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September 11, 2003

Legend:

M (Taxpayer) =

N (Program) =

A (State) =

Statute A =

QAP (2003) §§:

l =
m =
n =
o =
p =

Dear Taxpayer:

This is in response to your authorized representative's letters and submissions of March 11, 2003, and other correspondence and submissions, in which he requested on your behalf a ruling regarding a certain election available to participants in your, M's, N program, a State low-income housing tax credit program. We are pleased to address your concerns.

Section 42 of the Internal Revenue Code (Code) provides rules concerning the federal low-income housing tax credit (§ 42 credit), including the formula used to

establish the aggregate credit dollar amount allocated to state housing agencies. State housing agencies, such as M, are authorized to allocate § 42 credits to qualified housing projects located in their jurisdiction. Each state agency allocates § 42 credits pursuant to the terms of its Qualified Allocation Plan (QAP). The § 42 credit is claimed over a period of ten years, generally beginning with the year in which the building is placed in service or, if the taxpayer makes an election, beginning in the following year.

In order to supplement the federal program, State A provides a low-income housing tax credit (state credit) to certain taxpayers who are allocated a § 42 credit on or after January 1, 2003. Statute A. This state credit "piggybacks" on the § 42 credit, as described further below. The state credit can be taken either in the form of a refundable credit or a loan. Taxpayers who file applications with M to obtain an allocation of the § 42 credit may be either using the cash receipts and disbursements method of accounting or an accrual method of accounting.

You, M, have inquired whether a taxpayer/applicant that represents on its full application for a § 42 credit allocation (submitted to M) that it will subsequently elect under Statute A to receive a loan from M instead of the refundable state credit, will nonetheless be considered to have received, or be entitled to, the state credit for purposes of §§ 61 and 451 of the Code. The answer affects the analysis of M's information reporting requirements under § 6041 of the Code.

Section 42 credit procedure in State A

M is a self-supporting public agency created under the laws of State A to operate federal and state housing programs. In order to obtain an allocation of the § 42 credit, taxpayer/applicants file preliminary applications, followed by full applications, with M in accordance with the provisions of the annual QAP. The 2003 Low-Income Housing Tax Credit Qualified Allocation Plan for the State of A, as amended (2003 QAP), provides that preliminary applications were due during January of 2003 and full applications were due during May of 2003. (QAP § I.)

After M reviews the full applications, it awards a reservation of credit authority to the projects that best meet the QAP criteria. Pursuant to the 2003 QAP, this occurred during August of 2003. The fact that a credit amount has been reserved does not mean that the actual allocation of the credit has been made; that occurs at a subsequent time during the same calendar year.

There are two methods for allocating § 42 credits. One method of allocating is by the issuance of a Form 8609, Low-Income Housing Credit Allocation Certification. The Form 8609 also serves as an information reporting document. The other method of allocating is by the issuance of a carryover allocation document.

The general rule under § 42 of the Code is that an allocation of credit is effective only if it is made by the close of the year that the building is placed in service. Under § 42(m)(2), the state agency is responsible for ensuring that the amount of credit

allocated (or received, in the case of credit predicated upon tax-exempt bond financing) does not exceed the amount necessary to ensure project feasibility. As a result, final cost certifications for the project are required before the state agency will issue a Form 8609. Because final cost certifications are usually not obtained before the close of the year a building is placed-in-service and the information on Part I of the Form 8609 must reflect the proper amount of credit allocated (or received), the Form 8609 is rarely used as the document to allocate § 42 credit. Rather, the issuance of a carryover allocating document is the prevalent method by which a state agency makes an allocation of § 42 credit.

A "carryover allocation" does not require completion of the project in the same year as the allocation. A carryover allocation can be made if (1) at least 10% of the reasonably anticipated costs of the project are incurred by the later of six months after the allocation is made or the end of the calendar year in which the allocation is made and (2) the building is placed in service by the end of the second calendar year following the year of the allocation. In this scenario, after a credit reservation award has been made, the taxpayer applies for a carryover allocation, and the state housing agency issues a carryover allocation document pursuant to § 1.42-6 of the Income Tax Regulations. Once the building is placed in service and the final costs have been certified, the taxpayer applies for the Form 8609 which, at this point, serves as an information reporting document.

State credit procedure

State A law provides that a taxpayer may elect to receive the state credit in the form of either a refundable credit or a loan from M. When a taxpayer submits to M a request to receive a carryover allocation of § 42 credit, the taxpayer must elect a method for receiving the state credit. A taxpayer may elect to receive the state credit in the form of either a direct tax refund or a loan generated by transferring the state credit to M. *See* subsection (d) of Statute A. As discussed above, a taxpayer submits a request to receive a carryover allocation after the taxpayer submits a full application to M and is notified by M that a § 42 credit reservation has been made.[1]

Statute A provides the general rule that a taxpayer may claim the state credit on a return filed for the taxable year in which the taxpayer receives a carryover allocation

[1] In the unusual case in which the taxpayer/applicant does not request a carryover allocation, subsection (e) of Statute A provides that the taxpayer must make the election at a particular time specified in that subsection. Such time would occur after the taxpayer submits a full application to M and is notified by M that a § 42 credit reservation has been made.

of a § 42 credit.[2] When a taxpayer has elected the refund method, the refundable excess of the credit (over the amount that is applied to reduce state tax liability) is transferred by the State A Department of Revenue (ADOR) to M, which holds the refund in escrow until certain conditions related to project completion are satisfied.

When a taxpayer/applicant has elected the loan method, the credit is transferred by ADOR to M, and the taxpayer receives a loan from M. The terms of the loan are specified by M in accordance with the annual QAP. The entire loan must be used to pay down a portion of the then existing construction debt, and the loan will not be closed until the outstanding balance on the first-tier construction financing exceeds the total state credit amount.

The 2003 QAP requires applicants to indicate, as part of the full application process, whether the state credit loan option or refund option will apply to the project. This decision may not be changed for the carryover allocation. (QAP § p.) An applicant's representation that it will elect to receive the loan option or refund option is an important part of the financing for an applicant's project. Any misrepresentation in an application document may result in disqualification of that application and revocation of a § 42 credit allocation. (QAP § m.) Also, M may revoke § 42 credits after the project has been placed in service if it determines that the owner has failed to implement all representations in the application to M's satisfaction. (QAP § n.) Additionally, a Form 8609 will not be issued until M confirms that the project has adhered to all representations made in the application. (QAP § o.)

Prior to August of 2003, M adopted a policy pursuant to QAP § p that it will always revoke a § 42 credit allocation if an applicant purports to make an election under Statute A inconsistent with its representation on its full application. M has represented that it will enforce that policy.

Section 451(a) of the Code provides the general rule that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period. Section 1.451-1(a) of the regulations provides, in part, that gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer, unless includible for a different year in accordance with the taxpayer's method of accounting. Under the cash receipts and disbursements method of accounting, income is includible in gross income for the taxable year in which it is actually or constructively received by the taxpayer. See also

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[2] Subsection (e) of Statute A provides that a taxpayer/applicant subject to the provisions of that subsection claims the state credit at a particular time specified in that subsection.

§ 1.451-2. Under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

Statute A requires a taxpayer/applicant to make the election between the loan option or refund option when it submits to M a request to receive a carryover allocation or, if a taxpayer does not submit to M a request to receive a carryover allocation, at the time specified in subsection (e) of Statute A. However, the 2003 QAP requires applicants to indicate whether the loan option or refund option under Statute A will apply to the project when the applicant submits its full application to M. A full application is submitted before the times specified in Statute A. M will always revoke a § 42 credit allocation if a taxpayer/applicant purports to make an election at the times specified in Statute A inconsistent with its representation on its full application. If a taxpayer does not have a § 42 credit allocation, that taxpayer is not entitled to the state credit.

Based on the information and representations provided, and assuming that the actual application process is conducted substantially as described above, we conclude that taxpayer/applicants who represent on their full application for a § 42 credit allocation submitted to M that they will subsequently elect under Statute A to receive a loan from M instead of the refundable state credit, will not be considered to have received, or be entitled to, the state credit for purposes of §§ 61 and 451.

This letter ruling is based on facts and representations provided by M, and is limited to the matters specifically addressed. No opinion is expressed as to the tax treatment of the transactions considered herein under the provisions of any other sections of the Code or regulations which may be applicable thereto, or the tax treatment of any conditions existing at the time of, or effects resulting from, such transactions which are not specifically addressed herein. More specifically, no opinion is expressed as to whether any particular "loan" elected by an N program participant under the "loan option" described herein constitutes a true loan or true indebtedness for federal income tax purposes, as represented by the Taxpayer. This determination is inherently factual, must be made on a case-by-case basis, and is subject to verification upon examination by M's IRS Industry Director.

Because it could help resolve possible federal tax issues, a copy of this letter ruling should be maintained with M's permanent records.

Pursuant to a power of attorney currently on file with this office, a copy of this letter is being sent to M's designated authorized representative. A copy of this letter ruling is also being forwarded to the Taxpayer's Industry Director.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

Sincerely yours,

Associate Chief Counsel
(Income Tax & Accounting)

By_____
WILLIAM A. JACKSON
Chief, Branch 5

Enclosures:
Copy of this letter
Copy for section 6110 purposes