

September 14, 1998

ADVANCE COPY OF INTERNAL REVENUE BULLETIN ITEM

Attached is an advance copy of Revenue Ruling 98-47, describing exempt facility bonds.

It will appear in Internal revenue Bulletin 1998-39, dated September 28, 1998.

You may release this rev. rul. immediately.

Communications Division

Part I

Section 142.--Exempt Facility Bond

26 CFR 1.103-8: Interest on bonds to finance certain exempt facilities.
(Also §§ 145 and 103)

Rev. Rul. 98-47

ISSUE

Are the buildings described below residential rental property for purposes of § 142(d) and § 145(d) of the Internal Revenue Code?

FACTS

Complex M provides housing units on a non-transient basis for individuals who are of retirement age or older. All of the units in Complex M are available to members of the general public. Complex M is comprised of Building X, Building Y, and Building Z, each of which is composed of similarly constructed housing units that have separate and complete facilities for living, sleeping, eating, cooking, bathing, and sanitation. The cooking and eating area contains a small refrigerator, a sink, a pull-down table, and a two-burner stove with an oven. Each unit is designed so that the stove can be replaced with a full-sized

microwave oven if the physical or mental frailties of the resident make it imprudent to provide a functioning cooking stove.

Each resident enters into a lease arrangement with Complex M. The amount of the monthly payment under the lease varies according to the level of care provided in the building in which the resident resides, with Building Z commanding the largest payment and Building X the smallest payment. The monthly payment is made in exchange for use of an individual unit, basic services and, with respect to Buildings Y and Z, other services. Under a lifetime lease payment option, residents of Complex M may pay a fixed monthly amount for the time they reside in Complex M. The lifetime lease option guarantees a resident the right to move to a unit in Buildings Y or Z if the resident requires additional care.

The basic services available to the residents in all three buildings include: laundry; housekeeping; regular daily meals in the common dining areas; 24 hour monitored emergency call service using call buttons and two-way communication devices located in each room of a unit; planned social activities; and scheduled transportation to various sites in the vicinity including commercial areas, shopping centers, hospitals, and doctor's offices.

Building X, Building Y, and Building Z each contains a separate common dining area. The dining area in each building will be used exclusively by residents of Complex M and visitors of those residents. The size of the dining area in any building

does not exceed that necessary to serve the residents of the building and their guests. The dining area serves the special needs of the residents and provides the staff of Complex M an opportunity to monitor the overall well-being, nutrition, and health of the residents.

Only the basic services are made available to residents of Building X. No other services are included in the monthly payment. Continual or frequent nursing, medical, or psychiatric services are not made available in Building X.

The basic services and the Building Y support services are made available to residents of Building Y. The Building Y support services are as follows: assistance by medication management technicians in medication management and intake; maintenance of detailed medication records; consultation with a nurse as needed about health concerns and medication plans; assistance by non-medically certified aides each day during waking hours in activities of daily living that include getting in and out of bed and chairs, walking, using the toilet, dressing, eating, and bathing; and routine checks by staff members of Building Y to insure the residents' general well-being. Some residents of Building Y have incapacitating infirmities that require continual assistance, but do not require continual or frequent nursing, medical, or psychiatric services. Continual or frequent nursing, medical, or psychiatric services are not made available in Building Y.

The basic services and the Building Y support services are made available to residents of Building Z. In addition, Building

Z is staffed in the following manner: registered nurses are on duty for 12 hours each day; licensed practical nurses are on duty for 24 hours each day; and licensed nurses' aides are available 24 hours each day. The nurses and nurses' aides are available to provide nursing care for residents' medical or psychiatric needs. Thus, continual or frequent nursing, medical, or psychiatric services are made available in Building Z.

Residents in Building X are required to move into Buildings Y or Z or another facility outside of Complex M if, because of physical or mental disability, they require additional care beyond that offered by Building X. Residents in Buildings X and Y are required to move into Building Z or another facility outside of Complex M if they require continual or frequent nursing, medical, or psychiatric services.

LAW AND ANALYSIS

Under the general rule of § 103(a), gross income does not include interest on any state or local bond. Section 103(b)(1), however, provides that the exclusion does not apply to any private activity bond unless it is one of the qualified bonds under § 141(e). Among these qualified bonds are exempt facility bonds and qualified § 501(c)(3) bonds.

Section 142(a) describes an exempt facility bond as any bond issued as part of an issue of bonds if 95 percent or more of the net proceeds of the issue are to be used to provide listed types of projects or facilities. Within the list, in § 142(a)(7), are qualified residential rental projects.

Section 142(d) defines a qualified residential rental

project as a project for residential rental property that houses occupants who meet one of the alternative income tests at all times throughout a qualified project period. In the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 519-575 (the "1986 Act"), Congress reorganized § 103 and § 103A of the Internal Revenue Code of 1954 (the "1954 Code") regarding tax-exempt bonds into § 103 and §§ 141 through 150 of the Internal Revenue Code of 1986. Congress intended that to the extent not amended by the 1986 Act, all principles of pre-1986 Act law would continue to apply to the reorganized provisions. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-686 (1986), 1986-3 (Vol. 4) C.B. 686. (Conference Report). Because no Income Tax Regulations have been promulgated under § 142(d), the regulations promulgated pursuant to § 103(b)(4) of the 1954 Code continue to apply to residential rental property except as otherwise modified by the 1986 Act and subsequent law.

Section 145(a) describes a qualified § 501(c)(3) bond as any bond issued as part of an issue of bonds if all of the property to be provided by the net proceeds of the issue is to be owned by a § 501(c)(3) organization or a governmental unit and 95 percent or more of the net proceeds of the issue are used in a manner related to the exempt purpose of the § 501(c)(3) organization. Under § 145(d)(1), however, a bond generally is not a qualified § 501(c)(3) bond if net proceeds of the issue are used directly or indirectly to provide residential rental property for family units. Section 145(d)(2) provides certain exceptions to § 145(d)(1). The legislative history of § 145(d) indicates that

the phrase residential rental property for family units in § 145(d) has the same meaning as residential rental property under § 1.103-8(b) of the Income Tax Regulations.

Under § 1.103-8(b)(4), a residential rental project is residential rental property that meets certain requirements including occupancy requirements by low-income tenants during the period when the units must be continually rented or available for rental. Residential rental property is a building or structure, together with any functionally related and subordinate facilities, containing one or more similarly constructed units that are available to members of the general public and used on other than a transient basis. The regulations also provide that 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.

Section 1.103-8(b)(8) defines a "unit" as any accommodation containing separate and complete facilities for living, sleeping, eating, cooking, and sanitation. The regulations note that an example of a unit would be a separate and distinct apartment containing a living area, a sleeping area, bathing and sanitation facilities, and cooking facilities equipped with a cooking range, refrigerator, and sink.

Additional insight into the meaning of residential rental property can be found under § 42, which provides the low-income housing credit. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1983-3 (Vol. 4) C.B. 89, states that the phrase

"residential rental property" generally has the same meaning under both § 42 and § 142(d).

Section 1.42-11(c) provides a distinction between residential rental properties and health care facilities by focusing on whether frequent nursing, medical, or psychiatric services are provided to residents. Under that section, if continual or frequent nursing, medical, or psychiatric services are provided to residents, it is presumed that the building is ineligible for the credit as is the case with a hospital or nursing home. The distinction drawn in the regulations under § 42 regarding the nature of the facility based on the frequency of nursing, medical, or psychiatric services available in the facility is also the appropriate standard for determining whether facilities are residential rental property for purposes of § 142(d) and § 145(d).

For purposes of § 142(d) and § 145(d), if a facility makes available continual or frequent nursing, medical, or psychiatric services, the facility will not be residential rental property under § 142(d) or § 145(d). In the case of a mixed use facility, the allocable portion of the facility in which continual or frequent nursing, medical, or psychiatric services are made available will not be residential rental property under § 142(d) or § 145(d).

As set forth in the facts above, Building X, Building Y, and Building Z each contains complete living units within the meaning of § 1.103-8(b)(8), all of the living units within the respective buildings are available to the general public, and all of the

living units are used on a non-transient basis. Since Complex M also provides significant non-housing services to residents of the three buildings (including continual or frequent nursing, medical, or psychiatric services to the residents of Building Z), the analysis must consider the nature and extent of the non-housing services. In the case of Complex M, the analysis must examine whether the buildings of Complex M are hospitals, nursing homes, sanitariums, or rest homes rather than residential rental property. For purposes of § 142(d) and § 145(d), labels are not determinative. The focus of these sections, their legislative histories, and the applicable regulations thereunder, is whether the facilities are, in substance, residences or health care facilities. Therefore, the nature and degree of the services provided by the facility controls.

Significant non-housing services are made available to residents of Building X and Building Y, including meals and various support services. The services available to residents of Building X and Building Y do not include continual or frequent nursing, medical, or psychiatric services although, under the lifetime lease option, certain residents are assured that they will receive continual or frequent nursing, medical, or psychiatric services in Building Z if required. Thus, under the principles set forth above, Buildings X and Y would be residential rental property.

Continual or frequent nursing, medical, or psychiatric services are made available to residents of Building Z in addition to the same non-housing services that are made available

to residents of Building X and Building Y. Thus, under the principles set forth above, Building Z would not be a residential rental property.

HOLDING

Building X and Building Y are residential rental property for purposes of § 142(d) and § 145(d). Because continual or frequent nursing, medical, or psychiatric services are made available in Building Z, Building Z is not residential rental property for purposes of § 142(d) and § 145(d).

Neither Building X nor Building Y would fail to be residential rental property under § 142(d) or § 145(d) merely because it was called a hospital, a sanitarium, a rest home, or a nursing home. Similarly, Building Z would not be residential rental property under § 142(d) or § 145(d) merely because it was called an assisted living facility or an elderly care facility.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Harold N. Diamond and Timothy L. Jones of the Office of Associate Chief Counsel (Domestic) and Edwin G. Oswald of the Department of the Treasury. For further information regarding this revenue ruling contact Harold N. Diamond at 202-622-3980 (not a toll-free call).