



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: attn:
ASSOCIATE CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS

SUBJECT:

This Field Service Advice responds to your memorandum dated September 2, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

- City =
- W =
- X =
- Y =
- Z =
- Year 1 =
- Year 2 =
- \$x = \$
- \$y = \$
- \$z = \$

ISSUE:

Whether the Service can adjust the eligible basis in the taxpayer's first open year, thereby requiring recapture of the accelerated amount of low-income housing credit pursuant to section 42(j)(1) in that year.

CONCLUSION:

An adjustment to eligible basis must be made in the year the eligible basis is initially determined, rather than in the first open year. Accordingly, the taxpayer is not required to recapture the accelerated amount of low-income housing credit on account of such adjustment.

FACTS:

W owned and operated low-income housing apartment buildings in City. From December of Year 1 through August of Year 2, W renovated the apartment buildings.

X, a limited partnership, was formed on July 31 of Year 2 by Y and Z for the purpose of purchasing the apartment buildings. Y, a non-profit corporation, was the general partner and held a one percent interest in X. Z, a corporation, was the limited partner and held the remaining 99 percent interest in X.

Effective August 1 of Year 2, X agreed to buy the apartment buildings (exclusive of the underlying land) from W for \$x. The rehabilitated buildings were placed in service by X in October of Year 2. X leased the apartments to Y, and Y leased the apartments to low-income tenants.

On the partnership returns, X reported the lease payments from Y as income and deducted the interest paid to W and real property taxes and depreciation with respect to the apartment buildings. X also claimed \$y annually in low-income housing credits.

LAW AND ANALYSIS

A low-income housing credit is allowed against the tax imposed for the taxable year. Section 38(a)(2), (b)(5). The amount of the low-income housing credit is equal to the applicable percentage of the qualified basis of each qualified low-income building. Section 42(a). The qualified basis of any qualified low-income building for any taxable year is an amount equal to the applicable fraction of the eligible basis. Section 42(c)(1)(A). 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(d)(1). Rehabilitation expenditures paid or incurred by the taxpayer with respect to any building are treated as a separate new building. Section 42(e)(1). The credit period is the period of ten years beginning with the taxable year in which the building is placed in service, or, at the election of the taxpayer, the succeeding taxable year. Section 42(f)(1).

If, as of the close of any taxable year in the compliance period, the amount of the qualified basis of any building is less than the amount of such basis as of the close of the preceding taxable year, then the taxpayer's tax shall be increased by the credit recapture amount. Section 42(j)(1).

Under the present facts, the eligible basis in the apartment buildings is the cost of the existing buildings and the cost of the rehabilitation as of the first taxable year of the credit period. Sections 42(d)(1), (e)(2). Because X did not make an election, the credit period begins in Year 2.

The revenue agent is proposing a reduction of \$z in the amount of allowable rehabilitation costs.¹ The reduction in allowable rehabilitation costs will reduce the eligible basis of the property, which will reduce the qualified basis. The issue is in what year should the reduction be made, the first taxable year of the credit period or the first open year. The resolution of this issue determines whether X is subject to the recapture provision of section 42(j)(1).

In general, the correct tax liability for a year not in issue (whether or not an assessment for a deficiency for that year is barred by the statute of limitations) can be computed when necessary to determine the correct tax liability for a year that is in issue. Lone Manor Farms, Inc. v. Commissioner, 61 T.C. 436, 440-41 (1974). In addition, facts in a later year can be used as part of the process of recomputing the tax liability for an earlier barred year in order to arrive at the correct tax liability for the open year. Lone Manor Farms, Inc., 61 T.C. at 441. See also Mennuto v. Commissioner, 56 T.C. 910, 923 (1971).

The above principles should be utilized under the present facts. To determine X's correct tax liability for an open year, the correct tax liability for the previous years, even though an assessment for such years may be barred by the statute of limitations, must be computed. A proposed adjustment to the eligible basis will affect the basis in Year 2 and all subsequent years. Once this proposed adjustment to the basis has been made for all such years, the eligible basis in the open year will not be less than the amount of the basis as of the close of the preceding taxable year. Accordingly, no recapture will be required pursuant to section 42(j)(1) on account of the adjustment to the eligible basis.

¹ We express no opinion regarding the proposed adjustment.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

To adjust the eligible basis in a year other than the first taxable year of the credit period, and require a recapture under section 42(j), the Service would have to take inconsistent positions. The Service would agree with the taxpayer's representation of the amount of eligible basis in a closed year while simultaneously arguing against the taxpayer's representation of the amount of eligible basis in an open year. This approach requires an inconsistent application of the law for the purpose of maximizing the taxpayer's tax liability.

It is also worthy of note that, if the first taxable year of the credit period and all subsequent years were open, the Service would take the position that the eligible basis should be adjusted from the first taxable year of the credit period forward. No rationale has been provided for why this position should change solely because some years are closed.

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