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Low-income housing credit; Secretary's authority to provide regulations.

This letter responds to your letter dated August 31, 1994, that requests a ruling under § 42(n)(4) of the Internal Revenue Code and § 1.42-13(b) of the Income Tax Regulations.

FACTS

The Agency and Nonprofit A have made the following representations.

The Partnership is a State A limited partnership formed on t1 to acquire, renovate, and operate the Project as low-income housing. The Partnership's general partner is General Partner, which holds a a% general partner interest in the Partnership. Limited Partner holds a b% limited partner interest in the Partnership. The Limited Partner is a fund comprised of Corp A, its general partner, and other investors as its limited partners.

General Partner has two shareholders. One is Nonprofit A, a State A nonprofit corporation that is exempt from federal income tax under § 501(c)(3). Nonprofit A holds c% of General Partner's issued and outstanding common stock. Nonprofit B, also a State A nonprofit entity exempt from federal income tax under § 501(c)(3), owns d% of General Partner's issued and outstanding common stock.

Nonprofit A's purpose is to catalyze public and private partnership to design programs and raise funds and support for appropriate residential services and facilities for the homeless residents of State A suffering from mental illness. Nonprofit A also provides or arranges for the operation and management of such facilities and services.

The District Director of Internal Revenue for City A has audit jurisdiction over the federal income tax returns of the Partnership, Nonprofit A, and General Partner.

A survey performed by Researchers, which was commissioned by the Department, the Agency, and a private nonprofit foundation, shows that City A currently has a homeless population of approximately e persons who suffer from a diagnosable mental illness. Of that number, Nonprofit A has counted at least f who are so severely ill and isolated that they do not respond to any form of support or treatment. The Partnership was formed to own and operate the Project to address the needs of this group.

In t2, Nonprofit A commenced searching for a suitable location to establish the Project. A vacant shoe factory in the inner city of City A was located, and on t3, Nonprofit A obtained title to the shoe factory property from an unrelated third-party for $g. Although Nonprofit A had no prior experience with low-income housing tax credits, it decided to seek equity financing through the syndication of the Project.

The first tenants became residents of the Project in t4. Currently, all h units are occupied, and there is a waiting list of additional tenants.

On t5, Nonprofit A submitted an application to the Agency for a low-income housing credit dollar amount (Credits) for the Project. In the application, Nonprofit A was listed as the developer, and the owner entity was listed as X. Nonprofit A was listed as a a% general partner of X. At that time, Nonprofit A planned to form a limited partnership to own the Project as a way of syndicating the Project. Nonetheless, no such partnership existed at that time, and all of the capital raised for the Project was from charitable gifts to Nonprofit A (other than a $i Community Development Block Grant loan from City A that was used to purchase the Project).

Nonprofit A had already raised in excess of $j of charitable contributions, which Nonprofit A planned to contribute to the syndication partnership. In an opinion letter given to the Agency, the chronology of the acquisition and financing of the Project was stated as follows:

1. Nonprofit A purchased the Project for $p on t3.

2. Nonprofit A intends to transfer the Project and approximately $k to Z for a general partner interest in Z. This transfer will constitute an equity contribution to Z and will not constitute a grant or gift to Z.

Thus, the application for Credits contained inconsistencies regarding the actual ownership of the Project and, to the extent the application reflected the owner to be any entity other than Nonprofit A at the time of submission, did not accurately reflect Nonprofit A's intention. Nonprofit A wanted the "reservation" of Credits in the name of Nonprofit A. As an inexperienced real estate developer, Nonprofit A was merely attempting to put the Agency on notice and fully describe its ultimate intentions for the Credits.

On t6, the Agency granted a "reservation" of Credits to the Project. The requested housing credit dollar amount was $l, and the maximum allowable housing credit dollar amount was $m. The reservation was sent to Nonprofit A and was made in the name of the Y as applicant. The project name was also listed as Y.

On t7, Nonprofit A submitted an application for a carryover allocation of Credits under § 42(h)(1)(E). The application was submitted by transmittal letter on Nonprofit A's letterhead and by Nonprofit A, as developer. The "Certification of Basis Expenditure," which was attached to the carryover allocation application, reflected the name of the then current owner as Nonprofit A. Attached to the "Certification of Basis Expenditure" was a copy of the deed to the land and building comprising the Project showing Nonprofit A's acquisition of the Project, which constituted part of Nonprofit A's expenditures entitled to a carryover allocation. The deed was in the name of Nonprofit A.

The Agency issued a carryover allocation under § 42(h)(1)(E) on t8 (the Carryover Allocation) in the name of X. (Because Nonprofit A's anticipated costs and the eligible basis of the Project had increased from the time the original application for Credits was filed, the Agency

increased the housing credit dollar amount for the Project in the Carryover Allocation to $n.) Thus, the face of the Carryover Allocation showed X as the actual owner. But the "Certification of Basis Expenditure" listed Nonprofit A as the owner, which is consistent with information supporting the certification. Therefore, the Carryover Allocation contained an inconsistency regarding the actual owner of the Project and, by implication, the entity that had incurred the costs qualifying the Project for an allocation under § 42(h)(h)(1)(E).

Nonprofit A was not attempting to mislead the Agency but was expressing its intention regarding the future syndication of the Project. At that time, the Partnership had not been formed.

The Agency acknowledges that the issuance of the Carryover Allocation in the name of X did not meet with the then current or ultimate intention for the Carryover Allocation of either the Agency or Nonprofit A. Both parties intended that the Agency issue the Carryover Allocation for the Project to Nonprofit A.

Prior to t1, the entity referred to in the original Credit application and the Carryover Allocation did not exist; it was just a reference to an entity that Nonprofit A planned to use. Subsequent to the formation of the Partnership, Nonprofit A made a capital contribution of the property and cash to General Partner, which made a further contribution of such property to the Partnership. The property was transferred on t9. Thus, Nonprofit A's original intention, as expressed in the documents it submitted to the Agency in t10, was fulfilled.

The Partnership completed renovation in 1993. On t11, the Partnership submitted to the Agency a final cost certification and other documents for the Project and requested that the Agency issue a Form 8609. The Agency issued the Form 8609 on t12, and provided for a maximum housing credit dollar amount for the Project of only $l, which was the original amount of requested Credit, rather than the %n amount shown on the Carryover Allocation, which is higher than $l. This was not discovered until after the Agency had filed the Form 8609 with the Internal Revenue Service. As a result of investigating the discrepancy in the Form 8609, the Agency discovered the inconsistencies regarding the name of the entity in the applications for, and reservation and allocation of, the Credits to the Project. The Agency properly treated the difference between $n and $l as a returned credit in 1993.

The discrepancy in the Credit amount on the Form 8609, $l, versus the Carryover Allocation amount, $n, is the result of an adjustment made by the Agency to the certified development costs. The Agency properly reduced the basis reported by the Partnership in its final cost certification for the land and building. The Partnership had erroneously certified a basis of $o, instead of $g, which is the amount Nonprofit A paid for the land and building. To further confuse the sources and uses of funds and total financing planned for the Project, the Partnership mistakenly certified as a source of funds the appreciation in the value of the land and building. The confusion stemmed from the transfer of the land and building from Nonprofit A to the Partnership, which did not occur until after the Carryover Allocation was issued and an appraisal of the Project showed a higher fair market value because of rezoning.

At the time it issued the Form 8609, the Agency did not know that the Partnership had included the appreciation of the land and building as a source of funds, however. Thus, the Agency reduced the Credit amount for the Project because the Project had a smaller "equity gap" than originally reported.

The Agency, Nonprofit A, and the Partnership agree that (1) the Agency should have issued the Carryover Allocation of Credits to Nonprofit A and (2) the amount of the final Credit allocation to the Partnership should be $n.

Therefore, the Agency has requested the following rulings:

1. That the Carryover Allocation to the Project be considered made properly to Nonprofit A; and

2. That the Agency may correct and reissue the Form 8609 for the Project to reflect an increased Credit allocation of $n, which is the amount allocated to the Project on the Carryover Allocation.

LAW AND ANALYSIS

Section 42(a) provides a tax credit for investment in low-income housing buildings placed in service after December 31, 1986. To claim the Credit, a taxpayer must satisfy various requirements under § 42. One requirement is that a building (other than certain buildings financed with tax-exempt bonds under § 42(h)(4)) must receive an allocation of housing credit dollar amounts from the applicable state or local housing credit agency (agency).

Under § 42(n)(4), agencies may correct administrative errors and omissions concerning allocations and recordkeeping within a reasonable period of time after their discovery. Section 1.42-13(b)(2) defines an administrative error or omission as a mistake that creates a document that inaccurately reflects the intent of the agency at the time the document is originally completed or, if the mistake affects a taxpayer, a document that inaccurately reflects the intent of the agency and the affected taxpayer at the time the document is originally completed. Section 1.42-13(b)(1), however, provides that an administrative error or omission does not include a misinterpretation of the applicable rules and regulations under § 42.

Under § 1.42-13(b)(3)(iii) (A), the Secretary must pre-approve a correction of an administrative error if the correction is not made before the close of the calendar year of the error and the correction requires a numerical change to the Credit amount allocated for a building or project. In this case, the Carryover Allocation, not the Form 8609, is the document on which the Agency allocated a housing credit dollar amount to the Project.

Nonprofit A committed an error by failing to inform the Agency that the Partnership had not been formed when it applied for the Carryover Allocation for the Project. The Agency committed an error by failing to verify which entity qualified for the Carryover Allocation. We do not believe that either error was a misinterpretation of the applicable rules and regulations of § 42. Further, this error created an allocation document, the Carryover Allocation, that did not accurately reflect the intent of the Agency and the Partnership when they executed the Carryover Allocation. The Agency will correct the administrative errors within a reasonable period of time.

For the second ruling requested, we believe that the Partnership committed an administrative error when completing the final cost certification for the Project. The Partnership was apparently confused as to the proper basis amount for the land and building that it could show on the final cost certification. We believe this confusion created an artificially inflated source of funds for the Project. In turn, that caused the Agency to reduce the maximum credit dollar amount allowable on the Form 8609. We believe that the Agency intended to allocate enough Credit to make the Project financially feasible as a low-income housing project. If it chooses to make a correction before the end of 1994, the Agency will correct this administrative error within a reasonable period of time.

After applying the relevant law and regulations to the facts submitted and the representations set forth above, we rule as follows:

1. Nonprofit A committed an administrative error by failing to inform the Agency that the Partnership had not been formed at the time it applied for the Carryover Allocation for the Project.

2. The Partnership committed administrative errors (1) by erroneously stating the Project's adjusted basis in the land and building as $o, instead of $g, and (2) by mistakenly including the land and building's appreciation as a source of funds for the Project.

3. The Agency committed an administrative error by failing to verify which party owned the Project when it issued the Carryover Allocation for the Project.

4. Because of these administrative errors, the Carryover Allocation and the Form 8609 issued for the Project inaccurately reflect the intent of the Agency, Nonprofit A, and the Partnership at the time the Agency executed the Carryover Allocation and completed Part I of the Form 8609.

5. The Agency will correct the administrative errors within a reasonable period of time after it became aware of the administrative errors.

To correct the administrative errors related to the issuance of the Carryover Allocation, the Agency must do the following:

1. Amend the Carryover Allocation to show Nonprofit A as the owner of the Project at the time it issued the Carryover Allocation to the Project. On the first page of the Carryover Allocation, the Agency should indicate that it made a correction of an administrative error under § 1.42-13 and the nature of the correction.

2. Attach a copy of the amended Carryover Allocation to an amended Form 8610 and file the amended Form 8610 with the Philadelphia Service Center. When completing the amended Form 8610, the Agency should follow the instructions on the Form 8610 under the heading "Amended Reports."

For the administrative error related to the issuance of the Form 8609 for the Project, the Agency may issue an additional Form 8609 to increase the total amount of Credit allowable to the Project to an amount that does not violate the requirements of § 42(m)(2). If it does issue in 1994 an additional Form 8609 for the Project, the Agency must reduce its 1994 State housing credit

ceiling, as determined under § 1.42-14(a), by the amount of the maximum housing credit dollar amount allowable on the additional Form 8609 issued in 1994 for the Project. Thus, the Project will have two Form 8609s if the Agency issues an additional Form 8609 in 1994 for the Project.

The Secretary places the following condition on the Partnership:

The Partnership must not begin the credit period for the Credit amount shown on the additional Form 8609 until 1994.

If the Agency fails to follow the instructions or the Partnership fails to obey the condition, this ruling is void.

Under the power of attorney on file, we are sending a copy of this ruling to the Partnership's authorized representative.

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. Specifically, we express no opinion on whether the Project qualifies for the low-income housing credit under § 42, on the proper characterization of the Community Block Development Grant loan, or on the classification of the entities for federal income tax purposes:

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

Sincerely yours, Barbara B. Walker, Assistant to the Chief, Branch 5, Office of the Assistant Chief Counsel (Passthroughs and Special Industries)