

Partnership Allocation of Selected Real Estate Tax Credits¹

Howard E. Abrams
Professor, Emory Law School

I. Introduction

This Article addresses the issues raised when two important real estate tax credits, the rehabilitation tax credit and the low-income housing tax credit, are properly claimed by a partnership and so must be allocated among its members. Most of the issues relating to the credits themselves are ignored or simplified. So, for example, interaction of the tax credits with the at-risk rules and the alternative minimum tax is ignored entirely. Similarly, the computational details associated with the tax credits are skipped, although those details can be exceptionally complicated. The focus here is the narrow question of the interaction of the credit rules with those of Subchapter K.

II. Overview of Selected Real Estate Tax Credits²

A. The Rehabilitation Tax Credit

The rehabilitation tax credit has been in the Internal Revenue Code in one form or another since 1976. Now found in section 47,³ the rehabilitation tax credit is a two-tiered structure providing a 20% credit for qualifying rehabilitation of "certified historic structures" and a 10% credit for qualifying rehabilitation of certain other buildings first placed in service prior to 1936.⁴ In either case, the credit is computed as a percentage of the qualified rehabilitation expenditures made by the taxpayer,⁵ a prior transferor,⁶ or (in the case of a lessee) a lessor who elects to have the credit pass through using the statutorily-authorized fiction that the lessee has purchased the property from the lessor at fair market value.⁷

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²See generally FORREST D. MILDER & RONALD S. BOROD, 477-3d T.M., *Rehabilitation Tax Credit and Low-Income Housing Tax Credit*.

³The rehabilitation tax credit as defined in section 47 is a component of the investment tax credit under section 46 which in turn is a component of the general business credit as defined in section 38.

⁴Section 47(a). For the definition of a certified historic structure, see §47(c)(3). For the definition of a qualified rehabilitated building, see §47(c)(1). For the definition of a qualified rehabilitation expenditure, see §47(c)(2).

⁵Section 47(c)(2).

⁶See Reg. §1.48-12(c)(3)(ii).

⁷Section 50(d)(5) incorporating repealed section 48(d).

In general, the allowable rehabilitation tax credit is taken in the year in which the rehabilitation is completed and placed in service. §47(b)(1). However, for certain rehabilitation projects taking more than two years, a taxpayer may elect to tax the investment tax credit into account as the progress payments are made. §47(d). If the taxpayer disposes of the rehabilitated property within five years of claiming the credit, some or all of the credit must be recaptured as income in the year of disposition. If the disposition occurs with one year after the property is placed in service, there is 100% recapture. The recapture amount declines by 20% for each year that elapses after the rehabilitated property is placed in service so that the recapture is eliminated after five full years.

B. The Low Income Housing Tax Credit

The Low Income Housing Credit (the "LIHC") provided by section 42 is available to owners of residential real estate used for low-income housing. In general, the credit will be available when either (a) 20% of the rental units in the building are "rent restricted"⁸ and occupied by households having incomes no greater than 50% of the area median income or (b) at least 40% of the units are rent restricted and are occupied by households having no more than 60% of the area median income. §42(g)(1). The amount of the credit is based on a combination of factors including the costs of acquiring, constructing or rehabilitating the building (called the "eligible basis" of the building), the percentage of the building occupied by low income households, and the "applicable credit percentage" as determined by the government.

For new buildings that are federally subsidized as well as for existing buildings, the applicable credit percentage equals that amount yielding a present discounted value of 30% of the qualified basis of the housing unit over a 10-year period. For other structures, the applicable credit percentage is determined so as to yield a present discounted value of 70% of the taxpayer's qualified.⁹ §42(b)(2)(C). For April of 2007, those amounts were 3.47% and 8.10%. Rev. Rul. 2007-23, 2007-1 C.B. 889. The aggregate volume of the LIHC is capped on a state-by-state basis based on the number of residents in each state, with the actual credits then allocated within each state by the designated state agency. §42(h).

The LIHC is claimed annually for 10 consecutive years beginning with the year the housing unit is placed in service. §42(f)(1).¹⁰ If the building is transferred during the 10-year credit period, the transferee may be able to step into the shoes of the transferor and claim the remaining credit.

⁸This restriction requires that the gross rent with respect to any unit not exceed 30% of the tenant's imputed income. See §42(g)(2).

⁹"Qualified basis" is computed by multiplying the taxpayer's "eligible basis" (essentially the taxpayer's investment in the residential unit) by the percentage of low-income units in the building.

¹⁰At the taxpayer's election, the credit can be deferred until the next year. §42(f)(1). Because the amount of the annual credit is determined by the dollar value of the taxpayer's investment and the percentage of low-income housing units in the building, *both determined as of the date the credit is claimed*, deferral may allow the taxpayer to enjoy a larger credit for all 10 years of the credit period. See Rev. Rul. 91-38, 1991-2 C.B. 3 (questions 2 and 3). Under some circumstances, subsequent improvement of the residential structure can result in an increased credit though at a reduced credit rate. §42(f)(3).

§42(d)(7). A failure to maintain sufficient qualified use of the housing unit at any point during the 15 years after it is placed in service can trigger recapture of a portion of the prior LIHC. If the recapture event occurs in the second through the eleventh year, the recapture amount is one-third of the prior credit (plus interest, §42(j)(2)(B)). If the recapture event occurs later, the recapture percentage thereafter is reduced by one-fifteenth per year in years 12 through 15.¹¹ Note that recapture thus can occur even after the full credit has been claimed in year ten. It is the Service's position that a change in ownership of the property also triggers recapture. Rev. Rev. 91-38, 1991-2 C.B. 3. In some circumstances recapture can be avoided by the posting of a bond to ensure subsequent compliance with the LIHC requirements. §42(j)(6); Rev. Rul. 90-60, 1990-2 C.B. 3.

III. Overview of Partnership Allocations

A. The Requirement of Substantial Economic Effect

A partnership's allocations of an entity-level tax item (income, gain, loss, deduction, and credit) as reflected in the partnership agreement will be given effect so long as it has "substantial economic effect." §704(a)-(b). Under existing treasury regulations, this mandate is divided into two separate requirements: the requirement of "economic effect" and the requirement that the economic effect be "substantial." Reg. §1.704-1(b)(2)(i). The allocation of any partnership item lacking "substantial economic effect" will be reallocated in accordance with the partners' interests in the partnership, taking account of all facts and circumstances. §704(b).

In order for an allocation to have economic effect, it must be consistent with the underlying economic arrangement of the partners. That is, in the event there is an economic benefit or economic burden that corresponds to an allocation, the partner to whom the allocation is made must receive such economic benefit or bear such economic burden. Reg. §1.704-1(b)(2)(ii)(a).

What does this mean? Suppose that a partnership earns \$100 of income, and suppose further that this item of income is allocated under the partnership agreement to partner P. If capital accounts are maintained properly, this allocation will result in a \$100 increase in P's capital account. And if liquidation proceeds will be distributed in accordance with final capital accounts, then P will receive 100 more dollars at liquidation (if not before) by reason of the allocation. The upward capital account adjustment, in other words, ensures that the economic benefit (receipt of more dollars) follows the tax allocation (inclusion of more income).

B. The General Rule Applicable to Partnership-Level Tax Credits

Current regulations provide, in general, that the allocation of partnership tax credits does not affect capital account balances and so cannot have economic effect. Reg. §1.704-1(b)(4)(ii). Such a conclusion is not inescapable: tax credits often can be replaced by deductions, the allocations of which affect capital accounts and so can satisfy have economic effect.¹² Alternatively, tax credits are

¹¹See §42(j)(4)(C); *see generally* Milder & Borod, *supra* note 2, at A-73. Thus, if the recapture event occurs in year 12, there is recapture of 4/15's of the prior credit; if the recapture event occurs in year 13, there is recapture of 3/15's of the prior credit, etc.

¹²*See generally* J. Edrey and H. Abrams, *Equitable Implementation of Tax Expenditures*, 9

equivalent to exempt income, and the allocation of exempt income also can have economic effect. Nonetheless, the regulations take a different view of the matter, and under that view partnership-level tax credits must be allocated among the partners "in accordance with the partners' interests in the partnership." Reg. §1.704-1(b)(4)(ii).

The general rules defining (albeit badly) the partners' interests in the partnership, Reg. §1.704-1(b)(3), apparently do not apply to the allocation of tax credits. Rather, special regulations, Reg. §1.704-1(b)(4)(ii), provide:

if a partnership expenditure (whether or not deductible) that gives rise to a tax credit in a partnership taxable year also gives rise to valid allocations of partnership loss or deduction (or other downward capital account adjustments) for such year, then the partners' interests in the partnership with respect to such credit (or the cost giving rise thereto) shall be in the same proportion as such partners' respective distributive shares of such loss or deduction (and adjustments). . . . Identical principles shall apply in determining the partners' interests in the partnership with respect to tax credits that arise from receipts of the partnership (whether or not taxable).

Suppose that the payments of wages by a partnership gives rise to a deduction or, at the election of the partnership, to a credit in lieu of the deduction. If the partnership elects the credit, then it still must allocate the payment among the partners because the payment, being a nondeductible and noncapitalizable expenditure, reduces the partners' capital accounts in accordance with the requirement of substantial economic effect. Reg. §1.704-1(b)(2)(iv)(b).¹³ Under the special rule allocable to the allocation of tax credits, the tax credit will follow the allocation of the capital account reductions.

C. Exceptions to the General Rule

1. Allocation of the Investment Tax Credit

The partnership regulations governing allocations of tax credits defer to more particular regulations in the context of the investment tax credit under section 38, of which the rehabilitation tax credit is a part. Those more particular regulations are discussed in part IV(A) below. In general, though, they require that the investment tax credit be allocated in accordance with a partnership's allocation of bottom-line profits as described in section 702(a)(8).

2. Allocation of the Foreign Tax Credit

Detailed regulations have been promulgated specifying the proper allocation of creditable foreign taxes. Reg. §1.704-1(b)(4)(viii)(b). Under these regulation, the partnership's creditable foreign taxes must be allocated among the partners consistently with the allocation of creditable foreign tax expenditures (CFTEs). CFTEs are allocated based on the category of income to which they relate.

VA. TAX REV. 109 (1989).

¹³The expenditure also reduces the partners' outside bases in the same proportion as the partners' capital accounts are reduced. Reg. §§1.704-1(b)(2)(iv)(i), 1.704-1(b)(5) (example 11).

As a result, the allocation of foreign taxes generally follows the allocation of net income upon which the foreign taxes were imposed.

IV. Partnership Allocation of Real Estate Tax Credits

A. The Rehabilitation Tax

1. Initial Tax Allocation

a. The General Rule

Regulation §1.46-3(f) provides the general rule that a partner's share of a partnership's investment tax credit property is equal to the partner's share of the "general profits of the partnership," where that term means the residual allocation of partnership profits under section 702(a)(8). Reg. 1.46-3(f)(2)(i).¹⁴ The regulations make clear that the residual profit percentages are used "regardless of whether the partnership has a profit or a loss for its taxable year."¹⁵

This is a peculiar standard on which to base the allocation of partnership tax credits because it can so easily be manipulated. Section 702(a)(8) does not include partnership items "of income, gain, loss, deduction or credit to the extent provided by regulations." *See* §702(a)(7). Under the regulations, a partner's separately-stated items include any item of income, gain, loss, deduction and credit "subject to a special allocation under the partnership agreement which differs materially from the allocation of partnership taxable income or loss generally." Reg. §1.702-1(a)(8)(i). Separately-stated items also include a partner's distributive share of any partnership item "which would, if separately taken into account by any partner, would result in an income tax liability for that partner, or for any other person, different from that which would result if that partner did not take the item into account separately." Reg. §1.702-1(a)(8)(ii).

If this definition means what it says (and there is no reason to think otherwise), then the investment tax credit can be allocated almost however the partners want. For example, suppose X and Y are equal partners in the XY partnership, allocating all tax items equally. If the partnership wishes to allocate an investment tax credit equally between X and Y, nothing need be done because all items are allocated in that proportion.

Reconsider the XY partnership, but suppose the partnership wishes to allocate everything other than depreciation and tax credits equally between X and Y, with depreciation and tax credits going 25% to X and 75% to Y. The partnership can specially allocate all tax items other than depreciation equally between the partners and then provide that all residual items are allocated 25% to X and

¹⁴Reg. §1.46-3(f)(2)(i) references section 702(a)(9) which was redesignated as section 702(a)(8) by §1901(b)(1)(I)(i) of the Tax reform Act of 1976, P.L. 94-55 (1976).

¹⁵The regulations further provide that "if the ratio in which the partners divide the general profits of the partnership changes during the taxable year of the partnership, the ratio effective on the date on which the property is placed in service shall apply." Reg. §1.46-3(f)(2).

75% to Y. Conversely, if the partnership wishes to allocate the tax credit equally between the partners, it can specially allocate the depreciation 25/75 and then provide for residual sharing on an equal basis. It seems, in other words, that the tax credit can be allocated in any manner that is consistent with some other allocated item of the partnership.¹⁶

However, as discussed below, once that tax credit is allocated in accordance with the partners' residual profit sharing percentages, a subsequent change in those percentages can trigger a recapture of some or all of the tax credit. Reg. §1.47-6(a)(2)(i)(b). This is a true recapture and not a reallocation: any tax credit recaptured is effectively lost forever.

b. Uniform Special Allocations

There is an exception to the general allocation rule that is applicable if "all related items of income, gain, loss, and deduction with respect to any item of partnership section 38 [i.e., rehabilitated] property are specially allocated in the same manner" so long as that special allocation is valid under the more general rules of section 704(b). Reg. §1.46-3(f)(2)(ii). When this rule applies, the tax credit is allocated among the partners in the same proportion as are the tax items from the underlying property. In effect, these regulations treat the uniform special allocation as defining each partner's share of the property for purposes of the investment tax credit. This rule should be easily avoided by those partnerships wanting to do so by ensuring that not all tax items from the rehabilitated property are identically specially allocated.

c. *De Minimis*, Exiting Partner

A partnership may elect to treat a partner's share of the tax credit as zero even if more would be allocated under the general rule or the rule for uniform special allocations if (a) the partner's interest in residual profits is 5% or less and (b) the partnership agreement provides that the partner will retire from the partnership during the current taxable year or within the following seven taxable years. Reg. §1.46-3(f)(2)(iii). (Note that this rule is *not* available to a partner who intends to dispose of his partnership interest in a sale, either to a third party or to other partners in the partnership.) If the partnership wishes to take advantage of this rule, it must specify in the partnership agreement that the basis of section 38 property placed in service during the taxable year shall not be taken into account by the specified partner. *Id.* While this provision does not specifically cross-reference the definition of "partnership agreement" in section 761(c), there seems no reason this definition should not apply. Accordingly, the election should be available to the partnership (assuming the substantive requirements are met) until the partnership's return is due to be filed (excluding extensions).

2. Progress Payments

The election under section 47(d)(5) (for claiming the tax credit as progress payments are made) is made on a partner-by-partner basis. Reg. §1.46-5(p)(1). The allocation of progress payments is made

¹⁶Nonrecourse deductions, the allocations of which also lack economic effect, explicitly can be allocated in any way a partnership desires so long as the allocation is consistent with some other economic allocation. *See* Reg. §1.704-2(e)(2). Perhaps the tax credit rule is simply backing into a similar scheme.

in accordance with the same rules applicable to the tax credit itself, Reg. §1.46-5(p)(2), including not only the general rule but also the two exceptions (for uniform special allocations and *de minimis*, exiting partners) as discussed above.

3. Credit Recapture

Some or all of the rehabilitation tax credit must be recaptured if the rehabilitated property is disposed of within five years of when the tax credit was claimed (generally the year the property was placed in service). Disposition generally will occur if the partnership transfers the property, *see* Reg. §1.47-6(b) (example 1), if a partner exits the partnership, *id.* (example 2), or if a partner's share of profits declines, Reg. §1.47-6(a)(2).

An early disposition of the rehabilitated property by the partnership to a third party will trigger credit recapture to all of the partners who were allocated a portion of the entity's rehabilitation tax credit. If the disposition is made within 12 months of placing the property in service, the recapture amount is 100% of the credit claimed. §50(a)(1). If the disposition occurs more than one year but less than two years after the property was placed in service, the recapture amount is 80% of the credit claimed. *Id.* The recapture amount declines for each additional year until, after five years have elapsed, the credit capture amount is reduced to zero. *Id.* Similar rules apply if the tax credit is claimed over multiple taxable years because an election under section 47(d)(5) was made to claim the tax credit as progress payments were made. §50(a)(2).

A disposition of rehabilitated property will not trigger credit recapture if the transfer results in "a mere change in the form of conducting the trade or business so long as the property is retained in such trade or business as investment credit property and the taxpayer retains a substantial interest in such trade or business." §50(b)(4). So, for example, if a partnership transfers rehabilitated property to a newly-formed corporation in exchange for all of the corporation's outstanding stock and that stock is retained by the partnership, no tax credit recapture should be triggered. *See* Reg. §1.47-3(f)(6) (example 1). The same should be true if the stock of the corporation is distributed to the partners in the proportions in which they shared the tax credit. *Id.* (example 3). But if one partner receives cash or other property in lieu of his proportionate share of the stock, that partner will be forced to treat the transaction as a disposition of the rehabilitated property. *Id.* (example 4).

If the tax credit was allocated among the partners based on the general rule (that is, in proportion to residual profit shares), then a substantial reduction in a partner's residual profit share is treated as a partial disposition of the underlying property and will trigger tax credit recapture if it occurs within five years of when the tax credit was claimed. If the reduction occurs within the first year after the property is placed in service, then a reduction in share below two-thirds of the prior share will trigger recapture; in any subsequent year, the reduction must reduce the partner's share below one-third of his prior share. For example, if a three-person partnership increases to a four-person partnership within one year of when the rehabilitated tax credit was claimed, then no recapture is required because each partner's 25% share exceeds two-thirds of his prior, 33.3% share.¹⁷ However, if two new equal partners were admitted, recapture in that first year would be required because a 20% share is less than two-thirds of a 33.3% share, assuming all partnership items are allocated pro

¹⁷See Reg. §1.46-5(p)(3) (example 2).

rata among the partners. The same general rule applies if the tax credit was allocated in proportion to a uniform special allocation with respect to the rehabilitated property and then a partner's uniform share of items from that property declines.¹⁸ Careful special allocations should allow most partnerships to avoid these problems except when the uniform special allocation rule was followed and one or more partners desires to decrease his interest in the property subsequent to claiming the tax credit. For this reason it often might make sense to avoid that rule in favor of the more flexible (i.e., more manipulable) general rule.

4. Depreciation Recapture

A taxpayer who claims the rehabilitation tax credit must reduce basis in the rehabilitated property by the full amount of the credit claimed. §50(c)(1).¹⁹ This basis reduction is treated as accelerated depreciation for purposes of section 1245 and 1250. §50(c)(4). As a result, disposition of the rehabilitated property by the partnership before the end of its statutorily-defined applicable recovery period will trigger depreciation recapture. This is true for real estate even though the cost recovery deductions otherwise claimed by the partnership were taken on a straight-line basis. Such depreciation recapture is treated as ordinary income, §1250(a)(1), and is not eligible for installment reporting, §453(i)(1).

B. The Low Income Housing Credit

1. Annual Credit Allocation

In contradistinction to the rehabilitation tax credit, there are no special rules governing allocation of the LIHC. Accordingly, the allocation must be made in accordance with the general partnership rule governing the allocation of tax credits. That rule, Reg. §1.704-1(b)(4)(ii), provides:

if a partnership expenditure (whether or not deductible) that gives rise to a tax credit in a partnership taxable year also gives rise to valid allocations of partnership loss or deduction (*or other downward capital account adjustments*) for such year, then the partners' interests in the partnership with respect to such credit (or the cost giving rise thereto) shall be in the same proportion as such partners' respective distributive shares of such loss or deduction (and adjustments). . . . Identical principles shall apply in determining the partners' interests in the partnership with respect to tax credits that arise from receipts of the partnership (whether or not taxable). (emphasis added)

The LIHC is allowed with respect to qualified expenditures made in connection with the acquisition, construction, and rehabilitation of qualifying residential real estate, expenditures that must be capitalized and recovered over the appropriate statutory recovery period of the property.²⁰

¹⁸See the "(or in the particular item of property)" language in Reg. §1.47-6(a)(2)(ii).

¹⁹This reduction must be made to a partner's outside basis in an amount equal to the partner's share of the partnership tax credit. §50(c)(5).

²⁰The credit is not available for the taxpayer's investment in land. §42(d)(4)(A).

Accordingly, it seems that the LIHC must be allocated in the same proportion as the depreciation from the property is allocated.²¹ If the allocation of depreciation from the structure changes over time, then the allocation of the tax credit should change as well.

2. Credit Recapture

The LIHC statute plainly contemplates the possibility of credit recapture. §42(j). Furthermore, in the case of most partnerships, it is clear that credit recapture is determined on a partner-by-partner basis.²² However, the only rule specifying when credit recapture is required is the following:

If as of the close of any taxable year in the compliance period, the amount of the qualified basis of any building with respect to the taxpayer is less than the amount of such basis as of the close of the preceding taxable year, then the taxpayer's tax under this chapter for the taxable year shall be increased by the credit recapture amount.
(formatting omitted)

§42(j)(1). "Qualified basis" in this context means the product of the taxpayer's "eligible basis" (essentially the taxpayer's equity and debt investment in the residential structure unreduced by post-placed in service depreciation) multiplied by the portion of the residence used for low-income housing, §§42(c)(1), 42(d), subject to a variety of exceptions, §42(d)(3)-(5).

It seems clear from this language that if a portion of the low-income units in a building ceases to be available for low-income housing, recapture is triggered. It is less clear that a change in ownership should also result in recapture, especially when the statute specifically provides for a step-in-the-shoes rule for the transferee. §42(d)(7). On the other hand, the recapture only applies to a portion of the prior credits claimed, and that portion is designated as the "accelerated" portion of the credit. §42(j)(3). Perhaps the accelerated credit is recaptured because it has not yet been and never will be earned by the taxpayer. Note, though, that the transferee's LIHC is not increased by reason of any recapture to the transferor, *see* §42(d)(7)(A). Finally, the statute allows for the taxpayer to post a bond in lieu of recapture "[i]n the case of a disposition of a building or an interest there by the taxpayer," §42(j)(6), to insure continued satisfaction of the LIHC requirements. This language plainly contemplates that disposition of the property will trigger credit recapture.

Under some circumstances, the partnership rather than its members will be treated as the "taxpayer" for purposes of determining if credit recapture is required. §42(j)(5)(A). This rule applies only if the partnership has 35 or more partners, treating a husband and wife (and their estates) as a single partner. §42(j)(5)(B)-(C)(i). A partnership otherwise qualifying for this treatment may elect out, §42(j)(5)(B), and such election one made is irrevocable, §42(j)(5)(C)(ii).

²¹If there is a variation between the amounts of book and tax depreciation, the credit allocation should follow the allocation of *book* depreciation. Note also the word "other" in the italicized phrase in the quoted material above.

²²Certain partnerships are permitted, for credit recapture purposes, to be treated as the taxpayer under section 42(j)(5). If credit recapture always is computed at the partnership level, such a provision would not be needed.

For such a qualifying partnership, changes in the membership of the partnership should be irrelevant so long as a technical termination is not triggered under section 708(b)(1)(B); similarly, changes in allocations among the partners should be irrelevant to credit recapture. If, though, such a partnership treated as the taxpayer faces credit recapture, it is unclear how that credit recapture must be allocated among the partners. One possibility is that the credit recapture should be allocated among the existing partners in proportion to their prior sharing of the LIHC credit. Note, though, that if the membership of the partnership has changed, either some partners who claimed a share of the credit will recapture more than an equivalent proportion of the credit recapture or some partners who were allocated none of the credit will be allocated a portion of the credit recapture. A similar issue arises in the context of section 1245 recapture, and the regulations under section 1245 tie allocation of the depreciation recapture first to shares of prior depreciation creating the depreciation recapture and then to shares of dispositional gain from the recapture property. At least when credit recapture is triggered by disposition of the residential structure, a rule parallel might be drawn.

But if a partnership does not qualify for such treatment or elects out, the rules are even less clear. Assuming that the disposition of LIHC property (or of "an interest therein, *see* §42(j)(6)) triggers credit recapture, a partner who disposes of his partnership interest (including a retirement of the partnership interest in exchange for a liquidating distribution) should face credit recapture based on that partner's allocable share of the prior LIHC. But what if no disposition of the partnership interest is made but rather the partner's share of depreciation from the residential structure declines?

There is no guidance on this question. Presumably the negative implication of the special rule for large partnerships is that such a reduction triggers credit recapture. As a technical matter, recapture is triggered only by a reduction in a taxpayer's "qualified basis" in the residential structure. For changes in partnership allocations to trigger credit recapture, such changes would have to reduce a partner's share of the partnership's "qualified basis" in the property. Qualified basis is defined by reference to the initial tax basis of the property, and so the basis of the partnership's assets somehow must be allocated among the partners. Yet, no rule in section 42 or the regulations promulgated thereunder specify how that allocation should be made.

The one provision in Subchapter K that speaks to a partner's share of the partnership's basis in its assets is section 743(b). Regulations promulgated under that section define a partner's share of the inside basis of the partnership's assets as the sum of the partner's share of partnership liabilities plus the partner's share of the partnership's "previously-taxed" capital.²³ Perhaps LIHC recapture will borrow such a rule. However, the rule as specified under section 743(b) can allocate to a partner, in some circumstances, either more than 100% of the partnership's inside basis in its assets or a negative amount of that inside basis,²⁴ leading to some very peculiar results

V. Conclusion

Allocation of the rehabilitation tax credit follows the more general rule applicable to the investment

²³Reg. §1.743-1(d)(1).

²⁴*See* RICHARD L. DOERNBERG & HOWARD E. ABRAMS, FEDERAL INCOME TAXATION OF CORPORATIONS AND PARTNERSHIPS 886-87 (3d ed. 2000).

credit properly generally. That rule seems easily manipulable, and astute drafting of the partnership agreement should allow not only for advantageous credit allocation but also for a reduction in possible credit recapture. The low-income housing credit is allocable under the more general tax credit allocation which seems to tie allocation of the tax credit to allocation of depreciation from the underlying property. Unfortunately, this rule offers no significant guidance for the allocation of credit recapture from changes in partnership shares.