

Rev. Rul. 96-35, 1996-2 CB 4 IRC Section 42

Issues

(1) If a qualified low-income building is damaged by a disaster and a below-market loan is provided by the Federal Emergency Management Agency (FEMA) to the owner of the building to repair, reconstruct, or restore the building to its pre-casualty condition, does the loan cause the building to be characterized as federally subsidized under section 42(i)(2) of the Internal Revenue Code?

(2) If a qualified low-income building is damaged by a disaster and a grant is provided by FEMA to the owner of the building to repair, reconstruct, or restore the building to its pre-casualty condition, does the grant require the owner to reduce the building's eligible basis under section 42(d)(5) to the extent of the FEMA grant?

Facts

Taxpayer, T, owns and operates a new qualified low-income building (as defined in section 42(c)(2)) that qualified for the 70- percent present value credit under section 42(b)(2)(B)(i). The building was partially destroyed by a hurricane during the building's 15-year compliance period (as defined in section 42(i)(1)). The President declared the area affected by the hurricane a major disaster area, making available assistance through FEMA. T received a FEMA below-market loan and a grant that T used to restore the building to its pre-casualty condition.

Law and Analysis

Section 42 provides a tax credit for investment in qualified low-income buildings placed in service after December 31, 1986. For any taxable year in a 10-year credit period, the amount of credit is equal to the applicable percentage of the qualified basis of each qualified low-income building.

For a qualified low-income building placed in service after 1987, the term "applicable percentage" means the percentage 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 (70- percent present value credit), and (ii) 30 percent of the qualified basis of existing buildings, and of new buildings that are federally subsidized for the taxable year (30-percent present value credit).

Under section 42(i)(2)(A), a new building is federally subsidized for any taxable year if, at any time during the taxable year or any prior taxable year, there is or was outstanding any below-market federal loan, the proceeds of which were used (directly or indirectly) for the building or its operation.

Under section 42(c), the qualified basis of any qualified low-income building for any taxable year is an amount equal to the applicable fraction (defined in section 42(c)(1)(B)) of the eligible basis of the building. Section 42(d)(5) provides that if, during any taxable year of the compliance period, a federal grant is used for a building or its operation, the eligible basis of the building for the taxable year and all succeeding taxable years is reduced to the extent of the federal grant.

The rules of section 42(i)(2) and section 42(d)(5) limit the low-income housing credit if federally subsidized loans or federal grants are used to finance a building or meet the operating costs of the building. If a building is damaged in a federally declared disaster, however, FEMA assistance does not substitute for funds that were used to determine the building's basis nor is it used to meet operating costs of the building. Rather, FEMA funds merely help to restore the status of the building to its pre-casualty condition. FEMA funds provide no additional federal benefit to taxpayers that section 42(i)(2) and section 42(d)(5) were intended to limit. Furthermore, reducing the amount of the credit available under section 42 would place the owner of a qualified low-income building at a disadvantage compared with other building owners using FEMA funds. Therefore, the amount of credit available to a building will not be affected under section 42(i)(2) and section 42(d)(5) by the building owner's use of FEMA assistance.

Holding

(1) A below-market loan provided by FEMA to the owner of a qualified low-income building damaged by a disaster to repair, reconstruct or restore the building to its pre-casualty condition does not result in characterizing the building as federally subsidized under section 42(i)(2).

(2) A grant provided by FEMA to the owner of a qualified low-income housing building damaged by a disaster does not cause a reduction of the building's eligible basis under section 42(d)(5) to the extent that the grant funds are used to repair, reconstruct, or restore the building to its pre-casualty condition.

Drafting Information

The principal author of this revenue ruling is Christopher J. Wilson of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Wilson on (202) 622-3040 (not a toll-free call).