



# TaxNewsFlash

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## U.S. Tax Court: Financing costs, including bond fees, properly included in eligible basis for purposes of low-income housing tax credit

The U.S. Tax Court yesterday held that a taxpayer properly included in its “eligible basis” for purposes of computing the low-income housing tax credit under section 42, its financing costs incurred “by reason of” the taxpayer’s construction of residential rental property—including bond fees, whether or not the bondholders are exempt from federal income tax under section 103 on the bond interest.

The case is: *23<sup>rd</sup> Chelsea Associates L.L.C. v. Commissioner*, 162 T.C. No. 3 (February 20, 2024). Read text of the Tax Court’s [opinion](#) [PDF 191 KB]

### Summary

The taxpayer, a partnership, constructed residential rental property in New York City during 2001 and 2002. The partnership financed the construction with a loan from the New York State Housing Finance Agency (HFA), which funded the loan at least partially using bonds that were tax-exempt under section 103.

The taxpayer claimed low-income housing tax credits under section 42 for tax years 2003 through at least 2009. For purposes of determining the property’s “eligible basis”, the taxpayer included a portion of the various financing costs it incurred in connection with the HFA loan, including bond fees that the HFA passed on to the taxpayer. However, the IRS argued that the taxpayer was not entitled to include any of the financing costs in the property’s eligible basis for purposes of computing its credit under section 42.

The Tax Court rejected the IRS’ position, finding that for purposes of determining the project’s “eligible basis” under section 42(d)(1), the term “adjusted basis” has the meaning given to it in section 1011(a), and accordingly the uniform capitalization rules of section 263A apply. Because the taxpayer was required under Treas. Reg. § 1.263A- 1(e)(3)(i) to capitalize into the property’s basis all financing costs (including bond fees) incurred “by reason of” the taxpayer’s construction of the property, those costs were includible in the property’s eligible basis for purposes of section 42. The court specifically pointed to section 236A(f) as support that financing costs for production activities are not allocable to a separate “financing” activity if those costs are allocable to the production period (i.e., 2001 and 2002).

Finally, the court rejected the IRS’ assertion that the legislative history of section 42, which indirectly points to section 142 and its definition of “residential real property,” shows that the portion of the taxpayer’s financing

costs allocable to tax-exempt bonds should not be included in its “eligible basis.” The court noted that IRS did not allege that the language of the relevant portions of section 42 was ambiguous, and even if the language was ambiguous, its holding does not import a different meaning to phrase “residential real property” in section 42 compared to section 142.

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