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Date
Missouri Housing Development Commission
1201 Walnut Street, Suite 1800
Kansas City, Missouri 64106

Re: Missouri Housing Development Commission Project No: xx-xxx Relocation Costs

Ladies and Gentlemen:

We represent ____________________, a Missouri limited partnership (“Project Partnership”). The Project Partnership has incurred relocation costs in the amount of ____________________ in connection with the rehabilitation of the above-referenced project, as reflected on the cost certification prepared by ____________________ (“Relocation Costs”).

We render this opinion to you in connection with your review of the cost certification issued by RubinBrown LLP in connection with the development of the project and the issuance of Federal Low-Income Housing Tax Credits under Section 42 of the Internal Revenue Code of 1986, as amended (“Code”), and Missouri Low-Income Housing Tax Credits under Chapter 135 of the Revised Statutes of Missouri.

You have specifically requested our opinion as to whether the Relocation Costs are included in eligible basis, as that term is used in Code Section 42.

Code Section 42(e)(2) provides that the term “rehabilitation expenditures” means “amounts chargeable to capital account and incurred for property (or additions or improvements to property) of a character subject to the allowance for depreciation in connection with the rehabilitation of a building.”

Thus, Relocation Costs are included in eligible basis of a building if:

(i) The Relocation Costs are chargeable to capital account (that is, they are properly capitalized rather than expensed); and
(ii) The Relocation Costs are incurred for property or improvements to property of a character which must be depreciated; and
(iii) The Relocation Costs were incurred in connection with the rehabilitation of that building.

Therefore, if (i) the Relocation Costs are properly expensed currently, they may not be added to eligible basis; (ii) if the Relocation Costs are properly capitalized into a non-depreciable asset such as land, they may not be added to eligible basis; and (iii) if the Relocation Costs were not incurred in connection with the rehabilitation process, they may not be added to eligible basis.

Generally, the cost of constructing or improving buildings or other assets that have a useful life which extends beyond the end of the taxable year are not currently deductible. Rather, these expenditures are capitalized and become part of the basis of the constructed or improved property. The uniform capitalization rules under Code Section 263A apply to all costs incurred in constructing tangible property. Both direct costs and indirect costs must be capitalized. Costs incurred in constructing property must be depreciated over the useful life of the property.

In determining the tax treatment of Relocation Costs, the principal and predominant reason for the payments must be identified. Although not free from doubt, if the Project Partnership is required to compensate existing tenants in order to proceed with the rehabilitation work, the Relocation Costs should be capitalized rather than deducted. If they are capitalized, then they are included in basis of either land or rehabilitation expenditures treated as a separate new building.

The Internal Revenue Service issued Revenue Ruling 70-473, 1970-2 C.B. 34, in which the Internal Revenue Service held that government-mandated payments made to occupants of a to-be-demolished building as compensation to tenants for relocation should be capitalized into basis. In that case, the costs were capitalized into the basis of land (presumably because the building was being demolished). It is possible that had the building been rehabilitated, the amounts would have been capitalized into the cost of the rehabilitated building rather than into the cost of the land.

In the present case, Relocation Costs were made as required under provisions of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended. Those payments were made not with respect to buildings which were being destroyed, but rather, they were made with respect to existing buildings which were being rehabilitated. Furthermore, those payments would not have been made but for the rehabilitation effort of the Project Partnership. That is, had the Project Partnership decided not to rehabilitate the buildings, the Project Partnership would not have relocated tenants and would not have incurred the obligation to pay the Relocation Costs and would not have incurred the Relocation Costs. We note that none of the Relocation Costs were incurred to relocate tenants for reasons unrelated to the rehabilitation of existing buildings, which would arguably be in the nature of an ordinary expense (such as to accommodate a tenant request to move from one unit to another unit due to tenant relations issues or due to a change in tenant space requirements). While there are circumstances in which the origin and character of the expenditure in question is not capital in nature and thus is properly deductible rather than capitalized, the Relocation Costs incurred by the Project Partnership should not be properly viewed as deductible expenses, but rather, should, based on the facts, be capitalized because the origin and character of the Relocation Costs are directly related to a capital item, namely, the rehabilitation of existing buildings.

Based on the foregoing, we are of the opinion that there is a reasonable basis for including the Relocation Costs in eligible basis.

We note that the Internal Revenue Service's Low-Income Housing Audit Technique Guide issued in September 2014 takes a different position. In that audit guide, the Service takes the position that where a taxpayer makes a determination that an existing tenant is not a qualified low-income household and decides to move the tenant out of the unit permanently, the costs attributable to moving out the tenant permanently (including compensation paid to the tenant) are expensed as an ordinary and necessary business expense under Code Section 162, even if the vacated unit is rehabilitated. The Service also takes the position that where a taxpayer makes a determination that an existing tenant is a qualified low-income household and decides to move the tenant and provide temporary housing (either within the project or off-site) while the tenant's unit is being rehabilitated and the tenant is expected to occupy the rehabilitated unit after the rehabilitation is completed, the costs attributable to moving the tenant and providing temporary housing for the tenant during the rehabilitation (including tenant moving expenses, costs for temporarily storing a tenant's property, and temporary housing costs) are also expensed as ordinary and necessary business expenses under Code Section 162.

While the audit guide is evidence that the Internal Revenue Service takes a different position on audit, the audit guide does not have the force and effect of law. We are of the opinion that the position set forth in the audit guide does not necessarily accurately reflect the law as set forth in Code Sections 42 and 263A.

We are licensed to practice law only in the State of Missouri. The foregoing opinions are based on and are limited to laws of the State of Missouri and the relevant law of the United States, and we express no opinion with respect to the law of any other jurisdiction.

This opinion letter is directed to the addressee only, and is for the exclusive reliance of the addressee and its attorneys, successors and assigns, and no other persons may quote from this opinion letter in whole or in part, without the express written consent of the undersigned.

The opinions set forth in this letter are rendered as of the date of this letter, and we disclaim any undertakings to advise you of any changes which may be brought to our attention subsequent to that date.

Sincerely,

Name: Title: Firm: