

**Federal Regulation 1.42-4
Application of Not-for-Profit Rules**

Federal Regulations

Reg § 1.42-4. Application of not-for-profit rules of section 183 to low-income housing credit activities.

(a) Inapplicability to section 42. In the case of a qualified low-income building with respect to which the low-income housing credit under section 42 is allowable, section 183 does not apply to disallow losses, deductions, or credits attributable to the ownership and operation of the building.

(b) Limitation. Notwithstanding paragraph (a) of this section, losses, deductions, or credits attributable to the ownership and operation of a qualified low-income building with respect to which the low-income housing credit under section 42 is allowable may be limited or disallowed under other provisions of the Code or principles of tax law. See, e.g., sections 38(c), 163(d), 465, 469; *Knetsch v. United States*, 364 U.S. 361 (1960), 1961-1 C.B. 34 (“sham” or “economic substance” analysis); and *Frank Lyon Co. v Commissioner*, 435 U.S. 561 (1978), 1978-1 C.B. 46 (“ownership” analysis).

(c) Effective date. The rules set forth in paragraphs (a) and (b) of this section are effective with respect to buildings placed in service after December 31, 1986.

T.D. 8420, 6/10/92.

Federal Regulation 1.42-5
Compliance Monitoring Requirements

Federal Regulations

Reg § 1.42-5. Monitoring compliance with low-income housing credit requirements.

Caution: Reg §1.42-5, following, is effective after 12/31/2000. For Reg §1.42-5, effective before 1/1/2001, see above.

(a) Compliance monitoring requirement.

(1) *In general.* Under section 42(m)(1)(B)(iii), an allocation plan is not qualified unless it contains a procedure that the State or local housing credit agency (“Agency”) (or an agent of, or other private contractor hired by, the Agency) will follow in monitoring for noncompliance with the provisions of section 42 and in notifying the Internal Revenue Service of any noncompliance of which the Agency becomes aware. These regulations only address compliance monitoring procedures required of Agencies. The regulations do not address forms and other records that may be required by the Service on examination or audit. For example, if a building is sold or otherwise transferred by the owner, the transferee should obtain from the transferor information related to the first year of the credit period so that the transferee can substantiate credits claimed.

(2) *Requirements for a monitoring procedure.*

(i) In general. A procedure for monitoring for noncompliance under section 42(m)(1)(B)(iii) must include—

- (A) The recordkeeping and record retention provisions of paragraph (b) of this section;
- (B) The certification and review provisions of paragraph (c) of this section;
- (C) The inspection provision of paragraph (d) of this section; and
- (D) The notification-of-noncompliance provisions of paragraph (e) of this section.

(ii) Order and form. A monitoring procedure will meet the requirements of section 42(m)(1)(B)(iii) if it contains the substance of these provisions. The particular order and form of the provisions in the allocation plan is not material. A monitoring procedure may contain additional provisions or requirements.

(b) Recordkeeping and record retention provisions.

(1) *Recordkeeping provision.* Under the recordkeeping provision, the owner of a low-income housing project must be required to keep records for each qualified low-income building in the project that show for each year in the compliance period—

- (i) The total number of residential rental units in the building (including the number of bedrooms and the size in square feet of each residential rental unit);
- (ii) The percentage of residential rental units in the building that are low-income units;
- (iii) The rent charged on each residential rental unit in the building (including any utility allowances);
- (iv) The number of occupants in each low-income unit, but only if rent is determined by the number of occupants in each unit under section 42(g)(2) (as in effect before the amendments made by the Omnibus Budget Reconciliation Act of 1989);
- (v) The low-income unit vacancies in the building and information that shows when, and to whom, the next available units were rented;
- (vi) The annual income certification of each low-income tenant per unit. For an exception to this requirement, see section 42(g)(8)(B) (which provides a special rule for a 100 percent low-income

building);

(vii) Documentation to support each low-income tenant's income certification (for example, a copy of the tenant's federal income tax return, Forms W-2, or verifications of income from third parties such as employers or state agencies paying unemployment compensation). For an exception to this requirement, see section 42(g)(8)(B) (which provides a special rule for a 100 percent low-income building). Tenant income is calculated in a manner consistent with the determination of annual income under section 8 of the United States Housing Act of 1937 ("Section 8"), not in accordance with the determination of gross income for federal income tax liability. In the case of a tenant receiving housing assistance payments under Section 8, the documentation requirement of this paragraph (b)(1)(vii) is satisfied if the public housing authority provides a statement to the building owner declaring that the tenant's income does not exceed the applicable income limit under section 42(g);

(viii) The eligible basis and qualified basis of the building at the end of the first year of the credit period; and

(ix) The character and use of the nonresidential portion of the building included in the building's eligible basis under section 42(d) (e.g., tenant facilities that are available on a comparable basis to all tenants and for which no separate fee is charged for use of the facilities, or facilities reasonably required by the project).

(2) *Record retention provision.* Under the record retention provision, the owner of a low-income housing project must be required to retain the records described in paragraph (b)(1) of this section for at least 6 years after the due date (with extensions) for filing the federal income tax return for that year. The records for the first year of the credit period, however, must be retained for at least 6 years beyond the due date (with extensions) for filing the federal income tax return for the last year of the compliance period of the building.

(3) *Inspection record retention provision.* Under the inspection record retention provision, the owner of a low-income housing project must be required to retain the original local health, safety, or building code violation reports or notices that were issued by the State or local government unit (as described in paragraph (c)(1)(vi) of this section) for the Agency's inspection under paragraph (d) of this section. Retention of the original violation reports or notices is not required once the Agency reviews the violation reports or notices and completes its inspection, unless the violation remains uncorrected.

(c) Certification and review provisions.

(1) *Certification.* Under the certification provision, the owner of a low-income housing project must be required to certify at least annually to the Agency that, for the preceding 12-month period—

(i) The project met the requirements of:

(A) The 20-50 test under section 42(g)(1)(A), the 40-60 test under section 42(g)(1)(B), or the 25-60 test under sections 42(g)(4) and 142(d)(6) for New York City, whichever minimum set-aside test was applicable to the project; and

(B) If applicable to the project, the 15-40 test under sections 42(g)(4) and 142(d)(4)(B) for "deep rent skewed" projects;

(ii) There was no change in the applicable fraction (as defined in section 42(c)(1)(B)) of any building in the project, or that there was a change, and a description of the change;

(iii) The owner has received an annual income certification from each low-income tenant, and

documentation to support that certification; or, in the case of a tenant receiving Section 8 housing assistance payments, the statement from a public housing authority described in paragraph (b)(1)(vii) of this section. For an exception to this requirement, see section 42(g)(8)(B) (which provides a special rule for a 100 percent low-income building);

(iv) Each low-income unit in the project was rent-restricted under section 42(g)(2);

(v) All units in the project were for use by the general public (as defined in Sec. 1.42-9), including the requirement that no finding of discrimination under the Fair Housing Act, 42 U.S.C. 36013619, occurred for the project. A finding of discrimination includes an adverse final decision by the Secretary of the Department of Housing and Urban Development (HUD), 24 CFR 180.680, an adverse final decision by a substantially equivalent state or local fair housing agency, 42 U.S.C. 3616a(a)(1), or an adverse judgment from a federal court;

(vi) The buildings and low-income units in the project were suitable for occupancy, taking into account local health, safety, and building codes (or other habitability standards), and the State or local government unit responsible for making local health, safety, or building code inspections did not issue a violation report for any building or low-income unit in the project. If a violation report or notice was issued by the governmental unit, the owner must attach a statement summarizing the violation report or notice or a copy of the violation report or notice to the annual certification submitted to the Agency under paragraph (c)(1) of this section. In addition, the owner must state whether the violation has been corrected;

(vii) There was no change in the eligible basis (as defined in section 42(d)) of any building in the project, or if there was a change, the nature of the change (e.g., a common area has become commercial space, or a fee is now charged for a tenant facility formerly provided without charge);

(viii) All tenant facilities included in the eligible basis under section 42(d) of any building in the project, such as swimming pools, other recreational facilities, and parking areas, were provided on a comparable basis without charge to all tenants in the building;

(ix) If a low-income unit in the building became vacant during the year, that reasonable attempts were or are being made to rent that unit or the next available unit of comparable or smaller size to tenants having a qualifying income before any units in the project were or will be rented to tenants not having a qualifying income;

(x) If the income of tenants of a low-income unit in the project increased above the limit allowed in section 42(g)(2)(D)(ii), the next available unit of comparable or smaller size in the project was or will be rented to tenants having a qualifying income; and

(xi) An extended low-income housing commitment as described in section 42(h)(6) was in effect (for buildings subject to section 7108(c)(1) of the Omnibus Budget Reconciliation Act of 1989, 103 Stat. 2106, 2308-2311), including the requirement under section 42(h)(6)(B)(iv) that an owner cannot refuse to lease a unit in the project to an applicant because the applicant holds a voucher or certificate of eligibility under section 8 of the United States Housing Act of 1937, 42 U.S.C. 1437f (for buildings subject to section 13142(b)(4) of the Omnibus Budget Reconciliation Act of 1993, 107 Stat. 312, 438-439); and

(xii) All low-income units in the project were used on a nontransient basis (except for transitional housing for the homeless provided under section 42(i)(3)(B)(iii) or single-room-occupancy units rented on a month-by-month basis under section 42(i)(3)(B)(iv)).

(2) *Review.* The review provision must—

(i) Require that the Agency review the certifications submitted under paragraph (c)(1) of this section for compliance with the requirements of section 42;

(ii) Require that with respect to each low-income housing project—

(A) The Agency must conduct on-site inspections of all buildings in the project by the end of the second calendar year following the year the last building in the project is placed in service and, for at least 20 percent of the project's low-income units, inspect the units and review the low-income certifications, the documentation supporting the certifications, and the rent records for the tenants in those units; and

(B) At least once every 3 years, the Agency must conduct on-site inspections of all buildings in the project and, for at least 20 percent of the project's low-income units, inspect the units and review the low-income certifications, the documentation supporting the certifications, and the rent records for the tenants in those units; and

(iii) Require that the Agency randomly select which low-income units and tenant records are to be inspected and reviewed by the Agency. The review of tenant records may be undertaken wherever the owner maintains or stores the records (either on-site or off-site). The units and tenant records to be inspected and reviewed must be chosen in a manner that will not give owners of low-income housing projects advance notice that a unit and tenant records for a particular year will or will not be inspected and reviewed. However, an Agency may give an owner reasonable notice that an inspection of the building and low-income units or tenant record review will occur so that the owner may notify tenants of the inspection or assemble tenant records for review (for example, 30 days notice of inspection or review).

(3) *Frequency and form of certification.* A monitoring procedure must require that the certifications and reviews of paragraph (c)(1) and (2) of this section be made at least annually covering each year of the 15-year compliance period under section 42(i)(1). The certifications must be made under penalty of perjury. A monitoring procedure may require certifications and reviews more frequently than on a 12-month basis, provided that all months within each 12-month period are subject to certification.

(4) *Exception for certain buildings.*

(i) In general. The review requirements under paragraph (c)(2)(ii) of this section may provide that owners are not required to submit, and the Agency is not required to review, the tenant income certifications, supporting documentation, and rent records for buildings financed by the Rural Housing Service (RHS), formerly known as Farmers Home Administration, under the section 515 program, or buildings of which 50 percent or more of the aggregate basis (taking into account the building and the land) is financed with the proceeds of obligations the interest on which is exempt from tax under section 103 (tax-exempt bonds). In order for a monitoring procedure to except these buildings, the Agency must meet the requirements of paragraph (c)(4)(ii) of this section.

(ii) Agreement and review. The Agency must enter into an agreement with the RHS or tax-exempt bond issuer. Under the agreement, the RHS or tax-exempt bond issuer must agree to provide information concerning the income and rent of the tenants in the building to the Agency. The Agency may assume the accuracy of the information provided by RHS or the tax-exempt bond issuer without verification. The Agency must review the information and determine that the income limitation and rent restriction of section 42(g)(1) and (2) are met. However, if the information provided by the RHS or tax-exempt bond issuer is not sufficient for the Agency to make this determination, the Agency must request the necessary additional income or rent information from the owner of the buildings. For example, because RHS determines tenant eligibility based on its definition of “adjusted annual income,” rather than “annual income” as defined under Section 8, the Agency may have to calculate the tenant's income for section 42

purposes and may need to request additional income information from the owner.

(iii) Example. The exception permitted under paragraph (c)(4)(i) and (ii) of this section is illustrated by the following example.

Example An Agency selects for review buildings financed by the RHS. The Agency has entered into an agreement described in paragraph (c)(4)(ii) of this section with the RHS with respect to those buildings. In reviewing the RHS-financed buildings, the Agency obtains the tenant income and rent information from the RHS for 20 percent of the low-income units in each of those buildings. The Agency calculates the tenant income and rent to determine whether the tenants meet the income and rent limitation of section 42(g)(1) and (2). In order to make this determination, the Agency may need to request additional income or rent information from the owners of the RHS buildings if the information provided by the RHS is not sufficient.

(5) *Agency reports of compliance monitoring activities.* The Agency must report its compliance monitoring activities annually on Form 8610, “Annual Low-Income Housing Credit Agencies Report.”

(d) Inspection provision.

(1) *In general.* Under the inspection provision, the Agency must have the right to perform an on-site inspection of any low-income housing project at least through the end of the compliance period of the buildings in the project. The inspection provision of this paragraph (d) is a separate requirement from any tenant file review under paragraph (c)(2)(ii) of this section.

(2) *Inspection standard.* For the on-site inspections of buildings and low-income units required by paragraph (c)(2)(ii) of this section, the Agency must review any local health, safety, or building code violations reports or notices retained by the owner under paragraph (b)(3) of this section and must determine—

(i) Whether the buildings and units are suitable for occupancy, taking into account local health, safety, and building codes (or other habitability standards); or

(ii) Whether the buildings and units satisfy, as determined by the Agency, the uniform physical condition standards for public housing established by HUD (24 CFR 5.703). The HUD physical condition standards do not supersede or preempt local health, safety, and building codes. A low-income housing project under section 42 must continue to satisfy these codes and, if the Agency becomes aware of any violation of these codes, the Agency must report the violation to the Service. However, provided the Agency determines by inspection that the HUD standards are met, the Agency is not required under this paragraph (d)(2)(ii) to determine by inspection whether the project meets local health, safety, and building codes.

(3) *Exception from inspection provision.* An Agency is not required to inspect a building under this paragraph (d) if the building is financed by the RHS under the section 515 program, the RHS inspects the building (under 7 CFR part 1930), and the RHS and Agency enter into a memorandum of understanding, or other similar arrangement, under which the RHS agrees to notify the Agency of the inspection results.

(4) *Delegation.* An Agency may delegate inspection under this paragraph (d) to an Authorized Delegate retained under paragraph (f) of this section. Such Authorized Delegate, which may include HUD or a HUD-approved inspector, must notify the Agency of the inspection results.

(e) Notification-of-noncompliance provision.

(1) *In general.* Under the notification-of-noncompliance provisions, the Agency must be required to give the notice described in paragraph (e)(2)

of this section to the owner of a low-income housing project and the notice described in paragraph (e)(3) of this section to the Service.

(2) *Notice to owner.* The Agency must be required to provide prompt written notice to the owner of a low-income housing project if the Agency does not receive the certification described in paragraph (c)(1) of this section, or does not receive or is not permitted to inspect the tenant income certifications, supporting documentation, and rent records described in paragraph (c)(2)(ii) of this section, or discovers by inspection, review, or in some other manner, that the project is not in compliance with the provisions of section 42.

(3) *Notice to Internal Revenue Service.*

(i) *In general.* The Agency must be required to file Form 8823, “Low-Income Housing Credit Agencies Report of Noncompliance,” with the Service no later than 45 days after the end of the correction period (as described in paragraph (e)(4) of this section, including extensions permitted under that paragraph) and no earlier than the end of the correction period, whether or not the noncompliance or failure to certify is corrected. The Agency must explain on Form 8823 the nature of the noncompliance or failure to certify and indicate whether the owner has corrected the noncompliance or failure to certify. Any change in either the applicable fraction or eligible basis under paragraph (c)(1)(ii) and

(vii) of this section, respectively, that results in a decrease in the qualified basis of the project under section 42(c)(1)(A) is noncompliance that must be reported to the Service under this paragraph (e)(3). If an Agency reports on Form 8823 that a building is entirely out of compliance and will not be in compliance at any time in the future, the Agency need not file Form 8823 in subsequent years to report that building's noncompliance. If the noncompliance or failure to certify is corrected within 3 years after the end of the correction period, the Agency is required to file Form 8823 with the Service reporting the correction of the noncompliance or failure to certify.

(ii) *Agency retention of records.* An Agency must retain records of noncompliance or failure to certify for 6 years beyond the Agency's filing of the respective Form 8823. In all other cases, the Agency must retain the certifications and records described in paragraph (c) of this section for 3 years from the end of the calendar year the Agency receives the certifications and records.

(4) *Correction period.* The correction period shall be that period specified in the monitoring procedure during which an owner must supply any missing certifications and bring the project into compliance with the provisions of section 42. The correction period is not to exceed 90 days from the date of the notice to the owner described in paragraph (e)(2) of this section. An Agency may extend the correction period for up to 6 months, but only if the Agency determines there is good cause for granting the extension.

(f) Delegation of Authority.

(1) *Agencies permitted to delegate compliance monitoring functions.*

(i) *In general.* An Agency may retain an agent or other private contractor (“ Authorized Delegate”) to perform compliance monitoring. The Authorized Delegate must be unrelated to the owner of any building that the Authorized Delegate monitors. The Authorized Delegate may be delegated all of the functions of the Agency, except for the responsibility of notifying the Service

under paragraphs (5) and (e)(3) of this section. For example, the Authorized Delegate may be delegated the responsibility of reviewing tenant certifications and documentation under paragraph (c)(1) and (2) of this section, the right to inspect buildings and records as described in paragraph (d) of this section, and the responsibility of notifying building owners of lack of certification or noncompliance under paragraph (e)(2) of this section. The Authorized Delegate must notify the Agency of any noncompliance or failure to certify.

(ii) *Limitations.* An Agency that delegates compliance monitoring to an Authorized Delegate under paragraph (f)(1)(i) of this section must use reasonable diligence to ensure that the Authorized Delegate properly performs the delegated monitoring functions. Delegation by an Agency of compliance monitoring functions to an Authorized Delegate does not relieve the Agency of its obligation to notify the Service of any noncompliance of which the Agency becomes aware.

(2) *Agencies permitted to delegate compliance monitoring functions to another Agency.* An Agency may delegate all or some of its compliance monitoring responsibilities for a building to another Agency within the State. This delegation may include the responsibility of notifying the Service under paragraph (e)(3) of this section.

(g) Liability. Compliance with the requirements of section 42 is the responsibility of the owner of the building for which the credit is allowable. The Agency's obligation to monitor for compliance with the requirements of section 42 does not make the Agency liable for an owner's noncompliance.

(h) Effective date. Allocation plans must comply with these regulations by June 30, 1993. The requirement of section 42(m)(1)(B)(iii) that allocation plans contain a procedure for monitoring for noncompliance becomes effective on January 1, 1992, and applies to buildings for which a low-income housing credit is, or has been, allowable at any time. Thus, allocation plans must comply with section 42(m)(1)(B)(iii) prior to June 30, 1993, the effective date of these regulations. An allocation plan that complies with these regulations, with the notice of proposed rulemaking published in the Federal Register on December 27, 1991, or with a reasonable interpretation of section 42(m)(1)(B)(iii) will satisfy the requirements of section 42(m)(1)(B)(iii) for periods before June 30, 1993. Section 42(m)(1)(B)(iii) and these regulations do not require monitoring for whether a building or project is in compliance with the requirements of section 42 prior to January 1, 1992. However, if an Agency becomes aware of noncompliance that occurred prior to January 1, 1992, the Agency is required to notify the Service of that noncompliance. In addition, the requirements in paragraphs (b)(3) and (c)(1)(v), (vi), and (xi) of this section (involving recordkeeping and annual owner certifications) and paragraphs (c)(2)(ii)(B), (c)(2)(iii), and (d) of this section (involving tenant file reviews and physical inspections of existing projects, and the physical inspection standard) are applicable January 1, 2001. The requirement in paragraph (c)(2)(ii)(A) of this section (involving tenant file reviews and physical inspections of new projects) is applicable for buildings placed in service on or after January 1, 2001. The requirements in paragraph (c)(5) of this section (involving Agency reporting of compliance monitoring activities to the Service) and paragraph (e)(3)(i) of this section (involving Agency reporting of corrected noncompliance or failure to certify within 3 years after the end of the correction period) are applicable January 14, 2000.

T.D. 8430, 9/1/92, amend T.D. 8563, 9/30/94, T.D. 8859, 1/13/2000.

Federal Regulation 1.42-6
Buildings Qualifying for Carryover
Allocations

Federal Regulations

Reg § 1.42-6. Buildings qualifying for carryover allocations.

Caution: Reg § 1.42-6, following, is effective before 1/1/2001. For Reg § 1.42-6, effective after 12/31/2000, see below.

(a) Carryover allocations. A carryover allocation is an allocation that meets the requirements of section 42(h)(1)(E) or (F). If the requirements of section 42(h)(1)(E) or (F) that are required to be satisfied by the close of the calendar year are not satisfied, the allocation is treated as if it had not been made. For example, if the taxpayer's basis in the project as of the close of the calendar year of allocation is not more than 10 percent of the taxpayer's reasonably expected basis in the project as of the close of the second calendar year following the year of allocation, the carryover allocation is not valid and is treated as if it had not been made.

(b) Carryover-allocation basis.

(1) In general. Subject to the limitations of paragraph (b)(2) of this section, a taxpayer's basis in a project for purposes of section 42(h)(1)(E)(ii) or (F) (carryover-allocation basis) is the taxpayer's adjusted basis in land or depreciable property that is reasonably expected to be part of the project, whether or not these amounts are includible in eligible basis under section 42(d). Thus, for example, if the project is to include property that is not residential rental property, such as commercial space, the basis attributable to the commercial space, although not includible in eligible basis, is includible in carryover-allocation basis. The adjusted basis of land and depreciable property is determined under sections 1012 and 1016, and generally includes the direct and indirect costs of acquiring, constructing, and rehabilitating the property. Costs otherwise includible in carryover-allocation basis are not excluded by reason of having been incurred prior to the calendar year in which the carryover allocation is made.

(2) Limitations. For purposes of determining carryover-allocation basis under paragraph (b)(1) of this section, the following limitations apply.

(i) Taxpayer must have basis in land or depreciable property related to the project. A taxpayer has carryover-allocation basis to the extent that it has basis in land or depreciable property and the land or depreciable property is reasonably expected to be part of the project for which the carryover allocation is made. This basis includes all items that are properly capitalizable with respect to the land or depreciable property. For example, a nonrefundable downpayment for, or an amount paid to acquire an option to purchase, land or depreciable property may be included in carryover-allocation basis if properly capitalizable into the basis of land or depreciable property that is reasonably expected to be part of a project.

(ii) High cost areas. Any increase in eligible basis that may result under section 42(d)(5)(C) from a building's location in a qualified census tract or difficult development area is not taken into account in determining carryover-allocation basis or reasonably expected basis.

(iii) Amounts not treated as paid or incurred. An amount is not includible in carryover-allocation basis unless it is treated as paid or incurred under the method of accounting used by the taxpayer. For example, a cash method taxpayer cannot include construction costs in carryover-allocation basis unless the costs have been paid, and an accrual method taxpayer cannot include construction costs in carryover-allocation basis unless they have been properly accrued. See paragraph (b)(2)(iv) of this section for a special rule for fees.

(iv) Fees. A fee is includible in carryover-allocation basis only to the extent the requirements of paragraph (b)(2)(iii) of this section are met and—

(A) The fee is reasonable;

(B) The taxpayer is legally obligated to pay the fee;

(C) The fee is capitalizable as part of the taxpayer's basis in land or depreciable property that is reasonably expected to be part of the project;

(D) The fee is not paid (or to be paid) by the taxpayer to itself; and

(E) If the fee is paid (or to be paid) by the taxpayer to a related person, and the taxpayer uses the cash method of accounting, the taxpayer could properly accrue the fee under the accrual method of accounting (considering, for example, the rules of section 461(h)). A person is a related person if the person bears a relationship to the taxpayer specified in sections 267(b) or 707(b)(1), or if the person and the taxpayer are engaged in trades or businesses under common control (within the meaning of subsections (a) and

(b) of section 52).

(3) *Reasonably expected basis.* Rules similar to the rules of paragraphs (a) and (b) of this section apply in determining the taxpayer's reasonably expected basis in a project (land and depreciable basis) as of the close of the second calendar year following the calendar year of the allocation.

(4) *Examples.* The following examples illustrate the rules of paragraphs (a) and (b) of this section.

Example (1). (i) *Facts.* C, an accrual-method taxpayer, receives a carryover allocation from Agency, the state housing credit agency, in September of 1993. As of that date, C has not begun construction of the low-income housing building C plans to build. However, C has owned the land on which C plans to build the building since 1985. C's basis in the land is \$100,000. C reasonably expects that by the end of 1995, C's basis in the project of which the building is to be a part will be \$2,000,000. C also expects that because the project is located in a qualified census tract, C will be able to increase its basis in the project to \$2,600,000. Before the close of 1993, C incurs \$150,000 of costs for architects' fees and site preparation. C properly accrues these costs under its method of accounting and capitalizes the costs.

(ii) *Determination of carryover-allocation basis.* C's \$100,000 basis in the land is includible in carryover-allocation basis even though C has owned the land since 1985. The \$150,000 of costs C has incurred for architects' fees and site preparation are also includible in carryover-allocation basis. The expected increase in basis due to the project's location in a qualified census tract is not taken into account in determining C's carryover-allocation basis. Accordingly, C's carryover-allocation basis in the project of which the building is a part is \$250,000.

(iii) *Determination of whether building is qualified.* C's reasonably expected basis in the project at the close of the second calendar year following the calendar year of allocation is \$2,000,000. The expected increase in eligible basis due to the project's location in a qualified census tract is not taken into account in determining this amount. Because C's carryover-allocation basis is more than 10 percent of C's reasonably expected basis in the project of which the building is a part, the building for which C received the carryover allocation is a qualified building for purposes of section 42(h)(1)(E)(ii) and paragraph (a) of this section.

Example (2). (i) *Facts.* D, an accrual-method taxpayer, receives a carryover allocation from Agency, the state housing credit agency, on September 11, 1993. As of that date, D has not begun construction of the low-income housing building D plans to build and D does not have

basis in the land on which D plans to build the building. In 1993, D incurs some costs related to the planned building, including architects' fees. However, at the close of 1993, these costs do not exceed 10 percent of D's reasonably expected basis in the project.

(ii) Determination of whether building is qualified. Because D's carryover-allocation basis is not more than 10 percent of D's reasonably expected basis in the project of which the building is a part, the building for which D received a carryover allocation is not a qualified building for purposes of section 42(h)(1)(E)(ii) and paragraph (a) of this section. The carryover allocation to D is not valid, and is treated as if it had not been made.

(c) Verification of basis by agency.

(1) *Verification requirement.* An Agency that makes a carryover allocation to a taxpayer must verify that, as of the close of the calendar year of allocation, the taxpayer has incurred more than 10 percent of the reasonably expected basis in the project (land and depreciable basis).

(2) *Manner of verification.* An Agency may verify that a taxpayer has incurred more than 10 percent of its reasonably expected basis in a project by obtaining a certification from the taxpayer, in writing and under penalty of perjury, that the taxpayer has incurred by the close of the calendar year of the allocation more than 10 percent of the reasonably expected basis in the project. The certification must be accompanied by supporting documentation that the Agency must review. Supporting documentation may include, for example, copies of checks or other records of payments. Alternatively, an Agency may verify that the taxpayer has incurred adequate basis by requiring that the taxpayer obtain from an attorney or certified public accountant a written certification to the Agency, that the attorney or accountant has examined all eligible costs incurred with respect to the project and that, based upon this examination, it is the attorney's or accountant's belief that the taxpayer has incurred more than 10 percent of its reasonably expected basis in the project by the close of the calendar year of the allocation.

(3) *Time of verification.* An Agency may require that the basis certification be submitted to or received by the Agency prior to the close of the calendar year of allocation or within a reasonable time after the close of the calendar year of allocation. The Agency will need to verify basis in order to accurately complete the Form 8610, Annual Low-Income Housing Credit Agencies Report, for the calendar year. If certification is not timely made, or supporting documentation is lacking, inadequate, or does not actually support the certification, the Agency should notify the taxpayer and try to get adequate documentation. If the Agency cannot verify before the Form 8610 is filed that the taxpayer has satisfied the basis requirement for a carryover allocation, the allocation is treated as if it had not been made and the carryover allocation document should not be filed with the Form 8610.

(d) Requirements for making carryover allocations.

(1) *In general.* Generally, an allocation is made when an Agency issues the Form 8609, Low-Income Housing Credit Allocation Certification, for a building. See §1.42-1T(d)(8)(ii). An Agency does not issue the Form 8609 for a building until the building is placed in service. However, in cases where allocations of credit are made pursuant to section 42(h)(1)(E) (relating to carryover allocations for buildings) or section 42(h)(1)(F) (relating to carryover allocations for multiple-building projects), Form 8609 is not used as the allocating document because the buildings are not yet in service. When an allocation is made pursuant to section 42(h)(1)(E) or

(F), the allocating document is the document meeting the requirements of paragraph (d)(2) of this section. In addition, when an allocation is made pursuant to section 42(h)(1)(F), the requirements of paragraph (d)(3) of this section must be met for the allocation to be valid. An allocation pursuant to section 42(h)(1)(E) or (F) reduces the state housing credit ceiling for the year in which the allocation is made, whether or not the Form 8609 is also issued in that year.

(2) Requirements for allocation. An allocation pursuant to section 42(h)(1)(E) or (F) is made when an allocation document containing the following information is completed, signed, and dated by an authorized official of the Agency—

- (i) The address of each building in the project, or if none exists, a specific description of the location of each building;
- (ii) The name, address, and taxpayer identification number of the taxpayer receiving the allocation;
- (iii) The name and address of the Agency;
- (iv) The taxpayer identification number of the Agency;
- (v) The date of the allocation;
- (vi) The housing credit dollar amount allocated to the building or project, as applicable;
- (vii) The taxpayer's reasonably expected basis in the project (land and depreciable basis) as of the close of the second calendar year following the calendar year in which the allocation is made;
- (viii) The taxpayer's basis in the project (land and depreciable basis) as of the close of the calendar year in which the allocation is made and the percentage that basis bears to the reasonably expected basis in the project (land and depreciable basis) as of the close of the second following calendar year;
- (ix) The date that each building in the project is expected to be placed in service; and
- (x) The Building Identification Number (B.I.N.) to be assigned to each building in the project. The B.I.N. must reflect the year an allocation is first made to the building, regardless of the year that the building is placed in service. This B.I.N. must be used for all allocations of credit for the building. For example, rehabilitation expenditures treated as a separate new building under section 42(e) should not have a separate B.I.N. if the building to which the rehabilitation expenditures are made has a B.I.N. In this case, the B.I.N. used for the rehabilitation expenditures shall be the B.I.N. previously assigned to the building, although the rehabilitation expenditures must have a separate Form 8609 for the allocation. Similarly, a newly constructed building that receives an allocation of credit in different calendar years must have a separate Form 8609 for each allocation. The B.I.N. assigned to the building for the first allocation must be used for the subsequent allocation.

(3) Special rules for project-based allocations.

- (i) In general. An allocation pursuant to section 42(h)(1)(F) (a project-based allocation) must meet the requirements of this section as well as the requirements of section 42(h)(1)(F), including the minimum basis requirement of section 42(h)(1)(E)(ii).
- (ii) Requirement of section 42(h)(1)(F)(i)(III). An allocation satisfies the requirement of section 42(h)(1)(F)(i)(III) if the Form 8609 that is issued for each building that is placed in service in the project states the portion of the project-based allocation that is applied to that building.

(4) Recordkeeping requirements.

- (i) Taxpayer. When an allocation is made pursuant to section 42(h)(1)(E) or (F), the taxpayer must retain a copy of the allocation document and file an additional copy with the Form 8609 that is issued to the taxpayer for a building after the building is placed in service. The taxpayer need only file a copy of the allocation

document with the Form 8609 for the building for the first year the credit is claimed. However, the Form 8609 must be filed for the first taxable year in which the credit is claimed and for each taxable year thereafter throughout the compliance period, whether or not a credit is claimed for the taxable year.

(ii) Agency. The Agency must retain the original carryover allocation document made under paragraph (d)(2) of this section and file Schedule A (Form 8610), "Carryover Allocation of the Low-Income Housing Credit," with the Agency's Form 8610 for the year the allocation is made. The Agency must also retain a copy of the Form 8609 that is issued to the taxpayer and file the original with the Agency's Form 8610 that reflects the year the form is issued.

(5) *Separate procedure for election of appropriate percentage month.* If a taxpayer receives an allocation under section 42(h)(1)(E) or (F) and wishes to elect under section 42(b)(2)(A)(ii) to use the appropriate percentage for a month other than the month in which a building is placed in service, the requirements specified in §1.42-8 must be met for the election to be effective.

(e) Special rules. The following rules apply for purposes of this section.

(1) *Treatment of partnerships and other flow-through entities.* With respect to taxpayers that own projects through partnerships or other flow-through entities (e.g., S corporations, estates, or trusts), carryover-allocation basis is determined at the entity level using the rules provided by this section. In addition, the entity is responsible for providing to the Agency the certification and documentation required under the basis verification requirement in paragraph (c) of this section.

(2) *Transferees.* If land or depreciable property that is expected to be part of a project is transferred after a carryover allocation has been made for a building that is reasonably expected to be part of the project, but before the close of the calendar year of the allocation, the transferee's carryover-allocation basis is determined under the principles of this section and section 42(d)(7). See also Rev. Rul. 91-38, 1991-2 C.B. 3 (see §601.601(d)(2)(ii)(b) of this chapter). In addition, the transferee is treated as the taxpayer for purposes of the basis verification requirement of this section, and therefore, is responsible for providing to the Agency the required certifications and documentation.

T.D. 8520, 3/2/94, amend T.D. 8859, 1/13/2000.

**Federal Regulation 1.42-9
For Use by the General Public**

Federal Regulations

Reg § 1.42-9. For use by the general public.

(a) General rule. If a residential rental unit in a building is not for use by the general public, the unit is not eligible for a section 42 credit. A residential rental unit is for use by the general public if the unit is rented in a manner consistent with housing policy governing non-discrimination, as evidenced by rules or regulations of the Department of Housing and Urban Development (HUD) (24 CFR subtitle A and chapters I through XX). See HUD Handbook 4350.3 (or its successor). A copy of HUD Handbook 4350.3 may be requested by writing to: HUD, Directives Distribution Section, room B-100, 451 7th Street, SW., Washington, DC 20410.

(b) Limitations. Notwithstanding paragraph (a) of this section, if a residential rental unit is provided only for a member of a social organization or provided by an employer for its employees, the unit is not for use by the general public and is not eligible for credit under section 42. In addition, any residential rental unit that is part of a hospital, nursing home, sanitarium, lifecare facility, trailer park, or intermediate care facility for the mentally and physically handicapped is not for use by the general public and is not eligible for credit under section 42.

(c) Treatment of units not for use by the general public. The costs attributable to a residential rental unit that is not for use by the general public are not excludable from eligible basis by reason of the unit's ineligibility for the credit under this section. However, in calculating the applicable fraction, the unit is treated as a residential rental unit that is not a low-income unit.

T.D. 8520, 3/2/94.

Federal Regulation 1.42-11
Provision of Services

Federal Regulations

Reg § 1.42-11. Provision of services.

Caution: Reg §1.42-11, following, is effective before 1/1/2001. For Reg §1.42-11, effective after 12/31/2000, see below.

(a) General rule. The furnishing to tenants of services other than housing (whether or not the services are significant) does not prevent the units occupied by the tenants from qualifying as residential rental property eligible for credit under section 42. However, any charges to low-income tenants for services that are not optional generally must be included in gross rent for purposes of section 42(g).

(b) Services that are optional.

(1) General rule. A service is optional if payment for the service is not required as a condition of occupancy. For example, for a qualified low-income building with a common dining facility, the cost of meals is not included in gross rent for purposes of section 42(g)(2)(A) if payment for the meals in the facility is not required as a condition of occupancy and a practical alternative exists for tenants to obtain meals other than from the dining facility.

(2) Continual or frequent services. If continual or frequent nursing, medical, or psychiatric services are provided, it is presumed that the services are not optional and the building is ineligible for the credit, as is the case with a hospital, nursing home, sanitarium, lifecare facility, or intermediate care facility for the mentally and physically handicapped. See also §1.42-9(b).

(3) Required services.

(i) General rule. The cost of services that are required as a condition of occupancy must be included in gross rent even if federal or state law requires that the services be offered to tenants by building owners.

(ii) Exceptions.

(A) Supportive services. Section 42(g)(2)(B)(iii) provides an exception for certain fees paid for supportive services. For purposes of section 42(g)(2)(B)(iii), a supportive service is any service provided under a planned program of services designed to enable residents of a residential rental property to remain independent and avoid placement in a hospital, nursing home, or intermediate care facility for the mentally or physically handicapped. For a building described in section 42(i)(3)(B)(iii) (relating to transitional housing for the homeless) or section 42(i)(3)(B)(iv) (relating to transitional housing for the homeless), a supportive service includes any service provided to assist tenants in locating and retaining permanent housing.

(B) Specific project exception. Gross rent does not include the cost of mandatory meals in any federally-assisted project for the elderly and handicapped (in existence on or before January 9, 1989) that is authorized by 24 CFR part 278 to provide a mandatory meals program.

T.D. 8520, 3/2/94.

Federal Regulation 1.42-15
Available Unit Rule

Federal Regulations

Reg § 1.42-15. Available unit rule.

(a) Definitions. The following definitions apply to this section: *Applicable income limitation* means the limitation applicable under section 42(g)(1) or, for deep rent skewed projects described in section 142(d)(4)(B), 40 percent of area median gross income. *Available unit rule* means the rule in section 42(g)(2)(D)(ii). *Comparable unit* means a residential unit in a low-income building that is comparably sized or smaller than an over-income unit or, for deep rent skewed projects described in section 142(d)(4)(B), any low-income unit. For purposes of determining whether a residential unit is comparably sized, a comparable unit must be measured by the same method used to determine qualified basis for the credit year in which the comparable unit became available. *Current resident* means a person who is living in the low-income building. *Low-income unit* is defined by section 42(i)(3)(A). *Nonqualified resident* means a new occupant or occupants whose aggregate income exceeds the applicable income limitation. *Over-income unit* means a low-income unit in which the aggregate income of the occupants of the unit increases above 140 percent of the applicable income limitation under section 42(g)(1), or above 170 percent of the applicable income limitation for deep rent skewed projects described in section 142(d)(4)(B). *Qualified resident* means an occupant either whose aggregate income (combined with the income of all other occupants of the unit) does not exceed the applicable income limitation and who is otherwise a low-income resident under section 42, or who is a current resident.

(b) General section 42(g)(2)(D)(i) rule. Except as provided in paragraph (c) of this section, notwithstanding an increase in the income of the occupants of a low-income unit above the applicable income limitation, if the income of the occupants initially met the applicable income limitation, and the unit continues to be rent-restricted—

- (1) The unit continues to be treated as a low-income unit; and
- (2) The unit continues to be included in the numerator and the denominator of the ratio used to determine whether a project satisfies the applicable minimum set-aside requirement of section 42(g)(1).

(c) Exception. A unit ceases to be treated as a low-income unit if it becomes an over-income unit and a nonqualified resident occupies any comparable unit that is available or that subsequently becomes available in the same low-income building. In other words, the owner of a low-income building must rent to qualified residents all comparable units that are available or that subsequently become available in the same building to continue treating the over-income unit as a low-income unit. Once the percentage of low-income units in a building (excluding the over-income units) equals the percentage of low-income units on which the credit is based, failure to maintain the over-income units as low-income units has no immediate significance. The failure to maintain the over-income units as low-income units, however, may affect the decision of whether or not to rent a particular available unit at market rate at a later time. A unit is not available for purposes of the available unit rule when the unit is no longer available for rent due to contractual arrangements that are binding under local law (for example, a unit is not available if it is subject to a preliminary reservation that is binding on the owner under local law prior to the date a lease is signed or the unit is occupied).

(d) Effect of current resident moving within building. When a current resident moves to a different unit within the building, the newly occupied unit adopts the status of the vacated unit. Thus, if a current resident, whose income exceeds the applicable income limitation, moves from an over-income unit to a vacant unit in the same building, the newly occupied unit is treated as an over-income unit. The vacated unit assumes the status the newly occupied unit had immediately before it was occupied by the current resident.

(e) Available unit rule applies separately to each building in a project. In a project containing more than one low-income building, the available unit rule applies separately to each building.

(f) Result of noncompliance with available unit rule. If any comparable unit that is available or that subsequently becomes available is rented to a nonqualified resident, all over-income units for which the available unit was a comparable unit within the same building lose their status as low-income units; thus, comparably sized or larger over-income units would lose their status as low-income units.

(g) Relationship to tax-exempt bond provisions. Financing arrangements that purport to be exempt-facility bonds under section 142 must meet the requirements of sections 103 and 141 through 150 for interest on the obligations to be excluded from gross income under section 103(a). This section is not intended as an interpretation under section 142.

(h) Examples. The following examples illustrate this section:

Example (1). This example illustrates noncompliance with the available unit rule in a low-income building containing three over-income units. On January 1, 1998, a qualified low-income housing project, consisting of one building containing ten identically sized residential units, received a housing credit dollar amount allocation from a state housing credit agency for five low-income units. By the close of 1998, the first year of the credit period, the project satisfied the minimum set-aside requirement of section 42(g)(1)(B). Units 1, 2, 3, 4, and 5 were occupied by individuals whose incomes did not exceed the income limitation applicable under section 42(g)(1) and were otherwise low-income residents under section 42. Units 6, 7, 8, and 9 were occupied by market-rate tenants. Unit 10 was vacant. To avoid recapture of credit, the project owner must maintain five of the units as low-income units. On November 1, 1999, the certificates of annual income state that annual incomes of the individuals in Units 1, 2, and 3 increased above 140 percent of the income limitation applicable under section 42(g)(1), causing those units to become over-income units. On November 30, 1999, Units 8 and 9 became vacant. On December 1, 1999, the project owner rented Units 8 and 9 to qualified residents who were not current residents at rates meeting the rent restriction requirements of section 42(g)(2). On December 31, 1999, the project owner rented Unit 10 to a market-rate tenant. Because Unit 10, an available comparable unit, was leased to a market-rate tenant, Units 1, 2, and 3 ceased to be treated as low-income units. On that date, Units 4, 5, 8, and 9 were the only remaining low-income units. Because the project owner did not maintain five of the residential units as low-income units, the qualified basis in the building is reduced, and credit must be recaptured. If the project owner had rented Unit 10 to a qualified resident who was not a current resident, eight of the units would be low-income units. At that time, Units 1, 2, and 3, the over-income units, could

be rented to market-rate tenants because the building would still contain five low-income units.

Example (2). This example illustrates the provisions of paragraph (d) of this section. A low-income project consists of one six-floor building. The residential units in the building are identically sized. The building contains two over-income units on the sixth floor and two vacant units on the first floor. The project owner, desiring to maintain the over-income units as low-income units, wants to rent the available units to qualified residents. J, a resident of one of the over-income units, wishes to occupy a unit on the first floor. J's income has recently increased above the applicable income limitation. The project owner permits J to move into one of the units on the first floor. Despite J's income exceeding the applicable income limitation, J is a qualified resident under the available unit rule because J is a current resident of the building. The unit newly occupied by J becomes an over-income unit under the available unit rule. The unit vacated by J assumes the status the newly occupied unit had immediately before J occupied the unit. The over-income units in the building continue to be treated as low-income units.

(i) Effective date. This section applies to leases entered into or renewed on and after September 26, 1997.

T.D. 8732, 9/25/97.

Federal Regulation 1.42-17
Qualified Allocation Plan

Federal Regulations

Reg § 1.42-17. Qualified allocation plan.

Caution: Reg §1.42-17 is effective 1/1/2001.

(a) Requirements.

(1) *In general.* [Reserved]

(2) *Selection criteria.* [Reserved]

(3) *Agency evaluation.* Section 42(m)(2)(A) requires that the housing credit dollar amount allocated to a project is not to exceed the amount the Agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period. In making this determination, the Agency must consider—

- (i) The sources and uses of funds and the total financing planned for the project. The taxpayer must certify to the Agency the full extent of all federal, state, and local subsidies that apply (or which the taxpayer expects to apply) to the project. The taxpayer must also certify to the Agency all other sources of funds and all development costs for the project. The taxpayer's certification should be sufficiently detailed to enable the Agency to ascertain the nature of the costs that will make up the total financing package, including subsidies and the anticipated syndication or placement proceeds to be raised. Development cost information, whether or not includible in eligible basis under section 42(d), that should be provided to the Agency includes, but is not limited to, site acquisition costs, construction contingency, general contractor's overhead and profit, architect's and engineer's fees, permit and survey fees, insurance premiums, real estate taxes during construction, title and recording fees, construction period interest, financing fees, organizational costs, rent-up and marketing costs, accounting and auditing costs, working capital and operating deficit reserves, syndication and legal fees, and developer fees;
- (ii) Any proceeds or receipts expected to be generated by reason of tax benefits;
- (iii) The percentage of the housing credit dollar amount used for project costs other than the costs of intermediaries. This requirement should not be applied so as to impede the development of projects in hard-to-develop areas under section 42(d)(5)(C); and
- (iv) The reasonableness of the developmental and operational costs of the project.

(4) *Timing of Agency evaluation.*

(i) In general. The financial determinations and certifications required under paragraph (a)(3) of this section must be made as of the following times—

- (A) The time of the application for the housing credit dollar amount;
- (B) The time of the allocation of the housing credit dollar amount; and
- (C) The date the building is placed in service.

(ii) Time limit for placed-in-service evaluation. For purposes of paragraph (a)(4)(i)(C) of this section, the evaluation for when a building is placed in service must be made not later than the date the Agency issues the Form 8609, "Low-Income Housing Credit Allocation Certification." The Agency must evaluate all sources and uses of funds under paragraph (a)(3)(i) of this section paid, incurred, or committed by the taxpayer for the project up until date the Agency issues the Form 8609.

(5) *Special rule for final determinations and certifications.* For the Agency's evaluation under paragraph (a)(4)(i)(C) of this section, the taxpayer must submit a schedule of project costs. Such

schedule is to be prepared on the method of accounting used by the taxpayer for federal income tax purposes, and must detail the project's total costs as well as those costs that may qualify for inclusion in eligible basis under section 42(d). For projects with more than 10 units, the schedule of project costs must be accompanied by a Certified Public Accountant's audit report on the schedule (an Agency may require an audited schedule of project costs for projects with fewer than 11 units). The CPA's audit must be conducted in accordance with generally accepted auditing standards. The auditor's report must be unqualified.

(6) Bond-financed projects. A project qualifying under section 42(h)(4) is not entitled to any credit unless the governmental unit that issued the bonds (or on behalf of which the bonds were issued), or the Agency responsible for issuing the Form(s) 8609 to the project, makes determinations under rules similar to the rules in paragraphs (a) (3), (4), and (5) of this section.

(b) Effective date. This section is effective on January 1, 2001.

T.D. 8859, 1/13/2000.

TAM
Treatment of Casualty Loss

CCA 200134006 - IRC Section 42 - Low-income housing credit

IRC Section 42 Document Date: May 4, 2001

INTERNAL REVENUE SERVICE

Date: May 4, 2001 Number: 200134006 Release Date: 8/24/2001

U.I.L. No: 42.08-07 WTA-N-109015-01/CC:P&SI:5 MEMORANDUM FOR: William Healey Team Manager Examination Specialization and Processes C:CP:RC:ES&P FROM: Harold Burghart Assistant to the Chief, Branch 5 CC:PSI:5 Office of Associate Chief Counsel (Passthroughs and Special Industries)

SUBJECT: Treatment of Casualty Losses Under Section 42(j)(4)(E)

Introduction

The following is in response to your memorandum dated February 8, 2001, concerning the treatment of casualty losses to low-income housing tax credit properties under section 42(j)(4)(E) of the Internal Revenue Code. Apparently, Examination previously informally advised the state housing credit agencies that:

1) the definition of "casualty loss" under section 42(j)(4)(E) would be the same as the definition utilized in Publication 547, Casualty, Disasters, and Thefts, and Publication 584, Casualty, Disaster, and Theft Loss Workbook (i.e., damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual).

In reliance on Publication 547, Examination identified two years as a reasonable replacement period for the damaged property;

2) it was not necessary to report noncompliance on Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition, at the time the owner decides to replace the property. Further, Examination informed state agencies that they should report noncompliance only when the owner has suffered a casualty loss and has not restored the loss through reconstruction or replacement within a reasonable period of time; and

3) owners may continue to take credits on units or buildings damaged by a casualty while they are being replaced.

Law

Section 42(j)(1) provides that if--(A) 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 (B) 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.

Section 42(j)(2) provides that the credit recapture amount in section 42(j)(1) is an amount equal to the sum of--(A) the aggregate decrease in the credits allowed to the taxpayer under section 38 for all prior taxable years which would have resulted if the accelerated portion of the credit allowable by reason of this section were not allowed for all prior taxable years with respect to the excess of the amount described in section 420)(1)(B) over the amount described in section 42(j)(1)(A), plus

(B) interest at the overpayment rate established under section 6621 on the amount determined under section 42(j)(2)(A) for each prior taxable year for the period beginning on the due date for filing the return for the prior taxable year involved.

Section 42(j)(4)(E) of the Internal Revenue Code provides that the increase in tax under section 42(j) shall not apply to a reduction in qualified basis by reason of a casualty loss to the extent such loss is restored by reconstruction or replacement within a reasonable period established by the Secretary (emphasis added).

Rev. Proc. 95-28, 1995-1 C.B. 704, establishes the process under which temporary relief will be granted from certain provisions of section 42 of the Internal Revenue Code to owners of low-income housing projects (owners) and housing credit agencies (Agencies) in major disaster areas. Section 7.01 of this revenue procedure provides that an owner of a building (1) that is beyond the first year of the credit period, and (2) that, because of a disaster that caused the President to issue a major disaster declaration, has suffered a reduction in qualified basis that would cause it to be subject to recapture or loss of credit will not be subject to recapture or loss of credit if the building's qualified basis is restored within a reasonable period. The Agency that monitors the project for compliance with section 42 may determine what constitutes a reasonable period, but in no instance will it end later than 24 months after the end of the calendar year in which the President issued a major disaster declaration for the area where the building is located.

Section 7.02 of Rev. Proc. 95-28 provides that to determine the credit amount allowable during the reconstruction or replacement period, an owner of a building described in section 7.01 of this revenue procedure must use the building's qualified basis at the end of the taxable year that preceded the President's major disaster declaration.

Section 1.42-5(c)(1) of the Income Tax Regulations requires an owner to report any reduction in qualified basis to the state housing credit agency that monitors the building for compliance. Section 1.42-5(e)(3) specifies that a change in eligible basis that results in a decrease in qualified basis is noncompliance that must be reported to the Service after a specified time for correction.

Discussion

The following discusses in the order of the above-mentioned points concerning Examination's informal advice to the state housing credit agencies:

1) We concur that the meaning of "casualty loss" under section 42(j)(4)(E) should be consistent with generally accepted tax principles under section 165. Under section 42(j)(4)(E), the Secretary is given the authority to provide guidance as to a reasonable period in which to restore a loss resulting from casualty and thereby avoid recapture of the section 42 credit. No guidance has been issued on this reasonable period, but a pealed of up to 2 years following the end of the tax year in which the casualty loss occurred is consistent with general replacement principles involving casualties. See section 1033. Additionally, we note that section 1.42-5(e)(4) permits the state housing credit agencies to allow up to a 6-month correction period for compliance violations. This regulatory provision, however, does not address the reasonable period for restoration of a casualty loss under section 42(j)(4)(E).

2) We disagree with the suggestion that state housing credit agencies should report noncompliance only when the owner has suffered a casualty loss and has not restored the property within the two-year period. Rather, state housing credit agencies must, as required by section 1.42-5(e)(3), report to the Service via Form 8823 any casualty loss that takes low-income property in whole or in part out of service and results in a reduction in qualified basis.

3) We find no support for allowing property owners to continue to claim credits on units while the units are not in service because of a casualty event. First, section 42(j)(4)(E) only specifies the avoidance of recapture on the accelerated portion during the replacement period, not the continuing ability to claim credits. Secondly, the relief under section 7.02 of Rev. Proc. 9528 pertaining to the continuation of credits during the replacement period is conditioned on the area where the property is located being designated as a major disaster area by the President of the United States. Such an event is quite distinct from the general casualty loss situation confronting property owners.

TAM
**Clarification of “Reasonable
Attempts/UVR”**

CCA 200137028 - IRC Section 42 - Low-income housing credit

IRC Section 42 Document Date: June 14, 2001

DEPARTMENT OF THE TREASURY INTERNAL
REVENUE SERVICE WASHINGTON, D.C. 20224
OFFICE OF CHIEF COUNSEL

June 14, 2001 Number: 200137028 CC:PSI:5:DSelig Release Date: 9/14/2001 WTA-N-115199-01 Index No.: 42.07-00

MEMORANDUM FOR William J. Healey Team Manager, Examination Specialization and Processes S:C:CP:RC:ES

FROM: Harold Burghart Assistant to the Branch Chief, Branch 5 CC:PSI:5

SUBJECT: Low Income Housing Credit Program: Clarification of "Reasonable Attempts" for Purposes of § 1.42-5(c)(ix)

This Chief Counsel Advice responds to your memorandum dated March 13, 2001. In accordance with § 6110(k)(3) of the Internal Revenue Code, this Chief Counsel Advice should not be cited as precedent.

In your memorandum, you ask if the vacant unit rule in § 1.42-5(c)(ix) of the Income Tax Regulations can be applied on a building-by-building basis, rather than on a project basis. Also, you inquire about the definition of "reasonable attempts" made to rent a vacant low-income unit. Lastly, you ask whether the qualification under the available unit rule in § 42(g)(2)(D)(ii) that a unit is not available for rent when subject to a reservation that is binding under local law can be applied to the vacant unit rule.

The available unit rule under § 42(g)(2)(D)(i) provides that, except as provided in § 42(g)(2)(D)(ii), notwithstanding an increase in the income of the occupants of a low-income unit above the income limitation applicable under § 42(g)(1), the unit will continue to be treated as a low-income unit if the income of the occupants initially met the income limitation and the unit continues to be rent-restricted. However, under § 42(g)(2)(D)(ii), if the income of the occupants of the unit increases above 140 percent of the applicable income limitation, the unit will no longer be treated as a low-income unit if any residential unit in the building (of a size comparable to, or smaller than, the unit) is occupied by a new resident whose income exceeds the applicable income limitation.

Section 1.42-15(c) provides that a unit is not available for purposes of the available unit rule when the unit is no longer available for rent due to contractual arrangements that are binding under local law (for example, a unit is not available if it is subject to a preliminary reservation that is binding on the owner under local law prior to the date a lease is signed or the unit is occupied).

The vacant unit rule in § 1.42-5(c)(1)(ix) provides that the owner of a low-income housing project must be required to certify that if a low-income unit in the project became vacant during the year, that reasonable attempts were or are being made to rent that unit or the next available unit of comparable or smaller size to tenants having a qualifying income before any units in the project were or will be rented to tenants not having a qualifying income.

Under the vacant unit rule of § 1.42-5(c)(ix), vacant units formerly occupied by low-income individuals may continue to be treated as occupied by a qualified low-income individual for purposes of the set-aside requirement (as well as for determining qualified basis) provided reasonable attempts are made to rent the unit and no other units of comparable or smaller size in the project are rented to nonqualifying individuals. As stated in the legislative history, the vacant unit rule is applied on a project-wide basis, rather than on a building-by-building basis. H.R. Conf. Rep. No. 99-41, 99th. Cong. 2d Sess. 11-94 (1986). Therefore, we do not apply the vacant unit rule on a building-by-building basis. Note, however, that § 42(g)(2)(D)(ii) specifically requires that the available unit rule be applied on a building-by-building basis.

What constitutes a reasonable attempt to rent a vacant unit is factual, and may differ from project to project depending on the size, location, and dollar value of the particular project. Also, the different advertising media and technologies accessible (geographically and financially) to projects would affect what is considered reasonable. Therefore, we do not define what is a reasonable attempt to rent a vacant unit.

The fact that a unit is subject to a reservation under local law would indicate that reasonable attempts have been made to rent the unit. Although not specifically provided, it appears appropriate to apply this reservation standard for purposes of the available unit rule to determine when a unit is considered rented under the vacant unit rule.

If you have any questions regarding this memorandum or further questions relating to these issues, please call Dave Selig at (202) 622-3040.

TAM
Clarification with Respect to 1st Year of
Credit Period

CCA 200137044 - IRC Section 42 - Low-Income Housing Credit

IRC Section 42 Document Date: June 28, 2001

DEPARTMENT OF THE TREASURY INTERNAL
REVENUE SERVICE WASHINGTON, D.C. 20224
OFFICE OF CHIEF COUNSEL

June 28, 2001 Number: 200137044 Release Date: 9/14/2001 Index Number: 42.12-00 CC:PSI:5:CWilson WTA-N-120076-01

MEMORANDUM FOR Sharon M, Oliver Director,
Reporting Compliance S:C:CP:RC

FROM: Harold Burghart Assistant to the Chief, Branch 5 CC:PSI:5

SUBJECT: Low Income Housing Credit: Clarification of § 42(I)(1), Certification With Respect to 1st Year of Credit Period.

This Chief Counsel Advice responds to your memorandum dated April 2, 2001. In accordance with § 6110(k)(3) of the Internal Revenue Code, this Chief Counsel Advice should not be cited as precedent. Your memorandum concerns certain questions under § 42(I)(1) and Form 8609, Low-Income Housing Credit Allocation Certification. These questions are summarized below.

Q1. When is a building placed in service and how can this be documented?

Q2. Once a Form 8609 is first issued by an applicable allocating authority, can the taxpayer file an amended return to claim credits for taxable years in a building's compliance period prior to the issuance of the Form 8609?

Q3. If a taxpayer has claimed § 42 credits for any year prior to the issuance of the Form 8609, can all credits claimed prior to the issuance of the Form 8609 be disallowed?

Q4. Can a taxpayer satisfy the certification requirements of § 42(I) during the examination process?

Q5. If a revenue agent finds that the first year certification requirements of § 42(I)(1) have not been met, can the entire credit amount for the first and all successive years be disallowed?

LAW & ANSWERS

Section 42(I)(1) provides that following the first year of the credit period for any qualified low-income building, the taxpayer shall certify to the Secretary (at such time and in such form and in such manner as the Secretary prescribes)

- (a) the taxable year, and calendar year, in which the building was placed in service,
- (b) the adjusted basis and eligible basis of the building as of the close of the 1st year of the credit period,
- (c) the maximum applicable percentage and qualified basis permitted to be taken into account by the appropriate housing credit agency under § 42(h),
- (d) the election made under § 42(g) for the qualified housing project of which such building is a part (i.e., the "minimum set-aside requirement"), and
- (e) such other information as the Secretary may require.

In the case of a failure to make the certification required by the preceding sentence on the date prescribed therefore, unless it is shown that such failure is due to reasonable cause and not to willful neglect, no credit shall be allowable under § 42(a) to such building for any taxable year ending before such certification is made.

Section 42(I)(2) provides that the Secretary may require taxpayers to submit an information return (at such time and in such form and manner as the Secretary prescribes) for each taxable year setting forth

- (a) the qualified basis for the taxable year of each qualified low-income building of the taxpayer,
- (b) the maximum applicable percentage and qualified basis permitted to be taken into account by the appropriate housing credit agency under § 42(h) for the taxable year, and
- (c) such other information as the Secretary may require.

The penalty under § 6652(j) shall apply to any failure to submit the return required by the Secretary under the preceding sentence on the date prescribed therefor.

Section 1.42-1T(d)(8)(ii) of the Income Tax Regulations provides that credit allocations are made when Part 1 of Form 8609 is completed and signed by an authorized official of the housing credit agency and mailed to the owner of the qualified low-income building.

Section 1.42-1T(h)(1) provides that a form shall be treated as completed if the state or local housing credit agency or the building owner has made a good faith effort to complete the form in accordance with the form and the form's instructions.

Section 1.42-1T(h)(2) provides that a completed Form 8609 (or copy thereof) shall be filed with the owner's Federal income tax return for each of the 15 taxable years in the compliance period. For tax-exempt bond financed projects for which no allocation is made, an owner is to obtain a blank copy of Form 8609 and fill in the address of the building and the name and address of the owner. Part II of Form 8609 is to be completed by the building owner only for the first year

the low income housing credit is claimed by the building owner. Part III of Form 8609 (Statement of Qualification) shall be completed by the owner of the building for each year of the 15-year compliance period.

Section 1.42-IT(h)(3) provides that if any form is revised or renumbered, any reference in this section to the form shall be treated as a reference to the revised or renumbered form.

The instructions to Form 8609 provide that an owner must get a Form 8609 from the appropriate housing credit agency (with the applicable items of Part 1, completed, including an assigned building identification number (BIN)).

Enumerated below are our answers to your questions.

A1. Notice 88-116, 1988-2 C.B. 449, provides guidance on when a building will be considered to be placed in service for purposes of § 42. It provides that the placed-in-service date for a new or existing building used as residential rental property is the date on which the building is ready and available for its specifically assigned function, i.e., the date on which the first unit in the building is certified as being suitable for occupancy in accordance with state or local law. See the notice for rules on rehabilitation expenditures treated as a building. A building may be placed-in-service even if the rental units in it are not currently occupied by low-income tenants.

Documentation of a building's placed-in-service date is generally fact specific. For example, for new buildings, a temporary certificate of occupancy (TCO) might provide adequate documentation if the local jurisdiction that issues the TCO requires that the building be habitable at the time the TCO is issued.

A2. Once a Form 8609 is issued by the applicable allocation authority, the taxpayer can file an amended return to claim credits for taxable years in a building's compliance period prior to the year in which the Form 8609 is issued.

A3. Under certain circumstances, if a taxpayer claimed § 42 credits for a year prior to issuance of the Form 8609 by the applicable allocating authority, all credits claimed prior to issuance of the Form 8609 can be disallowed.

Section 1.42-IT(h)(1) provides that a form is not completed unless the state or local housing agency or the building owner has made a good faith effort to complete the form in accordance with the form and the instructions for the form. Form 8609 provides that Part 1 is to be filled out by the housing credit agency only. Section 1.42-IT(h)(2) provides that a completed Form 8609 (or copy thereof) shall be filed with the owner's Federal income tax return for each of the 15 taxable years in the compliance period (which encompasses the first year of the credit period). This requirement cannot be satisfied in the case of an incomplete Form 8609. If, in the case of an allocation from the state housing credit ceiling, the state agency has not completed Part 1, the form is incomplete. Since the first-year certification requirement of § 42(I)(1) is incorporated into Form 8609, an incomplete form under these circumstances would not satisfy the § 42(I)(1) first year requirement. The flush language following § 42(I)(1)(E) provides that in the case of a failure to make the certification required by § 42(I)(1) on the date prescribed thereof, unless it is shown that such failure is due to reasonable cause and not to willful neglect, no credit shall be allowable under § 42(a) for any taxable year before such certification is made. If the failure to meet the § 42(I)(1) certification requirement is a result of the taxpayer's willful neglect, credit may be disallowed for any open years (assuming no fraud) in the compliance period until this requirement is met.

The above paragraph pertains to buildings that receive a credit allocation from the state housing credit ceiling. It is not clear what the result would be for a tax-exempt bond project. Section 1.42-IT(h)(2) provides that for tax-exempt bond financed projects for which no allocation is made, an owner is to obtain a blank copy of Form 8609 and fill in (for Part 1) the address of the building and the name and address of the owner. This requirement is inconsistent with the Form 8609 instructions that Part 1 is to be completed by the housing credit agency only and post 1986 amendments to § 42 that provide an implicit oversight responsibility by the applicable state housing credit agency (see e.g., § 42(m)).

A4. There is no prohibition against satisfying the certification requirements of § 42(I) during the examination process.

A5. The answer to whether the entire credit amount for the first and all successive years can be disallowed if the first-year certifications requirements of § 42(I)(1) have not been met is similar to that in A3. The flush language following § 42(I)(1)(E) provides that in the case of a failure to make the certification required by § 42(I)(1) on the date prescribed thereof, unless it is shown that such failure is due to reasonable cause and not to willful neglect, no credit shall be allowable under § 42(a) for any taxable year before such certification is made. If the failure to meet the § 42(I)(1) certification requirement is a result of the taxpayer's willful neglect, credit may be disallowed for any open years (assuming no fraud) in the compliance period until this requirement is met.

If you have any questions about this memorandum or further questions about these issues, please call Christopher Wilson at (202) 622-3040.

Federal Notice 89-6
Utility Allowance Requirements

Low-Income Housing Tax Credit--Utility Allowance Requirements, Determination of General Public Use, and Provision of Services

The purpose of this Notice is to inform taxpayers that regulations under section 42 of the Internal Revenue Code of 1986 (the "Code") relating to the Low-Income Housing Tax Credit will provide that--

1. Department of Housing and Urban Development (HUD) regulated buildings shall use HUD utility allowances for purposes of section 42(g)(2) of the Code. Other housing shall use the utility rates or schedules provided for the relevant area by the applicable Public Housing Authority (PHA). Special rules apply to buildings or tenants receiving Farmers Home Administration (FmHA) housing assistance.
2. Residential rental units will be considered to be "for use by the general public" if housing is provided in a manner consistent with federal housing policy governing nondiscrimination as determined under HUD rules and regulations.
3. Any services may be provided to low-income tenants in connection with their occupancy of residential rental units. However, the cost of any services that are required to be paid by a tenant as a condition of occupancy generally must be included in gross rent for purposes of applying the gross rent limitation of section 42(g)(2) of the Code.

UTILITY ALLOWANCES.

In order to qualify as a "rent-restricted unit" within the meaning of section 42(g) of the Code, the gross rent for such unit must not exceed 30 percent of the applicable income limitation. Failure to qualify as a rent restricted unit may result in ineligibility for the section 42 credit, reduction in the amount of the credit, and/or recapture of previously allowed credits. For this purpose, gross rent includes the cost of any utilities, other than telephone. If any utilities are paid directly by the tenant, section 42(g)(2)(B)(ii) requires the inclusion in gross rent of a utility allowance determined by the Secretary, after taking into account the procedures under section 8 of the United States Housing Act of 1937.

Regulations will provide that the owner of a HUD-regulated building--a building whose rents and utility allowances are reviewed by HUD on an annual basis--must use HUD utility allowances. For other buildings occupied by one or more tenants receiving HUD rental assistance payments ("HUD tenant assistance"), an owner must use the applicable Public Housing Authority (PHA) utility allowances established for the Section 8 Existing Housing Program. A building owner must apply FmHA utility allowances to any rent-restricted unit in a building where either the building or any tenant receives FmHA housing assistance. If a building is both HUD-regulated and FmHA assisted, then FmHA utility allowances must be used. Similarly, all low-income tenants receiving HUD rental assistance are subject to FmHA utility allowances where the building or any other tenant in the building receives FmHA assistance. For example, a low-income building receiving assistance under FmHA section 515 shall use Exhibit A-5 of FmHA Instruction 1944-E (or a successor method of determining utility allowances), regardless of whether the building is HUD regulated or any low-income tenant in the building

receives HUD rental assistance. These rules will apply only for the purposes of section 42(g), and will not apply to the use of utility allowances by HUD or FmHA for their own internal purposes.

Regulations will also provide that a building owner must use the applicable Public Housing Authority (PHA) utility allowance for a building where there is neither (1) HUD tenant assistance, nor (2) an applicable HUD or FmHA utility allowance. In these cases, any interested party (e.g., a low-income tenant, building owner, or state housing authority) may obtain a letter from a local utility company providing the estimated cost of that utility for each unit of similar size and construction for the geographic area in which the low-income building is located. An interested party may obtain a letter from the local utility company at any time during the building's 15-year compliance period. Costs incurred in this process must be borne by the initiating party. The interested party must furnish a copy of the letter to the owner of the building and should retain the original. If the utility estimates provided by the local utility companies differ from the utility allowances provided by the PHA, the utility company estimates shall be used in calculating the gross rent limitation. If the utility estimates provided by the local utility companies are higher for one or more rent-restricted units, the building owner must adjust the rents of any rent-restricted unit where failure to do so would result in a violation of the gross rent limitation of section 42(g)(2). Finally, if at any time during the building's 15-year compliance period the building or a low-income tenant (1) becomes subject to HUD or FmHA utility allowances, or (2) receives HUD tenant assistance, all rent-restricted units in the building become subject to the appropriate HUD, FmHA, or PHA utility allowance.

A building owner who is required to use either HUD, FmHA, or PHA utility allowances must use such allowances to compute gross rents of rent-restricted units paid more than 90 days after the date of publication of this Notice in the Internal Revenue Bulletin. These allowances shall apply throughout the building's 15-year compliance period and shall be updated at the time rents are revised. A building owner who must apply a new utility allowance during the 15-year compliance period because a building or tenant receives HUD or FmHA assistance, or because local utility company estimates become applicable, must use such new utility allowances to compute gross rents of rent-restricted units paid 90 days after the date of occupancy of the federally-assisted tenant or 90 days from the post date of the last utility company estimate. These utility allowances shall also be updated when rents are revised.

In all cases, rent paid for occupancy after the deadline for applying the correct utility allowance must reflect the correct utility allowance. If application of the correct utility allowance results in a violation of the gross rent limitation of section 42(g)(2) for any low-income tenant, then the building owner must adjust that tenant's rent to claim a credit for the unit occupied by that tenant.

GENERAL PUBLIC USE REQUIREMENT.

The legislative history of section 42 of the Code provides that "Residential rental units must be for use by the general public. ... Residential rental units are not for use by the general public, for example, if the units are provided only for members of a social organization or provided by an employer for its employees." H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-95 (the "Conf. Rep."), 1986-3 (Vol. 4) C.B. 95. Regulations will provide that the term "for use by the general public" shall be determined in a manner consistent with HUD housing policy governing non-discrimination as evidenced by HUD rules and regulations. See HUD Handbook 4350.3 (or its

successor). Accordingly, owners of residential rental units that give preferences to certain classes of tenants (e.g., the homeless, disabled and/or handicapped) will not violate the general public use requirement if such preferences would not violate any HUD policy governing non-discrimination expressed in the HUD handbook. However, if residential rental units are restricted to a class of residents that would violate HUD housing policy (e.g., residential rental units provided solely for members of a social organization or by an employer for its employees) then the building in which these units are located will be ineligible for the credit.

PROVISION OF SERVICES.

Regulations will provide that, solely for purposes of section 42 of the Code, the furnishing to tenants of services other than housing (whether or not such services are significant) will not prevent property from qualifying as residential rental property. Regulations will also provide that, with the exception of certain federally-assisted projects for the elderly and handicapped (see below), any charges for services that are not optional to low-income tenants must be included in gross rent for purposes of section 42(g)(2)(A). A service is optional if payment for the service is not required as a condition of occupancy. Thus, in certain circumstances, a retirement-type facility may qualify under section 42 as residential rental property, notwithstanding that significant services other than housing are furnished to tenants. However, if continual nursing, medical, or psychiatric care is provided, it will be presumed that such services are mandatory. Such is generally the case with hospitals, nursing homes, sanitariums, and lifecare facilities.

For example, assume that meals and other services are provided to low-income tenants in a retirement home. Assume also that the cost of these services, when combined with rent and utility allowances, exceeds the 30 percent gross rent limitation. If any low-income tenants are required to pay for these services as a condition of occupancy, then the units occupied by these tenants are not rent-restricted units and are not included in qualified basis. However, if payment for these services is optional, then these units are rent-restricted units and are includible in qualified basis assuming that the gross rent limitation is otherwise satisfied. Where multiple services are provided, a building owner must decide which services are mandatory and included in the 30 percent gross rent limitation. All other services must be provided on an optional basis.

The cost of services must be included in the 30 percent gross rent limitation even if federal or state law requires that services be offered to tenants by project owners. A limited exception to this rule applies to existing federally-assisted projects for the elderly and handicapped that are authorized by 24 CFR 278 to provide a mandatory meals program. In these projects, mandatory meal charges will not be included in gross rent for purposes of section 42(g)(2)(A) if the provisions of 24 CFR 278 are otherwise complied with.

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Revenue Rule 92-61
Full-Time Resident Manager Unit

REVENUE RULE 92-61

1992-2 C.B. 7, 1992-32 I.R.B. 4.

Internal Revenue Service
Revenue Ruling

FULL-TIME RESIDENT MANAGER IN BUILDING ELIGIBLE FOR LOW-INCOME HOUSING CREDIT

Published: August 10, 1992

Section 42. Low-Income Housing Credit

(See Also Sections 103, 142; 1.103-8.)

Full-time resident manager in building eligible for low-income housing credit. The adjusted basis of a unit occupied by a full-time resident manager is included in the eligible basis of a qualified low-income building under section 42(d)(1) of the Code, but the unit is excluded from the applicable fraction under section 42(c)(1)(B) for purposes of determining the building's qualified basis.

ISSUE

If a unit in a qualified low-income building is occupied by a full-time resident manager, is the adjusted basis of that unit included in the building's eligible basis under section 42(d)(1) of the Internal Revenue Code and is that unit included in the applicable fraction under section 42(c)(1)(B) for determining the qualified basis of the building?

FACTS

At the beginning of 1990, LP, a limited partnership with a calendar tax year, placed in service a newly constructed apartment building that qualified for the low-income housing credit under section 42(a) of the Code. LP elected to meet the 40-60 test of section 42(g)(1)(B), which requires that at least 40 percent of the units in the building be rent-restricted and occupied by tenants whose incomes are 60 percent or less of area median gross income. Throughout 1990, the first year of the building's credit period, 69 of the 70 units in the building were rent-restricted and occupied by tenants whose incomes were 60 percent or less of area median gross income. The remaining unit in the building was occupied by a resident manager who was hired by LP to manage the building and to be on call to attend to the maintenance needs of the other tenants. All of the units in the building meet the same standard of quality and have the same amount of floor space.

LAW AND ANALYSIS

Section 42(a) of the Code provides that the amount of the low-income housing credit determined for any tax year in the credit period is an amount equal to the applicable percentage of the qualified basis of each low-income building.

Section 42(c)(1)(A) of the Code defines the qualified basis of any qualified low-income building for any tax year as an amount equal to the applicable fraction, determined as of the close of the tax year, of the eligible basis of the building, determined under section 42(d)(5).

Sections 42(c)(1)(B) of the Code defines the applicable fraction as the smaller of the unit fraction or the floor space fraction. Section 42(c)(1)(B) defines the unit fraction as the fraction the numerator of which is the number of low-income units in the building and the denominator of which is the number of residential rental units, whether or not occupied, in the building. Section 42(c)(1)(D) defines the floor space fraction as the fraction the numerator of which is the total floor space of the low-income units in the building and the denominator of which is the total floor space of the residential rental units, whether or not occupied, in the building. In general, under section 42(i)(3)(B), a low-income unit is any unit that is rent-restricted and occupied by individuals meeting the income limitation applicable to the building.

Section 42(d)(1) of the Code provides that the eligible basis of a new building is its adjusted basis as of the close of the first tax year of the credit period. Section 42(d)(4)(A) provides that, except as provided in section 42(d)(4)(B), the adjusted basis of any building is determined without regard to the adjusted basis of any property that is not residential rental property. Section 42(d)(4)(B) provides that the adjusted basis of any building includes the adjusted basis of property of a character subject to the allowance for depreciation used in common areas or provided as comparable amenities to all residential rental units in the building.

The legislative history of section 42 of the Code states that residential rental property, for purposes of the low-income housing credit, has the same meaning as residential rental property within section 103. The legislative history of section 42 further states that residential rental property thus includes residential rental units, facilities for use by the tenants, and other facilities reasonably required by the project. 2 H.R.Conf.Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89. Under section 1.103-8(b)(4) of the Income Tax Regulations, facilities that are functionally related and subordinate to residential rental units are considered residential rental property. Section 1.103-8(b)(4)(iii) provides that facilities that are functionally related and subordinate to residential rental units include facilities for use by the tenants, such as swimming pools and similar recreational facilities, parking areas, and other facilities reasonably required for the project. The examples given by section 1.103-8(b)(4)(iii) of facilities reasonably required for a project specifically include units for resident managers or maintenance personnel.

Accordingly, the unit occupied by LP's resident manager is residential rental property for purposes of section 42 of the Code. The adjusted basis of the unit is includible in the building's eligible basis under section 42(d)(1). The inclusion of the adjusted basis of the resident manager's unit in eligible basis will not be affected by a later conversion of that apartment to a residential rental unit.

The term "residential rental unit" has a narrower meaning under section 42 of the Code than residential rental property. As noted above, under the legislative history of section 42, residential rental property includes facilities for use by the tenants and other facilities reasonably required by the project, as well as residential rental units. Under section 1.103-8(b)(4) of the regulations, units for resident managers or maintenance personnel are not classified as residential rental units, but rather as facilities reasonably required by a project that are functionally related and subordinate to residential rental units.

LP's resident manager's unit is properly considered a facility reasonably required by the project, not a residential rental unit for purposes of section 42 of the Code. Consequently, the unit is not included in either the numerator or denominator of the applicable fraction under section 42(c)(1)(B) for purposes of determining the qualified basis of the building for the first year of the credit period.

Therefore, as of the end of the first year of the credit period, the adjusted basis of the unit occupied by LP's resident manager is included in the building's eligible basis under section 42(d)(1) of the Code, but the unit is excluded from the applicable fraction under section 42(c)(1)(B). Because all of the residential rental units in LP's building are low-income units, the applicable fraction for the building is "one" (69/69, using the unit fraction).

If in a later year of the credit period, the resident manager's unit is converted to a residential rental unit, the unit will be included in the denominator of the applicable fraction for that year. If the unit also becomes a low-income unit in that year, the unit will be included in the numerator of the applicable fraction for that year. In this case, the applicable fraction will also be "one" (70/70, using the unit fraction).

HOLDING

The adjusted basis of a unit occupied by a full-time resident manager is included in the eligible basis of a qualified low-income building under section 42(d)(1) of the Code, but the unit is excluded from the applicable fraction under section 42(c)(1)(B) for purposes of determining the building's qualified basis.

EFFECTIVE DATE

The Internal Revenue Service will not apply this revenue ruling to any building placed in service prior to September 9, 1992, or to any building receiving an allocation of credit prior to September 9, 1992, unless the owner files or has filed a return that is consistent with this ruling. Similarly, the Service will not apply this revenue ruling to any building described in section 42(h)(4)(B) of the Code with respect to which bonds were issued prior to September 9, 1992, unless the owner files or has filed a return that is consistent with this ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Paul F. Handleman of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Handleman on (202) 622-3040 (not a toll-free call).

Rev. Rul. 92-61, 1992-2 C.B. 7, 1992-32 I.R.B. 4.

Revenue Rule 94-57
Gross Rent Floor Selection

Rev. Proc. 94-57, 1994-2 CB 744--IRC Sec(s). 42

August 24, 1994

Part III Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part I, sections 42; 1.42-13(a).)

1. PURPOSE

This revenue procedure informs owners of qualified low-income housing projects and housing credit agencies (Agencies) when the gross rent floor in section 42(g)(2)(A) of the Internal Revenue Code takes effect.

2. BACKGROUND

On May 5, 1993, new area median gross income (AMGI) figures went into effect for the United States Department of Housing and Urban Development programs and other federal programs that use AMGI figures, including the section 42 low-income housing tax credit program. In some areas, the AMGI level fell below previous levels.

Section 42(g)(1) defines a qualified low-income housing project as any project for residential rental use that meets one of the following requirements: (A) 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of AMGI, as adjusted for family size, or (B) 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of AMGI, as adjusted for family size.

Section 42(g)(2)(A) provides that, under section 42(g)(1), a residential unit is rent-restricted if the gross rent for the unit does not exceed 30 percent of the imputed income limitation applicable to the unit. Under section 42(g)(2)(C), the imputed income limitation applicable to a unit is the income limitation that would apply under section 42(g)(1) to individuals occupying the unit if the number of individuals occupying the unit were as follows: (i) in the case of a unit that does not have a separate bedroom, one individual, or (ii) in the case of a unit that has one or more separate bedrooms, 1.5 individuals for each separate bedroom.

For calculating gross rent on a rent-restricted unit, section 7108(e)(2) of the Revenue Reconciliation Act of 1989, 1990-1 C.B. 214, 220, amended section 42(g)(2)(A) to provide that the amount of the income limitation under section 42(g)(1) applicable for any period is not less than the limitation applicable for the earliest period the building that contains the unit was included in the determination of whether the project is a qualified low-income housing project (the gross rent floor). Section 42(g)(3)(A) provides that, except as otherwise provided in section 42(g)(3), a building is treated as a qualified low-income building only if the project (of which the building is a part) meets the requirements of section 42(g)(1) not later than the close of the first year of the credit period for the building.

Section 42(h)(1)(A) provides that the amount of credit determined under section 42 for any taxable year for any building shall not exceed the housing credit dollar amount allocated to the building under section 42(h). Under section 42(m)(2)(A), the housing credit dollar amount allocated to a

project shall not exceed the amount an Agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period. Section 42(m)(2)(B) provides that in making the determination under section 42(m)(2)(A), an Agency shall consider (i) the sources and uses of funds and the total financing planned for the project, (ii) any proceeds or receipts expected to be generated by reason of tax benefits, (iii) the percentage of housing credit dollar amounts used for project costs other than the cost of intermediaries, and (iv) the reasonableness of the developmental and operational costs of the project. The gross rent under section 42(g)(2)(A) that a low-income housing project may generate is a source of funds an Agency must consider in making the determination under section 42(m)(2)(A).

Section 42(h)(4)(A) provides that section 42(h)(1) does not apply to the portion of any credit allowable under section 42(a) that is attributable to eligible basis financed by any obligation the interest on which is exempt from tax under section 103 if (i) the obligation is taken into account under section 146, and (ii) principal payments on the financing are applied within a reasonable period to redeem obligations the proceeds of which were used to provide the financing. Section 42(h)(4)(B) provides that for purposes of section 42(h)(4)(A), if 50 percent or more of the aggregate basis of any building and the land on which the building is located is financed by an obligation described in section 42(h)(4)(A), section 42(h)(1) does not apply to any portion of the credit allowable under section 42(a) for the building. Section 42(m)(2)(D) provides that section 42(h)(4) does not apply to any project unless the governmental unit that issued the bonds (or on behalf of which the bonds were issued) makes a determination under rules similar to the rules of section 42(m)(2)(A) and (B). Upon making this determination, an Agency will issue a "determination letter" to a building.

Under section 1.42-13(a) of the Income Tax Regulations, the Secretary may provide guidance through various publications in the Internal Revenue Bulletin to carry out the purposes of section 42.

3. SCOPE

This revenue procedure applies to Agencies and owners of qualified low-income housing projects, as defined by section 42(g)(1).

4. PROCEDURE

Except for a low-income building described in section 42(h)(4)(B) (a bond-financed building), the Internal Revenue Service will treat the gross rent floor in section 42(g)(2)(A) as taking effect on the date an Agency initially allocates a housing credit dollar amount to the building under section 42(h)(1). However, the Service will treat the gross rent floor as taking effect on a building's placed in service date if the building owner designates that date as the date on which the gross rent floor will take effect for the building. An owner must make this designation to use the placed in service date and inform the Agency that made the allocation to the building no later than the date on which the building is placed in service.

For a bond-financed building, the Service will treat the gross rent floor in section 42(g)(2)(A) as taking effect on the date an Agency initially issues a determination letter to the building. However, the Service will treat the gross rent floor as taking effect on a building's placed in service date if the building owner designates that date as the date on which the gross rent floor will take effect for the building. An owner must make this designation to use the placed in service date and inform the Agency that issued the determination letter to the building no later than the date on which the building is placed in service.

An Agency should establish a procedure that will allow an owner to inform the Agency of this designation no later than the date the owner's building is placed in service.

For the effect of a change in AMGI on the initial qualification of a tenant as a low-income tenant and the available unit rule, see Rev. Rul. 94-57.

5. EFFECTIVE DATE

This revenue procedure is effective for low-income housing projects receiving initial allocations or determination letters issued after * . For those projects that received initial allocations or determination letters prior to this effective date, for purposes of establishing the gross rent floor in section 42(g)(2)(A), owners and Agencies may use a date based on a reasonable interpretation of section 42.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jeffrey A. Erickson of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Erickson at (202) 6223040 (not a toll free call).

Revenue Rule 94-65
Signed Sworn Statements by Tenants to
Satisfy Documentation Requirements

Rev. Proc. 94-65, 1994-2 CB 798--IRC Sec(s). 42

October 11, 1994

1. Purpose

This revenue procedure informs housing credit agencies (Agency) and owners of qualified low-income housing projects (owners) when a signed, sworn statement by a low-income tenant will satisfy the documentation requirement of section 1.42-5(b)(1)(vii) of the Income Tax Regulations.

2. Background

Section 1.42-5 provides the minimum requirements that an Agency's compliance monitoring procedure must contain to satisfy its compliance monitoring duties under section 42(m)(1)(B)(iii). Section 1.42-5(b)(1)(vi) provides that an Agency must require an owner to keep records for each qualified low-income building in the project that show for each year in the compliance period the annual income certifications of each low-income tenant per unit. Section 1.42-5(b)(1)(vii) provides that an Agency must require an owner to keep documents for each qualified low-income building in its project for each year in the compliance period that support each low-income tenant's income certification. The term "low-income tenant" refers to the individuals occupying a rent-restricted unit in a qualified low-income housing project whose annual income satisfies the section 42(g)(1) income limitation elected by the owner of the project. Examples of the documentation required under section 1.42-5(b)(1)(vii) include a copy of the tenant's federal income tax return, Forms W2, or verifications of income from third parties such as employers or state agencies paying unemployment compensation. A verification of income from a third party is referred to as a "third party verification."

The Internal Revenue Service has determined that an owner may satisfy the documentation requirement of section 1.42-5(b)(1)(vii) for a low-income tenant's income from assets by obtaining a signed, sworn statement from the tenant or prospective tenant if (1) the tenant's or prospective tenant's Net Family assets do not exceed \$5,000, and (2) the tenant or prospective tenant provides a signed, sworn statement to this effect to the building owner. See H.R. Conf. Rep. No. 213, 103d Cong., 1st Sess. 544 (1993).

3. Scope

This revenue procedure applies to Agencies and owners of qualified low-income housing projects.

4. Procedure

.01 To determine a tenant's Net Family assets, owners and Agencies must use the definition of "Net Family assets" in 24 CFR 813.102, which provides definitions for the H.U.D. section 8 program.

.02 Except as provided in sections 4.03 and 4.04 of this revenue procedure, an Agency's monitoring procedure may provide that an owner may satisfy the documentation requirement for income from assets in section 1.42-5(b)(1)(vii) for a low-income tenant

whose Net Family assets do not exceed \$5,000 by annually obtaining a signed, sworn statement that includes the following:

- (1) That the tenant's Net Family assets do not exceed \$5,000, and
- (2) The tenant's annual income from Net Family assets.

.03 An Agency's monitoring procedure, however, may not permit an owner to rely on a low-income tenant's signed, sworn statement of annual income from assets if a reasonable person in the owner's position would conclude that the tenant's income is higher than the tenant's represented annual income. In this case, the owner must obtain other documentation of the low-income tenant's annual income from assets to satisfy the documentation requirement in section 1.42-5(b)(1)(vii). .04 An Agency's monitoring procedure may continue to require that an owner obtain documentation, other than the statement described in section 4.02 of this revenue procedure, to support a low-income tenant's annual certification of income from assets.

5. Effective Date

This revenue procedure is effective October 11, 1994.

Drafting Information

The principal author of this revenue procedure is Jeffrey A. Erickson of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Erickson at (202) 6223040 (not a toll-free call).

Revenue Rule 95-28
Major Disaster Declarations

Rev. Proc. 95-28, 1995-1 CB 704--IRC Sec(s). 42

May 31, 1995

1. Purpose

This revenue procedure establishes the process under which temporary relief will be granted from certain provisions of section 42 of the Internal Revenue Code to owners of low-income housing projects (owners) and housing credit agencies (Agencies) in major disaster areas.

2. Background

Under section 1.42-13(a) of the Income Tax Regulations, the Secretary may provide guidance to carry out the purposes of section 42 through various publications in the Internal Revenue Bulletin. In the past, for owners and Agencies in certain major disaster areas, the Service has published notices that granted temporary relief from specific requirements of section 42. See Notice 92-43, 1992-2 C.B. 373; Notice 94-63, 1994-1 C.B. 373; and Notice 94-94, 1994-2 C.B. 564. To further the purposes of section 42, this revenue procedure establishes a procedure that provides for temporary relief from certain requirements of section 42 for owners and Agencies in major disaster areas.

3. Scope

This revenue procedure applies to Agencies and owners of low-income housing projects in major disaster areas.

4. Major Disaster Area

When a disaster occurs that warrants assistance from the federal government, the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the Stafford Act), Title 42 U.S.C. 5121-5201 (1988 & Supp. IV 1992), authorizes the President to issue a major disaster declaration for the affected area. When the President issues such a declaration, the Federal Emergency Management Agency (FEMA) publishes a notice in the Federal Register designating the particular cities and/or counties covered by the President's major disaster declaration. Under this revenue procedure, a city and/or county so designated by FEMA under the President's major disaster declaration is a major disaster area.

5. Relief for Carryover Allocations

A carryover allocation is an allocation of housing tax credits made in a year before the project is placed in service. .01 If an owner of a project located in a major disaster area has a carryover allocation during the year in which the area is declared a major disaster area, the Service will treat the owner as having satisfied the 10 percent basis requirement of section 42(h)(1)(E)(ii) if the owner incurs more than 10 percent of the owner's reasonably expected basis in the project (land and depreciable basis) by June 30 of the year following the year in which the carryover allocation for the project is made. See section 1.42-6 for specific rules on carryover allocations. .02 If an owner of a project located in a major disaster area has a carryover allocation and the area is declared a major disaster area during the 2-year period described in section 42(h)(1)(E)(i), the Service will treat the owner as having satisfied the applicable placed in service requirement if the owner places the project in service by December 31 of the year following the end of the 2-year period. See section 1.42-6 for specific rules on carryover allocations.

.03 If an owner obtains the relief provided in section 5.01 of this revenue procedure but fails to satisfy the

10 percent basis requirement of section 42(h)(1)(E)(ii) by June 30 of the year following the year in which the Agency issued the carryover allocation for the project, the Service will treat the carryover allocation credit amount as a credit returned to the Agency on July 1 of the year following the year in which the carryover allocation was made. .04 If an owner obtains the relief provided in section 5.02 of this revenue procedure but fails to satisfy the placed in service requirement of section 42(h)(1)(E)(i) by the close of the calendar year following the end of the 2-year period of section 42(h)(1)(E)(i), the Service will treat the carryover allocation credit amount as a credit returned to the allocating Agency on January 1 of the second year following the 2-year period of section 42(h)(1)(E)(i). See section 1.42-14 for specific rules on returned credits.

Sec. 6 Procedure to Obtain Carryover Allocation Relief

.01 An owner of a project may obtain the carryover allocation relief described in section 5.01 or 5.02 of this revenue procedure only if the owner receives approval for the relief from the Agency that issued the carryover allocation for the owner's project. .02 The Agency may approve the carryover allocation relief provided in section 5.01 and 5.02 of this revenue procedure only for projects whose owners cannot reasonably satisfy the deadlines of section 42(h)(1)(E) because of a disaster that caused a major disaster declaration under the Stafford Act. An Agency may make this determination on an individual project basis or may determine, because of the extent of the damage in a major disaster area, that all project owners or a group of project owners in the major disaster area warrant the relief provided in section 5.01 and 5.02 of this revenue procedure. .03 An Agency that chooses to approve the relief provided in section 5.01 and 5.02 of this revenue procedure must do so before filing the Form 8610, Annual Low-Income Housing Credit Agencies Report, that covers the preceding calendar year. The Form 8610 is due by February 28 of the year following the year to which the Form 8610 applies. .04 An Agency that approves the relief provided in section 5.01 and 5.02 of this revenue procedure must attach to the Form 8610 a list of the projects for which it has approved relief. The Agency should list only those projects, including projects granted relief in January and February of the year in which the Agency files the Form 8610, that had received its approval of the carryover allocation relief provided in section 5.01 and 5.02 of this revenue procedure since the Agency last filed the Form 8610.

7. Recapture Relief

.01 Under section 42(j)(4)(E), an owner of a building (1) that is beyond the first year of the credit period and (2) that, because of a disaster that caused the President to issue a major disaster declaration, has suffered a reduction in qualified basis that would cause it to be subject to recapture or loss of credit will not be subject to recapture or loss of credit if the building's qualified basis is restored within a reasonable period. The Agency that monitors the project for compliance with section 42 may determine what constitutes a reasonable period, but in no instance will it end later than 24 months after the end of the calendar year in which the President issued a major disaster declaration for the area where the building is located. .02 To determine the credit amount allowable during the reconstruction or replacement period, an owner of a building described in section 7.01 of this revenue procedure must use the building's qualified basis at the end of the taxable year that preceded the President's major disaster declaration. .03 Section 1.42-5(c)(1) requires an owner to report any reduction in qualified basis to the Agency that monitors the building for compliance with section 42 whether or not an owner obtains the relief provided in section 7.01 of this revenue procedure. .04 As part of its review procedure adopted under section 1.42-5(c)(2), an Agency must determine whether the owner of a building described in section 7.01 of this revenue procedure has restored its project's qualified basis by the end of the reasonable period determined by the Agency. The Agency must report on Form 8823, Low-Income Housing Credit Agency Report of Noncompliance, any failure to restore qualified basis within such period.

8. Compliance Monitoring Relief

An Agency will have until December 31 of the second year following the end of the calendar year in which a major disaster occurred to meet the section 1.42-5 compliance monitoring requirements applicable to it for an owner affected by the major disaster. The granting of compliance monitoring relief to an Agency does not extend the compliance monitoring deadlines for owners of projects in major disaster areas. If an Agency discovers that an owner has failed to comply with the rules of section 42 because of a major disaster, the Agency must report on the Form 8823 how the major disaster contributed to the noncompliance.

9. Other Relief

Under the authority granted in section 42(n) and in accordance with section 1.42-13(a), the Service will consider granting relief similar to that described in section 5.01, 5.02, or 7.01 of this revenue procedure for situations that are brought to its attention and not covered by this revenue procedure.

10. Effective Date

This revenue procedure is effective for a major disaster declaration issued by the President under the Stafford Act on or after January 1, 1995.

Drafting Information

The principal author of this revenue procedure is Jeffrey A. Erickson of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Jack Malgeri at (202) 622-3040 (not a toll free call).

Revenue Procedure 2004-38
Annual Recertification Waiver

Rev. Proc. 2004-38, 2004-27 I.R.B.

Part III

Administrative, Procedural, and Miscellaneous

22 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, ' 42; 1.42-5.)

Rev. Proc. 2004-38

SECTION 1. PURPOSE

This revenue procedure informs owners of qualified low-income housing projects how to obtain the waiver from the Internal Revenue Service of the annual recertification of tenant income (waiver) provided in ' 42(g)(8)(B) of the Internal Revenue Code.

SECTION 2. BACKGROUND

Section 1.42-5 of the Income Tax Regulations provides the minimum requirements that a housing credit agency's (Agency=s) compliance monitoring procedure must contain to satisfy its compliance monitoring duties under ' 42(m)(1)(B)(iii). Section 1.42-5(b)(1)(vi) provides that an Agency must require an owner to keep records for each qualified low-income building in the project that show for each year in the compliance period the annual income certifications of each low-income tenant per unit. Section 1.42-5(b)(1)(vii) provides

that an Agency must require an owner to keep documents for each qualified low-income building in its project for each year in the compliance period that support each low-income tenant's income certification. Section 1.42-5(c)(1)(iii) provides that an Agency must require an owner to certify at least annually that, for the preceding 12-month period, the owner has received an annual income certification from each low-income tenant and documentation supporting that certification.

Section 42(g)(8)(B) provides that on application by the taxpayer, the Secretary may waive any annual recertification of tenant income for purposes of § 42(g) if the entire building is occupied by low-income tenants (a 100 percent low-income building). Low-income tenants are individuals occupying a rent-restricted unit in a qualified low-income housing project whose combined income satisfies the § 42(g)(1) income limitation elected by the owner of the project.

SECTION 3. SCOPE

This revenue procedure applies to Agencies and owners of qualified low-income housing projects that consist entirely of 100 percent low-income buildings.

SECTION 4. PROCEDURE FOR OBTAINING A WAIVER UNDER § 42(g)(8)(B)

An owner applying for the waiver for its 100 percent low-income building must (1) complete and sign the applicable portions of the Form 8877, Request for Waiver of Annual Recertification Requirement for the Low-Income Housing Credit, (2) have the Agency responsible for monitoring the building for compliance with § 42 sign the applicable portion of the form, and (3) file the form with the Service pursuant to the instructions accompanying the form. A copy of the 2004 version of Form 8877 is included in the

appendix to this revenue procedure. The Service will notify the owner whether the request for waiver has been approved or denied. See section 5.02 of this revenue procedure for the period the waiver is in effect.

SECTION 5. EFFECT OF OBTAINING A WAIVER UNDER § 42(g)(8)(B)

.01 If an owner of a 100 percent low-income building obtains a waiver of the annual income recertification from the Service, the owner will be exempt from the recertification requirements of § 1.42-5(b)(1)(vi) and (vii) and § 1.42-5(c)(1)(iii). As a result, the owner is not required under those sections to (1) keep records that show an annual income recertification of all the low-income tenants in the building who have previously had their annual income verified, documented, and certified; (2) maintain documentation to support that recertification; or (3) certify to the Agency responsible for monitoring the building for compliance with § 42 that it has received this information.

.02 The waiver takes effect on the date the Service approves the waiver. Once the waiver takes effect, it remains in effect until the end of the 15-year compliance period (defined in § 42(i)(1)), unless the waiver is revoked, in which case the waiver ceases to be in effect on the date of revocation. See sections 5.04 and 5.05 of this revenue procedure regarding revocations.

.03 Obtaining the waiver will not prevent an owner from having to produce documentation to verify the owner's compliance with § 42 upon an examination of the owner's federal income tax return. Thus, for example, the owner must keep records and documentation that show the income of tenants upon initial occupancy of any residential unit in the building. In addition, except as provided in section 5.01 of this revenue

procedure, obtaining the waiver will not prevent an owner from having to satisfy the requirements of the compliance monitoring procedure adopted by the Agency responsible for monitoring the building for compliance with ' 42.

.04 The Service may revoke the waiver if the building ceases to be a 100 percent low-income building or if the Service determines that an owner has violated ' 42 in a manner that is sufficiently serious to warrant revocation. In any case, the Service will revoke the waiver if the Agency requests, in accordance with the instructions to Form 8877, that the Service revoke the waiver.

.05 A waiver will be automatically revoked if there is a change in the ownership for federal tax purposes of the 100 percent low-income building (including a change resulting from a termination of a partnership under ' 708). In this case, the owner that received the waiver must notify the Service of the revocation in accordance with the instructions to Form 8877. The new owner may apply for a waiver.

.06 An Agency's compliance monitoring procedure will not fail to satisfy ' 42(m)(1)(B)(iii) solely because the 100 percent low-income buildings to which the waiver applies have been exempted from the recertification requirements of ' 1.42-5(b)(1)(vi) and (vii) and ' 1.42-5(c)(1)(iii). Nonetheless, the Agency's compliance monitoring procedure must continue to require that an owner satisfy the requirements in ' 1.42-5(b)(1)(vi) and (vii) and ' 1.42-5(c)(1)(iii) upon a tenant's initial occupancy of any residential rental unit in the building.

.07 A 100 percent low-income building to which the waiver applies continues to be subject to the review requirements of ' 1.42-5(c)(2).

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 94-64, 1994-2 C.B. 797, is superseded. Waivers obtained under Rev. Proc. 94-64 are not affected by this revenue procedure.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for applications filed on or after July 6, 2004.

DRAFTING INFORMATION

The principal author of this revenue procedure is David Selig of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Selig at (202) 622-3040 (not a toll-free call).

APPENDIX

2004 Version of Form 8877

Revenue Procedure 2004-82
Questions and Answers about the LIHTC

Part I

Section 42.--Low-Income Housing Credit (Also §§1.42-5, 1.42-15, 1.103-8.)

Rev. Rul. 2004-82

PURPOSE

This revenue ruling answers certain questions about the low-income housing credit under § 42 of the Internal Revenue Code.

LAW AND QUESTIONS AND ANSWERS

A. ELIGIBLE BASIS AND QUALIFIED BASIS ISSUES

Law

Section 42(a) provides for a credit for investment in certain low-income housing buildings. The amount of the low-income housing credit for any taxable year in the credit period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building (as defined in §42(c)(2)).

Section 42(c)(1)(A) provides that the qualified basis of any qualified low-income building for any taxable year is an amount equal to (i) the applicable fraction (determined as of the close of the taxable year) of (ii) the eligible basis of the building (determined under § 42(d)).

Section 42(c)(1)(B) defines the applicable fraction as the smaller of the unit fraction or the floor space fraction. Section 42(c)(1)(C) defines the unit fraction as the fraction the numerator of which is the number of low-income units (as defined in §42(i)(3)(A)) in the building and the denominator of which is the number of residential rental units (that is, all units in the building which are available to rent as personal residences), whether or not occupied, in the building. Section 42(c)(1)(D) defines the floor space fraction as the fraction the numerator of which is the total floor space of the low-income units in the building and the denominator of which is the total floor space of the residential rental units, whether or not occupied, in the building.

Section 42(d)(1) provides that the eligible basis of a new building is its adjusted basis as of the close of the first taxable year of the credit period. Section 42(d)(4)(A) provides that, except as provided in §42(d)(4)(B) and (C), the adjusted basis of any building is determined without regard to the adjusted basis of any property that is not residential rental property. Section 42(d)(4)(B) provides that the adjusted basis of any building includes the adjusted basis of property of a character subject to the allowance for depreciation (1) used in common areas or (2) provided as comparable amenities to all residential rental units in the building.

Section 42(d)(4)(C)(i) provides that the adjusted basis of any building located in a qualified census tract is determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation and not otherwise taken into account) used throughout the taxable year in providing any community service facility. Section 42(d)(4)(C)(iii) provides that the term "community service facility" means any facility designed to serve primarily individuals whose income is 60

percent or less of area median income (AMGI) (within the meaning of §42(g)(1)(B)). Section 42(d)(5)(C)(ii)(I) defines the term "qualified census tract" as any census tract (1) which is designated by the Secretary of Housing and Urban Development (HUD), and (2) for the most recent year for which census data are available on household income in the tract, either in which 50 percent or more of the households have an income which is less than 60 percent of the AMGI for the year or which has a poverty rate of at least 25 percent. See <http://www.huduser.org/datasets/qct.html> for a listing of census tracts designated by the Secretary of HUD.

Section 42(d)(4)(C)(ii) provides that the increase in the adjusted basis of any building which is taken into account because of a community service facility may not exceed 10 percent of the eligible basis of the qualified low-income housing project (as defined in §42(g)(1)) of which the community service facility is a part. For this purpose, §42(d)(4)(C)(ii) provides that all community service facilities which are part of the same qualified low-income housing project are treated as one facility.

Rev. Rul. 2003-77, 2003-29 I.R.B. 75, provides that the requirement that a community service facility must be designed to serve primarily individuals whose income is 60 percent or less of AMGI will be satisfied if the following conditions are met. First, the facility must be used to provide services that will improve the quality of life for community residents. Second, the taxpayer must demonstrate that the services provided at the facility will be appropriate and helpful to individuals in the area of the project whose income is 60 percent or less of AMGI. This may, for example, be demonstrated in the market study required to be conducted under § 42(m)(1)(A)(iii), or another similar study. Third, the facility must be located on the same tract of land as one

of the buildings that is part of the qualified low-income housing project. Finally, if fees are charged for services provided, they must be affordable to individuals whose income is 60 percent or less of AMGI.

The legislative history of §42 states that residential rental property for purposes of the low-income housing credit has the same meaning as residential rental property for purposes of § 103. The legislative history of §42 further states that residential rental property includes residential rental units, facilities for use by the tenants, and other facilities reasonably required by the project. H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89.

In the Tax Reform Act of 1986 (the "1986 Act"), Congress reorganized §§103 and 103A of the Internal Revenue Code of 1954 (the "1954 Code") regarding tax-exempt bonds into §§103 and 141 through 150 of the Internal Revenue Code of 1986. Congress intended that to the extent not amended by the 1986 Act, all principles of pre-1986 Act law would continue to apply to the reorganized provisions. H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-686 (1986), 1986-3 (Vol. 4) C.B. 686. Because no regulations have been promulgated relating to residential rental property for purposes of §103, the regulations relating to residential rental property promulgated pursuant to the 1954 Code continue to apply except as otherwise modified by the 1986 Act and subsequent law.

Under § 1.1038(b)(4)(i) of the Income Tax Regulations, facilities that are functionally related and subordinate to residential rental projects are considered residential rental property. Section 1.1038(b)(4)(iii) provides that functionally related and subordinate facilities include facilities for use by the tenants, such as swimming pools

and other recreational facilities, parking areas, and other facilities reasonably required for the project. Examples in § 1.1038(b)(4)(iii) of facilities reasonably required for a project include units for resident managers or maintenance personnel.

Q-1.

A new qualified low-income building (Building) is located in an area in which owners of apartment buildings typically employ security officers due to the level of crime in the area.

(a) If a unit in Building is occupied by a full-time security officer for that building and Building's owner requires the security officer to live in the unit, is the adjusted basis of that unit includable in Building's eligible basis under §42(d)(1)?

(b) If yes, is that unit a residential rental unit includable in the numerator and denominator of Building's applicable fraction under § 42(c)(1)(B)?

A-1.

(a) Yes. The legislative history of §42 indicates that residential rental property includes, in addition to the residential rental units, facilities for use by the tenants and other facilities reasonably required by the project.

Under §1.103-8(b)(4)(iii), functionally related and subordinate property is property that is reasonably required for the project. Examples of functionally related and subordinate property are units for resident managers or maintenance personnel. See §1.103-8(b)(4)(iii). Thus, while units for resident managers or maintenance personnel are not residential rental units, they are treated as part of residential rental property because these units are functionally related and subordinate to the project. The unit occupied by a full-time security officer is similar to the units described in the examples

contained in § 1.103-8(b)(4)(iii), and is reasonably required by the project because of the level of crime in the area. Thus, the unit is functionally related and subordinate to Building. As a result, the unit is residential rental property for purposes of §42 and its adjusted basis is includable in Building's eligible basis under § 42(d)(1).

(b) No. The term "residential rental unit" has a different meaning than the term "residential rental property" for purposes of §42. Under §1.103-8(b)(4)(iii), units for resident managers or maintenance personnel are residential rental property because they are functionally related and subordinate to residential rental projects, not because they are residential rental units. Similarly, a unit occupied by a full-time security officer is not a residential rental unit. Only residential rental units are includable in Building's applicable fraction under § 42(c)(1)(B).

If in a later year of the credit period, the unit occupied by the full-time security officer is converted to a residential rental unit, the unit will be includable in the denominator of Building's applicable fraction for that year. If the unit also becomes a low-income unit in a later year, the unit will be includable in the numerator of Building's applicable fraction for that year.

Q-2.

A new qualified low-income building (Building) received a housing credit allocation on June 1, 2003, and was placed in service in 2004. Building is located in a qualified census tract (as defined in §42(d)(5)(C)). The neighborhood in which Building is located is an area with a high rate of crime. In 2004, the local police department leases a unit in Building to be used as a police substation (Facility). The Facility is part of the police department's community outreach program. This Facility is intended to

serve as a deterrent to crime in the community, assist the community with solving crime-related problems, reduce the response time to area calls for service, and provide the locally assigned police officers with a local office. The services provided by the police are free of charge. The adjusted basis of the property constituting the Facility (of a character subject to the allowance for depreciation and not otherwise taken into account in the adjusted basis of Building) does not exceed 10 percent of the eligible basis of Building.

As required by § 42(m)(1)(A)(iii), prior to the allocation of low-income housing credit to Building, a comprehensive market study was conducted to assess the housing needs of the low-income individuals in the area to be served by Building. The study found, among other items, that due to the high rate of crime in the community in which Building is located, providing a police substation would be appropriate and helpful to individuals in the area of Building whose income is 60 percent or less of AMGI.

(a) Is the adjusted basis of the Facility includable in Building's eligible basis under § 42(d)(1)?

(b) If yes, is the Facility includable in Building's applicable fraction under § 42(c)(1)(B)?

A-2.

(a) Yes. The Facility qualifies as a community service facility under §42(d)(4)(C)(iii). Under the facts presented, the Facility is designed to serve primarily individuals whose income is 60 percent or less of AMGI for the following reasons: (1) the services provided at the Facility are services that will help improve the quality of life for community residents; (2) the market study required to be conducted under §

42(m)(1)(A)(iii) found that the services provided at the Facility would be appropriate and helpful to individuals in the area of Building whose income is 60 percent or less of AMGI; (3) the Facility is located within Building; and (4) the services provided at the Facility are affordable to individuals whose income is 60 percent or less of AMGI.

Because the other requirements set forth in § 42(d)(4)(C) are met, the adjusted basis of Building will be determined by taking into account the adjusted basis of the Facility. Thus, the adjusted basis of the Facility is includable in Building's eligible basis.

(b) No. The Facility is not a residential rental unit for purposes of §42. Therefore, the Facility is not includable in either the numerator or denominator of Building's applicable fraction.

Q-3.

On applying to the housing credit agency for an allocation of §42 credits for a new building, the housing credit agency requires that the applicant pay a nonrefundable application fee. If the applicant is successful, an allocation fee is payable to the housing credit agency. Are the application fee and allocation fee includable in the eligible basis of the applicant's low-income housing building?

A-3.

No. The application fee and allocation fee are not includable in the eligible basis of the applicant's low-income housing building because the fees are not capitalizable into the adjusted basis of the building. See §263 and §263A. However, depending on the facts and circumstances, all or a portion of these fees may be required to be capitalized as amounts paid to create an intangible asset. See § 1.263(a)-4. Any portion of these fees not required to be capitalized under § 1.263(a)-4 may be deductible as an

ordinary and necessary expense under § 162 or § 212, provided the taxpayer satisfies the requirements of those sections.

B. FIRST-YEAR LOW-INCOME UNIT ISSUE

Law

Section 42(i)(3)(A) defines "low-income unit" as any unit in a building if (i) the unit is rent-restricted (as defined in §42(g)(2)), and (ii) the individuals occupying the unit meet the income limitation applicable under §42(g)(1) to the project of which the building is a part (individuals that meet the applicable income limitation are referred to as "income-qualified"). Section 42(i)(3)(B) provides that a unit will not be treated as a low-income unit unless the unit is suitable for occupancy and used other than on a transient basis.

Section 42(f)(1) defines the "credit period" for a low-income housing credit building as the period of 10 taxable years beginning with (A) the taxable year in which the building is placed in service or (B) at the election of the taxpayer, the succeeding taxable year, but in either case only if the building is a qualified low-income building as of the close of the first year of the period.

Section 42(f)(2)(A) provides a special rule for determining the amount of the low-income housing credit allowable for the first year of the credit period. It provides that the credit allowable under §42(a) with respect to any building for the first taxable year of the credit period must be determined by substituting for the applicable fraction under § 42(c)(1) the fraction (i) the numerator of which is the sum of the applicable fractions determined under § 42(c)(1) as of the close of each full month of the first taxable year of

the credit period during which the building was in service, and (ii) the denominator of which is 12.

Q-4.

On initial occupancy of a unit in the first year of a newly constructed building's credit period, an income-qualified tenant moved into the unit on the last day of a month. The unit was rent-restricted in accordance with §42(g)(2). In determining the low-income housing credit for the building for the first year of the credit period, is the unit treated as a low-income unit for that month for purposes of the fraction calculated under §42(f)(2)(A)?

A-4.

Yes. The unit is treated as a low-income unit eligible for inclusion in the numerator and denominator of the monthly applicable fraction calculated under § 42(f)(2)(A)(i) if the tenant, who meets the income limitation under §42(g)(1), resides in the rent-restricted unit on the last day of the month. However, in accordance with § 42(f)(2)(A), the building must have been placed in service for a full month for the unit to be includable in the numerator and denominator of the monthly applicable fraction.

C. EXTENDED LOW-INCOME HOUSING COMMITMENT ISSUE

Law

Section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless an extended low-income housing commitment (as defined in §42(h)(6)(B)) is in effect as of the end of the taxable year. Section 42(h)(6)(B)(i) provides that "the term "extended low-income housing commitment" means any agreement between the taxpayer and the housing credit agency which

requires that the applicable fraction (as defined in §42(c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in the agreement and which prohibits the actions described in subclauses (I) and (II) of §42(h)(6)(E)(ii)" (emphasis added).

Section 42(h)(6)(E)(ii) provides that the termination of an extended low-income housing commitment under §42(h)(6)(E)(i) will not be construed to permit before the close of the 3-year period following the termination (I) the eviction or termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or (II) any increase in the gross rent with respect to a low-income unit not otherwise permitted under §42.

Section 42(h)(6)(D) defines the term "extended use period" as the period beginning on the first day in the compliance period on which the building is part of a qualified low-income housing project and ending on the later of (1) the date specified by the agency in the extended low-income housing commitment, or (2) the date which is 15 years after the close of the compliance period.

Section 42(h)(6)(J) provides that if, during a taxable year, there is a determination that a valid extended low-income housing commitment was not in effect as of the beginning of the year, the determination will not apply to any period before that year and §42(h)(6)(A) will be applied without regard to the determination provided that the failure is corrected within 1 year from the date of the determination.

In the Omnibus Budget Reconciliation Act of 1990, 1991-2 C.B. 481, 531 (the "1990 Act"), Congress amended §42(h)(6)(B)(i) by adding the language emphasized above, which prohibits the actions described in subclauses (I) and (II) of §

42(h)(6)(E)(ii). At the time of this amendment, however, §42(h)(6)(E)(ii) was already part of §42.

The legislative history to §42 states that the extended low-income housing commitment must prohibit the eviction or termination of tenancy (other than for good cause) of an existing tenant of a low-income unit or any increase in the gross rent inconsistent with the rent restrictions on the unit. H. Rep. No. 894, 101st Cong., 2d Sess. 10, 13 (1990).

Q-5.

Must the extended low-income housing commitment prohibit the actions described in subclauses (I) and (II) of §42(h)(6)(E)(ii) only for the 3-year period described in §42(h)(6)(E)(ii)?

A-5.

No. Section 42(h)(6)(B)(i) requires that an extended low-income housing commitment include a prohibition during the extended use period against (1) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit (no-cause eviction protection) and (2) any increase in the gross rent with respect to the unit not otherwise permitted under §42. When Congress amended §42(h)(6)(B)(i) to add the language emphasized above, §42(h)(6)(E)(ii) was already part of §42. As a result, Congress must have intended the amendment to §42(h)(6)(B)(i) to add an additional requirement beyond what was contained in §42(h)(6)(E)(ii), which already prohibited the actions described in that section for the 3 years following the termination of the extended use period. Because the requirements of §42(h)(6)(B)(i) otherwise apply for the extended use period, Congress must have

intended the addition of the prohibition against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) to apply throughout the extended use period.

If it is determined by the end of a taxable year that a taxpayer's extended low-income housing commitment for a building does not meet the requirements for an extended low-income housing commitment under §42(h)(6)(B) (for example, it does not provide no-cause eviction protection for the tenants of low-income units throughout the extended use period), the low-income housing credit is not allowable with respect to the building for the taxable year, or any prior taxable year. However, if the failure to have a valid extended low-income housing commitment in effect is corrected within 1 year from the date of the determination, the determination will not apply to the current year of the credit period or any prior year.

Pursuant to this revenue ruling, each housing credit agency is required to review its extended low-income housing commitments for compliance with the interpretation of § 42(h)(6)(B)(i) provided in this question and answer. This review must be completed by December 31, 2004. If during the review period the housing credit agency determines that an extended low-income housing commitment is not in compliance with the interpretation of §42(h)(6)(B)(i) provided in this question and answer, the 1-year period described under §42(h)(6)(J) will commence on the date of that determination.

D. HOME INVESTMENT PARTNERSHIP ACT LOAN ISSUES

Law

Section 42(b)(2)(A) provides that for a qualified low-income building placed in service by the taxpayer after 1987, the term "applicable percentage" means (1) the 70-percent present value credit under §42(b)(2)(B)(i) for new buildings which are not

federally subsidized, and (2) the 30-percent present value credit under §42(b)(2)(B)(ii) for new buildings which are federally subsidized and for existing buildings.

In general, §42(d)(5)(C)(i) provides that in the case of any building located in a designated qualified census tract or difficult development area (as defined in § 42(d)(5)(C)(ii) and (iii)), (I) the eligible basis of a new building will be 130 percent of the eligible basis determined without regard to this rule, and (II) in the case of an existing building, the rehabilitation expenditures taken into account under §42(e) will be 130 percent of the expenditures determined without regard to this rule.

Section 42(g)(1) defines the term "qualified low-income housing project" as any project for residential rental property if the project meets the requirements of § 42(g)(1)(A) or (B), whichever the taxpayer elects. The election is irrevocable. The project meets the requirements of §42(g)(1)(A) if 20 percent or more of the residential units in the project are rent-restricted and occupied by individuals whose income is 50 percent or less of AMGI. The project meets the requirements of §42(g)(1)(B) if 40 percent or more of the residential units in the project are rent-restricted and occupied by individuals whose income is 60 percent or less of AMGI. The requirement a taxpayer elects is referred to as the "minimum set-aside" for the project.

Section 42(g)(2)(A) provides that for purposes of §42(g)(1), a residential unit is rent-restricted if the gross rent with respect to the unit does not exceed 30 percent of the imputed income limitation applicable to the unit.

Section 42(g)(2)(C) provides that the imputed income limitation applicable to a unit is the income limitation which would apply under §42(g)(1) to individuals occupying the unit if the number of individuals occupying the unit were: (i) in the case of a unit

which does not have a separate bedroom, 1 individual; and (ii) in the case of a unit which has one or more separate bedrooms, 1.5 individuals for each separate bedroom.

Section 42(g)(3)(A) provides that a building will be treated as a qualified low-income building only if the project (of which the building is a part) meets the requirements of §42(g)(1) not later than the close of the first year of the credit period for the building.

Section 42(i)(2)(A) provides that for purposes of §42(b)(1), a new building will be treated as federally subsidized for any taxable year if, at any time during the taxable year or any prior taxable year, there is or was outstanding any obligation the interest on which is exempt from tax under §103, or any below market Federal loan, the proceeds of which are or were used (directly or indirectly) with respect to the building or operation thereof.

Section 42(i)(2)(B) provides that a loan or tax-exempt obligation will not be taken into account under §42(i)(2)(A) if the taxpayer elects to exclude from eligible basis of the building for purposes of §42(d), in the case of a loan, the principal amount of the loan, and in the case of a tax-exempt obligation, the proceeds of the obligation.

Section 42(i)(2)(C) provides that §42(i)(2)(A) will not apply to any tax-exempt obligation or below market Federal loan used to provide construction financing for any building if (i) the obligation or loan (when issued or made) identified the building for which the proceeds of the obligation or loan would be used, and (ii) the obligation is redeemed, and the loan is repaid, before the building is placed in service.

Section 42(i)(2)(D) provides that the term "below market Federal loan" means any loan funded in whole or in part with Federal funds if the interest rate payable on the

loan is less than the applicable Federal rate (AFR) in effect under §1274(d)(1) (as of the date the loan was made).

Section 42(i)(2)(E)(i) generally provides that assistance provided under the HOME Investment Partnerships Act (HOME) with respect to any building will not be treated as a below market Federal loan under § 42(i)(2)(D) if 40 percent or more of the residential units in the building are occupied by individuals whose income is 50 percent or less of AMGI (the special set-aside). Section 42(d)(5)(C) (the 130 percent eligible basis increase) does not apply to any building to which the preceding sentence applies.

Q-6.

Taxpayer owns a new qualified low-income housing project consisting of Buildings 1 and 2, each containing 100 residential rental units. Forty percent of the units in each building are low-income units. Taxpayer elected the minimum set-aside for the project under §42(g)(1)(B). Also, Taxpayer elected on Form 8609, Low-Income Housing Credit Allocation Certification, to treat the buildings as part of a multiple building project. A HOME loan at less than the AFR was provided with respect to the project.

(a) How does the special set-aside under §42(i)(2)(E)(i) apply to qualify Buildings 1 and 2 for the 70-percent present value credit under §42(b)?

(b) What rent restriction applies to the low-income units used to satisfy the special set-aside under §42(i)(2)(E)(i)?

A-6.

(a) To qualify the project for the 70-percent present value credit, Taxpayer must rent at least 40 units in each of Buildings 1 and 2 to tenants whose income is 50 percent or less of AMGI throughout the 15-year compliance period because the rule under

§42(i)(2)(E)(i) applies on a building-by-building basis. Because these units are to be low-income units and Taxpayer elected the minimum set-aside under § 42(g)(1)(B), the same units used to satisfy the special set-aside under §42(i)(2)(E)(i) will also satisfy the project's minimum set-aside.

(b) The rent restriction that applies for all of the low-income units in the project, including the units in Buildings 1 and 2 which are used to satisfy the special set-aside under § 42(i)(2)(E)(i), is based on the applicable income limitation under § 42(g)(1)(B) because §42(g)(2)(C) contains no exception for buildings that satisfy the special set-aside contained in §42(i)(2)(E)(i). Therefore, the imputed income limitation (as defined in §42(g)(2)(C)) applicable to the units in this project is 60 percent of AMGI. Under §42(g)(2), rent may not exceed 30 percent of this imputed income limitation.

Q-7.

(a) Taxpayer owns a newly constructed qualified low-income housing project consisting of one building located in a qualified census tract (Building). A HOME loan at less than the AFR was provided with respect to Building. Construction of Building was funded in part with an obligation the interest on which is exempt from tax under §103 that was outstanding after Building was placed in service. Taxpayer did not elect to exclude from eligible basis the principal amount of the HOME loan or the proceeds of the tax-exempt obligation as provided under §42(i)(2)(B). Forty percent of the residential units in Building are occupied by individuals whose income is 50 percent or less of area median gross income. Is Building eligible for the increase in eligible basis provided under §42(d)(5)(C)(i)(I)?

(b) The facts are the same as in (a) above except that the interest rate on the HOME loan when made was not less than the AFR in effect under §1274(d)(1), and the tax-exempt obligation was redeemed before Building was placed in service. Is Building eligible for the increase in eligible basis under §42(d)(5)(C)(i)(I)?

(c) The facts are the same as in (a) above except that the special set-aside under §42(i)(2)(E)(i) was not met, and the tax-exempt obligation was redeemed before Building was placed in service. Is Building eligible for the increase in eligible basis under §42(d)(5)(C)(i)(I)?

A-7.

(a) Yes. Because the tax-exempt obligation is outstanding after Building was placed in service and the proceeds of the obligation were not excluded from Building's eligible basis under §42(i)(2)(B), Building is treated as federally subsidized under § 42(i)(2)(A). Inasmuch as the building is treated as federally subsidized, the 30-percent present value credit under §42(b) will apply to Building. The fact that the tax-exempt obligation caused Building to be federally subsidized makes §42(i)(2)(E)(i) (which provides that certain HOME loans will not cause a project to be federally subsidized if the special set-aside requirement under that section is satisfied, and whose applicability prohibits the increase in eligible basis under §42(d)(5)(C)) inapplicable. Accordingly, Building is eligible for the increase in eligible basis under § 42(d)(5)(C)(i)(I).

If the tax-exempt obligation was redeemed before Building was placed in service or the proceeds of the obligation were excluded from Building's eligible basis, Building would no longer be treated as federally subsidized by the tax-exempt obligation under § 42(i)(2)(A). Therefore, §42(i)(2)(E)(i) would be applicable, and cause Building not to be

treated as federally subsidized by the HOME loan under §42(i)(2)(A). Accordingly, the prohibition in §42(i)(2)(E)(i) against using §42(d)(5)(C) would apply, and Building would not be eligible for the increase in eligible basis under §42(d)(5)(C)(i)(I). The 70-percent value credit under §42(b) would apply to Building.

(b) Yes. When the HOME loan was made, the interest rate on the loan was not less than the AFR. Therefore, the loan is not described in §42(i)(2)(D), and the building will not be treated as federally subsidized under §42(i)(2)(A). The 70-percent present value credit will apply to Building. Because §42(i)(2)(E)(i) is inapplicable to HOME loans not described in §42(i)(2)(D), this loan is not subject to §42(i)(2)(E)(i), and the prohibition in §42(i)(2)(E)(i) against using §42(d)(5)(C) does not apply. Accordingly, Building is eligible for the increase in eligible basis under §42(d)(5)(C)(i)(I).

(c) Yes. Although Building meets the exception under §42(i)(2)(C) with respect to the tax-exempt obligation, Building is treated as federally subsidized under § 42(i)(2)(A) because it received a HOME loan at less than the AFR and does not meet the special set-aside under §42(i)(2)(E)(i). The 30-percent present value credit will apply to Building as it is treated as federally subsidized. Because Building does not meet the special set-aside under §42(i)(2)(E)(i), the prohibition in §42(i)(2)(E)(i) against using §42(d)(5)(C) does not apply, and Building is eligible for the increase in eligible basis under §42(d)(5)(C)(i)(I).

If Taxpayer elected to exclude the principal amount of the HOME loan from the eligible basis of Building under §42(i)(2)(B) (whether or not the special set-aside under § 42(i)(2)(E)(i) was met), Building would not be treated as federally subsidized under § 42(i)(2)(A), and the 70-percent present value credit would apply to Building. Because

the HOME loan would not be taken into account, §42(i)(2)(D) and §42(i)(2)(E)(i) do not apply to Building. Therefore, Building would not be described in §42(i)(2)(E)(i).

Accordingly, the prohibition in §42(i)(2)(E)(i) against using §42(d)(5)(C) would not apply, and Building would be eligible for the increase in eligible basis under § 42(d)(5)(C)(i)(I).

E. VACANT UNIT RULE ISSUES

Law

Section 1.42-5(c)(1)(ix) provides that a housing credit agency must require the owner of a low-income housing project to certify at least annually to the housing credit agency that, for the preceding 12-month period, if a low-income unit in the project became vacant during the year, reasonable attempts were or are being made to rent that unit or the next available unit of comparable or smaller size to tenants having a qualifying income before any units in the project were or will be rented to tenants not having a qualifying income (the "vacant unit rule").

The legislative history to §42 indicates that vacant units, formerly occupied by low-income individuals, may continue to be treated as occupied by qualified low-income individuals for purposes of the minimum set-aside requirement (as well as for determining qualified basis) provided reasonable attempts are made to rent the unit.

H.R. Conf. Rep. No. 841, *supra*, at II-94.

Section 42(g)(2)(D)(i) provides that notwithstanding an increase in the income of the occupants of a low-income unit above the income limitation applicable under § 42(g)(1), the unit will continue to be treated as a low-income unit if the income of the occupants initially met the income limitation and the unit continues to be rent-restricted. Section 42(g)(2)(D)(ii) provides that if the income of the occupants of the unit increases

above 140 percent of the income limitation applicable under §42(g)(1), the unit ceases to be treated as a low-income unit if any available or subsequently available residential rental unit in the building (of a size comparable to, or smaller than, the unit) is occupied by a new resident whose income exceeds the income limitation (the "available unit rule").

Under §1.42-15(a), a low-income unit in which the aggregate income of the occupants of the unit rises above 140 percent of the applicable income limitation under §42(g)(1) is referred to as an "over-income unit."

Section 1.42-15(c) provides that a unit is not available for purposes of the available unit rule when the unit is no longer available for rent due to contractual arrangements that are binding under local law (for example, a unit is not available if it is subject to a preliminary reservation that is binding on the owner under local law prior to the date a lease is signed or the unit is occupied).

Q-8.

On July 1, 2003, an income-qualified household (Household) initially occupied a rent-restricted residential rental unit in Building 1 of Project. On October 31, 2003, the property manager moved Household (and transferred Household's lease) to a similar rent-restricted unit in Building 2 of Project that was not previously occupied. Household occupied the Building 2 unit at the end of 2003. The unit Household vacated in Building 1 was unoccupied during November and December. Are both units in Buildings 1 and 2 low-income units at the end of 2003?

A-8.

No. While a vacant low-income unit generally retains its character as a low-income unit, where an owner simply moves a tenant from a unit in one building to a unit in another building in the same project, both units may not be treated as low-income units; rather, only the unit that the tenant actually occupies at the end of a month in the first year of the credit period and at the end of each year in subsequent years qualifies as a low-income unit. Thus, in this situation, while the unit in Building 1 vacated by Household was treated as a low-income unit during the months it was occupied by Household, the unit ceased to be treated as a low-income unit when Household vacated the unit. At that time, the vacated unit would be treated as a unit not previously occupied.

Q-9.

Ten units previously occupied by income-qualified tenants in a 200-unit mixed-use housing project are vacant. None of the low-income units in the project had been over-income units. The project owner displayed a banner and for rent signs at the entrance to the project, placed classified advertisements in two local newspapers, and contacted prospective low-income tenants on a waiting list for the project and on a local public housing authority list of section 8 voucher holders about the low-income unit vacancies. These are customary methods of advertising apartment vacancies in the area of the project for identifying prospective tenants. Subsequent to the low-income unit vacancies, a market-rate unit of comparable size to the low-income units became vacant. Will the owner violate the vacant unit rule if the owner rents the market-rate unit before any of the low-income units?

A-9.

No. In accordance with §1.42-5(c)(1)(ix), the owner of a qualified low-income housing project has to use reasonable attempts to rent a vacant low-income unit or the next available unit of comparable or smaller size to tenants having a qualifying income before any units in the project are rented to tenants not having a qualifying income. Thus, if the project owner makes reasonable attempts to rent the vacant low-income units to income-qualified tenants, the owner may rent the newly vacated market-rate unit before renting the low-income units and continue to characterize the vacant low-income units as low-income units for purposes of the minimum set-aside requirements in §42(g)(1) and calculation of the applicable fraction under § 42(c)(1)(B).

What constitutes reasonable attempts to rent a vacant unit is based on facts and circumstances, and may differ from project to project depending on factors such as the size and location of the project, tenant turnover rates, and market conditions. Also, the different advertising methods that are accessible to owners and prospective tenants would affect what is considered reasonable. Under the facts in this situation, the owner used reasonable methods of advertising an apartment vacancy in the area of the project before the owner rented the market-rate unit. Thus, the owner made reasonable attempts to rent the vacant low-income units.

In addition, the available unit rule is not violated by rental of the market-rate unit before the low-income units because there are no over-income units in the building.

Q-10.

A building has 10 units of comparable size, consisting of 7 low-income units (none was an over-income unit) and 3 market-rate units. All units in the building were occupied except for one market-rate unit. A low-income unit became vacant on March

15, 2004. Between March 15, 2004, and March 29, 2004, the owner made reasonable attempts to rent this unit to an income-qualified tenant. The vacant low-income unit became subject to a reservation (a contractual arrangement that is binding on the building owner under local law prior to the date a lease is signed or the unit is occupied) on March 29, 2004, under which the owner agreed to rent the unit to A, whose income meets the income limitation elected for the project under §42(g)(1). Thereafter, the owner ceased any efforts to attempt to rent the unit. On April 30, 2004, A signed a lease for the unit and occupied the unit on May 1, 2004. The vacant market-rate unit was rented to a market-rate tenant on April 15, 2004. Did the owner violate the vacant unit rule?

A-10.

No. For purposes of the vacant unit rule, an owner needs to make reasonable attempts to rent an available vacant low-income unit. To determine what constitutes an available unit for purposes of the vacant unit rule, the Internal Revenue Service will adopt the rule under §1.42-15(c) for when a unit is considered not available. Therefore, a unit is not available for purposes of the vacant unit rule when the unit is no longer available for rent due to contractual arrangements that are binding under local law, such as a reservation entered into between a building owner and a prospective tenant. Thus, in this situation, because the vacant low-income unit was subject to a reservation that was binding under local law prior to the renting of the vacant market-rate unit, the low-income unit was not available when the market-rate unit was rented. Accordingly, the owner no longer needed to make reasonable efforts to rent the low-income unit.

In addition, the available unit rule is not violated by rental of the market-rate unit because there is no over-income unit in the building.

F. RECORDKEEPING AND RECORD RETENTION ISSUE

Law

Section 42(m)(1)(A)(i) requires each housing credit agency to allocate low-income housing credits according to a qualified allocation plan. Under § 42(m)(1)(B)(iii), an allocation plan is not qualified unless it contains a procedure that the housing credit agency (or an agent or other private contractor of the agency) will follow in (1) monitoring for noncompliance with the provisions of § 42, (2) notifying the Service of any noncompliance which the agency becomes aware of, and (3) monitoring for noncompliance with habitability standards through regular site visits.

Under § 1.425(a)(2)(i)(A), for the procedure to satisfy §42(m)(1)(B)(iii), the procedure must include the recordkeeping and record retention provisions of § 1.425(b). However, a monitoring procedure adopted by a housing credit agency may require additional recordkeeping and record retention provisions beyond those specifically provided in §1.42-5(b).

Section 1.42-5(b)(1) provides that a housing credit agency must require the owner of a low-income housing project to keep certain specified records for each qualified low-income building in the project for each year in the compliance period. Under §1.425(b)(2), the owner must be required to retain the records described in § 1.42-5(b)(1) for a particular year for at least 6 years after the due date (with extensions) for filing the Federal income tax return for that year. The records for the first year of the credit period, however, must be retained for at least 6 years beyond the due date (with

extensions) for filing the Federal income tax return for the last year of the compliance period (as defined in §42(i)(1)) of the building. Section 1.42-5(b)(3) also specifies that the owner must be required to retain the original local health, safety, or building code violation reports or notices that were issued by the state or local government unit (as described in § 1.425(c)(1)(vi)) for inspection by the housing credit agency.

The general requirements for keeping records for purposes of the Code are in § 6001 and the regulations thereunder.

Rev. Proc. 97-22, 1997-1 C.B. 652, provides guidance to taxpayers that maintain books and records by using an electronic storage system that either images their hardcopy (paper) books and records or transfers their computerized books and records to an electronic storage media, such as an optical disk. Rev. Proc. 97-22 provides that records maintained in an electronic storage system that complies with the requirements of this revenue procedure will constitute records within the meaning of § 6001.

Q-11.

May a taxpayer comply with the recordkeeping and record retention provisions under § 1.425(b) by using an electronic storage system instead of maintaining hardcopy (paper) books and records?

A-11.

Yes, provided that the electronic storage system satisfies the requirements of Rev. Proc. 97-22. However, complying with the recordkeeping and record retention requirements of the Service does not exempt an owner from having to satisfy any additional recordkeeping and record retention requirements of the monitoring procedure

adopted by the housing credit agency. For example, the housing credit agency may require the taxpayer to maintain hardcopy books and records.

For the basic requirements of maintaining records in an automated data processing system, including electronic storage systems, see Rev. Proc. 98-25, 1998-1 C.B. 689.

G. TENANT INCOME DOCUMENTATION ISSUE

Law

Section 1.42-5(b)(1)(vi) provides that a housing credit agency must require the owner of a low-income housing project to keep records for each qualified low-income building in the project that show, for each year in the compliance period, the annual income certification of each low-income tenant per unit. Under §1.42-5(b)(1)(vii), the housing credit agency must require the owner to keep documentation to support each low-income tenant's income certification (for example, a copy of the tenant's Federal income tax return, Forms W-2, or verifications of income from third parties such as employers or state agencies paying unemployment compensation).

Under §1.42-5(c)(1)(iii), the housing credit agency must require the owner of a low-income housing project to certify at least annually that, for the preceding 12-month period, the owner has received an annual income certification from each low-income tenant, and documentation to support that certification.

Rev. Proc. 94-65, 1994-2 C.B. 798, indicates that an owner may satisfy the documentation requirement of §1.42-5(b)(1)(vii) for a low-income tenant's income from assets by obtaining a signed, sworn statement from the tenant or prospective tenant if (1) the tenant's or prospective tenant's Net Family assets do not exceed \$5,000, and (2)

the tenant or prospective tenant provides a signed, sworn statement to this effect to the building owner. The revenue procedure provides that a housing credit agency's monitoring procedure may not permit an owner to rely on a low-income tenant's signed, sworn statement of annual income from assets if a reasonable person in the owner's position would conclude that the tenant's income is higher than the tenant's represented annual income. In this case, the owner must obtain other documentation of the low-income tenant's income from assets to satisfy the documentation requirement. In addition, the revenue procedure indicates that a housing credit agency's monitoring procedure may continue to require that an owner obtain documentation, other than the signed, sworn statement, to support a low-income tenant's annual certification of income from assets.

Q-12.

On reviewing tenant files of a project, the housing credit agency discovered that for purposes of determining the income of certain tenants, the owner had accepted signed, sworn self-certifications in which the tenants stated that they had not received any child support payments. Is a signed, sworn self-certification by a tenant sufficient documentation under §1.42-5(b)(1)(vii) to show that the tenant is not receiving child support payments?

A-12.

Yes. Consistent with the documentation requirements in Rev. Proc. 94-65, a signed, sworn self-certification by a tenant is sufficient documentation under § 1.42-5(b)(1)(vii) to show that a tenant is not receiving child support payments. In addition to specifying that a tenant is not receiving any child support payments, an annual signed,

sworn self-certification should indicate whether the tenant will be seeking or expects to receive child support payments within the next 12 months. If the tenant possesses a child support agreement but is not presently receiving any child support payments, the tenant should include an explanation of this and all supporting documentation such as a divorce decree and court documents to enforce payment. Also, the self-certification should indicate that the tenant will notify the owner of any changes in the status of child support.

A housing credit agency's monitoring procedure, however, may not permit an owner to rely on a low-income tenant's signed, sworn statement indicating that the tenant is not receiving child support payments if a reasonable person in the owner's position would conclude that the tenant's income is higher than the tenant's represented annual income. In this case, the owner must obtain other documentation of the low-income tenant's annual child support payments to satisfy the documentation requirement in §1.42-5(b)(1)(vii).

A housing credit agency's monitoring procedure may continue to require that an owner obtain documentation, other than the statement described above, to support a low-income tenant's annual certification of child support payments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran. For further information regarding this revenue ruling, contact Harold Burghart of the Office of Associate Chief Counsel (Passthroughs and Special Industries) at (202) 622-3040 (not a toll-free call).