

INTERNAL REVENUE SERVICE

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September 29, 2000

LEGEND:

Taxpayers =

District =

Property 1 =

Property 2 =

A =

B =

C =

D =

a =

b =

c =

d =

e =

f =

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g =

h =

i =

j =

k =

l =

m =

Dear

This letter responds to a request for a private letter ruling, dated October 22, 1999, and subsequent submissions filed by you on behalf of Taxpayers. Taxpayers, husband and wife, requested several rulings with respect to the application of sections 1400B and 1397B of the Internal Revenue Code to two commercial properties.

Taxpayers represent that the facts are as follows:

Taxpayers file joint federal income tax returns. Taxpayers utilize the cash method of accounting and report income on the basis of an annual accounting period which runs from January 1 to December 31. District has examination jurisdiction over the Federal tax returns filed by Taxpayers.

In a, Taxpayers purchased Property 1 for \$b. The approximate value of the land at that time was \$c. Property 1 consists of a building and land upon which the building is located. The building was depreciated under the straight-line method of depreciation. The adjusted basis of the building as of d, is zero. The estimated value of the land as of d, is \$e.

Property 1 was treated as a commercial rental property from the time Taxpayers acquired it. The tenants included A, B, and C. Property 1 is located in a census tract with a poverty rate of 10 percent or more based on the 1990 census. From f to g, improvements were made to Property 1 consisting of enlarging a parking lot at a cost of \$h and replacing an air conditioner for \$i. C operated a senior day care facility on Property 1 until Taxpayers sold the property to D for \$j. Closing of the sale of Property 1 occurred on k.

The husband also owns a one-half interest in Property 2, which is commercial

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property. Property 2 was transferred to the husband and his sister by deed of gift as equal joint tenants in l. The husband and his sister own only the land of Property 2 and do not own the improvements thereon. Property 2 is located in a census tract with a poverty rate of 10 percent or more based on the 1990 census.

RULINGS REQUESTED

With respect to Property 1, Taxpayers request the Internal Revenue Service to rule that:

(1) The holding period required pursuant to section 1400B(b)(4)(A)(iii) during which substantially all of the use of Taxpayers' Property 1 was in Taxpayers' DC Zone business is comprised of the five year period immediately preceding the sale of Property 1 and, accordingly, Taxpayers' Property 1 constitutes a DC Zone business property within the meaning of section 1400B(b)(4) and a DC Zone asset within the meaning of section 1400B(b)(1)(c);

(2) The gross income of Taxpayers for the m taxable year shall not include any qualified capital gain realized from the sale of Property 1;

(3) Except for any portion of gain that would be treated as ordinary income under section 1245 or section 1250, any gain realized by Taxpayers from the sale of Property 1 shall be treated as qualified capital gain within the meaning of section 1400B(e);

(4) Any gain realized by Taxpayers from the sale of Property 1 shall be treated as gain attributable to the taxable year in which the sale of Property 1 occurred for purposes of section 1400B(e)(2);

(5) Taxpayers' Property 1 satisfies the requirements to be treated as substantially improved as defined in section 1400B(b)(4)(B);

(6) Taxpayers' rental of Property 1 constitutes a qualified business within the meaning of section 1397B(d); and

(7) Taxpayers' rental of Property 1 satisfies the requirements of a qualified proprietorship pursuant to section 1397B(c) and, accordingly, constitutes an enterprise zone business within the meaning of section 1397B(a)(2) and a DC Zone business within the meaning of section 1400B(c).

With respect to Property 2, Taxpayers request the Service to rule that:

(8) Provided that at least 50 percent of the gross rental income received from Property 2 is from enterprise zone businesses, the husband's rental of his one-half interest in Property 2 constitutes a qualified business within the meaning of section

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1397B(d); and

(9) If the answer to (8) is affirmative, the husband's rental of Property 2 satisfies the requirements of a qualified proprietorship pursuant to section 1397B(c) and, accordingly, constitutes an enterprise zone business within the meaning of section 1397B(a)(2) and a DC Zone business within the meaning of section 1400B(c).

LAW AND ANALYSIS

Under section 1400B(a), gross income does not include qualified capital gain from the sale or exchange of any DC zone asset held for more than 5 years.

Under section 1400B(b)(1)(C), "DC Zone asset" means any DC Zone business property. Section 1400B(b)(4)(A) defines "DC Zone business property" as tangible property if (1) the property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 1997, and before January 1, 2003; (2) the original use of the property in the DC Zone commences with the taxpayer; and (3) during substantially all of the taxpayer's holding period for the property, substantially all of the use of the property was in a DC Zone business of the taxpayer.

Section 1400B(b)(4)(B) provides a special rule for property that is substantially improved. Under section 1400B(b)(4)(B)(i), property (including any land on which the property is located) will be treated as acquired by the taxpayer by purchase after December 31, 1997, and before January 1, 2003, and the original use of the property in the DC Zone will be considered to have commenced with the taxpayer if the property is substantially improved by the taxpayer before January 1, 2003. Under section 1400B(b)(4)(B)(ii), property shall be treated as substantially improved by the taxpayer only if, during the 24-month period beginning after December 31, 1997, additions to basis for the property in the hands of the taxpayer exceed the greater of an amount equal to the adjusted basis of the property at the beginning of the 24-month period in the hands of the taxpayer, or \$5,000.

Section 1400B(d) defines the DC Zone as all census tracts located in the District of Columbia for which the poverty rate is not less than 10 percent, as determined on the basis of the 1990 census.

Section 1400B(c) defines a "DC Zone business," for purposes of section 1400B, as any enterprise zone business, as defined in section 1397B with certain modifications.

Section 1397B(a)(2) defines an "enterprise zone business" as meaning any qualified proprietorship. With modifications specified in section 1400B(c), section

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1397B(c) defines a “qualified proprietorship” to mean, with respect to any taxable year, any qualified business carried on by an individual as a proprietorship if for such year the requirements set forth in section 1397B(c)(1)-(7) are met.

Section 1397B(d)(1) provides that except as otherwise provided in section 1397B(d), the term “qualified business” means any trade or business.

Under section 1397B(d)(2), the rental to others of real property located in an empowerment zone shall be treated as a qualified business if and only if the property is not residential rental property (as defined in section 168(e)(2)), and at least 50 percent of the gross rental income from the real property is from enterprise zone businesses. For the rental of tangible personal property, section 1397B(d)(3) provides that the rental to others of tangible personal property shall be treated as a qualified business if and only if at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone.

Section 1400B(e)(1) provides that, except as otherwise provided in this subsection, the term “qualified capital gain” means any gain recognized on the sale or exchange of a capital asset, or property used in the trade or business, as defined in section 1231(b).

Section 1231(b)(1) provides that the term “property used in the trade or business” generally means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 1 year, and real property used in the trade or business, held for more than 1 year, which is not inventory, property held primarily for sale to customers, a copyright or similar property, or a United States Government publication.

Section 1400B(e)(2) provides that the term “qualified capital gain” shall not include any gain attributable to periods before January 1, 1998, or after December 31, 2007.

Section 1400B(e)(3) provides that the term “qualified capital gain” does not include any gain which would be treated as ordinary income under section 1245 or under section 1250 if section 1250 applied to all depreciation rather than the additional depreciation.

Property 1

Issues 1 and 2

With respect to Property 1, Taxpayers’ request raises issues directly related to the application of section 1400B to the sale of this property.

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In the present case, Taxpayers represent that Property 1 is commercial rental property and is located in a census tract with a poverty rate of 10 percent or more based on the 1990 census. Taxpayers also represent that they acquired Property 1 in a, which is before 1998, and owned Property 1 for more than 5 years before selling it on k. Further, Taxpayers made improvements to Property 1 after December 31, 1997, and before k.

Section 1400B(a) provides that gross income shall not include qualified capital gain from the sale or exchange of any DC Zone asset held for more than 5 years (Emphasis added). Assuming the requirement under section 1400B(b)(4)(B)(ii) is satisfied, Property 1 would be treated as DC Zone business property and a DC Zone asset beginning as of the date the property is substantially improved under section 1400B(b)(4)(B)(ii). Consequently, for purposes of section 1400B, Taxpayers only held the property as a DC Zone asset for approximately 10 months prior to its sale (that is, from g to k). Accordingly, section 1400B does not apply to Taxpayers' sale of Property 1 and, as a result, Taxpayers' gain realized from the sale of Property 1 is not excluded from gross income pursuant to section 1400B(a).

Issues 3-7

Because section 1400B does not apply to Taxpayers' sale of Property 1, issues 3 through 7, which are directly related to the primary issue of the application of section 1400B to the sale of Property 1, are rendered moot. Accordingly, we decline to issue rulings on issues 3 through 7.

Property 2

With respect to Property 2, Taxpayers' request raises issues relating to the application of section 1400B to the husband's one-half interest in this property.

In the present case, Taxpayers represent that Property 2 is commercial property and is located in a census tract with a poverty rate of 10 percent or more based on the 1990 census. Taxpayers also represent that Property 2 was transferred to the husband and his sister by deed of gift as equal joint tenants in l, which is before 1998.

Section 1400B(a) of the Code provides that gross income shall not include qualified capital gain from the sale or exchange of any DC Zone asset held for more than 5 years (Emphasis added). Under section 1400B(b)(1)(C), the term "DC Zone asset" is defined as including DC Zone business property. One of the requirements for eligibility as a DC Zone business property is that tangible property be acquired by the taxpayer by purchase after December 31, 1997, and before January 1, 2003. Section 1400B(b)(4)(A)(i). Because the husband acquired his one-half interest in Property 2 before 1998, the husband's one-half interest in Property 2 does not constitute DC Zone

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business property. Accordingly, the sale of such property by the husband could never be subject to section 1400B(a). Because section 1400B could not apply to the sale of the husband's one-half interest in Property 2, issues 8 and 9, which are related to the issue of the application of section 1400B to Property 2, are rendered moot. Accordingly, we decline to issue rulings on issues 8 and 9.

No opinion is expressed or implied as to the federal tax consequences of this transaction under any provision not specifically addressed herein.

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this ruling is being sent to Taxpayers.

Sincerely yours,

Kathleen Reed

KATHLEEN REED
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
(Passthroughs and Special
Industries)

Enclosure:
6110 copy