo. 2006-113 (2006) (if a taxpayer represents on its returns that it was entitled to section 42 credits in a closed taxable year, then the taxpayer is estopped under the duty of consistency to deny that it had qualified basis at the end of that taxable year).

Question 3: If a building consisting of 25 low-income units suffers a casualty event (e.g., a fire) that significantly damages the building on March 15, 2007, and the building is placed back in service on October 15, 2007, can the calendar-year owner claim credits on the units in its 2007 taxable year?

Answer 3: Assume that October 15, 2007, is within the reasonable period to restore the building under section 42(j)(4)(E). Also assume that each unit is occupied by low-income tenants by December 31, 2007, or the owner, beginning no later than October 15, 2007, initiated continual and verifiable measures to rent restored vacant units to low-income tenants. See Q&A#9, Rev. Rul. 2004-82, 2004-2 C.B. 350, for reasonable attempts to rent vacant units.

Under section 42(f)(1), a building's credit period is the period of 10 years (120 months) beginning with the first day of the taxable year in which the building is placed in service, or the succeeding taxable year if the election under section 42(f)(1)(B) is made. Credit is determined on a monthly basis only for the first year of the credit period under section 42(f)(2)(A) and additions to qualified basis under section 42(f)(3)(B). Otherwise, credit is claimed on annual basis. Other than sections 42(f)(2)(A) and 42(f)(2)(B), there is no authority for disallowing credits on a monthly basis. If a building is damaged by a casualty and fully restored and rented to low-income tenants within the same taxable year, then there is no recapture and no loss of credits. Thus, under the above facts and assumptions, the owner may claim credits on the 25 low-income units for the 2007 taxable year. We also conclude that if the owner had failed to restore the building by December 31, 2007, no credits would be allowed for the entire taxable year of 2007, even if the reasonable period or reasonable restoration period to the restore the building extends into 2008.

Please call me or Jack Malgeri at (202) 622-3040 if you have any further questions about this matter.