Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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LEGEND

Taxpayer =

Consolidated Group A =
Consolidated Group B =

Examination Office =

Subsidiary 1 =

Subsidiary 2 =

Subsidiary 3 =

Subsidiary 4 =

Subsidiary 5 =

Subsidiary 6 =

Year 1	=
Year 2	=
Date 1	=
Partnership 1	=
Partnership 2	=
Partnership 3	=
Year 3	=
a	=
Date 2	=
b	=
c	=
Year 4	=
d	=
e	=
f	=
Date 3	=
g	=
h	=
i	=
j	=
k	=

l =

m =

n =

Year 5 =

o =

Partnership 4 =

p =

q =

Dear :

This letter responds to your letter dated April 9, 2004, and subsequent submissions, made on behalf of Taxpayer, requesting a ruling that certain transfers of interests in partnerships owning low-income housing tax credit property will not result in recapture under § 42(j)(1) of the Internal Revenue Code. The Internal Revenue Service Office that will have examination jurisdiction over Taxpayer and Consolidated Group A is the Examination Office.

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

FACTS

Taxpayer is mutual holding company and the parent of Consolidated Group A, a life-nonlife consolidated group under § 1504(c)(2) of the Code. Subsidiary 1, a non-life holding company, is a wholly owned subsidiary of Taxpayer.

Subsidiary 2 is a wholly owned subsidiary of Subsidiary 1. Subsidiary 2 is the only life insurance company within Consolidated Group A and is taxed under § 801 of the Code.

Subsidiary 3 is a wholly owned non-life subsidiary of Subsidiary 2. Subsidiary 4 is a wholly owned non-life subsidiary of Subsidiary 3. Subsidiary 3 and Subsidiary 4 are holding companies. Subsidiary 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 are all members of Consolidated Group A.

Consolidated Group B consists of Subsidiary 5, and its wholly owned subsidiary, Subsidiary 6. Subsidiary 5 is a wholly owned subsidiary of Subsidiary 4. In Year 1, Subsidiary 3 purchased a two-thirds interest in the predecessor corporation of Subsidiary 4. In Year 2, Subsidiary 3 purchased the remaining one-third interest in Subsidiary 4. Subsidiary 4 joined Consolidated Group A immediately. However, due to waiting requirements of § 1504(c), Subsidiary 5 and Subsidiary 6 are unable to join Consolidated Group A until Date 1.

Subsidiary 5 is in the business of insuring life insurance, annuity, and other related risks, and is taxed as a life insurance company under § 801 of the Code. Subsidiary 6 is a wholly owned subsidiary of Subsidiary 5. Subsidiary 6 is in the business of insuring life insurance, annuity, and other related risks and is taxed as a life insurance company under § 801.

Through a series of § 351 transactions, Subsidiary 2 proposes to transfer it's limited partner interest in three investment partnerships that invest in qualified low-income housing credit partnerships. The three investment partnerships are Partnership 1, Partnership 2, and Partnership 3.

To the best of Taxpayer's knowledge, none of the partnerships qualify as a § 42(j)(5) partnership.

Beginning in Year 3, invested $a in Partnership 1. Based on the most recent financial statements and independent auditor's report, as of Date 2, Partnership 1 had total assets of $b and total equity of $c. On its Year 4 K-1, Subsidiary 2's end of year capital account was $d, and Subsidiary 2 was allocated e percent of the profit sharing, loss sharing and ownership of capital.

Beginning in Year 1, Subsidiary 2 invested $f in Partnership 2. Based on the most recent financial statements and independent auditor's report, as of Date 3, Partnership 2 had total assets of $g and total equity of $h. On its Year 4 K-1, Subsidiary 2's end of year capital account was $i, and Subsidiary 2 was allocated j percent of profit sharing, loss sharing and ownership of capital.

Beginning in Year 1, Subsidiary 2 invested $a in Partnership 3. Based on the most recent financial statements and independent auditor's report, as of Date 2, Partnership 3 had total assets of $k and partners equity of $l. On the partnership's Year 4 K-1, Subsidiary 2's capital account was $m, and Subsidiary 2 was allocated n percent of the profit sharing, loss sharing and ownership of capital.

Subsidiary 6 is also a partner in a separate low income housing partnership. Beginning in Year 5, Subsidiary 6 invested $o in Partnership 4. On Partnership 4's Year 4 K-1, Subsidiary 6's capital account was $p, and Subsidiary 6 was allocated q percent of the partnership's profit sharing, loss sharing and ownership of capital.

PROPOSED TRANSACTION

Subsidiary 2 will, through the chain of wholly owned corporations, make § 351 capital contributions of its interest in Partnerships 1, 2, and 3 to Subsidiary 6. In each case, the interest transferred from Subsidiary 2 to Subsidiary 6 will be less than 50% of the profits and capital interests of the investment partnership. Further, there will not have been, and it is expected that there will not be, a transfer of greater than 50% of such interest by Subsidiary 2, in combination with any other partner, in any twelve month period containing the date of transfer.

Taxpayer specifically represents that the transfers of Subsidiary 2's interests in Partnerships 1, 2, and 3, through the chain of wholly owned corporations to Subsidiary 6, will qualify under § 351 as tax-free transfers of assets by each transferor corporation in exchange or constructive exchange for additional stock of the transferee corporations. Taxpayer further represents that immediately after these exchanges, Subsidiary 6's basis in its partnership interests in Partnerships 1, 2, and 3, will equal the basis of these partnership interests in the hands of Subsidiary 2 immediately prior to the proposed transaction.

RULING REQUESTED

Taxpayer requests the Service to rule that the transfer of Subsidiary 2's interests in Partnerships 1, 2, and 3, through it's chain of wholly owned corporations, to Subsidiary 6 will not result in recapture under § 42(j).

LAW AND ANALYSIS:

Section 38(a) 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) provides that, for purposes of section 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.

In the case of any qualified low-income building placed in service by the taxpayer after 1987, § 42(b) provides, in part, that the term "applicable percentage" means the appropriate percentage prescribed by the Secretary for the month applicable under § 42(b)(2)(A)(i) or (ii). Section 42(b)(2)(B) provides that the percentages prescribed by the Secretary for any month shall be percentages that will yield over a 10-year period amounts of credit that have a present value equal to: (i) 70 percent of the qualified basis of new buildings that are not federally subsidized for the taxable year, and (ii) 30 percent of the qualified basis of existing buildings, and of new buildings that are federally subsidized for the taxable year.

Section 42(c) provides that the qualified basis of any qualified low-income building for any taxable year is an amount equal to the applicable fraction (defined in § 42(c)(1)(B)) of the eligible basis of such building. In general, under § 42(d) the eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period.

Under § 42(j)(1), if at the close of any taxable year in the compliance period, the amount of the qualified basis of any building with respect to the taxpayer is less than the amount of such basis as of the close of the preceding taxable year, the taxpayer's tax for the taxable year will be increased by the credit recapture amount. The credit recapture amount is determined under § 42(j)(2) and § 42(j)(3).

Generally, under § 42(j)(1), any disposition by a taxpayer of a building (or an interest therein) upon which credits were claimed during the compliance period is a recapture event. Under § 42(j)(6), however, no recapture will be imposed on a disposition of a low-income building (or an interest therein) if the taxpayer furnishes to the Secretary a bond, and it is reasonably expected that the building will continue to be operated as a qualified low-income building through the end of the compliance period.

Little guidance is available to illustrate when, under § 42(j), a reduction in qualified basis of a building with respect to the taxpayer has occurred or when there has been a disposition that requires the taxpayer to post a bond to avoid recapture. However, analogous provisions concerning recapture of investment tax credit (ITC) property provide relevant guidance for determining recapture under § 42(j).

Section 50(a)(1) provides, generally, for recapture if during any taxable year ITC property is disposed of or otherwise ceases to be ITC property with respect to the taxpayer before the close of the recapture period. Currently, there are no regulations under § 50. However, for property placed in service before January 1, 1991, former § 47(a)(1) (and the regulations thereunder) contained a similar ITC recapture rule. The regulations under former § 47 (which are still effective) mirror the general recapture rule of former § 47 that a disposition or cessation of ITC property before the close of the estimated useful life of the property that was taken into account in computing the taxpayer's qualified investment will result in ITC recapture. However, there are some exceptions to the general rule concerning the recapture of ITC property. For example, § 1.47-6(a)(2) of the Income Tax Regulations provides a de miminis rule that permits a partner to dispose of up to 33-1/3 percent of its proportionate interest in the general profits of a partnership (or in a particular item of section 38 property) before ITC recapture applies. In determining the partner's proportionate interest in the general profits of a partnership for purposes of applying this de minimis rule, § 1.47-6(a)(2)(b)(iii) provides an 'identity of interest' rule whereby the partner is considered to own any interest in the partnership that it owns directly or indirectly (through ownership in other entities provided the other entities' bases in the interest are determined in whole or in part by reference to the basis of the interest in the hands of the partner). For example, if A, whose proportionate interest in the general profits of partnership X is 20 percent, transfers all of this interest to corporation Y in exchange for all of the stock of Y in a § 351 transaction, then A shall be considered to own a 20 percent interest in partnership X.

Rev. Rul. 90-60, 1990-2 C.B. 6, adopts a similar de minimis rule for purposes of § 42(j) whereby no bond is required to avoid or defer recapture for any disposition(s) by a partner of its interest in a low-income building held through certain partnerships (i.e., partnerships with less than 35 partners or partnerships to which § 42(j)(5) does not apply) until the partner has disposed of more than 33-1/3 percent of its greatest total interest in the building held through the partnership.

Section 351(a) provides that no gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange the person or persons are in control (as defined in § 368(c)) of the corporation. Under § 368(c), the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of a corporation. Section 362(a) provides that if property is acquired by a corporation in connection with a transaction to which § 351 applies, the basis of the property is the same as it was in the hands of the transferor, increased by the amount of any gain recognized by the transferor on the transfer.

Rev. Rul. 64-155, 1964-1 C.B. 138, provides, in part, that a contribution of property by a corporation to a wholly owned subsidiary, although not resulting in the issuance of additional stock to the contributing corporation, is an exchange of property for stock under § 351 of the Code.

Section 708(a) provides that a partnership shall be considered as continuing if it is not terminated. Section 708(b)(1)(B) provides that, for purposes of § 708(a), a partnership shall be considered terminated if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

If § 42(j)(5) does not apply to a partnership, a § 42 recapture event can occur at the partnership level and also at the partner level. A recapture event can occur at the partnership level, for example, if a partnership disposes of a building upon which a § 42 credit has been allowed. Recapture liability (if any) would be the responsibility of the partners in the partnership at the time of the disposition. A recapture event can also apply at the partner level, for example, if a partner disposes of more than 33-1/3 percent of its greatest total interest in any § 42 buildings held through the partnership.

In the present case, Subsidiary 2 intends to transfer, through a series of § 351 capital contributions to wholly-owned subsidiaries, its entire limited partner interest in each of Partnerships 1, 2, and 3 to Subsidiary 6. Taxpayer represents that, to the best of its knowledge, § 42(j)(5) does not apply to Partnerships 1, 2, and 3. Accordingly, a recapture event can occur at both the partnership and partner level. Taxpayer also represents that, in each case, the § 351 capital contributions of Subsidiary 2's limited partner interests in Partnerships 1, 2, and 3, through its wholly owned subsidiaries, to Subsidiary 6 will be less than 50% of the profits and capital interests of these partnerships. Further, Taxpayer represents that there will not have been, and it is expected that there will not be, a transfer of 50% or more of such interest by Subsidiary 2 and its wholly owned subsidiaries, in combination with any other partner, in any twelve month period containing the date of these transfers. In other words, to the best of the Taxpayer's knowledge, there will be no § 708(b)(1)(B) technical termination of Partnerships 1, 2, or 3 during any 12-month period containing the date of the transfers of Subsidiary 2's interests in Partnerships 1, 2, and 3, through the chain of wholly owned subsidiaries, to Subsidiary 6. Accordingly, there is no recapture event at the Partnership level (as respects Partnerships 1, 2, and 3) as a result of these transfers.

However, Subsidiary 2 will be disposing its entire interest in Partnerships 1, 2, and 3. This will result in a transfer of Subsidiary 2's entire interests in any underlying assets (including any § 42 property) owned directly by any lower tier partnership(s) (e.g, operating partnership(s)) in which Partnerships 1, 2, and 3 are limited partners. Any dispositions of ownership interests in § 42 property (direct or indirect) are treated as transfers (or a change in ownership) for purposes of recapture and any change in ownership is a recapture event. Thus, Subsidiary 2's proposed transfer of its total interest in each of Partnerships 1, 2, and 3, will, absent an exception, be a disposition and therefore a recapture event at the partner level. Under the facts of this transaction, such an exception is available. The 33-1/3 percent de minimis rule of Rev. Rul. 90-60 is intended to reflect the 33-1/3 percent de minimis rule of § 1.47-6(a)(2). Therefore, any rule(s) clarifying how the 33-1/3 percent de minimis rule of § 1.47-6(a)(2) is determined should also apply for purposes of § 42. This includes the identity of interest rule of § 1.42-6(a)(2)(B)(iii) which provides that in determining a partner's proportionate interest in the general profits of a partnership, the partner shall be considered to own any interest in the partnership that it owns directly or indirectly (through ownership in other entities provide the other entities' bases in the interest are determined in whole or in part by reference to the basis of the interest in the hands of the partners).

Here, Subsidiary 2's proportionate interest in the § 42 property will not (after applying the rule of § 1.47-6(a)(2)(b)(iii)) have decreased by more than 33-1/3 percent. In fact, in applying the rule of § 1.47-6(a)(2)(b)(iii), Subsidiary 2's proportionate interest in the § 42 property will be deemed not to have changed at all because (1) the § 351 capital contributions of Subsidiary 2's interest in Partnerships 1, 2, and 3 will be to its wholly-owned subsidiaries and (2) Subsidiary 6 will hold the same percentage interest in Partnerships 1, 2, and 3 (and thus, the same percentage interest in the underlying § 42 property) that Subsidiary 2 will hold immediately prior to the capital contributions. Accordingly, under these circumstances, Subsidiary 2 may rely on the 33-1/3 percent de minimis exception provided in Rev. Rul. 90-60 to avoid the partner level recapture liability that would otherwise result from the § 351 capital contributions of its entire interest in Partnerships 1, 2, and 3 to its wholly owned subsidiaries.

Accordingly, based solely on the taxpayer's representations of fact and relevant law as set forth above, we conclude that the transfer of Subsidiary 2's interest in Partnerships 1, 2, and 3, through its wholly owned subsidiaries, to Subsidiary 6 will not, in and of itself, result in recapture under § 42(j).

We express no opinion on whether any other requirement of § 42 has been met or whether recapture under § 42(j)(1) would otherwise apply to any of the subsidiaries named in this ruling request as a result, for example, of a recapture event occurring from a sale or other disposition of the underlying § 42 property (or interest therein) by the lower tier operating partnership.

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

This ruling is directed only to the Taxpayer which requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter should be filed with the federal income tax return for Taxpayer and its partners for the first taxable year in which the low-income housing credit for Building is claimed.

Sincerely yours,

/s/ Susan Reaman

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

Enclosure:
6110 copy

cc :