23rd Chelsea Associates, L. L. C. v. Commissioner, 162 T. C. No. 3 (2024)

The U. S. Tax Court ruled that financing costs, including bond fees, are includible in the eligible basis of a low-income housing project under Section 42 of the Internal Revenue Code, affirming their inclusion in calculating low-income housing credits. This decision impacts how developers finance and calculate tax benefits for affordable housing projects.

Parties

23rd Chelsea Associates, L. L. C. , with Related 23rd Chelsea Associates, L. L. C. , as the tax matters partner (TMP), was the petitioner. The respondent was the Commissioner of Internal Revenue. The case was heard in the United States Tax Court, docketed as No. 22382-19.

Facts

23rd Chelsea Associates, L. L. C. (23rd Chelsea) constructed a 313-unit residential rental property called the Tate in New York City between 2001 and 2002. The construction was financed through a $110 million loan from the New York State Housing Finance Agency (HFA), which raised the funds via bond issuances, including both taxable and tax-exempt bonds. 23rd Chelsea claimed low-income housing credits (LIHCs) under I. R. C. § 42 for tax years 2003 through at least 2009, including in its eligible basis a portion of the financing costs associated with the HFA loan. The Commissioner of Internal Revenue challenged the inclusion of these financing costs in the eligible basis for tax year 2009, proposing adjustments that would reduce the LIHC and impose a credit recapture under I. R. C. § 42(j).

Procedural History

The Commissioner issued a notice of final partnership administrative adjustment (FPAA) on September 30, 2019, for tax year 2009, determining that 23rd Chelsea should not have included the financing costs in the eligible basis of the Tate. 23rd Chelsea timely filed a petition for readjustment of partnership items under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). The case was submitted fully stipulated without trial, with the Commissioner conceding the inclusion of union dues and pension contributions in the eligible basis. The Tax Court had jurisdiction to determine partnership items for tax year 2009, including the allowable LIHC and any recapture amount under I. R. C. § 6226(f) and § 6231(a)(3).

Issue(s)

Whether, for purposes of the LIHC under I. R. C. § 42, the eligible basis of a qualified low-income residential building includes financing costs related to the issuance of bonds (whether taxable or tax-exempt) whose proceeds were used for the construction of the building?

Rule(s) of Law

Under I. R. C. § 42(d)(1), the eligible basis of a new building is its adjusted basis at the end of the first taxable year of the credit period. The adjusted basis is determined under I. R. C. § 1011(a), which includes the costs capitalized under I. R. C. § 263A. Treasury Regulation § 1. 263A-1(e)(3)(i) defines indirect costs as those incurred by reason of the performance of production activities, requiring their capitalization into the basis of the produced property.

Holding

The Tax Court held that the financing costs, including bond fees, incurred by reason of the construction of the residential rental property and before the end of the first year of the credit period, are includible in the eligible basis for purposes of the LIHC under I. R. C. § 42(d)(1) and § 263A.

Reasoning

The court reasoned that the term “adjusted basis” in I. R. C. § 42(d)(1) must be understood in light of I. R. C. § 1011(a) and § 263A, which require the capitalization of direct and indirect costs incurred in the production of property. The financing costs were deemed indirect costs incurred by reason of the construction of the Tate, as they were necessary for obtaining the HFA loan used for construction. The court rejected the Commissioner’s arguments that these costs should be capitalized into the loan itself and not the building, and that the legislative history of I. R. C. § 42 and § 103/142 suggested a different treatment of such costs. The court emphasized that the uniform capitalization rules under I. R. C. § 263A supersede prior law and that the legislative history did not support excluding financing costs from the eligible basis. The court also noted that Congress had already addressed tax-exempt bond financing by reducing the applicable percentage for the LIHC under I. R. C. § 42(b)(2)(B)(ii), and thus did not need to further exclude financing costs from eligible basis.

Disposition

The Tax Court entered a decision for the petitioner, 23rd Chelsea Associates, L. L. C. , sustaining its inclusion of the financing costs in the eligible basis for calculating the LIHC.

Significance/Impact

This decision clarifies that financing costs related to bond issuances used for construction can be included in the eligible basis for calculating LIHCs under I. R. C. § 42, potentially affecting how developers finance and calculate tax benefits for affordable housing projects. It aligns with the uniform capitalization rules of I. R. C. § 263A and may encourage the use of bond financing for low-income housing projects by affirming the inclusion of related costs in the tax credit calculation. The decision also reinforces the importance of statutory text and the uniform application of tax rules, impacting how courts interpret and apply the Internal Revenue Code in future cases involving similar issues.

