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May 18, 2000

Legend

X =

Y =

HLP =

A =

D1 =

State =

a% =

This responds to the letter dated August 26, 1999, and subsequent correspondence dated January 24, 2000 and May 4, 2000, submitted on behalf of X and HLP, requesting rulings under §§ 708 and 42 of the Internal Revenue Code.

FACTS

X is a limited partner in numerous operating limited partnerships (OLPs) that own and operate qualified projects that provide low-income rental housing and receive low-income housing tax credits ("LIHTCS") under § 42. Section 42(j)(5) does not apply to the OLPs. Except for five of the OLPs, X has more than a 50 percent interest in the capital and profits of each of the OLPs.

X is also a partner in a holding limited partnership (HLP) formed in D1. X is the general partner and A, an officer of X, is the limited partner.

For what has been represented to be valid business reasons, including consolidating and improving the administration of the OLPs, X and HLP plan to implement a holding company structure. Under this structure, X will contribute its limited partnership interests in the OLPs to HLP. X's general partnership interest in

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HLP will be converted into a limited partnership interest, and A will terminate his interest in HLP. Further, Y, who has significant expertise in the management of investments in real estate, will contribute property and services to HLP in exchange for a general partnership interest in HLP.

X and HLP represent that:

- (1) HLP will be classified as a partnership for federal tax purposes;
- (2) X's interest in HLP will exceed a% throughout the compliance period (as defined in § 42(i)(I)) of each OLP; and
- (3) With respect to HLP, § 1.47-1 will not apply to any § 38 property that is subject to recapture due to its being held by a partnership terminated under § 708(b)(1)(B) because HLP will satisfy the "mere change in form" exception under § 1.47-3(f).

RULINGS REQUESTED

In connection with the proposed restructuring described above, X and HLP request the following rulings:

- (1) The contribution of X's interests in the OLPs to HLP will not terminate the OLPs under § 708(b)(1)(B); and
- (2) The contribution of X's interests in the OLPs to HLP will not cause X to recapture LIHTCs under § 42(j).

LAW AND ANALYSIS

Ruling Request #1

Section 708(a) provides that a partnership continues to exist for federal income tax purposes until it is terminated. A partnership is terminated if, within a 12-month period, there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits. Section 708(b)(1)(B).

Section 1.708-1(b)(iv) provides that if a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; and, immediately thereafter, the terminated partnership distributes its interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership, either for continuation of the business by the new partnership or for its dissolution and winding up.

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Here, the contribution to HLP of X's interest in an OLP will be treated as a sale or exchange for purposes of § 708(b)(1)(B). Accordingly, the contribution to HLP of X's interests in those OLPs in which X holds an interest equal to or in excess of 50 percent of the OLP's total interests in partnership capital and profits will terminate such OLPs under § 708(b)(1)(B).

Ruling Request #2

Section 38(a) provides for a general business credit against tax that includes the amount of the current year business credit. Section 38(b)(5) provides that the amount of the current year business credit includes the low-income housing credit determined under § 42(a).

Section 42(a) provides that, for purposes of § 38, the amount of the low-income housing credit determined under § 42 for any taxable year in a 10-year credit period shall be an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

In the case of any qualified low-income building placed in service by a taxpayer after 1987, § 42(b) provides, in part, that the term "applicable percentage" means the appropriate percentage prescribed by the Secretary for the month applicable under § 42(b)(2)(A)(i) or (ii). Section 42(b)(2)(B) provides that the percentages prescribed by the Secretary for any month shall be percentages that will yield over a 10-year period amounts of credit that have a present value equal to: (i) 70 percent of the qualified basis of new buildings that are not federally subsidized for the taxable year; and (ii) 30 percent of the qualified basis of existing buildings, and of new buildings that are federally subsidized for the taxable year.

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

Section 42(j)(1) provides that if at the close of any taxable year in the compliance period, the amount of the qualified basis of any building with respect to the taxpayer is less than the amount of such basis as of the close of the preceding taxable year, the taxpayer's tax for the taxable year will be increased by the credit recapture amount. The credit recapture amount is determined under § 42(j)(2) and § 42(j)(3).

The legislative history to § 42 provides that, generally, any change in ownership of a low-income building during the compliance period is a recapture event and that all dispositions of ownership interests in buildings are treated as transfers for purposes of recapture. See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., II-96 and II-102 (1986), 1986-3 (Vol. 4) C.B. 1, 96, 102. Under § 42(j)(6), however, no recapture will be imposed on a disposition of a low-income building (or an interest therein) if the taxpayer furnishes to the Secretary a bond, and it is reasonably expected that the building will

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continue to be operated as a qualified low-income building through the end of the compliance period. A taxpayer may satisfy the bond posting requirement of § 42(j)(6) by: (1) completing a portion of Form 8693, Low-Income Housing Credit Disposition Bond, and having it approved by the Internal Revenue Service; or (2) following the procedures outlined in Rev. Proc. 99-11 (1992-2 I.R.B. 14) establishing a Treasury Direct Account.

Analogous provisions concerning recapture of investment tax credit (ITC) property provide relevant guidance for determining recapture under § 42(j). Under § 50(a)(1), if during any taxable year ITC property is disposed of or otherwise ceases to be ITC property with respect to the taxpayer before the close of the recapture period, the tax for such taxable year shall be increased. Currently, there are no regulations under § 50. However, for property placed in service before January 1, 1991, former § 47(a)(1) (and the regulations thereunder) contained a similar ITC recapture rule. The regulations under former § 47 (which are still effective) mirror the general recapture rule of former § 47 that a disposition or cessation of ITC property before the close of the estimated useful life of the property that was taken into account in computing the taxpayer's qualified investment will result in ITC recapture.

One exception to the general rule concerning the recapture of ITC property, § 1.47-3(f)(1) (reflected now, in part, in § 50(a)(4)), provides that no ITC recapture will occur in the case of a mere change in form of conducting a trade or business. To qualify for the § 1.47-3(f)(1) exception, the following requirements must be met: (1) the ITC property must be retained as ITC property in the same trade or business; (2) the transferor (or in the case where the transferor is a partnership, the partner) of the ITC property must retain a substantial interest in the trade or business; (3) substantially all the assets (whether or not ITC property) necessary to operate the trade or business must be transferred to the transferee to whom the ITC property is transferred; and (4) the basis of the ITC property in the hands of the transferee is determined in whole or in part by reference to the basis of the ITC property in the hands of the transferor.

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

Another exception to the general rule concerning the recapture of ITC property, § 1.47-6(a)(2), provides a de minimis rule whereby a partner may dispose up to 33 $\frac{1}{3}$ percent of its proportionate interests in the general profits of a partnership (or in a particular item of § 38 property) before ITC recapture applies. In determining the partner's proportionate interest in the general profits of a partnership for purposes of applying this de minimis rule, § 1.47-6(a)(2)(b)(iii) provides an 'identity of interest' rule whereby the partner is considered to own any interest in the partnership that it owns directly or indirectly (through ownership in other entities provided the other entities' bases in the interest are determined in whole or in part by reference to the basis of the interest in the hands of the partner). For example, if A, whose proportionate interest in

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the general profits of partnership X is 20 percent, transfers all of this interest to Corporation Y in exchange for all of the stock of Y in a § 351 transaction, then A shall be considered to own a 20 percent interest in partnership X.

Rev. Rul. 90-60, 1990-2 C.B. 6, adopts a similar de minimis rule for purposes of § 42(j) whereby no bond is required to avoid or defer recapture for a disposition by a partner of its interest in a low income building held through a partnership (other than a partnership described in § 42(j)(5)(B)) until the partner has disposed of more than 33⅓ percent of its greatest total interest in the building held through the partnership.

Here, X intends to transfer its entire interest in each of the OLPs to HLP. This will result in a transfer of X's entire interest in the assets (including any § 42 buildings) owned by the OLPs to HLP. All dispositions of ownership interests in § 42 buildings are treated as transfers (or a change in ownership) for purposes of recapture and any change in ownership is a recapture event; thus, X's proposed transfer of its OLP interests would, absent an exception, be a disposition and therefore a recapture event.

Section 42(j)(5) does not apply to the OLPs. For these partnerships, a § 42 recapture event can occur at the partnership level and at the partner level. Applying the two levels of recapture potential for these partnerships to the proposed transaction, the following results occur –

A. Partnership Level Recapture Event

Where X's contribution of its interest in each of the OLPs to HLP results in a § 708(b)(1)(B) technical termination of the OLP, then each OLP will be deemed to have contributed all their assets, including all their § 42 building(s), to a new OLP in return for an interest in the new OLP. Each old OLP's contribution will be a disposition and a § 42 recapture event. X will be a partner in HLP, and HLP will be a partner in each of the old OLPs when they terminate. Accordingly, X will be subject to any recapture liability allocated by HLP to its partners as a result of the old OLPs' disposition of their § 42 buildings to the new OLPs, unless an exception to § 42 recapture applies.

X and HLP represent that with respect to HLP, § 1.47-1 will not apply to any § 38 property that is subject to recapture due to its being held by a partnership terminated under § 708(b)(1)(B) because HLP will satisfy the "mere change in form" exception of § 1.47-3(f). Provided the requirements of § 1.47-3(f) are met, no recapture liability will result from the disposition of § 38 property by the old OLPs; and HLP, as a partner in the old OLPs (and X as a partner in the HLP) at the time of the dispositions, likewise will not be subject to ITC recapture. It is appropriate to analogize the § 1.47-3(f) exception for ITC recapture to determining recapture under § 42(j). Therefore, based on the analogous application of § 1.47-3(f), the deemed contribution of the § 42 buildings to the new OLPs under § 708(b)(1)(B) will not be treated as a disposition of § 42 property resulting in the recapture of § 42 credits by X.

B. Partner Level Recapture Event

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Generally, X, as a partner in partnerships to which § 42(j)(5) does not apply, is subject to recapture for any disposition of its interest in § 42 property held through these partnerships. However, X may (if applicable) avail itself of the 33 $\frac{1}{3}$ percent de minimis exception of Rev. Rul. 90-60. By assigning its entire interest in each of the OLPs to HLP, X will appear to have disposed of more than 33 $\frac{1}{3}$ percent of its greatest total interest in the § 42 buildings held through the OLPs. However, because the 33 $\frac{1}{3}$ percent de minimis rule of Rev. Rul. 90-60 is intended to reflect the 33 $\frac{1}{3}$ percent de minimis rule of § 1.47-6(a)(2), any rule(s) clarifying how the 33 $\frac{1}{3}$ percent de minimis rule of § 1.47-6(a)(2) is determined should also apply for purposes of § 42. This includes the identity of interest rule of § 1.47-6(a)(2)(b)(iii) which provides that in determining a partner's proportionate interest in the general profits of a partnership the partner shall be considered to own any interest in the partnership that it owns directly or indirectly (through ownership in other entities provided the other entities' bases in the interest are determined in whole or in part by reference to the basis of the interest in the hands of the partner). Here, X's proportionate interest in the § 42 buildings will not (after applying the rule of § 1.47-6(a)(2)(b)(iii)) have decreased by more than 33 $\frac{1}{3}$ percent. Accordingly, under the above facts, X may rely on the 33 $\frac{1}{3}$ percent de minimis exception provided in Rev. Rul. 90-60 to avoid the recapture liability that would otherwise result from the contribution (disposition) to HLP of its interest in the § 42 buildings held through the OLPs.

CONCLUSIONS

Based solely on the facts submitted and representations made, we conclude as follows:

(1) The contribution to HLP of X's interests in those OLPs in which X holds an interest equal to or in excess of 50 percent of the OLP's total interests in partnership capital and profits will terminate such OLPs under § 708(b)(1)(B). The contribution to HLP of X's interests in those OLPs in which X holds an interest that is less than 50 percent of the OLP's total interests in capital and profits will not terminate such OLPs under § 708(b)(1)(B) unless the contribution, taken together with all other transfers of interests in the OLP during 12 consecutive months results in 50 percent or more of the total interest in capital and profits of the OLP being transferred within a 12-month period; and

(2) The contribution of X's total interest in each of the OLPs to HLP results in potential partnership level recapture liability to X because X will be a partner in HLP who, in turn, will be a partner in the OLPs when the OLPs technically terminate. However, X is not subject to § 42(j) recapture because it is represented that HLP may avail itself of the § 1.47-3(f) exception to ITC recapture (and, by analogy, § 42(j) recapture). To the extent that there is not a technical termination of an OLP under § 708(b)(1)(B), there will not be a partnership level recapture event. Further, the contribution of X's total interest in each of the OLPs to HLP will result in no partner level recapture because, applying the identity of interest rule of § 1.47-6(a)(2)(b)(iii) to dispositions of § 42 property, X will not dispose of more than 33 $\frac{1}{3}$ percent of its greatest total interest in the § 42 buildings held by the OLPs. Therefore, X may rely on the de

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minimis exception provided in Rev. Rul. 90-60 to avoid recapture liability.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed or implied as to whether HLP is a partnership for federal tax purposes.

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

Pursuant to the Power of Attorney on file with this office, a copy of this ruling is being sent to your authorized representatives.

Sincerely,

Signed/David R. Haglund

Senior Technician Reviewer, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

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