Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

26 CFR 1.42-1T: Limitation on low-income housing credit allowed with respect to qualified low-income buildings receiving housing credit allocations from a State or local housing credit agency.

Guidance is provided for computing the income limits applicable to low-income housing credits under section 42 of the Code. See Rev. Rul. 89-24, page 5.

Section 103.—Interest on State and Local Bonds

26 CFR 1.103-8: Interest on bonds to finance certain exempt facilities.

Guidance is provided for computing the income limits applicable to exempt facility bonds issued to provide for qualified residential rental projects. See Rev. Rul. 89-24, page 5.

Section 142.—Exempt Facility Bonds (Also Sections 42. 103, 6652; 1.42-1T, 1.103-8.)

Exempt facility bonds; low-income housing credit. Guidance is provided for computing the income limits applicable to exempt facility bonds issued to provide for qualified residential rental projects under section 142 of the Code and to low-income housing credits under section 42.

Rev. Rul. 89-24

This revenue ruling provides the manner in which properly to compute the income limits applicable both to exempt facility bonds issued to provide for qualified residential rental projects under section 142 of the Internal Revenue Code and to low-income housing credits under section 42.

LAW

Section 1301 of the Tax Reform Act of 1986, 1986-3 (Vol. I) C.B. 524 (the Act), revised the income limits applicable to exempt facility bonds issued to provide for multifamily residential rental projects. *Compare* section 142(d) and former section 103(b)(4)(A) of the Code.

In general, in order for interest on an exempt facility bond issued to provide for a multifamily residential rental project to be tax-exempt, the project must meet the income limit requirement of section 142(d)(1) of the Code. Under section 142(d)(1), a "qualified residential rental project" is defined to include only residential rental projects where, either (A) 20 percent or more of the residential units in the project are occupied by individuals whose income is 50 percent or less of the area median gross income (the 20-50 requirement), or (B) 40 percent or more of the residential units in the project are occupied by individuals whose income is 60 percent or less of the area median gross income (the 40-60 requirement), whichever is elected by the issuer of the bonds providing for such project.

Section 142(d)(4) of the Code provides that, in the case of a deep rent skewed project, 15 percent or more of the low-income units must be occupied by individuals whose income is 40 percent or less of the area median gross income.

Section 142(d)(2) of the Code provides that the income of individuals and the area median gross income shall be determined by the Secretary in a manner consistent with determinations of lower income families and area median gross income under section 8 of the United States Housing Act of 1937 or, if such program is terminated, under such program as in effect immediately before such termination. Determinations under the preceding sentence shall include adjustments for family size.

Section 252 of the Act enacted section 42 of the Code, which provides a new federal income tax credit that may be claimed by owners of residential rental projects providing low-income housing. Section 42(a) provides that the amount of the credit shall be based on an applicable percentage of the qualified basis of each qualified low-income building. Section 42(c)(2) defines the term "qualified low-income building" to mean, in part, any building that at all times during the compliance period with respect to such building is part of a qualified low-income housing project.

Section 42(g)(1) provides that the term "qualified low-income housing project" means any project for residential rental property if, either (A) 20 percent or more of the units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of the area median gross income, or (B) 40 percent or more of the units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of the area median gross income, whichever is elected by the taxpayer.

Section 42(g)(4) of the Code provides, in part, that paragraph (2) (other than subparagraph (A)) and paragraph (4) of section 142(d) shall apply for purposes of determining whether any project is a qualified low-income housing project and whether any unit is a low-income unit.

ANALYSIS AND HOLDING

The income limits applicable to qualified residential rental projects and to qualified low-income housing projects are required to be made in a manner consistent with determinations of lower income families under section 8 of the United States Housing Act of 1937. With respect to the 20-50 requirement of sections 142(d)(1)(A) and 42(g)(1)(A) of the Code, 20 percent or more of the applicable units must be occupied by individuals or families having incomes equal to or less than the income limit for a "very low-income" family of the same size. With respect to the 40-60 requirement of sections 142(d)(1)(B) and 42(g)(1)(B) , 40 percent of the applicable units must be occupied by individuals or families having incomes equal to 120 percent or less of the income limit for a very low-income family of the same size.

With respect to certain deep rent skewed projects, as described in section 142(d)(4), the determination of whether 15 percent of the low-income units are occupied by individuals having incomes equal to 40 percent or less of the area median gross income shall be made by determining whether 15 percent of such units are occupied by individuals or families having incomes equal to or less than 80 percent of the income limit for a very low-income family of the same size.

The income limits for very low-income families are computed and listed, according to family size, by the Department of Housing and Urban Development (HUD) for every Metropolitan Statistical Area, Primary Metropolitan Statistical Area, and nonmetropolitan county of the United States and Puerto Rico. HUD also releases income limits for the possessions of Guam and the Virgin Islands.

A list of income limits released by HUD may be relied upon until 30 days after the Internal Revenue Service publishes an announcement or notice in the Internal Revenue Bulletin indicating that HUD has released updated income limits.

DRAFTING INFORMATION

The principal author of this revenue ruling is Mark Scott of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Mr. Scott on (202) 566-4336 (not a toll-free call).

Section 167.—Depreciation

26 CFR 1.167(a)-2: Tangible property.

Depreciation; home-builder; houses used as models and or sales offices. Houses that a home-builder used for models and/or sales offices were not subject to an allowance for depreciation under section 167 of the Code.

Rev. Rul. 89-25

ISSUE

If a home-builder temporarily used new houses for models and/or sales offices, were the houses subject to an allowance for depreciation?

FACTS

The taxpayer is in the business of building and selling residential houses. To assist in its sales activity, the taxpayer used certain houses as models and/or sales offices temporarily (*i.e.*, for a small fraction of their expected useful life). Such use generated no rental income to the taxpayer. During the period of that use, the taxpayer made no effort to sell those houses; however, the taxpayer expected to sell all houses in development D within a few years (including the houses temporarily used as models and/or sales offices).

LAW AND ANALYSIS

Section 167 of the Internal Revenue Code provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business or held for the production of income.

Section 1.167(a)-2 of the Income Tax Regulations provides that the depreciation allowance in the case of tangible property applies only to that part of the property that is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence, and the allowance does not apply to inventories or stock in trade.

Rev. Rul. 75-538, 1975-2 C.B. 35, concerns the treatment for federal income tax purposes of motor vehicles held by a taxpayer engaged in the business of selling motor vehicles. A taxpayer engaged in the trade or business of selling motor vehicles is presumed to hold all such vehicles primarily for sale to customers in the ordinary course of the taxpayer's trade or business. To overcome this presumption, the taxpayer must show clearly that the motor vehicle was actually devoted to use in the business of the dealer and that the dealer looks to consumption through use of the vehicle in the ordinary course of business operation to recover the dealer's cost. Rev. Rul. 75-538 provides that a vehicle is not property used in the business if it is used merely for demonstration purposes, or temporarily withdrawn from stock-in-trade or inventory for business use.

Duval Motor Co. v. Commissioner, 264 F.2d 548 (5th Cir. 1959), *aff'g* 28 T.C. 42 (1957), concerned automobiles used as demonstrators and provided by a car dealer to company officials and salesmen for other business uses. The court found that these automobiles were held primarily for sale to customers. As a result, the dealer was not entitled to a depreciation deduction with respect to such automobiles. *See also Luhring Motor Co. v. Commissioner*, 42 T.C. 732 (1964); *R.E. Moorhead & Son, Inc. v. Commissioner*, 40 T.C. 704 (1963).

In the present situation the houses were used as models and/or sales offices for a small fraction of their expected useful lives and never generated any rental income. After this period of use, the taxpayer expected to sell the houses in the same manner as it had been selling its other houses. Moreover, the essential purpose for which the houses were built — sale to customers — was never altered. Thus, although the houses were used temporarily as models and/or sales offices, and although the taxpayer may have been reluctant or unwilling to sell the houses while they were being used in this way, they remained property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's business rather than property used in the trade or business. Thus, they may not be depreciated. See section 167(a) of the Code; *Duval Motor Co., Supra.*

HOLDING

Houses that a home-builder temporarily used for models and/or sales offices were not subject to an allowance for depreciation.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael J. Hahn of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Noel J. Sheehan on (202) 566-4819 (not a toll-free call).

Section 170.—Charitable, Etc. Contributions and Gifts

26 CFR 1.170A-6: Charitable contributions in trust.

The Service ordinarily will not issue rulings as to whether a transfer to an inter vivos charitable remainder trust described in section 664 of the Code that provides for annuity or unitrust payments for one measuring life qualifies for a charitable deduction under section 170(f)(2)(A). See Rev. Proc. 89-19, page 59.

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26 CFR 1.170A-6: Charitable contributions in trust.

Contributions to a qualifying inter vivos charitable remainder unitrust providing for unitrust payments during one life are deductible for income tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 89-20, page 59.

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26 CFR 1.170A-6: Charitable contributions in trust.

Contributions to a qualifying inter vivos charitable remainder annuity trust providing for annuity payments during one life are deductible for income tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 89-21, page 60.

Section 263A.—Capitalization and Inclusion in Inventory Costs of Certain Expenses

26 CFR 1.263A-1T: Capitalization and inclusion in inventory costs of certain expenses.

Inventories; gross receipts exception. Retailers and wholesalers with annual gross receipts of less than $10 million are exempt from the capitalization rules of section 263A of the Code. Gross receipts from all businesses of the taxpayer are included in the computation for purposes of the $10 million test.

Rev. Rul. 89-26

ISSUE

If a taxpayer's average annual gross receipts from all of its businesses exceed