

LEXSEE PLR 200703024

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Private Letter Ruling 200703024

PLR 200703024; 2006 PLR LEXIS 2378

October 17, 2006

[\*1]

**SUBJECT MATTER:** Low-Income Housing Credit

**SUMMARY:**

The taxpayer, a state limited partnership, was formed to acquire, develop, own, and operate a multi-building rental housing development, each unit of which was a low-income unit under § 42(i)(3)(A). The taxpayer sought to amend its recorded commitment to provide the tenants with a right of first refusal to purchase their units at the end of the compliance period. Under the right of first refusal, the purchase price for each unit would be affordable to the tenants because it would be based on the maximum applicable rents and would include a purchase discount. The IRS concluded that the right of first refusal granted to tenants as part of a condominium home ownership plan to purchase their units after the close of the compliance period applicable to each unit satisfied the requirements of § 42(i)(7)(A). The commitment would continue to satisfy § 42(h)(6) even though it would be amended to grant each tenant the right of first refusal, terminate after the compliance period, and be replaced with a new commitment that would provide for continuing § 42 rental income restrictions for all rental units and income restrictions for all buyers of the units sold.

**APPLICABLE SECTIONS:**

Section 42 -- Low-Income Housing Credit

**UI LIST:**

UI No. 42.09-03

UI No. 42.08-06

**REFERENCE:** Refer Reply To: CC:PSI:B05 - PLR-130019-06

**TEXT:**

Index Number: 42.09-03, 42.08-06  
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LEGEND:

Taxpayer = \* \* \*  
 Examination Office = \* \* \*  
 State = \* \* \*  
 Project = \* \* \*  
 City = \* \* \*  
 General Partner = \* \* \*  
 Limited Partner = \* \* \*  
 a = \* \* \*  
 Year 1 = \* \* \*  
 Agency = \* \* \*  
 b = \* \* \*  
 State Act = \* \* \*  
 c = \* \* \*  
 d = \* \* \*  
 e = \* \* \*

Dear \* \* \*:

This letter responds to a letter dated June 7, 2006, made on behalf of Taxpayer, requesting rulings on proposed actions by Taxpayer that involve a right of first refusal under § 42(i)(7) of the Internal Revenue Code and a low-income housing commitment (commitment) under § 42(h)(6). The Internal Revenue Service Office that will have examination jurisdiction over Taxpayer is the Examination Office.

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

#### FACTS

Taxpayer is a State limited partnership, originally formed to acquire, rehabilitate develop, own and operate Project, located in City. The general partner of Taxpayer is General Partner. The limited partner of Taxpayer is Limited Partner.

Project [\*2] is a multi-building, a-unit rental housing development, each unit of which is a low-income unit as defined under § 42(i)(3)(A) of the Code. Taxpayer acquired and rehabilitated Project in Year 1. In the same year, Project received an allocation of low-income housing credits pursuant to § 42 from Agency. The first year of Project's credit period was Year 1.

Project has a recorded a commitment (entitled "Declaration of Land Use Restriction Covenants for Low-Income Housing Tax Credits") dated as of b, as amended, for the 30-year period required by § 42(h)(6) of the Code, which commitment covers Project entirely. Agency can enforce the commitment.

Taxpayer wants to amend the commitment to provide the tenants of Project the opportunity to purchase their units upon the conclusion of the compliance period. All a units will remain as low-income rental units through the end of the compliance period. Taxpayer, with the support of Agency as described in a letter dated e, has developed an ownership plan (as described below) to accomplish this.

The ownership plan contemplates that all a units in Project will be converted to condominiums in accordance with the State Act and City ordinances. Upon the [\*3] receipt of a favorable ruling from the Internal Revenue Service and prior to the end of Project's 15-year compliance period, Taxpayer will record (i) a declaration for the property stating Taxpayer's intent to convert all the units in Project to condominiums, and (ii) simultaneously with the recording of the declaration, a condominium plat. The condominium documents will provide that the

actual conversion to condominiums will not be effective until after the end of the compliance period.

Taxpayer and Agency have determined that a condominium conversion is the most beneficial structure to allow for tenant ownership.

Upon receipt of approval by Agency and Taxpayer's lenders and partners, the existing commitment will be amended to provide each tenant (and any successor occupant of that unit) a right of first refusal as provided under *§ 42(i)(7) of the Code* to purchase their unit. Each tenant in good standing under their rental lease will be eligible to exercise such right.

Taxpayer represents that under the right of first refusal, the purchase price for each unit will be set so as to be affordable to the tenants because the purchase price will be based on the mortgage payments and condominium [\*4] fees that could be paid by the tenant based on the maximum rents applicable to such unit at the time of sale. Taxpayer will also offer each tenant a discount on the purchase price of their unit, which discount will be tied to the compliance period of the building occupied by that tenant and based on the length of time that each tenant has lived in their unit during such period -- 1% for each year a tenant has lived in their unit during the ten years preceding the year of condominium conversion. To receive the benefit of the discount, (i) the tenant must continue to reside in their unit at that time of the condominium conversion, and (ii) the tenant must exercise their right of first refusal to purchase the unit within 6 months from the date of the conversion.

Agency has determined that the prices to be used for sales of the condominium units will preserve their affordability. In all cases, the purchase price will not be less than the minimum purchase price described under *§ 42(i)(7) of the Code*. Taxpayer intends to sell one-bedroom units for an estimated \$c (subject to market conditions) and two-bedroom units for an estimated \$d (subject to market conditions). Further, to maintain affordability [\*5] for future buyers upon the resale of the condominium units, the resale price for each unit will not exceed the gross sales price paid by the seller (at the time the seller purchased the unit) plus a 10% per annum cumulative increase based on such gross sales price.

Subject to the receipt of a favorable ruling, Taxpayer will include in all new and renewed tenant leases notice that a condominium conversion may occur following the end of the compliance period. Further, when the time of the condominium conversion is known by Taxpayer, it will provide notice ("tenant notice") to all tenants describing when the condominium conversion process will begin after the end of each building's 15-year compliance period and the intent to sell the units, including the timing of the completion of the conversion process, the methods for selling the condominiums and sales prices of each, and information about the new commitment.

Each tenant will be allowed up to 6 months from the commencement of the conversion to exercise the right of first refusal. If a tenant does not exercise such right, the unit will continue as residential rental property, and the tenant will have the right to remain in the unit for [\*6] as long as the tenant chooses. The rent for rental units will continue to be restricted to the maximum rents applicable to such units under *§ 42(g) of the Code*.

Under the ownership plan, the existing commitment, as amended, will terminate after the close of the 15-year compliance period and upon the effective date of the condominium conversion, at which time a new commitment will be recorded against Project, in a manner consistent with *Rev. Rul. 95-49, 1995-2 C.B. 7*.

The period and affordability restrictions of the new commitment will be for 30 years, commencing on the date the new commitment is recorded, as described above. This commitment will be in a form substantially similar to a form of commitment already approved by Agency.

The new commitment will have two parts. The first part will address those units in which the tenant did not exercise their right of first refusal. Until such tenant vacates the unit, it will remain a rental unit subject to terms identical to the existing commitment. This will avoid displacement, as a tenant not electing to exercise such right will not be evicted unless for good cause. When the tenant vacates their unit, Taxpayer may either continue the unit [\*7] as a rental unit or offer it for sale to a qualified buyer. A qualified buyer is a person whose income at the time of purchase satisfies the applicable § 42 income limitation to which the Project is subject at the time. The second part of the new commitment will apply to all units sold as condominiums. It will require that each sale or sales must be to an existing tenant or qualified buyer. Eventually, when all rental units are sold, the provisions in the new commitment pertaining to the rental units will no longer apply and only the provisions relating to the condominium units sold will apply.

Agency's consent will be required to amend or terminate the new commitment. Further, Taxpayer will (i) keep Agency apprised of the implementation of the sales program during regular intervals preceding and following the start of the condominium conversion through its implementation, including providing Agency with 60-days advance notice prior to tenant notification of the condominium conversion process, the intent to sell the units, the timing of the completion of the conversion process, the methods for selling the condominiums and sales prices of each, and information about the new commitment. [\*8] This will give Agency the opportunity to comment on the mechanism for reviewing the sales prices and overseeing that condominiums are sold to qualified buyers; and (ii) obligate the condominium manager to monitor and annually report to Agency on the continued occupancy by, and sales to, qualified buyers (or tenants of the remaining rental units) whose incomes satisfied the applicable income limitation.

#### RULING REQUESTED

Taxpayer requests the Service to rule that:

(1) The right of first refusal granted by Taxpayer to each tenant as part of a condominium homeownership plan to purchase their unit after the close of the compliance period applicable to that unit will satisfy the requirements of § 42(i)(7)(A) of the Code, and

(2) Assuming Project's existing commitment otherwise satisfies § 42(h)(6) of the Code, it will continue to satisfy § 42(h)(6) even though it will (i) be amended to grant each tenant occupying their unit a right of first refusal to purchase that unit; (ii) terminate after the compliance period of the buildings in Project; and (iii) be replaced with a new commitment which will provide for (a) continuing § 42 rental income restrictions for all units which continue as rental [\*9] units, and (b) § 42 income restrictions for all buyers (other than the existing tenants) of the units sold at the time they are sold.

#### LAW AND ANALYSIS

Section 38(a) of the Code 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) of the Code* 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.

*Section 42(h) (6) (A) of the Code* provides that no tax credit is allowed for a building unless an extended low-income housing commitment (as defined in § 42(h) (6) (B)) between the low-income building owner and the appropriate housing credit agency is in effect at the end of the taxable year. The commitment is binding on all successors to the owner and includes certain provisions that continue after the close of the building's 15-year compliance period. The commitment provision [\*10] under § 42(h) (6) (B) (i) ensures that a certain percentage of a low-income building's units will continue to be available for rental by low-income tenants after the close of the compliance period. The commitment provision under § 42(h) (6) (B) (iii) prohibits the disposition to any person of any portion of the building to which such agreement applies unless all of the building to which such agreement applies is disposed of to such person.

*Section 42(i) (7) of the Code* provides that no Federal income tax benefit shall fail to be allowable to a taxpayer with respect to any qualified low-income building merely by reason of a right of first refusal held by the tenants (in cooperative form or otherwise) to purchase the property after the close of the compliance period for a price which is not less than the minimum purchase price determined under § 42(i) (7) (B). *Section 42(i) (7) (B)* defines the minimum purchase price as an amount equal to the sum of (i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred with the 5-year period ending on the date of the sale to the tenants), and (ii) all Federal, State, and local taxes attributable to such sale. [\*11] Except in the case of Federal income taxes, there shall not be taken into account under clause (ii) any additional tax attributable to the application of clause (ii).

*Section 42(m) (1) (B) of the Code* provides that the term "qualified allocation plan" means any plan (i) that sets forth selection criteria to be used to determine housing priorities of the housing credit agency which are appropriate to local conditions, (ii) which also gives preference in allocating housing credit dollar amounts among selected projects to (I) projects serving the lowest income tenants, (II) projects obligated to serve qualified tenants for the longest periods, and (III) projects which are located in qualified census tracts (as defined in § 42(d) (5) (C)) and the development of which contributes to a concerted community revitalization plan, and (iii) which provides a procedure that the agency (or an agent or other private contractor of such agency) will follow in monitoring for noncompliance with the provisions of this section and in notifying the Service of such noncompliance which such agency becomes aware of and in monitoring for noncompliance with habitability standards through regular site visits.

*Section 42(m) (1) (C) of the Code* [\*12] provides that certain selection criteria must be used by the housing credit agency in the qualified allocation plan. The selection criteria set forth in a qualified allocation plan must include (i) project location, (ii) housing needs characteristics, (iii) project characteristics, including whether the project includes the use of existing housing as part of a community revitalization plan, (iv) sponsor characteristics, (v) tenant populations with special housing needs, (vi) public housing waiting lists, (vii) tenant populations of individuals with children, and (viii) projects intended for eventual tenant ownership.

*Rev. Rul. 95-49, 1995-2 C.B. 7*, concludes that an extended low-income housing commitment satisfies § 42(h) (6) of the Code even though its provisions may be

suspended or terminated after the compliance period when a tenant exercises a right of first refusal to purchase a low-income building.

*Notice 88-91, 1988-2 C.B. 414*, concludes that final regulations will provide that the term "qualified low-income building" includes residential rental property that is an apartment building, a single family dwelling, a townhouse, a row house or duplex, or a condominium.

As provided in *Rev. Rul. 95-49*, [\*13] the objectives of § 42(h)(6) and § 42(i)(7) of the Code are similar in that both sections attempt to promote housing for low-income individuals beyond the compliance period, by rental in the case of § 42(h)(6) or by outright ownership in the case of § 42(i)(7). Section 42(i)(7) provides that the right of first refusal may be held by the tenants in cooperative form or otherwise (emphasis added). Thus, implicitly, § 42(i)(7) can permit a right of first refusal to be held by tenants in their individual capacity. In the case of a multi-unit building, where a tenant only has an interest in purchasing their own living unit, conversion of the units into separate condominiums is a practical form for accomplishing the sale of such units.

Further, *Rev. Rul. 95-49* provides latitude to owners and state allocating agencies in achieving the objectives of ownership for qualifying individuals in that the provisions of a § 42(h)(6) commitment may be terminated or suspended following the close of the compliance period upon the exercise of a right of first refusal. Thus, § 42(h)(6)(B)(iii), which prohibits the disposition to any person of any portion of the building to which an agreement applies unless [\*14] all of the building to which such agreement applies is disposed of to such person, may, as under Taxpayer's facts, be made inapplicable if agreed to by the owner and agency. Similarly, § 42(h)(6)(B)(i), which ensures that a certain percentage of a low-income building's units will continue to be available for rental by low-income tenants after the close of the compliance period, may also be terminated or suspended if agreed to by the owner and agency.

Taxpayer represents that in all cases, the purchase price of the condominium units will not be less than the minimum purchase price as described under § 42(i)(7) of the Code. Taxpayer further represents that the condominium conversion process and sale of the units will not begin until after the close of the compliance period for Project buildings.

Agency has indicated that it supports the proposed ownership plan as described in the above facts.

Accordingly, based solely on the Taxpayer representations of fact and relevant law as set forth above, we conclude that:

(1) The right of first refusal granted by Taxpayer to each tenant as part of a condominium homeownership plan to purchase their unit after the close of the compliance period applicable [\*15] to that unit satisfies the requirements of § 42(i)(7)(A) of the Code, and

(2) Assuming Project's existing commitment otherwise satisfies § 42(h)(6) of the Code, the commitment will continue to satisfy § 42(h)(6) even though it will (i) be amended to grant each tenant occupying their unit a right of first refusal to purchase that unit; (ii) terminate after the compliance period of the buildings in Project; and (iii) be replaced with a new commitment that will provide for (a) continuing § 42 rental income restrictions for all units which continue as rental units, and (b) § 42 income restrictions for all buyers (other than the existing tenants) of the units sold.

We express no opinion on any other aspect of § 42 of the Code, including whether Project's existing commitment presently satisfies § 42(h)(6). This rul-

ing does not in anyway obligate Agency to amend their existing commitment or otherwise agree to any of the contemplated changes described in Taxpayer's request.

In accordance with the power of attorney, we are sending a copy of this letter ruling to Taxpayer's authorized representatives.

This ruling is directed only to Taxpayer. *Section 6110(k)(3)* provides that it may not be used or [\*16] cited as precedent. A copy of this letter should be retained by Taxpayer for its records.

Sincerely yours,

Susan Reaman  
Chief, Branch 5  
Office of Associate Chief Counsel  
(Passthroughs and Special  
Industries)

Enclosure:  
6110 copy

cc: \* \* \*