

**Internal Revenue Service**

**Department of the Treasury**  
Washington, DC 20224

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**Person to Contact:**

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**Refer Reply To:**  
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**Date:** January 26, 2000

**Legend:**

Taxpayer =

City =

State =

CDC 1 =

CDC 2 =

CDC 3 =

CDC 4 =

CDC 5 =

CDC 6 =

CDC 7 =

CDC 8 =

CDC 9 =

Holding Corp. =

Bank =

c =

d =

e =

f =

Dear :

This letter responds to your letter dated September 16, 1999, and subsequent submission dated January 25, 2000 on behalf of Taxpayer requesting a ruling that none of the low-income housing tax credits derived through various partnership interests and reported on the consolidated tax returns of Taxpayer and its subsidiaries will be subject to recapture under § 42(j) of the Internal Revenue Code as a result of a proposed corporate restructuring described in the below facts. The Internal Revenue Service District Office that will have examination jurisdiction over the Taxpayer and its subsidiaries is located in City.

The relevant facts as represented in these submissions are set forth below.

**FACTS:**

Taxpayer is a multi-bank holding company organized under the laws of State and registered under the Bank Holding Company Act of 1956. Its principal assets are the shares of stock of its subsidiaries. Through banking and non-banking subsidiaries, Taxpayer provides a diverse range of banking and non-banking financial services and products, primarily through the full service banking centers in c states and the District of Columbia. Taxpayer and its subsidiaries' annual accounting period is the calendar year. They utilize the accrual method of accounting for maintaining their accounting books and filing their consolidated federal income tax returns.

One component of Taxpayer's diverse banking and non-banking activities relevant to this ruling request is Taxpayer's investment in and promotion of affordable housing in the communities it serves.

Taxpayer currently has d direct or indirect for-profit subsidiaries operating as community development corporations and/or involved in various housing and other community-based activities, including:

- Two subsidiaries directly owned 100% by Taxpayer;

- CDC 1, and
  - CDC 2.

- Three subsidiaries owned 100% by Holding Corp., a 100% subsidiary of Taxpayer;

- CDC 3,
  - CDC 4, and
  - CDC 5.

- Four subsidiaries owned by Bank, a 100% owned subsidiary of Holding Corp.;

- CDC 6
- CDC 7
- CDC 8, and
- CDC 9.

CDCs 1 through 5 are non-bank subsidiaries and as such they are subject to the regulatory authority of the Federal Reserve Board. CDCs 6 through 9 are bank subsidiaries and as such are subject to the regulatory authority of the Comptroller of the Currency.

In addition to certain other authorized activities that are not relevant to this ruling request, CDCs 1 through 9 (collectively, the CDCs) provide equity capital to developers of affordable housing projects eligible for low-income housing tax credits under § 42. The majority of the CDC's equity capital investments in qualifying § 42 projects are made through intermediate investment entities or funds formed as partnerships (or limited liability companies treated as partnerships for federal income tax purposes) which, in turn, invest in operating partnerships (or limited liability companies treated as partnerships for federal income tax purposes) that develop, own and operate low-income housing tax credit projects. These intermediate investment entities or funds typically have fewer than 35 partners. In addition, certain investments are made by the CDCs directly to operating entities formed as partnerships (or limited liability companies treated as partnerships for federal income tax purposes), each of which operating entities has fewer than 5 partners or members.

The CDCs direct or indirect investments in partnerships (or limited liability companies treated as partnerships for federal income tax purposes) which own and operate affordable housing projects eligible for low-income housing tax credits under § 42 are hereinafter referred to individually as the "Partnership Interest" and collectively as the "Partnership Interests." The CDCs hold in excess of e Partnership Interests which are direct investments in an operating partnership and in excess of f indirect investments in operating partnerships through intermediate investment entities.

The CDC's were formed by Taxpayer's predecessor entities to manage bank and non-bank community development activities and related investments. As a result of the bank and bank holding company mergers that ultimately formed Taxpayer, there is no longer a need for the current structure of multiple bank and multiple non-bank subsidiaries involved in the aforementioned activities. To stay competitive in the world market, Taxpayer must increase its efficiency and reduce its costs. Accordingly, for administrative convenience and in an effort to reduce operating costs, Taxpayer desires to consolidate its § 42 activities into two entities, a non-bank CDC subject to Federal Reserve Board regulations and a bank CDC subject to regulation by the Comptroller of the Currency.

Currently, Taxpayer files consolidated returns which, among other subsidiaries, include the Bank, Holding Corp., and the CDCs as 100% directly or indirectly owned subsidiaries. The corporate restructuring described herein will have no substantive effect on the federal income tax filing obligations or liability of the affiliated group of corporations consisting of Taxpayer, Bank, Holding Corp., the CDCs and the other direct and indirect subsidiaries of Taxpayer.

A. Proposed Corporate Restructuring.

Taxpayer proposes to rearrange its corporate structure in the following manner:

1. Taxpayer will transfer all the outstanding capital stock of CDCs 1 and 2 to Holding Corp. in a transaction qualifying under § 351 of the Code.
2. Holding Corp. will then cause its wholly-owned subsidiaries, CDCs 1 through 4, to be merged into CDC 5 in simultaneous transactions intended to qualify for federal income tax purposes as tax-free reorganizations described in § 368(a) (excluding for this purpose § 368(a)(1)(F)), thereby creating a single non-bank CDC.
3. Bank will cause its wholly-owned subsidiaries CDCs 6, 7, and 9 to be merged into CDC 8 in simultaneous transactions intended to qualify for federal income tax purposes as tax-free reorganizations described in § 368(a) (excluding for this purpose § 368(a)(1)(F)), thereby creating a single bank CDC.

B. Taxpayer Representations.

In connection with the proposed corporate restructuring, Taxpayer specifically represents on behalf of itself, Bank, Holding Corp. and the CDCs that:

1. Taxpayer is a registered bank holding company.
2. Taxpayer is the parent of an affiliated group of corporations that includes among numerous other entities Holding Corp., Bank, and the CDCs.
3. The foregoing affiliated group files a consolidated federal income tax return and the transfers contemplated in the proposed corporate restructuring (paragraph A. above) will all be made within the same affiliated group during the same consolidated return year. Further, neither Taxpayer nor any of its subsidiaries identified in the ruling request have a present intention to dispose of any interest in a building qualifying for § 42 credits during the 15-year compliance period in § 42(i)(1) through disposition of any of the applicable subsidiaries in a manner such that the

applicable subsidiary or its assets would be transferred outside of the affiliated group.

4. Holding Corp. is a wholly owned subsidiary of Taxpayer which acts as a bank holding company.
5. Bank is a wholly owned subsidiary of Holding Corp. which is engaged in the commercial banking business.
6. CDCs 1 and 2 are wholly owned subsidiaries of Taxpayer which directly or indirectly provide equity capital to developers of affordable housing projects eligible for § 42 credits.
7. CDCs 3, 4, and 5 are wholly owned subsidiaries of Holding Corp. which directly or indirectly provide equity capital to developers of affordable housing projects eligible for § 42 credits.
8. CDCs 6 through 9 are wholly owned subsidiaries of Bank which directly or indirectly provide equity capital to developers of affordable housing projects eligible for § 42 credits.
9. Within the past 15 years the CDCs have acquired Partnership Interests.
10. Except for the reorganization contemplated in paragraph A. above, Taxpayer, Holding Corp., Bank and the CDCs have no present intention of disposing of their (i) interests in CDCs 1 through 9 during the compliance period under § 42(d)(i)(1), or (ii) partnerships in which CDCs 1 through 9 hold an ownership interest that hold § 42 buildings during the compliance period under §42(i)(1).
11. CDC 5 intends to hold the Partnership Interests for the same purposes that CDCs 1 through 4 are currently holding them.
12. CDC 8 intends to hold the Partnership Interests for the same purposes that CDCs 6, 7, and 9 are currently holding them.
13. The basis of the Partnership Interests in the hands of (i) CDC 5 will be determined in whole or in part by reference to the basis of such Partnership Interests in the hands of CDCs 1 through 4 and (ii) CDC 8 will be determined in whole or in part by reference to the basis of such Partnership Interests in the hands of CDCs 6, 7, and 9.
14. Taxpayer, Holding Corp., Bank, and the CDCs are not entities described in § 593(a)(1).

15. With respect to the transfers contemplated in paragraph A. above, and assuming that CDCs 1 through 9 hold section 38 property, (i) the conditions set forth in regulation § 1.47-3(f) will be met and (ii) the exception for early dispositions of section 38 property set forth in regulation § 1.1502-3(f)(2) will be met.
16. The transfers contemplated in paragraph A. above will cause a technical termination of some (or all) of the partnerships that CDCs 1, 2, 3, 4, 6, 7, and 9 currently have an ownership interest in.
17. With respect to the transfers contemplated in paragraph A. above, any section 38 property that is subject to recapture due to its being held by a partnership that will terminate under § 708(b)(1)(B) as a result of the contemplated transfers will satisfy the requirements of regulation § 1.47-3(f)(1).

**RULING REQUESTED:**

Taxpayer requests the Service to rule that none of the low-income housing tax credits derived through the Partnership Interests and reported on the consolidated tax return of Taxpayer and its subsidiaries will be subject to recapture under § 42(j) as a result of a proposed corporate restructuring described in the above facts.

**LAW AND ANALYSIS:**

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 section 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 the 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.

Under § 42(j)(1), 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, 99<sup>th</sup> 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 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 completing a portion of Form 8693, Low-Income Housing Credit Disposition Bond, and having it approved by the Internal Revenue Service.

Little guidance is available to illustrate when, under § 42(j), a reduction in qualified basis of a building with respect to the taxpayer has occurred or when there has been a disposition that requires the taxpayer to post a bond to avoid recapture. However, analogous provisions concerning recapture of investment 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. However, there are a number of exceptions to the general rule concerning the recapture of ITC property. For example, § 1.47-6(a)(2) of the Income Tax Regulations provides a de

minimis rule that permits a partner to dispose of up to 33-1/3 percent of its proportionate interests in the general profits of a partnership (or in a particular item of section 38 property) before ITC recapture applies. 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 (to which § 42(j)(5)(B) does not apply) until the partner has disposed of more than 33-1/3 percent of its greatest total interest in the building held through the partnership. Also regulation § 1.47-3(f)(1) (reflected now, in part, in § 50(a)(4)) provides an exception to ITC recapture 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.

Regulation § 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.

Regulation § 1.1502-3(f)(2)(i) provides generally that during a consolidated return year a transfer of section 38 property (which includes ITC property) from one member of an affiliated group to another member of the group during a consolidated return year is not treated as a disposition within the meaning of former § 47(a)(1).

Rev. Rul. 75-245, 1975-1 C.B. 6 involves the sale of a corporate partner's partnership interest to a member of the corporate partner's affiliated group during a consolidated return year. The revenue ruling relies on regulation § 1.1502-3(f)(2)(i) in finding an exception to the recapture provisions of former § 47(a)(1). The revenue ruling concludes that § 1.1502-3(f)(2)(i) was intended to prevent recapture for transfers



of section 38 property between members of an affiliated group, and that no recapture occurred under the circumstances.

Section 708(a) provides that a partnership shall be considered as continuing if it is not terminated. Section 708(b)(1)(B) provides that, for purposes of § 708(a), a partnership shall be considered 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.

Revenue Ruling 87-110, 1987-2 C.B. 159 provides that the transfer by a corporation of its interest in a partnership to another corporation in a transaction qualifying as a reorganization under §§ 361(a) and 368(a)(1) (other than a reorganization under § 368(a)(1)(F)) is an exchange causing the termination of the partnership under § 708(b)(1)(B), provided that the interest transferred represents a 50% or greater interest in partnership profits and capital.

Final regulations published in the Federal Register on May 9, 1997 (62 Fed. Reg. 25498, T.D. 8717) amend previous regulations under § 708(b)(1)(B). The final regulations provide, in part, 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 partnership liquidates by distributing interests in the new partnership to the purchaser and the remaining partners, followed by the continuation of the business by the new partnership or its dissolution and winding up. Under § 723, the new partnership takes a basis in the old partnership's property equal to the adjusted basis such property had in the hands of the old partnership (i.e., carryover basis).

In the present case, Taxpayer, as part of its overall corporate restructuring, intends to transfer all the outstanding capital stock of CDCs 1 and 2 to Holding Corp., qualifying as a tax-free exchange under § 351. This exchange will not affect the ownership of any assets held by CDCs 1 and 2 and is therefore not a disposition of any § 42 property.

Holding Corp. will then cause its wholly-owned subsidiaries CDCs 1 through 4 to be merged into CDC 5 in simultaneous transactions intended to qualify for federal income tax purposes as tax-free reorganizations described in § 368(a) (other than reorganizations qualifying under § 368(a)(1)(F)), thereby creating a single non-bank CDC. Similarly, Bank will also cause its wholly-owned subsidiaries CDCs 6, 7, and 9 to be merged into CDC 8 in simultaneous transactions intended to qualify for federal income tax purposes as tax-free reorganizations described in § 368(a) (other than reorganizations qualifying under § 368(a)(1)(F)), thereby creating a single bank CDC. As provided in Rev. Rul. 87-110, a transaction qualifying as a reorganization under §§ 361(a) and 368(a)(1) (other than a reorganization under § 368(a)(1)(F)) is an exchange causing the termination of a partnership under § 708(b)(1)(B), provided that

the interest transferred represents a 50% or greater interest in partnership profits and capital. Taxpayer represents that the proposed reorganization will cause the technical termination of some (or all) of the partnerships that CDCs 1, 2, 3, 4, 6, 7, and 9 currently have an ownership interest in. Some of these partnerships may be partnerships to which § 42(j)(5)(B) applies. This ruling does not apply to any partnerships to which § 42(j)(5)(B) applies.

For a partnership to which § 42(j)(5)(B) does not apply, a § 42 recapture event can occur at the partnership level and also at the partner level. A recapture event can occur at the partnership level, for example, if a partnership disposes of a building upon which a § 42 credit has been allowed. Recapture liability (if any) would be the responsibility of the partners in the partnership at the time of the disposition. A recapture event can apply at the partner level, for example, if a partner disposes of more than 33-1/3 percent of its greatest total interest in any § 42 buildings held through the partnership.

The proposed § 368(a)(1)(A) reorganizations will result in transfers (and dispositions for purposes of § 42) of all the assets of CDCs 1 through 4 to CDC 5, and of CDCs 6, 7, and 9 to CDC 8. These assets include ownership interests in § 42 property held directly (or indirectly) through limited partnerships. Because the entire interest in § 42 property is being transferred, CDCs 1, 2, 3, 4, 6, 7, and 9, may not avail themselves of the 33-1/3 percent de minimis rule of Rev. Rul. 90-60 to avoid § 42 recapture at the partner level. However, Taxpayer represents that it currently files a consolidated return which, among other subsidiaries, include the Bank, Holding Corp., and the CDCs and that the transfers contemplated in the proposed corporate restructuring (described in paragraph A. above) will all be made within the same affiliated group during a consolidated return year. Taxpayer further represents that (i) neither Taxpayer nor any of its subsidiaries identified in the ruling request have a present intention to dispose of any interest in a building qualifying for § 42 credits during the 15-year compliance period in § 42(i)(1) through a disposition of any of the applicable subsidiaries in a manner such that the applicable subsidiary or its assets would be transferred outside of the affiliated group, and (ii) assuming the assets of CDCs 1 through 9 include section 38 property, the exception for early dispositions of section 38 property set forth in regulation § 1.1502-3(f)(2) would be met. Therefore, based on the analogous recapture provision under former § 47(a) and the analogous application of § 1.1502-3(f)(2) which is intended to prevent recapture of ITCs for transfers of section 38 property between members of an affiliated group, the proposed transfer of all the assets of CDCs 1 through 4 to CDC 5 and of CDCs 6, 7, and 9 to CDC 8 will not be treated as a disposition of § 42 property resulting in § 42 recapture at the partner level.

As the acquiring corporations under the reorganization, Company 5 and Company 9 have not disposed of any of their interests in § 42 property and will not be subject to § 42 recapture at the partner level.

Taxpayer has stated that the transfers contemplated in paragraph A. above will cause the technical termination of some (or all) of the partnerships that CDCs 1, 2, 3, 4, 6, 7, and 9 currently have an ownership interest in. Under regulation § 1.708-1(b)(1)(iv), each terminating partnership will be deemed to have contributed all their assets, including any § 42 property, to a new partnership in return for an interest in the new partnership. Under the general rule of § 42 that any change of ownership (e.g., transfer) of a 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, each terminating partnership's contribution is a disposition of the § 42 property and a § 42 recapture event. Recapture liability (if any) will be the responsibility of those partners who are members of the terminating partnerships at the time of the disposition. Although the transfer of the interests in § 42 property held directly (or indirectly) through limited partnerships by CDCs 1, 2, 3, 4, 6, 7, and 9 will cause the technical termination of some (or perhaps all) of these terminating partnerships, CDCs 1, 2, 3, 4, 6, 7, and 9 will not be partners in these partnerships at the time these partnerships are deemed to contribute (dispose of) their interests in the § 42 property to the new partnerships. Therefore, CDCs 1, 2, 3, 4, 6, 7, and 9 will not be subject to any potential § 42 recapture at the partnership level resulting from the deemed contribution of § 42 property by the terminating partnerships to the new partnerships.

As the acquiring corporations under the reorganizations, CDCs 5 and 8 will be partners in the terminating partnerships at the time these partnerships contribute their assets, including any § 42 property, to the new partnerships. As stated above, the partnership contributions are dispositions and therefore, recapture events. Absent an exception, § 42(j) recapture liability will be the responsibility of those partners who are members of the terminating partnerships at the time of the disposition. Accordingly, absent an exception, CDCs 5 and 8 will be subject to § 42(j) recapture as a result of the deemed contribution (disposition) of § 42 property by the terminating partnerships to the new partnerships.

Taxpayer has represented that with respect to the transfers contemplated in paragraph A. above (and assuming that CDCs 1 through 9 hold section 38 property) any section 38 property that is subject to recapture due to its being held by a partnership that will terminate under § 708(b)(1)(B) as a result of the contemplated transfers will satisfy the mere change in form requirements of regulation § 1.47-3(f). Assuming the requirements of § 1.47-3(f) are met, no recapture liability will result from the disposition of section 38 property by the terminating partnerships and CDCs 5 and 8, who are partners in the terminating partnerships at the time of the dispositions will likewise not be subject to ITC recapture. We believe that it is appropriate in this case to analogize the § 1.47-3(f) exception for ITC recapture to the determination of recapture under § 42(j). Therefore, based on the analogous application of § 1.47-3(f), the deemed contribution of the § 42 property to the new partnerships under § 708(b)(1)(B) will not be treated as a disposition of § 42 property resulting in the recapture of § 42 credits by CDCs 5 and 8.

Accordingly, based solely on the taxpayer's representations of fact and relevant law as set forth above, we conclude that none of the low-income housing tax credits derived through the Partnership Interests and reported on the consolidated tax return of Taxpayer and its subsidiaries will be subject to recapture under § 42(j) as a result of a proposed corporate restructuring described in the above facts.

We express no opinion on whether Taxpayer or any other member of the affiliated group that includes Holding Corp., Bank, and the CDCs qualifies for the low-income housing credit under § 42, or whether any other requirement of § 42 is met. Also, no opinion is expressed or implied regarding the application of regulation § 1.708-1(b)(1)(iv) to a large partnership to which § 42(j)(5)(B) applies. Therefore, this ruling does not extend to any partnership interests held by the CDCs in partnerships to which § 42(j)(5)(B) applies. In addition, we express no opinion whether Taxpayer's specific representations concerning whether the conditions set forth in § 1.47-3(f) for disposition of section 38 property are met or whether the exception for early dispositions of section 38 property set forth in § 1.1502-3(f)(2) are met.

Further, this ruling does not protect Taxpayer or, if applicable, any member of the affiliated group that includes Holding Corp., Bank, and the CDCs from liability for the amount of any tax credits claimed by CDCs 5 and 8 or the affiliated group (through CDCs 5 and 8's interest in the new partnerships) from a determination of recapture under § 42(j) that may result from a subsequent disposition or other noncompliance event.

In accordance with the power of attorney filed with the ruling request, we are sending a copy of this letter ruling to Partnership's authorized representative.

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.

Sincerely yours,  
Walter Woo  
Senior Technician Reviewer, Branch 5  
Office of Assistant Chief Counsel  
(Passthroughs and Special Industries)

Enclosure: 6110 copy