

## **Appendix A**

1. Internal Revenue Code, Section 42 – Low-Income Housing Credit
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# **Sec. 42. Low-income housing credit**

## **STATUTE**

### **(a) In general**

For purposes of section 38, the amount of the low-income housing credit determined under this section for any taxable year in the credit period shall be an amount equal to -

- (1) the applicable percentage of
- (2) the qualified basis of each qualified low-income building.

### **(b) Applicable percentage: 70 percent present value credit for certain new buildings; 30 percent present value credit for certain other buildings**

For purposes of this section -

#### **(b)(1) Building placed in service during 1987**

In the case of any qualified low-income building placed in service by the taxpayer during 1987, the term 'applicable percentage' means -

- (A) 9 percent for new buildings which are not federally subsidized for the taxable year, or
- (B) 4 percent for -
  - (i) new buildings which are federally subsidized for the taxable year, and
  - (ii) existing buildings.

#### **(b)(2) Buildings placed in service after 1987**

##### **(b)(2)(A) In general**

In the case of any qualified low-income building placed in service by the taxpayer after 1987, the term 'applicable percentage' means the appropriate percentage prescribed by the Secretary for the earlier of -

- (i) the month in which such building is placed in service, or
- (ii) at the election of the taxpayer -
  - (I) the month in which the taxpayer and the housing credit agency enter into an agreement with respect to such building (which is binding on such agency, the

taxpayer, and all successors in interest) as to the housing credit dollar amount to be allocated to such building, or  
(II) in the case of any building to which subsection (h)(4)(B) applies, the month in which the tax-exempt obligations are issued.

A month may be elected under clause (ii) only if the election is made not later than the 5th day after the close of such month. Such an election, once made, shall be irrevocable.

**(b)(2)(B) Method of prescribing percentages**

The percentages prescribed by the Secretary for any month shall be percentages which will yield over a 10-year period amounts of credit under subsection (a) which have a present value equal to -

- (i) 70 percent of the qualified basis of a building described in paragraph (1)(A), and
- (ii) 30 percent of the qualified basis of a building described in paragraph (1)(B).

**(b)(2)(C) Method of discounting**

The present value under subparagraph (B) shall be determined -

- (i) as of the last day of the 1st year of the 10-year period referred to in subparagraph (B),
- (ii) by using a discount rate equal to 72 percent of the average of the annual Federal mid-term rate and the annual Federal long-term rate applicable under section 1274(d)(1) to the month applicable under clause (i) or (ii) of subparagraph (A) and compounded annually, and
- (iii) by assuming that the credit allowable under this section for any year is received on the last day of such year.

**(b)(3) Cross references**

- (A) For treatment of certain rehabilitation expenditures as separate new buildings, see subsection (e).
- (B) For determination of applicable percentage for increases in qualified basis after the 1st year of the credit period, see subsection (f)(3).
- (C) For authority of housing credit agency to limit applicable percentage and qualified basis which may be taken into account under this section with respect to any building, see subsection (h)(7).

**(c) Qualified basis; qualified low-income building**

For purposes of this section -

**(c)(1) Qualified basis**

**(c)(1)(A) Determination**

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 such taxable year) of
- (ii) the eligible basis of such building (determined under subsection (d)(5)).

**(c)(1)(B) Applicable fraction**

For purposes of subparagraph (A), the term 'applicable fraction' means the smaller of the unit fraction or the floor space fraction.

**(c)(1)(C) Unit fraction**

For purposes of subparagraph (B), the term 'unit fraction' means the fraction -

- (i) the numerator of which is the number of low-income units in the building, and
- (ii) the denominator of which is the number of residential rental units (whether or not occupied) in such building.

**(c)(1)(D) Floor space fraction**

For purposes of subparagraph (B), the term 'floor space fraction' means the fraction -

- (i) the numerator of which is the total floor space of the low-income units in such building, and
- (ii) the denominator of which is the total floor space of the residential rental units (whether or not occupied) in such building.

**(c)(1)(E) Qualified basis to include portion of building used to provide supportive services for homeless**

In the case of a qualified low-income building described in subsection (i)(3)(B)(iii), the qualified basis of such building for any taxable year shall be increased by the lesser of -

- (i) so much of the eligible basis of such building as is used throughout the year to provide supportive services designed to assist tenants in locating and retaining permanent housing, or
- (ii) 20 percent of the qualified basis of such building (determined without regard to this subparagraph).

**(c)(2) Qualified low-income building**

The term 'qualified low-income building' means any building -

- (A) which is part of a qualified low-income housing project at all times during the period -
- (i) beginning on the 1st day in the compliance period on which such building is part of such a project, and
  - (ii) ending on the last day of the compliance period with respect to such building, and
- (B) to which the amendments made by section 201(a) of the Tax Reform Act of 1986 apply.

Such term does not include any building with respect to which moderate rehabilitation assistance is provided, at any time during the compliance period, under section 8(e)(2) (FOOTNOTE 1) of the United States Housing Act of 1937 (other than assistance under the Stewart B. McKinney Homeless Assistance Act of 1988 (as in effect on the date of the enactment of this sentence)).

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(FOOTNOTE 1) See References in Text note below. (d) Eligible basis

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For purposes of this section -

(1) New buildings

The eligible basis of a new building is its adjusted basis as of the close of the 1st taxable year of the credit period.

(2) Existing buildings

(A) In general

The eligible basis of an existing building is -

- (i) in the case of a building which meets the requirements of subparagraph (B), its adjusted basis as of the close of the 1st taxable year of the credit period, and
- (ii) zero in any other case.

(B) Requirements

A building meets the requirements of this subparagraph if -

- (i) the building is acquired by purchase (as defined in section 179(d)(2)),
- (ii) there is a period of at least 10 years between the date of its acquisition by the taxpayer and the later of -
  - (I) the date the building was last placed in service, or
  - (II) the date of the most recent nonqualified substantial improvement of the building,
- (iii) the building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service, and
- (iv) except as provided in subsection (f)(5), a credit is allowable under subsection (a) by reason of subsection (e) with respect to the building.

**(c)(2)(C) Adjusted basis**

For purposes of subparagraph (A), the adjusted basis of any building shall not include so much of the basis of such building as is determined by reference to the basis of other property held at any time by the person acquiring the building.

**(c)(2)(D) Special rules for subparagraph (B)**

**(c)(2)(D)(i) Nonqualified substantial improvement**

For purposes of subparagraph (B)(ii) -

**(c)(2)(D)(i)(I) In general**

The term 'nonqualified substantial improvement' means any substantial improvement if section 167(k) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) was elected with respect to such improvement or section 168 (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) applied to such improvement.

**(c)(2)(D)(i)(II) Date of substantial improvement**

The date of a substantial improvement is the last day of the 24-month period referred to in subclause (III).

**(c)(2)(D)(i)(III) Substantial improvement**

The term 'substantial improvement' means the improvements added to capital account with respect to the building during any 24-month period, but only if the sum of the amounts added to such account during such period equals or exceeds 25 percent of the adjusted basis of the building (determined without regard to paragraphs (2) and (3) of section 1016(a)) as of the 1st day of such period.

**(c)(2)(D)(ii) Special rules for certain transfers**

For purposes of determining under subparagraph (B)(ii) when a building was last placed in service, there shall not be taken into account any placement in service -

- (I) in connection with the acquisition of the building in a transaction in which the basis of the building in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such building in the hands of the person from whom acquired,
- (II) by a person whose basis in such building is determined under section 1014(a) (relating to property acquired from a decedent),
- (III) by any governmental unit or qualified nonprofit organization (as defined in subsection (h)(5)) if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such unit or organization and all the income from such property is exempt from Federal income taxation,
- (IV) by any person who acquired such building by foreclosure (or by instrument in lieu of foreclosure) of any purchase-money security interest held by such person if the requirements of subparagraph (B)(ii) are met with respect to the placement in service by such person and such building is resold within 12 months after the date such building is placed in service by such person after such foreclosure, or

(V) of a single-family residence by any individual who owned and used such residence for no other purpose than as his principal residence.

**(c)(2)(D)(iii) Related person, etc.**

**(c)(2)(D)(iii)(I) Application of section 179**

For purposes of subparagraph (B)(i), section 179(d) shall be applied by substituting '10 percent' for '50 percent' in section (FOOTNOTE 2) 267(b) and 707(b) and in section 179(b)(7).

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(FOOTNOTE 2) So in original. Probably should be 'sections'.

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**(c)(2)(D)(iii)(II) Related person**

For purposes of subparagraph (B)(iii), a person (hereinafter in this subclause referred to as the 'related person') is related to any person if the related person bears a relationship to such person specified in section 267(b) or 707(b)(1), or the related person and such person are engaged in trades or businesses under common control (within the meaning of subsections (a) and (b) of section 52). For purposes of the preceding sentence, in applying section 267(b) or 707(b)(1), '10 percent' shall be substituted for '50 percent'.

**(c)(3) Eligible basis reduced where disproportionate standards for units**

**(c)(3)(A) In general**

Except as provided in subparagraph (B), the eligible basis of any building shall be reduced by an amount equal to the portion of the adjusted basis of the building which is attributable to residential rental units in the building which are not low-income units and which are above the average quality standard of the low-income units in the building.

**(c)(3)(B) Exception where taxpayer elects to exclude excess costs**

**(c)(3)(B)(i) In general**

Subparagraph (A) shall not apply with respect to a residential rental unit in a building which is not a low-income unit if -

- (I) the excess described in clause (ii) with respect to such unit is not greater than 15 percent of the cost described in clause (ii)(II), and
- (II) the taxpayer elects to exclude from the eligible basis of such building the excess described in clause (ii) with respect to such unit.

**(c)(3)(B)(ii) Excess**

The excess described in this clause with respect to any unit is the excess of -

(I) the cost of such unit, over

(II) the amount which would be the cost of such unit if the average cost per square foot of low-income units in the building were substituted for the cost per square foot of such unit.

The Secretary may by regulation provide for the determination of the excess under this clause on a basis other than square foot costs.

#### **(c)(4) Special rules relating to determination of adjusted basis**

For purposes of this subsection -

##### **(c)(4)(A) In general**

Except as provided in subparagraph (B), the adjusted basis of any building shall be determined without regard to the adjusted basis of any property which is not residential rental property.

##### **(c)(4)(B) Basis of property in common areas, etc., included**

The adjusted basis of any building shall be determined by taking into account 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 such building.

##### **(c)(4)(C) No reduction for depreciation**

The adjusted basis of any building shall be determined without regard to paragraphs (2) and (3) of section 1016(a).

#### **(c)(5) Special rules for determining eligible basis**

##### **(c)(5)(A) Eligible basis reduced by Federal grants**

If, during any taxable year of the compliance period, a grant is made with respect to any building or the operation thereof and any portion of such grant is funded with Federal funds (whether or not includible in gross income), the eligible basis of such building for such taxable year and all succeeding taxable years shall be reduced by the portion of such grant which is so funded.

##### **(c)(5)(B) Eligible basis not to include expenditures where section 167(k) elected**

The eligible basis of any building shall not include any portion of its adjusted basis which is attributable to amounts with respect to which an election is made under section 167(k)

(as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990).

**(c)(5)(C) Increase in credit for buildings in high cost areas**

**(c)(5)(C)(i) In general**

In the case of any building located in a qualified census tract or difficult development area which is designated for purposes of this subparagraph -

- (I) in the case of a new building, the eligible basis of such building shall be 130 percent of such basis determined without regard to this subparagraph, and
- (II) in the case of an existing building, the rehabilitation expenditures taken into account under subsection (e) shall be 130 percent of such expenditures determined without regard to this subparagraph.

**(c)(5)(C)(ii) Qualified census tract**

**(c)(5)(C)(ii)(I) In general**

The term 'qualified census tract' means any census tract which is designated by the Secretary of Housing and Urban Development and, for the most recent year for which census data are available on household income in such tract, in which 50 percent or more of the households have an income which is less than 60 percent of the area median gross income for such year. If the Secretary of Housing and Urban Development determines that sufficient data for any period are not available to apply this clause on the basis of census tracts, such Secretary shall apply this clause for such period on the basis of enumeration districts.

**(c)(5)(C)(ii)(II) Limit on MSA's designated**

The portion of a metropolitan statistical area which may be designated for purposes of this subparagraph shall not exceed an area having 20 percent of the population of such metropolitan statistical area.

**(c)(5)(C)(ii)(III) Determination of areas**

For purposes of this clause, each metropolitan statistical area shall be treated as a separate area and all nonmetropolitan areas in a State shall be treated as 1 area.

**(c)(5)(C)(iii) Difficult development areas**

**(c)(5)(C)(iii)(I) In general**

The term 'difficult development areas' means any area designated by the Secretary of Housing and Urban Development as an area which has high construction, land, and utility costs relative to area median gross income.

**(c)(5)(C)(iii)(II) Limit on areas designated**

The portions of metropolitan statistical areas which may be designated for purposes of this subparagraph shall not exceed an aggregate area having 20 percent of the population of such metropolitan statistical areas. A comparable rule shall apply to nonmetropolitan areas.

**(e)(5)(C)(iv) Special rules and definitions**

For purposes of this subparagraph -

- (I) population shall be determined on the basis of the most recent decennial census for which data are available,
- (II) area median gross income shall be determined in accordance with subsection (g)(4),
- (III) the term 'metropolitan statistical area' has the same meaning as when used in section 143(k)(2)(B), and
- (IV) the term 'nonmetropolitan area' means any county (or portion thereof) which is not within a metropolitan statistical area.

**(c)(6) Credit allowable for certain federally-assisted buildings acquired during 10-year period described in paragraph**

(2) (B) (ii)

**(c)(6)(A) In general**

On application by the taxpayer, the Secretary (after consultation with the appropriate Federal official) may waive paragraph (2)(B)(ii) with respect to any federally-assisted building if the Secretary determines that such waiver is necessary -

- (i) to avert an assignment of the mortgage secured by property in the project (of which such building is a part) to the Department of Housing and Urban Development or the Farmers Home Administration, or
- (ii) to avert a claim against a Federal mortgage insurance fund (or such Department or Administration) with respect to a mortgage which is so secured.

The preceding sentence shall not apply to any building described in paragraph (7)(B).

**(c)(6)(B) Federally-assisted building**

For purposes of subparagraph (A), the term 'federally-assisted building' means any building which is substantially assisted, financed, or operated under -

- (i) section 8 of the United States Housing Act of 1937,
- (ii) section 221(d)(3) or 236 of the National Housing Act, or
- (iii) section 515 of the Housing Act of 1949,

as such Acts are in effect on the date of the enactment of the Tax Reform Act of 1986.

**(c)(6)(C) Low-income buildings where mortgage may be prepaid**

A waiver may be granted under subparagraph (A) (without regard to any clause thereof) with respect to a federally-assisted building described in clause (ii) or (iii) of subparagraph (B) if -

- (i) the mortgage on such building is eligible for prepayment under subtitle B of the Emergency Low Income Housing Preservation Act of 1987 or under section 502(c) of the Housing Act of 1949 at any time within 1 year after the date of the application for such a waiver,
- (ii) the appropriate Federal official certifies to the Secretary that it is reasonable to expect that, if the waiver is not granted, such building will cease complying with its low-income occupancy requirements, and
- (iii) the eligibility to prepay such mortgage without the approval of the appropriate Federal official is waived by all persons who are so eligible and such waiver is binding on all successors of such persons.

**(c)(6)(D) Buildings acquired from insured depository institutions in default**

A waiver may be granted under subparagraph (A) (without regard to any clause thereof) with respect to any building acquired from an insured depository institution in default (as defined in section 3 of the Federal Deposit Insurance Act) or from a receiver or conservator of such an institution.

**(c)(6)(E) Appropriate Federal official**

For purposes of subparagraph (A), the term 'appropriate Federal official' means -

- (i) the Secretary of Housing and Urban Development in the case of any building described in subparagraph (B) by reason of clause (i) or (ii) thereof, and
- (ii) the Secretary of Agriculture in the case of any building described in subparagraph (B) by reason of clause (iii) thereof.

**(c)(7) Acquisition of building before end of prior compliance period**

**(c)(7)(A) In general**

Under regulations prescribed by the Secretary, in the case of a building described in subparagraph (B) (or interest therein) which is acquired by the taxpayer -

- (i) paragraph (2)(B) shall not apply, but
- (ii) the credit allowable by reason of subsection (a) to the taxpayer for any period after such acquisition shall be equal to the amount of credit which would have

been allowable under subsection (a) for such period to the prior owner referred to in subparagraph (B) had such owner not disposed of the building.

**(c)(7)(B) Description of building**

A building is described in this subparagraph if -

- (i) a credit was allowed by reason of subsection (a) to any prior owner of such building, and
  - (ii) the taxpayer acquired such building before the end of the compliance period for such building with respect to such prior owner (determined without regard to any disposition by such prior owner).
- (e) Rehabilitation expenditures treated as separate new building
- (1) In general  
Rehabilitation expenditures paid or incurred by the taxpayer with respect to any building shall be treated for purposes of this section as a separate new building.
  - (2) Rehabilitation expenditures  
For purposes of paragraph (1) -
    - (A) In general  
The term 'rehabilitation expenditures' means amounts chargeable to capital account and incurred for property (or additions or improvements to property) of a character subject to the allowance for depreciation in connection with the rehabilitation of a building.
    - (B) Cost of acquisition, etc, (FOOTNOTE 3) not included

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(FOOTNOTE 3) So in original. Probably should be 'etc.,'.

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- Such term does not include the cost of acquiring any building (or interest therein) or any amount not permitted to be taken into account under paragraph (3) or (4) of subsection (d).
- (3) Minimum expenditures to qualify
    - (A) In general  
Paragraph (1) shall apply to rehabilitation expenditures with respect to any building only if -
      - (i) the expenditures are allocable to 1 or more low-income units or substantially benefit such units, and
      - (ii) the amount of such expenditures during any 24-month period meets the requirements of whichever of the following subclauses requires the greater amount of such expenditures:
        - (I) The requirement of this subclause is met if such amount is not less than 10 percent of the adjusted basis of the building (determined as of the 1st day of such period and without regard to paragraphs (2) and (3) of section 1016(a)).
        - (II) The requirement of this subclause is met if the qualified basis attributable to such amount, when divided by the number of low-income units in the building, is \$3,000 or more.
    - (B) Exception from 10 percent rehabilitation  
In the case of a building acquired by the taxpayer from a governmental unit, at the election of the taxpayer,

subparagraph (A)(ii)(I) shall not apply and the credit under this section for such rehabilitation expenditures shall be determined using the percentage applicable under subsection (b)(2)(B)(ii).

(C) Date of determination

The determination under subparagraph (A) shall be made as of the close of the 1st taxable year in the credit period with respect to such expenditures.

(4) Special rules

For purposes of applying this section with respect to expenditures which are treated as a separate building by reason of this subsection -

(A) such expenditures shall be treated as placed in service at the close of the 24-month period referred to in paragraph (3)(A), and

(B) the applicable fraction under subsection (c)(1) shall be the applicable fraction for the building (without regard to paragraph (1)) with respect to which the expenditures were incurred.

Nothing in subsection (d)(2) shall prevent a credit from being allowed by reason of this subsection.

(5) No double counting

Rehabilitation expenditures may, at the election of the taxpayer, be taken into account under this subsection or subsection (d)(2)(A)(i) but not under both such subsections.

(6) Regulations to apply subsection with respect to group of units in building

The Secretary may prescribe regulations, consistent with the purposes of this subsection, treating a group of units with respect to which rehabilitation expenditures are incurred as a separate new building.

(f) Definition and special rules relating to credit period

(1) Credit period defined

For purposes of this section, the term 'credit period' means, with respect to any building, 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 only if the building is a qualified low-income building as of the close of the 1st year of such period. The election under subparagraph (B), once made, shall be irrevocable.

(2) Special rule for 1st year of credit period

(A) In general

The credit allowable under subsection (a) with respect to any building for the 1st taxable year of the credit period shall be determined by substituting for the applicable fraction under subsection (c)(1) the fraction -

(i) the numerator of which is the sum of the applicable fractions determined under subsection (c)(1) as of the close of each full month of such year during which such building was in service, and

(ii) the denominator of which is 12.

(B) Disallowed 1st year credit allowed in 11th year

Any reduction by reason of subparagraph (A) in the credit allowable (without regard to subparagraph (A)) for the 1st

taxable year of the credit period shall be allowable under subsection (a) for the 1st taxable year following the credit period.

- (3) Determination of applicable percentage with respect to increases in qualified basis after 1st year of credit period  
(A) In general

In the case of any building which was a qualified low-income building as of the close of the 1st year of the credit period, if -

- (i) as of the close of any taxable year in the compliance period (after the 1st year of the credit period) the qualified basis of such building exceeds  
(ii) the qualified basis of such building as of the close of the 1st year of the credit period,  
the applicable percentage which shall apply under subsection (a) for the taxable year to such excess shall be the percentage equal to 2/3 of the applicable percentage which (after the application of subsection (h)) would but for this paragraph apply to such basis.

- (B) 1st year computation applies

A rule similar to the rule of paragraph (2)(A) shall apply to any increase in qualified basis to which subparagraph (A) applies for the 1st year of such increase.

- (4) Dispositions of property

If a building (or an interest therein) is disposed of during any year for which credit is allowable under subsection (a), such credit shall be allocated between the parties on the basis of the number of days during such year the building (or interest) was held by each. In any such case, proper adjustments shall be made in the application of subsection (j).

- (5) Credit period for existing buildings not to begin before rehabilitation credit allowed

- (A) In general

The credit period for an existing building shall not begin before the 1st taxable year of the credit period for rehabilitation expenditures with respect to the building.

- (B) Acquisition credit allowed for certain buildings not allowed a rehabilitation credit

- (i) In general

In the case of a building described in clause (ii) -

- (I) subsection (d)(2)(B)(iv) shall not apply, and  
(II) the credit period for such building shall not begin before the taxable year which would be the 1st taxable year of the credit period for rehabilitation expenditures with respect to the building under the modifications described in clause (ii)(II).

- (ii) Building described

A building is described in this clause if -

- (I) a waiver is granted under subsection (d)(6)(C) with respect to the acquisition of the building, and  
(II) a credit would be allowed for rehabilitation

expenditures with respect to such building if subsection (e)(3)(A)(ii)(I) did not apply and if subsection (e)(3)(A)(ii)(II) were applied by substituting '\$2,000' for '\$3,000'.

- (g) Qualified low-income housing project  
For purposes of this section -

(1) In general

The term 'qualified low-income housing project' means any project for residential rental property if the project meets the requirements of subparagraph (A) or (B) whichever is elected by the taxpayer:

(A) 20-50 test

The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income.

(B) 40-60 test

The project meets the requirements of this subparagraph if 40 percent or more of the residential units in such project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income.

Any election under this paragraph, once made, shall be irrevocable. For purposes of this paragraph, any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.

(2) Rent-restricted units

(A) In general

For purposes of paragraph (1), a residential unit is rent-restricted if the gross rent with respect to such unit does not exceed 30 percent of the imputed income limitation applicable to such unit. For purposes of the preceding sentence, the amount of the income limitation under paragraph (1) applicable for any period shall not be less than such limitation applicable for the earliest period the building (which contains the unit) was included in the determination of whether the project is a qualified low-income housing project.

(B) Gross rent

For purposes of subparagraph (A), gross rent -

(i) does not include any payment under section 8 of the United States Housing Act of 1937 or any comparable rental assistance program (with respect to such unit or occupants thereof),

(ii) includes any utility allowance determined by the Secretary after taking into account such determinations under section 8 of the United States Housing Act of 1937,

(iii) does not include any fee for a supportive service which is paid to the owner of the unit (on the basis of the low-income status of the tenant of the unit) by any governmental program of assistance (or by an organization described in section 501(c)(3) and exempt from tax under section 501(a)) if such program (or organization) provides assistance for rent and the amount of assistance provided for rent is not separable from the amount of assistance provided for supportive services, and

(iv) does not include any rental payment to the owner of the unit to the extent such owner pays an equivalent amount to the Farmers' Home Administration under section 515 of the Housing Act of 1949.

For purposes of clause (iii), the term 'supportive service' means 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. In the case of a single-room occupancy unit or a building described in subsection (i)(3)(B)(iii), such term includes any service provided to assist tenants in locating and retaining permanent housing.

(C) Imputed income limitation applicable to unit

For purposes of this paragraph, the imputed income limitation applicable to a unit is the income limitation which would apply under paragraph (1) to individuals occupying the unit if the number of individuals occupying the unit were as follows:

(i) In the case of a unit which does not have a separate bedroom, 1 individual.

(ii) In the case of a unit which has 1 or more separate bedrooms, 1.5 individuals for each separate bedroom.

In the case of a project with respect to which a credit is allowable by reason of this section and for which financing is provided by a bond described in section 142(a)(7), the imputed income limitation shall apply in lieu of the otherwise applicable income limitation for purposes of applying section 142(d)(4)(B)(ii).

(D) Treatment of units occupied by individuals whose incomes rise above limit

(i) In general

Except as provided in clause (ii), notwithstanding an increase in the income of the occupants of a low-income unit above the income limitation applicable under paragraph (1), such unit shall continue to be treated as a low-income unit if the income of such occupants initially met such income limitation and such unit continues to be rent-restricted.

(ii) Next available unit must be rented to low-income tenant if income rises above 140 percent of income limit

If the income of the occupants of the unit increases above 140 percent of the income limitation applicable under paragraph (1), clause (i) shall cease to apply to such unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds such income limitation. In the case of a project described in section 142(d)(4)(B), the preceding sentence shall be applied by substituting '170 percent' for '140 percent' and by substituting 'any low-income unit in the building is occupied by a new resident whose income exceeds 40 percent of area median gross income' for 'any residential unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds such income limitation'.

(E) Units where Federal rental assistance is reduced as tenant's income increases

If the gross rent with respect to a residential unit exceeds the limitation under subparagraph (A) by reason of the fact that the income of the occupants thereof exceeds the income limitation applicable under paragraph (1), such unit shall, nevertheless, be treated as a rent-restricted unit for purposes of paragraph (1) if -

(i) a Federal rental assistance payment described in subparagraph (B)(i) is made with respect to such unit or its occupants, and

(ii) the sum of such payment and the gross rent with respect to such unit does not exceed the sum of the amount of such payment which would be made and the gross rent which would be payable with respect to such unit if -

(I) the income of the occupants thereof did not exceed the income limitation applicable under paragraph (1), and

(II) such units were rent-restricted within the meaning of subparagraph (A).

The preceding sentence shall apply to any unit only if the result described in clause (ii) is required by Federal statute as of the date of the enactment of this subparagraph and as of the date the Federal rental assistance payment is made.

(3) Date for meeting requirements

(A) In general

Except as otherwise provided in this paragraph, a building shall be treated as a qualified low-income building only if the project (of which such building is a part) meets the requirements of paragraph (1) not later than the close of the 1st year of the credit period for such building.

(B) Buildings which rely on later buildings for qualification

(i) In general

In determining whether a building (hereinafter in this subparagraph referred to as the 'prior building') is a qualified low-income building, the taxpayer may take into account 1 or more additional buildings placed in service during the 12-month period described in subparagraph (A) with respect to the prior building only if the taxpayer elects to apply clause (ii) with respect to each additional building taken into account.

(ii) Treatment of elected buildings

In the case of a building which the taxpayer elects to take into account under clause (i), the period under subparagraph (A) for such building shall end at the close of the 12-month period applicable to the prior building.

(iii) Date prior building is treated as placed in service

For purposes of determining the credit period and the compliance period for the prior building, the prior building shall be treated for purposes of this section as placed in service on the most recent date any additional building elected by the taxpayer (with respect to such prior building) was placed in service.

(C) Special rule

A building -

(i) other than the 1st building placed in service as part of a project, and

(ii) other than a building which is placed in service during the 12-month period described in subparagraph (A) with respect to a prior building which becomes a qualified low-income building,

shall in no event be treated as a qualified low-income building unless the project is a qualified low-income housing project (without regard to such building) on the date such building is placed in service.

(D) Projects with more than 1 building must be identified

For purposes of this section, a project shall be treated as consisting of only 1 building unless, before the close of the 1st calendar year in the project period (as defined in

subsection (h) (1) (F) (ii)), each building which is (or will be) part of such project is identified in such form and manner as the Secretary may provide.

(4) Certain rules made applicable

Paragraphs (2) (other than subparagraph (A) thereof), (3), (4), (5), (6), and (7) of section 142(d), and section 6652(j), shall apply for purposes of determining whether any project is a qualified low-income housing project and whether any unit is a low-income unit; except that, in applying such provisions for such purposes, the term 'gross rent' shall have the meaning given such term by paragraph (2) (B) of this subsection.

(5) Election to treat building after compliance period as not part of a project

For purposes of this section, the taxpayer may elect to treat any building as not part of a qualified low-income housing project for any period beginning after the compliance period for such building.

(6) Special rule where de minimis equity contribution

Property shall not be treated as failing to be residential rental property for purposes of this section merely because the occupant of a residential unit in the project pays (on a voluntary basis) to the lessor a de minimis amount to be held toward the purchase by such occupant of a residential unit in such project if -

(A) all amounts so paid are refunded to the occupant on the cessation of his occupancy of a unit in the project, and

(B) the purchase of the unit is not permitted until after the close of the compliance period with respect to the building in which the unit is located.

Any amount paid to the lessor as described in the preceding sentence shall be included in gross rent under paragraph (2) for purposes of determining whether the unit is rent-restricted.

(7) Scattered site projects

Buildings which would (but for their lack of proximity) be treated as a project for purposes of this section shall be so treated if all of the dwelling units in each of the buildings are rent-restricted (within the meaning of paragraph (2)) residential rental units.

(h) Limitation on aggregate credit allowable with respect to projects located in a State

(1) Credit may not exceed credit amount allocated to building

(A) In general

The amount of the credit determined under this section for any taxable year with respect to any building shall not exceed the housing credit dollar amount allocated to such building under this subsection.

(B) Time for making allocation

Except in the case of an allocation which meets the requirements of subparagraph (C), (D), (E), or (F), an allocation shall be taken into account under subparagraph (A) only if it is made not later than the close of the calendar year in which the building is placed in service.

(C) Exception where binding commitment

An allocation meets the requirements of this subparagraph if there is a binding commitment (not later than the close of the calendar year in which the building is placed in service) by the housing credit agency to allocate a specified housing

credit dollar amount to such building beginning in a specified later taxable year.

(D) Exception where increase in qualified basis

(i) In general

An allocation meets the requirements of this subparagraph if such allocation is made not later than the close of the calendar year in which ends the taxable year to which it will first apply but only to the extent the amount of such allocation does not exceed the limitation under clause (ii).

(ii) Limitation

The limitation under this clause is the amount of credit allowable under this section (without regard to this subsection) for a taxable year with respect to an increase in the qualified basis of the building equal to the excess of -

(I) the qualified basis of such building as of the close of the first taxable year to which such allocation will apply, over

(II) the qualified basis of such building as of the close of the first taxable year to which the most recent prior housing credit allocation with respect to such building applied.

(iii) Housing credit dollar amount reduced by full allocation

Notwithstanding clause (i), the full amount of the allocation shall be taken into account under paragraph (2).

(E) Exception where 10 percent of cost incurred

(i) In general

An allocation meets the requirements of this subparagraph if such allocation is made with respect to a qualified building which is placed in service not later than the close of the second calendar year following the calendar year in which the allocation is made.

(ii) Qualified building

For purposes of clause (i), the term 'qualified building' means any building which is part of a project if the taxpayer's basis in such project (as of the close of the calendar year in which the allocation is made) is more than 10 percent of the taxpayer's reasonably expected basis in such project (as of the close of the second calendar year referred to in clause (i)). Such term does not include any existing building unless a credit is allowable under subsection (e) for rehabilitation expenditures paid or incurred by the taxpayer with respect to such building for a taxable year ending during the second calendar year referred to in clause (i) or the prior taxable year.

(F) Allocation of credit on a project basis

(i) In general

In the case of a project which includes (or will include) more than 1 building, an allocation meets the requirements of this subparagraph if -

(I) the allocation is made to the project for a calendar year during the project period,

(II) the allocation only applies to buildings placed in service during or after the calendar year for which the allocation is made, and

(III) the portion of such allocation which is allocated to any building in such project is specified not later than the close of the calendar year in which the building is

placed in service.

(ii) Project period

For purposes of clause (i), the term 'project period' means the period -

(I) beginning with the 1st calendar year for which an allocation may be made for the 1st building placed in service as part of such project, and

(II) ending with the calendar year the last building is placed in service as part of such project.

(2) Allocated credit amount to apply to all taxable years ending during or after credit allocation year

Any housing credit dollar amount allocated to any building for any calendar year -

(A) shall apply to such building for all taxable years in the compliance period ending during or after such calendar year, and

(B) shall reduce the aggregate housing credit dollar amount of the allocating agency only for such calendar year.

(3) Housing credit dollar amount for agencies

(A) In general

The aggregate housing credit dollar amount which a housing credit agency may allocate for any calendar year is the portion of the State housing credit ceiling allocated under this paragraph for such calendar year to such agency.

(B) State ceiling initially allocated to State housing credit agencies

Except as provided in subparagraphs (D) and (E), the State housing credit ceiling for each calendar year shall be allocated to the housing credit agency of such State. If there is more than 1 housing credit agency of a State, all such agencies shall be treated as a single agency.

(C) State housing credit ceiling

The State housing credit ceiling applicable to any State for any calendar year shall be an amount equal to the sum of -

(i) \$1.25 multiplied by the State population,

(ii) the unused State housing credit ceiling (if any) of such State for the preceding calendar year,

(iii) the amount of State housing credit ceiling returned in the calendar year, plus

(iv) the amount (if any) allocated under subparagraph (D) to such State by the Secretary.

For purposes of clause (ii), the unused State housing credit ceiling for any calendar year is the excess (if any) of the sum of the amounts described in clauses (i) and (iii) over the aggregate housing credit dollar amount allocated for such year. For purposes of clause (iii), the amount of State housing credit ceiling returned in the calendar year equals the housing credit dollar amount previously allocated within the State to any project which does not become a qualified low-income housing project within the period required by this section or the terms of the allocation or to any project with respect to which an allocation is cancelled by mutual consent of the housing credit agency and the allocation recipient.

(D) Unused housing credit carryovers allocated among certain States

(i) In general

The unused housing credit carryover of a State for any

calendar year shall be assigned to the Secretary for allocation among qualified States for the succeeding calendar year.

(ii) Unused housing credit carryover

For purposes of this subparagraph, the unused housing credit carryover of a State for any calendar year is the excess (if any) of the unused State housing credit ceiling for such year (as defined in subparagraph (C)(ii)) over the excess (if any) of -

(I) the aggregate housing credit dollar amount allocated for such year, over

(II) the sum of the amounts described in clauses (i) and (iii) of subparagraph (C).

(iii) Formula for allocation of unused housing credit carryovers among qualified States

The amount allocated under this subparagraph to a qualified State for any calendar year shall be the amount determined by the Secretary to bear the same ratio to the aggregate unused housing credit carryovers of all States for the preceding calendar year as such State's population for the calendar year bears to the population of all qualified States for the calendar year. For purposes of the preceding sentence, population shall be determined in accordance with section 146(j).

(iv) Qualified State

For purposes of this subparagraph, the term 'qualified State' means, with respect to a calendar year, any State -

(I) which allocated its entire State housing credit ceiling for the preceding calendar year, and

(II) for which a request is made (not later than May 1 of the calendar year) to receive an allocation under clause (iii).

(E) Special rule for States with constitutional home rule cities

For purposes of this subsection -

(i) In general

The aggregate housing credit dollar amount for any constitutional home rule city for any calendar year shall be an amount which bears the same ratio to the State housing credit ceiling for such calendar year as -

(I) the population of such city, bears to

(II) the population of the entire State.

(ii) Coordination with other allocations

In the case of any State which contains 1 or more constitutional home rule cities, for purposes of applying this paragraph with respect to housing credit agencies in such State other than constitutional home rule cities, the State housing credit ceiling for any calendar year shall be reduced by the aggregate housing credit dollar amounts determined for such year for all constitutional home rule cities in such State.

(iii) Constitutional home rule city

For purposes of this paragraph, the term 'constitutional home rule city' has the meaning given such term by section 146(d)(3)(C).

(F) State may provide for different allocation

Rules similar to the rules of section 146(e) (other than

paragraph (2) (B) thereof) shall apply for purposes of this paragraph.

(G) Population

For purposes of this paragraph, population shall be determined in accordance with section 146(j).

- (4) Credit for buildings financed by tax-exempt bonds subject to volume cap not taken into account

(A) In general

Paragraph (1) shall not apply to the portion of any credit allowable under subsection (a) which is attributable to eligible basis financed by any obligation the interest on which is exempt from tax under section 103 if -

(i) such obligation is taken into account under section 146, and

(ii) principal payments on such financing are applied within a reasonable period to redeem obligations the proceeds of which were used to provide such financing.

- (B) Special rule where 50 percent or more of building is financed with tax-exempt bonds subject to volume cap

For purposes of subparagraph (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 any obligation described in subparagraph (A), paragraph (1) shall not apply to any portion of the credit allowable under subsection (a) with respect to such building.

- (5) Portion of State ceiling set-aside for certain projects involving qualified nonprofit organizations

(A) In general

Not more than 90 percent of the State housing credit ceiling for any State for any calendar year shall be allocated to projects other than qualified low-income housing projects described in subparagraph (B).

- (B) Projects involving qualified nonprofit organizations

For purposes of subparagraph (A), a qualified low-income housing project is described in this subparagraph if a qualified nonprofit organization is to own an interest in the project (directly or through a partnership) and materially participate (within the meaning of section 469(h)) in the development and operation of the project throughout the compliance period.

- (C) Qualified nonprofit organization

For purposes of this paragraph, the term 'qualified nonprofit organization' means any organization if -

(i) such organization is described in paragraph (3) or (4) of section 501(c) and is exempt from tax under section 501(a),

(ii) such organization is determined by the State housing credit agency not to be affiliated with or controlled by a for-profit organization; (FOOTNOTE 4) and

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(FOOTNOTE 4) So in original. The semicolon probably should be a comma.

(iii) 1 of the exempt purposes of such organization includes the fostering of low-income housing.

- (D) Treatment of certain subsidiaries

(i) In general

For purposes of this paragraph, a qualified nonprofit organization shall be treated as satisfying the ownership and material participation test of subparagraph (B) if any qualified corporation in which such organization holds stock satisfies such test.

(ii) Qualified corporation

For purposes of clause (i), the term 'qualified corporation' means any corporation if 100 percent of the stock of such corporation is held by 1 or more qualified nonprofit organizations at all times during the period such corporation is in existence.

(E) State may not override set-aside

Nothing in subparagraph (F) of paragraph (3) shall be construed to permit a State not to comply with subparagraph (A) of this paragraph.

(6) Buildings eligible for credit only if minimum long-term commitment to low-income housing

(A) In general

No credit shall be allowed by reason of this section with respect to any building for the taxable year unless an extended low-income housing commitment is in effect as of the end of such taxable year.

(B) Extended low-income housing commitment

For purposes of this paragraph, the term 'extended low-income housing commitment' means any agreement between the taxpayer and the housing credit agency -

(i) which requires that the applicable fraction (as defined in subsection (c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in such agreement and which prohibits the actions described in subclauses (I) and (II) of subparagraph (E)(ii),

(ii) which allows individuals who meet the income limitation applicable to the building under subsection (g) (whether prospective, present, or former occupants of the building) the right to enforce in any State court the requirement and prohibitions of clause (i),

(iii) which prohibits the disposition to any person of any portion of the building to which such agreement applies unless all of the building to which such agreement applies is disposed of to such person,

(iv) which is binding on all successors of the taxpayer, and

(v) which, with respect to the property, is recorded pursuant to State law as a restrictive covenant.

(C) Allocation of credit may not exceed amount necessary to support commitment

(i) In general

The housing credit dollar amount allocated to any building may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building, including any increase in such fraction pursuant to the application of subsection (f)(3) if such increase is reflected in an amended low-income housing commitment.

(ii) Buildings financed by tax-exempt bonds

If paragraph (4) applies to any building the amount of

credit allowed in any taxable year may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building. Such commitment may be amended to increase such fraction.

(D) Extended use period

For purposes of this paragraph, the term 'extended use period' means the period -

(i) beginning on the 1st day in the compliance period on which such building is part of a qualified low-income housing project, and

(ii) ending on the later of -

(I) the date specified by such agency in such agreement, or

(II) the date which is 15 years after the close of the compliance period.

(E) Exceptions if foreclosure or if no buyer willing to maintain low-income status

(i) In general

The extended use period for any building shall terminate -

(I) on the date the building is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Secretary determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate such period, or

(II) on the last day of the period specified in subparagraph (I) if the housing credit agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building.

Subclause (II) shall not apply to the extent more stringent requirements are provided in the agreement or in State law.

(ii) Eviction, etc. of existing low-income tenants not permitted

The termination of an extended use period under clause (i) shall not be construed to permit before the close of the 3-year period following such termination -

(I) the eviction or the 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 such unit not otherwise permitted under this section.

(F) Qualified contract

For purposes of subparagraph (E), the term 'qualified contract' means a bona fide contract to acquire (within a reasonable period after the contract is entered into) the nonlow-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the extended low-income housing commitment) of -

(i) the sum of -

(I) the outstanding indebtedness secured by, or with respect to, the building,

(II) the adjusted investor equity in the building, plus

(III) other capital contributions not reflected in the amounts described in subclause (I) or (II), reduced by

(ii) cash distributions from (or available for distribution

from) the project.

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this paragraph, including regulations to prevent the manipulation of the amount determined under the preceding sentence.

(G) Adjusted investor equity

(i) In general

For purposes of subparagraph (E), the term 'adjusted investor equity' means, with respect to any calendar year, the aggregate amount of cash taxpayers invested with respect to the project increased by the amount equal to -

(I) such amount, multiplied by

(II) the cost-of-living adjustment for such calendar year, determined under section 1(f)(3) by substituting the base calendar year for 'calendar year 1987'.

An amount shall be taken into account as an investment in the project only to the extent there was an obligation to invest such amount as of the beginning of the credit period and to the extent such amount is reflected in the adjusted basis of the project.

(ii) Cost-of-living increases in excess of 5 percent not taken into account

Under regulations prescribed by the Secretary, if the CPI for any calendar year (as defined in section 1(f)(4)) exceeds the CPI for the preceding calendar year by more than 5 percent, the CPI for the base calendar year shall be increased such that such excess shall never be taken into account under clause (i).

(iii) Base calendar year

For purposes of this subparagraph, the term 'base calendar year' means the calendar year with or within which the 1st taxable year of the credit period ends.

(H) Low-income portion

For purposes of this paragraph, the low-income portion of a building is the portion of such building equal to the applicable fraction specified in the extended low-income housing commitment for the building.

(I) Period for finding buyer

The period referred to in this subparagraph is the 1-year period beginning on the date (after the 14th year of the compliance period) the taxpayer submits a written request to the housing credit agency to find a person to acquire the taxpayer's interest in the low-income portion of the building.

(J) Effect of noncompliance

If, during a taxable year, there is a determination that an extended low-income housing agreement was not in effect as of the beginning of such year, such determination shall not apply to any period before such year and subparagraph (A) shall be applied without regard to such determination if the failure is corrected within 1 year from the date of the determination.

(K) Projects which consist of more than 1 building

The application of this paragraph to projects which consist of more than 1 building shall be made under regulations prescribed by the Secretary.

(7) Special rules

(A) Building must be located within jurisdiction of credit agency

A housing credit agency may allocate its aggregate housing credit dollar amount only to buildings located in the jurisdiction of the governmental unit of which such agency is a part.

(B) Agency allocations in excess of limit

If the aggregate housing credit dollar amounts allocated by a housing credit agency for any calendar year exceed the portion of the State housing credit ceiling allocated to such agency for such calendar year, the housing credit dollar amounts so allocated shall be reduced (to the extent of such excess) for buildings in the reverse of the order in which the allocations of such amounts were made.

(C) Credit reduced if allocated credit dollar amount is less than credit which would be allowable without regard to placed in service convention, etc.

(i) In general

The amount of the credit determined under this section with respect to any building shall not exceed the clause (ii) percentage of the amount of the credit which would (but for this subparagraph) be determined under this section with respect to such building.

(ii) Determination of percentage

For purposes of clause (i), the clause (ii) percentage with respect to any building is the percentage which -

(I) the housing credit dollar amount allocated to such building bears to

(II) the credit amount determined in accordance with clause (iii).

(iii) Determination of credit amount

The credit amount determined in accordance with this clause is the amount of the credit which would (but for this subparagraph) be determined under this section with respect to the building if -

(I) this section were applied without regard to paragraphs (2) (A) and (3) (B) of subsection (f), and

(II) subsection (f) (3) (A) were applied without regard to 'the percentage equal to 2/3 of'.

(D) Housing credit agency to specify applicable percentage and maximum qualified basis

In allocating a housing credit dollar amount to any building, the housing credit agency shall specify the applicable percentage and the maximum qualified basis which may be taken into account under this section with respect to such building. The applicable percentage and maximum qualified basis so specified shall not exceed the applicable percentage and qualified basis determined under this section without regard to this subsection.

### **(c)(8) Other definitions**

For purposes of this subsection -

#### **(c)(8)(A) Housing credit agency**

The term 'housing credit agency' means any agency authorized to carry out this subsection.

**(c)(8)(B) Possessions treated as States**

The term 'State' includes a possession of the United States.

(i) Definitions and special rules

For purposes of this section -

(1) Compliance period

The term 'compliance period' means, with respect to any building, the period of 15 taxable years beginning with the 1st taxable year of the credit period with respect thereto.

(2) Determination of whether building is federally subsidized

(A) In general

Except as otherwise provided in this paragraph, for purposes of subsection (b)(1), a new building shall be treated as federally subsidized for any taxable year if, at any time during such taxable year or any prior taxable year, there is or was outstanding any obligation the interest on which is exempt from tax under section 103, or any below market Federal loan, the proceeds of which are or were used (directly or indirectly) with respect to such building or the operation thereof.

(B) Election to reduce eligible basis by balance of loan or proceeds of obligations

A loan or tax-exempt obligation shall not be taken into account under subparagraph (A) if the taxpayer elects to exclude from the eligible basis of the building for purposes of subsection (d) -

(i) in the case of a loan, the principal amount of such loan, and

(ii) in the case of a tax-exempt obligation, the proceeds of such obligation.

(C) Special rule for subsidized construction financing

Subparagraph (A) shall not apply to any tax-exempt obligation or below market Federal loan used to provide construction financing for any building if -

(i) such obligation or loan (when issued or made) identified the building for which the proceeds of such obligation or loan would be used, and

(ii) such obligation is redeemed, and such loan is repaid, before such building is placed in service.

(D) Below market Federal loan

For purposes of this paragraph, the term 'below market Federal loan' means any loan funded in whole or in part with Federal funds if the interest rate payable on such loan is less than the applicable Federal rate in effect under section 1274(d)(1) (as of the date on which the loan was made). Such term shall not include any loan which would be a below market Federal loan solely by reason of assistance provided under section 106, 107, or 108 of the Housing and Community Development Act of 1974 (as in effect on the date of the enactment of this sentence).

(3) Low-income unit

(A) In general

The term 'low-income unit' means any unit in a building if -  
(i) such unit is rent-restricted (as defined in subsection (g)(2)), and  
(ii) the individuals occupying such unit meet the income limitation applicable under subsection (g)(1) to the project of which such building is a part.

(B) Exceptions

(i) In general

A unit shall not be treated as a low-income unit unless the unit is suitable for occupancy and used other than on a transient basis.

(ii) Suitability for occupancy

For purposes of clause (i), the suitability of a unit for occupancy shall be determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes.

(iii) Transitional housing for homeless

For purposes of clause (i), a unit shall be considered to be used other than on a transient basis if the unit contains sleeping accommodations and kitchen and bathroom facilities and is located in a building -

(I) which is used exclusively to facilitate the transition of homeless individuals (within the meaning of section 103 of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11302), as in effect on the date of the enactment of this clause) to independent living within 24 months, and

(II) in which a governmental entity or qualified nonprofit organization (as defined in subsection (h)(5)) provides such individuals with temporary housing and supportive services designed to assist such individuals in locating and retaining permanent housing.

(iv) Single-room occupancy units

For purposes of clause (i), a single-room occupancy unit shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis.

(C) Special rule for buildings having 4 or fewer units

In the case of any building which has 4 or fewer residential rental units, no unit in such building shall be treated as a low-income unit if the units in such building are owned by -

(i) any individual who occupies a residential unit in such building, or

(ii) any person who is related (as defined in subsection (d)(2)(D)(iii)) to such individual.

(D) Certain students not to disqualify unit

A unit shall not fail to be treated as a low-income unit merely because it is occupied by an individual who is -

(i) a student and receiving assistance under title IV of the Social Security Act, or

(ii) enrolled in a job training program receiving assistance under the Job Training Partnership Act or under other similar Federal, State, or local laws.

(E) Owner-occupied buildings having 4 or fewer units eligible for credit where development plan

(i) In general

Subparagraph (C) shall not apply to the acquisition or rehabilitation of a building pursuant to a development plan

of action sponsored by a State or local government or a qualified nonprofit organization (as defined in subsection (h) (5) (C)).

(ii) Limitation on credit

In the case of a building to which clause (i) applies, the applicable fraction shall not exceed 80 percent of the unit fraction.

(iii) Certain unrented units treated as owner-occupied

In the case of a building to which clause (i) applies, any unit which is not rented for 90 days or more shall be treated as occupied by the owner of the building as of the 1st day it is not rented.

(4) New building

The term 'new building' means a building the original use of which begins with the taxpayer.

(5) Existing building

The term 'existing building' means any building which is not a new building.

(6) Application to estates and trusts

In the case of an estate or trust, the amount of the credit determined under subsection (a) and any increase in tax under subsection (j) shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each.

(7) Impact of tenant's right of 1st refusal to acquire property

(A) In general

No Federal income tax benefit shall fail to be allowable to the taxpayer with respect to any qualified low-income building merely by reason of a right of 1st refusal held by the tenants (in cooperative form or otherwise) or resident management corporation of such building or by a qualified nonprofit organization (as defined in subsection (h) (5) (C)) or government agency to purchase the property after the close of the compliance period for a price which is not less than the minimum purchase price determined under subparagraph (B).

(B) Minimum purchase price

For purposes of subparagraph (A), the minimum purchase price under this subparagraph is an amount equal to the sum of -

(i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants), and

(ii) all Federal, State, and local taxes attributable to such sale.

Except in the case of Federal income taxes, there shall not be taken into account under clause (ii) any additional tax attributable to the application of clause (ii).

(j) Recapture of credit

(1) In general

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.

(2) Credit recapture amount

For purposes of paragraph (1), the credit recapture amount 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 paragraph (1)(B) over the amount described in paragraph (1)(A), plus

(B) interest at the overpayment rate established under section 6621 on the amount determined under subparagraph (A) for each prior taxable year for the period beginning on the due date for filing the return for the prior taxable year involved. No deduction shall be allowed under this chapter for interest described in subparagraph (B).

(3) Accelerated portion of credit

For purposes of paragraph (2), the accelerated portion of the credit for the prior taxable years with respect to any amount of basis is the excess of -

(A) the aggregate credit allowed by reason of this section (without regard to this subsection) for such years with respect to such basis, over

(B) the aggregate credit which would be allowable by reason of this section for such years with respect to such basis if the aggregate credit which would (but for this subsection) have been allowable for the entire compliance period were allowable ratably over 15 years.

(4) Special rules

(A) Tax benefit rule

The tax for the taxable year shall be increased under paragraph (1) only with respect to credits allowed by reason of this section which were used to reduce tax liability. In the case of credits not so used to reduce tax liability, the carryforwards and carrybacks under section 39 shall be appropriately adjusted.

(B) Only basis for which credit allowed taken into account

Qualified basis shall be taken into account under paragraph (1)(B) only to the extent such basis was taken into account in determining the credit under subsection (a) for the preceding taxable year referred to in such paragraph.

(C) No recapture of additional credit allowable by reason of subsection (f)(3)

Paragraph (1) shall apply to a decrease in qualified basis only to the extent such decrease exceeds the amount of qualified basis with respect to which a credit was allowable for the taxable year referred to in paragraph (1)(B) by reason of subsection (f)(3).

(D) No credits against tax

Any increase in tax under this subsection shall not be treated as a tax imposed by this chapter for purposes of determining the amount of any credit under subpart A, B, D, or G of this part.

(E) No recapture by reason of casualty loss

The increase in tax under this subsection 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.

(F) No recapture where de minimis changes in floor space  
The Secretary may provide that the increase in tax under this subsection shall not apply with respect to any building if -

- (i) such increase results from a de minimis change in the floor space fraction under subsection (c)(1), and
- (ii) the building is a qualified low-income building after such change.

(5) Certain partnerships treated as the taxpayer

(A) In general

For purposes of applying this subsection to a partnership to which this paragraph applies -

- (i) such partnership shall be treated as the taxpayer to which the credit allowable under subsection (a) was allowed,
- (ii) the amount of such credit allowed shall be treated as the amount which would have been allowed to the partnership were such credit allowable to such partnership,
- (iii) paragraph (4)(A) shall not apply, and
- (iv) the amount of the increase in tax under this subsection for any taxable year shall be allocated among the partners of such partnership in the same manner as such partnership's taxable income for such year is allocated among such partners.

(B) Partnerships to which paragraph applies

This paragraph shall apply to any partnership which has 35 or more partners unless the partnership elects not to have this paragraph apply.

(C) Special rules

(i) Husband and wife treated as 1 partner

For purposes of subparagraph (B)(i), a husband and wife (and their estates) shall be treated as 1 partner.

(ii) Election irrevocable

Any election under subparagraph (B), once made, shall be irrevocable.

(6) No recapture on disposition of building (or interest therein) where bond posted

In the case of a disposition of a building or an interest therein, the taxpayer shall be discharged from liability for any additional tax under this subsection by reason of such disposition if -

- (A) the taxpayer furnishes to the Secretary a bond in an amount satisfactory (FOOTNOTE 5) to the Secretary and for the period required by the Secretary, and

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(FOOTNOTE 5) So in original. Probably should be 'satisfactory'.

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(B) it is reasonably expected that such building will continue to be operated as a qualified low-income building for the remaining compliance period with respect to such building.

(k) Application of at-risk rules

For purposes of this section -

(1) In general

Except as otherwise provided in this subsection, rules similar to the rules of section 49(a)(1) (other than subparagraphs (D)(ii)(II) and (D)(iv)(I) thereof), section 49(a)(2), and

section 49(b)(1) shall apply in determining the qualified basis of any building in the same manner as such sections apply in determining the credit base of property.

(2) Special rules for determining qualified person

For purposes of paragraph (1) -

(A) In general

If the requirements of subparagraphs (B), (C), and (D) are met with respect to any financing borrowed from a qualified nonprofit organization (as defined in subsection (h)(5)), the determination of whether such financing is qualified commercial financing with respect to any qualified low-income building shall be made without regard to whether such organization -

(i) is actively and regularly engaged in the business of lending money, or

(ii) is a person described in section 49(a)(1)(D)(iv)(II).

(B) Financing secured by property

The requirements of this subparagraph are met with respect to any financing if such financing is secured by the qualified low-income building, except that this subparagraph shall not apply in the case of a federally assisted building described in subsection (d)(6)(B) if -

(i) a security interest in such building is not permitted by a Federal agency holding or insuring the mortgage secured by such building, and

(ii) the proceeds from the financing (if any) are applied to acquire or improve such building.. (FOOTNOTE 6)

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(FOOTNOTE 6) So in original.

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(C) Portion of building attributable to financing

The requirements of this subparagraph are met with respect to any financing for any taxable year in the compliance period if, as of the close of such taxable year, not more than 60 percent of the eligible basis of the qualified low-income building is attributable to such financing (reduced by the principal and interest of any governmental financing which is part of a wrap-around mortgage involving such financing).

(D) Repayment of principal and interest

The requirements of this subparagraph are met with respect to any financing if such financing is fully repaid on or before the earliest of -

(i) the date on which such financing matures,

(ii) the 90th day after the close of the compliance period with respect to the qualified low-income building, or

(iii) the date of its refinancing or the sale of the building to which such financing relates.

In the case of a qualified nonprofit organization which is not described in section 49(a)(1)(D)(iv)(II) with respect to a building, clause (ii) of this subparagraph shall be applied as if the date described therein were the 90th day after the earlier of the date the building ceases to be a qualified low-income building or the date which is 15 years after the close of a compliance period with respect thereto.

(3) Present value of financing

If the rate of interest on any financing described in paragraph (2)(A) is less than the rate which is 1 percentage point below

the applicable Federal rate as of the time such financing is incurred, then the qualified basis (to which such financing relates) of the qualified low-income building shall be the present value of the amount of such financing, using as the discount rate such applicable Federal rate. For purposes of the preceding sentence, the rate of interest on any financing shall be determined by treating interest to the extent of government subsidies as not payable.

(4) Failure to fully repay

(A) In general

To the extent that the requirements of paragraph (2) (D) are not met, then the taxpayer's tax under this chapter for the taxable year in which such failure occurs shall be increased by an amount equal to the applicable portion of the credit under this section with respect to such building, increased by an amount of interest for the period -

(i) beginning with the due date for the filing of the return of tax imposed by chapter 1 for the 1st taxable year for which such credit was allowable, and

(ii) ending with the due date for the taxable year in which such failure occurs,

determined by using the underpayment rate and method under section 6621.

(B) Applicable portion

For purposes of subparagraph (A), the term 'applicable portion' means the aggregate decrease in the credits allowed to a taxpayer under section 38 for all prior taxable years which would have resulted if the eligible basis of the building were reduced by the amount of financing which does not meet requirements of paragraph (2) (D).

(C) Certain rules to apply

Rules similar to the rules of subparagraphs (A) and (D) of subsection (j) (4) shall apply for purposes of this subsection.

(1) Certifications and other reports to Secretary

(1) Certification with respect to 1st year of credit period

Following the close of the 1st taxable year in the credit period with respect to 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 such building was placed in service,

(B) the adjusted basis and eligible basis of such 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 subsection (h),

(D) the election made under subsection (g) with respect to the qualified low-income housing project of which such building is a part, 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 therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, no credit shall be allowable by reason of subsection (a) with respect to such building for any taxable year ending before such certification is made.

(2) Annual reports to the Secretary

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 information described in paragraph (1)(C) for the taxable year, and

(C) such other information as the Secretary may require.

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

(3) Annual reports from housing credit agencies

Each agency which allocates any housing credit amount to any building for any calendar year shall submit to the Secretary (at such time and in such manner as the Secretary shall prescribe) an annual report specifying -

(A) the amount of housing credit amount allocated to each building for such year,

(B) sufficient information to identify each such building and the taxpayer with respect thereto, and

(C) such other information as the Secretary may require.

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

(m) Responsibilities of housing credit agencies

(1) Plans for allocation of credit among projects

(A) In general

Notwithstanding any other provision of this section, the housing credit dollar amount with respect to any building shall be zero unless -

(i) such amount was allocated pursuant to a qualified allocation plan of the housing credit agency which is approved by the governmental unit (in accordance with rules similar to the rules of section 147(f)(2) (other than subparagraph (B)(ii) thereof)) of which such agency is a part, and

(ii) such agency notifies the chief executive officer (or the equivalent) of the local jurisdiction within which the building is located of such project and provides such individual a reasonable opportunity to comment on the project.

(B) Qualified allocation plan

For purposes of this paragraph, the term 'qualified allocation plan' means any plan -

(i) which sets forth selection criteria to be used to determine housing priorities of the housing credit agency which are appropriate to local conditions,

(ii) which also gives preference in allocating housing credit dollar amounts among selected projects to -

(I) projects serving the lowest income tenants, and

(II) projects obligated to serve qualified tenants for the longest periods, and

(iii) which provides a procedure that the agency (or an agent or other private contractor of such agency) will follow in monitoring for noncompliance with the provisions of this section and in notifying the Internal Revenue Service of such noncompliance which such agency becomes aware of.

(C) Certain selection criteria must be used  
The selection criteria set forth in a qualified allocation plan must include

- (i) project location,
- (ii) housing needs characteristics,
- (iii) project characteristics,
- (iv) sponsor characteristics,
- (v) participation of local tax-exempt organizations,
- (vi) tenant populations with special housing needs, and
- (vii) public housing waiting lists.

(D) Application to bond financed projects

Subsection (h) (4) shall not apply to any project unless the project satisfies the requirements for allocation of a housing credit dollar amount under the qualified allocation plan applicable to the area in which the project is located.

(2) Credit allocated to building not to exceed amount necessary to assure project feasibility

(A) In general

The housing credit dollar amount allocated to a project shall not exceed the amount the housing credit 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.

(B) Agency evaluation

In making the determination under subparagraph (A), the housing credit 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, and

(iii) the percentage of the housing credit dollar amount used for project costs other than the cost of intermediaries. Clause (iii) shall not be applied so as to impede the development of projects in hard-to-develop areas. Such a determination shall not be construed to be a representation or warranty as to the feasibility or viability of the project.

(C) Determination made when credit amount applied for and when building placed in service

(i) In general

A determination under subparagraph (A) shall be made as of each of the following times:

(I) The application for the housing credit dollar amount.

(II) The allocation of the housing credit dollar amount.

(III) The date the building is placed in service.

(ii) Certification as to amount of other subsidies

Prior to each determination under clause (i), the taxpayer shall certify to the housing credit agency the full extent of all Federal, State, and local subsidies which apply (or which the taxpayer expects to apply) with respect to the building.

(D) Application to bond financed projects

Subsection (h) (4) shall not apply to any project unless the governmental unit which issued the bonds (or on behalf of which the bonds were issued) makes a determination under rules similar to the rules of subparagraphs (A) and (B).

(n) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section,

including regulations -  
(1) dealing with -  
    (A) projects which include more than 1 building or only a portion of a building,  
    (B) buildings which are placed in service in portions,  
(2) providing for the application of this section to short taxable years,  
(3) preventing the avoidance of the rules of this section, and  
(4) providing the opportunity for housing credit agencies to correct administrative errors and omissions with respect to allocations and record keeping within a reasonable period after their discovery, taking into account the availability of regulations and other administrative guidance from the Secretary.

(o) Termination

(1) In general

Except as provided in paragraph (2), for any calendar year after 1991 -

(A) clause (i) of subsection (h) (3) (C) shall not apply, and  
(B) subsection (h) (4) shall not apply to any building placed in service after 1991.

(2) Exception for bond-financed buildings in progress

For purposes of paragraph (1) (B), a building shall be treated as placed in service before 1992 if -

(A) the bonds with respect to such building are issued before 1992,

(B) the taxpayer's basis in the project (of which the building is a part) as of December 31, 1991, is more than 10 percent of the taxpayer's reasonably expected basis in such project as of December 31, 1993, and

(C) such building is placed in service before January 1, 1994.

## SOURCE

(Added Pub. L. 99-514, title II, Sec. 252(a), Oct. 22, 1986, 100 Stat. 2189, and amended Pub. L. 99-509, title VIII, Sec. 8072(a), Oct. 21, 1986, 100 Stat. 1964; Pub. L. 100-647, title I, Sec. 1002(l) (1)-(25), (32), 1007(g) (3) (B), title IV, Sec. 4003(a), (b) (1), (3), 4004(a), Nov. 10, 1988, 102 Stat. 3373-3381, 3435, 3643, 3644; Pub. L. 101-239, title VII, Sec. 7108(a) (1), (b)-(e) (2), (f)-(m), (n) (2)-(q), 7811(a), 7831(c), 7841(d) (13)-(15), Dec. 19, 1989, 103 Stat. 2306-2321, 2406, 2426, 2429; Pub. L. 101-508, title XI, Sec. 11407(a) (1), (b) (1)-(9), 11701(a) (1)-(3) (A), (4), (5) (A), (6)-(10), 11812(b) (3), 11813(b) (3), Nov. 5, 1990, 104 Stat. 1388-474, 1388-475, 1388-505 to 1388-507, 1388-535, 1388-551.)

## REFTEXT

### References In Text

Section 8 of the United States Housing Act of 1937, referred to in subsecs. (c)(2), (d)(6)(B)(i), and (g)(2)(B), is classified to section 1437f of Title 42, The Public Health and Welfare. Section 8(e)(2) of the Act was repealed by Pub. L. 101-625, title II, Sec. 289(b)(1), Nov. 28, 1990, 104 Stat. 4128, effective Oct. 1, 1991, but to remain in effect with respect to single room occupancy dwellings as authorized by subchapter IV (Sec. 11361 et seq.) of chapter 119 of Title 42. See section 12839(b) of Title 42.

The Stewart B. McKinney Homeless Assistance Act of 1988, referred to in subsec. (c)(2), probably means the Stewart B. McKinney Homeless Assistance Act, Pub. L. 100-77, July 22, 1987, 101 Stat. 482, as amended, which is classified principally to chapter 119 (Sec. 11301 et seq.) of Title 42. For complete classification of this Act to the Code, see Short Title note set out under section 11301 of Title 42 and Tables.

The date of the enactment of this sentence, referred to in subsec. (c)(2), is the date of the enactment of Pub. L. 101-508, which was approved Nov. 5, 1990.

Section 201(a) of the Tax Reform Act of 1986, referred to in subsec. (c)(2)(B), is section 201(a) of Pub. L. 99-514, which amended section 168 of this title generally.

The date of the enactment of the Tax Reform Act of 1986, referred to in subsec. (d)(2)(D)(i)(I), (6)(B), is the date of enactment of Pub. L. 99-514, which was approved Oct. 22, 1986.

The date of the enactment of the Revenue Reconciliation Act of 1990, referred to in subsec. (d)(2)(D)(i)(I), (5)(B), is the date of the enactment of Pub. L. 101-508, which was approved Nov. 5, 1990.

Sections 221(d)(3) and 236 of the National Housing Act, referred to in subsec. (d)(6)(B)(ii), are classified to sections 1715l(d)(3) and 1715z-1, respectively, of Title 12, Banks and Banking.

Sections 515 and 502(c) of the Housing Act of 1949, referred to in subsecs. (d)(6)(B)(iii), (C)(i) and (g)(2)(B)(iv), are classified to sections 1485 and 1472(c), respectively, of Title 42, The Public Health and Welfare.

The Emergency Low Income Housing Preservation Act of 1987, referred to in subsec. (d)(6)(C)(i), now the Low-Income Housing Preservation and Resident Homeownership Act of 1990, is title II of Pub. L. 100-242, Feb. 5, 1988, 101 Stat. 1877, as amended. Subtitle B of title II, which was formerly set out as a note under section 1715l of Title 12, Banks and Banking, and which amended section 1715z-6 of Title 12, was amended generally by Pub. L. 101-625 and is classified to chapter 42 (Sec. 4101 et seq.) of Title 12. For complete classification of this Act to the Code, see Short Title note set out under section 4101 of Title 12 and Tables.

Section 3 of the Federal Deposit Insurance Act, referred to in subsec. (d)(6)(D), is classified to section 1813 of Title 12.

The date of the enactment of this subparagraph, referred to in subsec. (g)(2)(E), is the date of enactment of Pub. L. 100-647, which was approved Nov. 10, 1988.

Sections 106, 107, and 108 of the Housing and Community Development Act of 1974 (as in effect on the date of the enactment of this sentence), referred to in subsec. (i)(2)(D), are classified to sections 5306, 5307, and 5308 of Title 42, The Public Health and Welfare, as in effect on the date of enactment of Pub. L. 101-239, which was approved Dec. 19, 1989.

The date of the enactment of this clause, referred to in subsec. (i)(3)(B)(iii)(I), is date of enactment of Pub. L. 101-239, which was approved Dec. 19, 1989.

The Social Security Act, referred to in subsec. (i)(3)(D)(i), is act Aug. 14, 1935, ch. 531, 49 Stat. 620, as amended. Title IV of the Act is classified generally to subchapter IV (Sec. 601 et seq.) of chapter 7 of Title 42, The Public Health and Welfare. For complete classification of this Act to the Code, see section 1305 of Title 42 and Tables.

The Job Training Partnership Act, referred to in subsec. (i)(3)(D)(ii), is Pub. L. 97-300, Oct. 13, 1982, 96 Stat. 1322, which is classified generally to chapter 19 (Sec. 1501 et seq.) of Title 29, Labor. For complete classification of this Act to the Code, see Short Title note set out under section 1501 of Title 29 and Tables.

## MISC2

### Prior Provisions

A prior section 42, added Pub. L. 94-12, title II, Sec. 203(a), Mar. 29, 1975, 89 Stat. 29, and amended Pub. L. 94-164, Sec. 3(a)(1), Dec. 23, 1975, 89 Stat. 972; Pub. L. 94-455, title IV, Sec. 401(a)(2)(A), (B), title V, Sec. 503(b)(4), title XIX, Sec. 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1555, 1562, 1834; Pub. L. 95-30, title I, Sec. 101(c), May 23, 1977, 91 Stat. 132, which related to the general tax credit allowed to individuals in an amount equal to the greater of (1) 2% of taxable income not exceeding \$9,000 or (2) \$35 multiplied by each exemption the taxpayer was entitled to, expired Dec. 31, 1978 pursuant to the terms of: (1) Pub. L. 94-12, Sec. 209(a) as amended by Pub. L. 94-164, Sec. 2(e), set out as an Effective and Termination Dates of 1975 Amendment note under section 56 of this title; (2) Pub. L. 94-164, Sec. 3(b) as amended by Pub. L. 94-455, Sec. 401(a)(1) and Pub. L. 95-30, Sec. 103(a); and (3) Pub. L. 94-455, Sec. 401(e), as amended by Pub. L. 95-30, Sec. 103(c) and Pub. L. 95-600, title I, Sec. 103(b), Nov. 6, 1978, 92 Stat. 2771, set out as an Effective and Termination Dates of 1976 Amendment note under section 32 of this title.

Another prior section 42 was renumbered section 35 of this title.

### Amendments

1990 - Subsec. (b)(1). Pub. L. 101-508, Sec. 11701(a)(1)(B), struck out at end 'A building shall not be treated as described in subparagraph (B) if, at any time during the credit period, moderate rehabilitation assistance is provided with respect to such building under section 8(e)(2) of the United States Housing Act of 1937.'

Subsec. (c)(2). Pub. L. 101-508, Sec. 11701(a)(1)(A), inserted at end 'Such term does not include any building with respect to which moderate rehabilitation assistance is provided, at any time during the compliance period, under section 8(e)(2) of the United States Housing Act of 1937.'

Pub. L. 101-508, Sec. 11407(b)(5)(A), inserted before period at end of last sentence '(other than assistance under the Stewart B. McKinney Homeless Assistance Act of 1988 (as in effect on the date of the enactment of this sentence))'.

Subsec. (d)(2)(D)(i)(I). Pub. L. 101-508, Sec. 11812(b)(3), inserted '(as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990)' after 'section 167(k).'

Subsec. (d)(2)(D)(ii)(V). Pub. L. 101-508, Sec. 11407(b)(8), added subcl. (V).

Subsec. (d)(5)(B). Pub. L. 101-508, Sec. 11812(b)(3), inserted '(as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990)' after 'section 167(k).'

Subsec. (d)(5)(C)(ii)(I). Pub. L. 101-508, Sec. 11407(b)(4), inserted at end 'If the Secretary of Housing and Urban Development determines that sufficient data for any period are not available to apply this clause on the basis of census tracts, such Secretary shall apply this clause for such period on the basis of enumeration districts.'

Pub. L. 101-508, Sec. 11701(a)(2)(B), inserted before period at end 'for such year'.

Pub. L. 101-508, Sec. 11701(a)(2)(A), which directed the insertion of 'which is designated by the Secretary of Housing and Urban Development and, for the most recent year for which census data are available on household income in such tract,' after 'census tract', was executed by making the insertion after 'any census tract' to reflect the probable intent of Congress.

Subsec. (g)(2)(B)(iv). Pub. L. 101-508, Sec. 11407(b)(3), added cl. (iv).

Subsec. (g)(2)(D)(i). Pub. L. 101-508, Sec. 11701(a)(3)(A), inserted before period at end 'and such unit continues to be rent-restricted'.

Subsec. (g)(2)(D)(ii). Pub. L. 101-508, Sec. 11701(a)(4), inserted at end 'In the case of a project described in section 142(d)(4)(B), the preceding sentence shall be applied by substituting '170 percent' for '140 percent' and by substituting 'any low-income unit in the building is occupied by a new resident whose income exceeds 40 percent of area median gross income' for 'any residential unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds such income limitation'.'

Subsec. (g)(3)(A). Pub. L. 101-508, Sec. 11701(a)(5)(A), substituted 'the 1st year of the credit period for such building' for 'the 12-month period beginning on the date the building is placed in service'.

Subsec. (h)(3)(C). Pub. L. 101-508, Sec. 11701(a)(6)(A), substituted 'the sum of the amounts described in clauses (i) and (iii)' for 'the amount described in clause (i)' in second sentence.

Subsec. (h) (3) (D) (ii) (II). Pub. L. 101-508, Sec. 11701(a) (6) (B), substituted 'the sum of the amounts described in clauses (i) and (iii)' for 'the amount described in clause (i)'.

Subsec. (h) (5) (B). Pub. L. 101-508, Sec. 11407(b) (9) (A), inserted 'own an interest in the project (directly or through a partnership) and' after 'nonprofit organization is to'.

Subsec. (h) (5) (C) (i) to (iii). Pub. L. 101-508, Sec. 11407(b) (9) (B), added cl. (ii) and redesignated former cl. (ii) as (iii).

Subsec. (h) (5) (D) (i). Pub. L. 101-508, Sec. 11407(b) (9) (C), inserted 'ownership and' before 'material participation'.

Subsec. (h) (6) (B) (i). Pub. L. 101-508, Sec. 11701(a) (7) (A), inserted before comma at end 'and which prohibits the actions described in subclauses (I) and (II) of subparagraph (E) (ii)'.

Subsec. (h) (6) (B) (ii). Pub. L. 101-508, Sec. 11701(a) (7) (B), substituted 'requirement and prohibitions' for 'requirement'.

Subsec. (h) (6) (B) (iii) to (v). Pub. L. 101-508, Sec. 11701(a) (8) (A), added cl. (iii) and redesignated former cls. (iii) and (iv) as (iv) and (v), respectively.

Subsec. (h) (6) (E) (i) (I). Pub. L. 101-508, Sec. 11701(a) (9), inserted before comma 'unless the Secretary determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate such period'.

Subsec. (h) (6) (E) (ii) (II). Pub. L. 101-508, Sec. 11701(a) (8) (C), inserted before period at end 'not otherwise permitted under this section'.

Subsec. (h) (6) (F). Pub. L. 101-508, Sec. 11701(a) (8) (D), inserted 'the nonlow-income portion of the building for fair market value and' before 'the low-income portion' in introductory provisions.

Subsec. (h) (6) (J) to (L). Pub. L. 101-508, Sec. 11701(a) (8) (B), redesignated subpars. (K) and (L) as (J) and (K), respectively, and struck out former subpar. (J) which related to sales of less than the low-income portions of a building.

Subsec. (i) (3) (D). Pub. L. 101-508, Sec. 11407(b) (6), substituted 'Certain students' for 'Students in government-supported job training programs' in heading and amended text generally. Prior to amendment, text read as follows: 'A unit shall not fail to be treated as a low-income unit merely because it is occupied by an individual who is enrolled in a job training program receiving assistance under the Job Training Partnership Act or under other similar Federal, State, or local laws.'

Subsec. (i) (7). Pub. L. 101-508, Sec. 11701(a) (10), redesignated par. (8) as (7).

Subsec. (i) (7) (A). Pub. L. 101-508, Sec. 11407(b) (1), substituted 'the tenants (in cooperative form or otherwise) or resident management corporation of such building or by a qualified nonprofit organization (as defined in subsection (h) (5) (C)) or government agency' for 'the tenants of such building'.

Subsec. (i) (8). Pub. L. 101-508, Sec. 11701(a) (10), redesignated par. (8) as (7).

Subsec. (k) (1). Pub. L. 101-508, Sec. 11813(b) (3) (A), substituted '49(a) (1)' for '46(c) (8)', '49(a) (2)' for '46(c) (9)', and '49(b) (1)' for '47(d) (1)'.

Subsec. (k) (2) (A) (ii), (D). Pub. L. 101-508, Sec. 11813(b) (3) (B), substituted '49(a) (1) (D) (iv) (II)' for '46(c) (8) (D) (iv) (II)'.

Subsec. (m) (1) (B) (ii) to (iv). Pub. L. 101-508, Sec. 11407(b) (7) (B), redesignated cls. (iii) and (iv) as (ii) and (iii),

respectively, and struck out former cl. (ii) which read as follows: 'which gives the highest priority to those projects as to which the highest percentage of the housing credit dollar amount is to be used for project costs other than the cost of intermediaries unless granting such priority would impede the development of projects in hard-to-develop areas,'.

Pub. L. 101-508, Sec. 11407(b)(2), amended cl. (iv) generally. Prior to amendment, cl. (iv) read as follows: 'which provides a procedure that the agency will follow in notifying the Internal Revenue Service of noncompliance with the provisions of this section which such agency becomes aware of.'

Subsec. (m)(2)(B). Pub. L. 101-508, Sec. 11407(b)(7)(A), added cl. (iii) and inserted provision that cl. (iii) not be applied so as to impede the development of projects in hard-to-develop areas.

Subsec. (o)(1). Pub. L. 101-508, Sec. 11407(a)(1)(A), substituted '1991' for '1990' wherever appearing.

Subsec. (o)(2). Pub. L. 101-508, Sec. 11407(a)(1)(B), added par. (2) and struck out former par. (2) which read as follows: 'For purposes of paragraph (1)(B), a building shall be treated as placed in service before 1990 if -

'(A) the bonds with respect to such building are issued before 1990,

'(B) such building is constructed, reconstructed, or rehabilitated by the taxpayer,

'(C) more than 10 percent of the reasonably anticipated cost of such construction, reconstruction, or rehabilitation has been incurred as of January 1, 1990, and some of such cost is incurred on or after such date, and

'(D) such building is placed in service before January 1, 1992.'

1989 - Subsec. (b)(1). Pub. L. 101-239, Sec. 7108(h)(5), inserted at end 'A building shall not be treated as described in subparagraph (B) if, at any time during the credit period, moderate rehabilitation assistance is provided with respect to such building under section 8(e)(2) of the United States Housing Act of 1937.'

Subsec. (b)(3)(C). Pub. L. 101-239, Sec. 7108(c)(2), which directed amendment of subpar. (C) by substituting 'subsection (h)(7)' for 'subsection (h)(6))', was executed by substituting 'subsection (h)(7)' for 'subsection (h)(6)', as the probable intent of Congress.

Subsec. (c)(1)(E). Pub. L. 101-239, Sec. 7108(i)(2), added subpar. (E).

Subsec. (d)(1). Pub. L. 101-239, Sec. 7108(l)(1), inserted 'as of the close of the 1st taxable year of the credit period' before period at end.

Subsec. (d)(2)(A). Pub. L. 101-239, Sec. 7108(l)(2), substituted 'subparagraph (B), its adjusted basis as of the close of the 1st taxable year of the credit period, and' for 'subparagraph (B), the sum of -

'(I) the portion of its adjusted basis attributable to its acquisition cost, plus

'(II) amounts chargeable to capital account and incurred by the taxpayer (before the close of the 1st taxable year of the credit period for such building) for property (or additions or improvements to property) of a character subject to the allowance for depreciation, and'.

Subsec. (d)(2)(B)(iv). Pub. L. 101-239, Sec. 7108(d)(1), added

cl. (iv).

Subsec. (d) (2) (C). Pub. L. 101-239, Sec. 7108(1) (3) (A), substituted 'Adjusted basis' for 'Acquisition cost' in heading and 'adjusted basis' for 'cost' in text.

Subsec. (d) (5). Pub. L. 101-239, Sec. 7108(1) (3) (B), substituted 'Special rules for determining eligible basis' for 'Eligible basis determined when building placed in service' in heading.

Subsec. (d) (5) (A). Pub. L. 101-239, Sec. 7108(1) (3) (B), redesignated subpar. (B) as (A) and struck out former subpar. (A) which read as follows: 'Except as provided in subparagraphs (B) and (C), the eligible basis of any building for the entire compliance period for such building shall be its eligible basis on the date such building is placed in service (increased, in the case of an existing building which meets the requirements of paragraph (2) (B), by the amounts described in paragraph (2) (A) (i) (II)).'

Subsec. (d) (5) (B). Pub. L. 101-239, Sec. 7108(1) (3) (B), redesignated subpar. (C) as (B). Former subpar. (B) redesignated (A).

Subsec. (d) (5) (C). Pub. L. 101-239, Sec. 7108(1) (3) (B), redesignated subpar. (D) as (C). Former subpar. (C) redesignated (B).

Pub. L. 101-239, Sec. 7811(a) (1), inserted 'section' before '167(k)' in heading.

Subsec. (d) (5) (D). Pub. L. 101-239, Sec. 7108(1) (3) (B), redesignated subpar. (D) as (C).

Pub. L. 101-239, Sec. 7108(g), added subpar. (D).

Subsec. (d) (6) (A) (i). Pub. L. 101-239, Sec. 7841(d) (13), substituted 'Farmers Home Administration' for 'Farmers' Home Administration'.

Subsec. (d) (6) (C) to (E). Pub. L. 101-239, Sec. 7108(f), added subpars. (C) and (D) and redesignated former subpar. (C) as (E).

Subsec. (d) (7) (A). Pub. L. 101-239, Sec. 7831(c) (6), inserted '(or interest therein)' after 'subparagraph (B)' in introductory provisions.

Subsec. (d) (7) (A) (ii). Pub. L. 101-239, Sec. 7841(d) (14), substituted 'under subsection (a)' for 'under subsection (a) '.

Subsec. (e) (2) (A). Pub. L. 101-239, Sec. 7841(d) (15), substituted 'to capital account' for 'to captial account'.

Subsec. (e) (3). Pub. L. 101-239, Sec. 7108(d) (3), substituted 'Minimum expenditures to qualify' for 'Average of rehabilitation expenditures must be \$2,000 or more' in heading, added subpars. (A) and (B), redesignated former subpar. (B) as (C), and struck out former subpar. (A) which read as follows: 'Paragraph (1) shall apply to rehabilitation expenditures with respect to any building only if the qualified basis attributable to such expenditures incurred during any 24-month period, when divided by the low-income units in the building, is \$2,000 or more.'

Subsec. (e) (5). Pub. L. 101-239, Sec. 7108(1) (3) (C), substituted 'subsection (d) (2) (A) (i)' for 'subsection (d) (2) (A) (i) (II) '.

Subsec. (f) (4). Pub. L. 101-239, Sec. 7831(c) (4), added par. (4).

Subsec. (f) (5). Pub. L. 101-239, Sec. 7108(d) (2), added par. (5).

Subsec. (g) (2) (A). Pub. L. 101-239, Sec. 7108(e) (2), inserted at end 'For purposes of the preceding sentence, the amount of the income limitation under paragraph (1) applicable for any period shall not be less than such limitation applicable for the earliest period the building (which contains the unit) was included in the determination of whether the project is a qualified low-income

housing project.'

Pub. L. 101-239, Sec. 7108(e)(1)(B), substituted 'the imputed income limitation applicable to such unit' for 'the income limitation under paragraph (1) applicable to individuals occupying such unit'.

Subsec. (g)(2)(B). Pub. L. 101-239, Sec. 7108(h)(2), added cl. (iii) and concluding provisions which defined 'supportive service'.

Subsec. (g)(2)(C) to (E). Pub. L. 101-239, Sec. 7108(e)(1)(A), added subpars. (C) and (D) and redesignated former subpar. (C) as (E).

Subsec. (g)(3)(D). Pub. L. 101-239, Sec. 7108(m)(3), added subpar. (D).

Subsec. (g)(4). Pub. L. 101-239, Sec. 7108(n)(2), struck out 'other than section 142(d)(4)(B)(iii))' after 'in applying such provisions'.

Subsec. (g)(7). Pub. L. 101-239, Sec. 7108(h)(3), added par. (7).

Subsec. (h)(1)(B). Pub. L. 101-239, Sec. 7108(m)(2), substituted '(E), or (F)' for 'or (E)'.

Subsec. (h)(1)(F). Pub. L. 101-239, Sec. 7108(m)(1), added subpar. (F).

Subsec. (h)(3)(C) to (G). Pub. L. 101-239, Sec. 7108(b)(1), added subpars. (C) and (D), redesignated former subpars. (D) to (F) as (E) to (G), respectively, and struck out former subpar. (C) which read as follows: 'The State housing credit ceiling applicable to any State for any calendar year shall be an amount equal to \$1.25 multiplied by the State population.'

Subsec. (h)(4)(B). Pub. L. 101-239, Sec. 7108(j), substituted '50 percent' for '70 percent' in heading and in text.

Subsec. (h)(5)(D)(ii). Pub. L. 101-239, Sec. 7811(a)(2), substituted 'clause (i)' for 'clause (ii)'.

Subsec. (h)(5)(E). Pub. L. 101-239, Sec. 7108(b)(2)(A), substituted 'subparagraph (F)' for 'subparagraph (E)'.

Subsec. (h)(6). Pub. L. 101-239, Sec. 7108(c)(1), added par. (6). Former par. (6) redesignated (7).

Subsec. (h)(6)(B) to (E). Pub. L. 101-239, Sec. 7108(b)(2)(B), redesignated subpars. (C) to (E) as (B) to (D), respectively, and struck out former subpar. (B) which provided that the housing credit dollar amount could not be carried over to any other calendar year.

Subsec. (h)(7), (8). Pub. L. 101-239, Sec. 7108(c)(1), redesignated pars. (6) and (7) as (7) and (8), respectively.

Subsec. (i)(2)(D). Pub. L. 101-239, Sec. 7108(k), inserted at end 'Such term shall not include any loan which would be a below market Federal loan solely by reason of assistance provided under section 106, 107, or 108 of the Housing and Community Development Act of 1974 (as in effect on the date of the enactment of this sentence).'

Subsec. (i)(3)(B). Pub. L. 101-239, Sec. 7108(i)(1), amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: 'A unit shall not be treated as a low-income unit unless the unit is suitable for occupancy (as determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes) and used other than on a transient basis. For purposes of the preceding sentence, a single-room occupancy unit shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis.'

Pub. L. 101-239, Sec. 7831(c)(1), inserted '(as determined under regulations prescribed by the Secretary taking into account local

health, safety, and building codes)' after 'suitable for occupancy'.

Pub. L. 101-239, Sec. 7108(h)(1), inserted at end 'For purposes of the preceding sentence, a single-room occupancy unit shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis.'

Subsec. (i)(3)(D). Pub. L. 101-239, Sec. 7831(c)(2), added subpar. (D).

Subsec. (i)(3)(E). Pub. L. 101-239, Sec. 7108(h)(4), added subpar. (E).

Subsec. (i)(6). Pub. L. 101-239, Sec. 7831(c)(3), added par. (6).

Subsec. (i)(8). Pub. L. 101-239, Sec. 7108(q), added par. (8).

Subsec. (k)(2)(D). Pub. L. 101-239, Sec. 7108(o), added provision at end relating to the applicability of cl. (ii) to qualified nonprofit organizations not described in section 46(c)(8)(D)(iv)(II) with respect to a building.

Subsec. (l)(1). Pub. L. 101-239, Sec. 7108(p), in introductory provisions, substituted 'Following' for 'Not later than the 90th day following' and inserted 'at such time and' before 'in such form'.

Subsec. (m). Pub. L. 101-239, Sec. 7108(o), added subsec. (m). Former subsec. (m) redesignated (n).

Subsec. (m)(4). Pub. L. 101-239, Sec. 7831(c)(5), added par. (4).

Subsec. (n). Pub. L. 101-239, Sec. 7108(o), redesignated subsec. (m) as (n). Former subsec. (n) redesignated (o).

Pub. L. 101-239, Sec. 7108(a)(1), amended subsec. (n) generally. Prior to amendment, subsec. (n) read as follows: 'The State housing credit ceiling under subsection (h) shall be zero for any calendar year after 1989 and subsection (h)(4) shall not apply to any building placed in service after 1989.'

Subsec. (o). Pub. L. 101-239, Sec. 7108(o), redesignated subsec. (n) as (o).

1988 - Subsec. (b)(2)(A). Pub. L. 100-647, Sec. 1002(l)(1)(A), substituted 'for the earlier of - ' for 'for the month in which such building is placed in service' and added cls. (i) and (ii) and concluding provisions.

Subsec. (b)(2)(C)(ii). Pub. L. 100-647, Sec. 1002(l)(1)(B), substituted 'the month applicable under clause (i) or (ii) of subparagraph (A)' for 'the month in which the building was placed in service'.

Subsec. (b)(3). Pub. L. 100-647, Sec. 1002(l)(9)(B), amended par. (3) generally. Prior to amendment, par. (3) read as follows: 'For treatment of certain rehabilitation expenditures as separate new buildings, see subsection (e).'

Subsec. (c)(2)(A). Pub. L. 100-647, Sec. 1002(l)(2)(A), amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: 'which at all times during the compliance period with respect to such building is part of a qualified low-income housing project, and'.

Subsec. (d)(2)(D)(ii). Pub. L. 100-647, Sec. 1002(l)(3), substituted 'Special rules for certain transfers' for 'Special rule for nontaxable exchanges' in heading and amended text generally. Prior to amendment, text read as follows: 'For purposes of determining under subparagraph (B)(ii) when a building was last placed in service, there shall not be taken into account any placement in service in connection with the acquisition of the building in a transaction in which the basis of the building in the

hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such building in the hands of the person from whom acquired.'

Subsec. (d) (3). Pub. L. 100-647, Sec. 1002(1)(4), amended par. (3) generally. Prior to amendment, par. (3) read as follows: 'The eligible basis of any building shall be reduced by an amount equal to the portion of the adjusted basis of the building which is attributable to residential rental units in the building which are not low-income units and which are above the average quality standard of the low-income units in the building.'

Subsec. (d) (5) (A). Pub. L. 100-647, Sec. 1002(1)(6) (B), substituted 'subparagraphs (B) and (C)' for 'subparagraph (B)'.  
Pub. L. 100-647, Sec. 1002(1)(5), inserted '(increased, in the case of an existing building which meets the requirements of paragraph (2) (B), by the amounts described in paragraph (2) (A) (i) (II))' before period at end.

Subsec. (d) (5) (C). Pub. L. 100-647, Sec. 1002(1)(6) (A), added subpar. (C).

Subsec. (d) (6) (A) (iii). Pub. L. 100-647, Sec. 1002(1)(7), struck out cl. (iii) which related to other circumstances of financial distress.

Subsec. (d) (6) (B) (ii). Pub. L. 100-647, Sec. 1002(1)(8), struck out 'of 1934' after 'Act'.

Subsec. (f) (1). Pub. L. 100-647, Sec. 1002(1)(2) (B), substituted 'beginning with - ' for 'beginning with' and subpars. (A) and (B) and concluding provisions for 'the taxable year in which the building is placed in service or, at the election of the taxpayer, the succeeding taxable year. Such an election, once made, shall be irrevocable.'

Subsec. (f) (3). Pub. L. 100-647, Sec. 1002(1)(9) (A), amended par. (3) generally. Prior to amendment, par. (3) 'Special rule where increase in qualified basis after 1st year of credit period' read as follows:

'(A) Credit increased. - If -

'(i) as of the close of any taxable year in the compliance period (after the 1st year of the credit period) the qualified basis of any building exceeds

'(ii) the qualified basis of such building as of the close of the 1st year of the credit period,  
the credit allowable under subsection (a) for the taxable year (determined without regard to this paragraph) shall be increased by an amount equal to the product of such excess and the percentage equal to 2/3 of the applicable percentage for such building.

'(B) 1st year computation applies. - A rule similar to the rule of paragraph (2) (A) shall apply to the additional credit allowable by reason of this paragraph for the 1st year in which such additional credit is allowable.'

Subsec. (g) (2) (B) (i). Pub. L. 100-647, Sec. 1002(1)(10), struck out 'Federal' after 'comparable'.

Subsec. (g) (2) (C). Pub. L. 100-647, Sec. 1002(1)(11), added subpar. (C).

Subsec. (g) (3). Pub. L. 100-647, Sec. 1002(1)(12), amended par. (3) generally, substituting subpars. (A) to (C) for former subpars. (A) and (B).

Subsec. (g) (4). Pub. L. 100-647, Sec. 1002(1)(13), inserted '  
except that, in applying such provisions (other than section 142(d)(4)(B)(iii)) for such purposes, the term 'gross rent' shall

have the meaning given such term by paragraph (2)(B) of this subsection' before period at end.

Subsec. (g)(6). Pub. L. 100-647, Sec. 1002(1)(32), added par. (6).

Subsec. (h)(1). Pub. L. 100-647, Sec. 1002(1)(14)(A), amended par. (1) generally. Prior to amendment, par. (1) read as follows: 'No credit shall be allowed by reason of this section for any taxable year with respect to any building in excess of the housing credit dollar amount allocated to such building under this subsection. An allocation shall be taken into account under the preceding sentence only if it occurs not later than the earlier of

'(A) the 60th day after the close of the taxable year, or  
'(B) the close of the calendar year in which such taxable year ends.'

Subsec. (h)(1)(B). Pub. L. 100-647, Sec. 4003(b)(1), substituted '(C), (D), or (E)' for '(C) or (D)'.

Subsec. (h)(1)(E). Pub. L. 100-647, Sec. 4003(a), added subpar. (E).

Subsec. (h)(4)(A). Pub. L. 100-647, Sec. 1002(1)(15), substituted 'if - ' for 'and which is taken into account under section 146' and added cls. (i) and (ii).

Subsec. (h)(5)(D), (E). Pub. L. 100-647, Sec. 1002(1)(16), added subpar. (D) and redesignated former subpar. (D) as (E).

Subsec. (h)(6)(B)(ii). Pub. L. 100-647, Sec. 1002(1)(14)(B), struck out cl. (ii) which read as follows:

'(ii) Allocation may not be earlier than year in which building placed in service. - A housing credit agency may allocate its housing credit dollar amount for any calendar year only to buildings placed in service before the close of such calendar year.'

Subsec. (h)(6)(D). Pub. L. 100-647, Sec. 1002(1)(17), amended subpar. (D) generally. Prior to amendment, subpar. (D) 'Credit allowable determined without regard to averaging convention, etc.' read as follows: 'For purposes of this subsection, the credit allowable under subsection (a) with respect to any building shall be determined -

'(i) without regard to paragraphs (2)(A) and (3)(B) of subsection (f), and

'(ii) by applying subsection (f)(3)(A) without regard to 'the percentage equal to 2/3 of'.'

Subsec. (h)(6)(E). Pub. L. 100-647, Sec. 1002(1)(18), added subpar. (E).

Subsec. (i)(2)(A). Pub. L. 100-647, Sec. 1002(1)(19)(A), inserted 'or any prior taxable year' after 'such taxable year' and substituted 'is or was outstanding' for 'is outstanding' and 'are or were used' for 'are used'.

Subsec. (i)(2)(B). Pub. L. 100-647, Sec. 1002(1)(19)(B), substituted 'balance of loan or proceeds of obligations' for 'outstanding balance of loan' in heading and amended text generally. Prior to amendment, text read as follows: 'A loan shall not be taken into account under subparagraph (A) if the taxpayer elects to exclude an amount equal to the outstanding balance of such loan from the eligible basis of the building for purposes of subsection (d).'

Subsec. (i)(2)(C). Pub. L. 100-647, Sec. 1002(1)(19)(C), added subpar. (C). Former subpar. (C) redesignated (D).

Subsec. (i) (2) (D). Pub. L. 100-647, Sec. 1002(1)(19) (C), (D), redesignated former subpar. (C) as (D) and substituted 'this paragraph' for 'subparagraph (A)'.

Subsec. (j) (4) (D). Pub. L. 100-647, Sec. 1007(g) (3) (B), substituted 'D, or G' for 'or D'.

Subsec. (j) (4) (F). Pub. L. 100-647, Sec. 1002(1)(20), added subpar. (F).

Subsec. (j) (5) (B). Pub. L. 100-647, Sec. 4004(a), amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: 'This paragraph shall apply to any partnership -

'(i) more than 1/2 the capital interests, and more than 1/2 the profit interests, in which are owned by a group of 35 or more partners each of whom is a natural person or an estate, and

'(ii) which elects the application of this paragraph.'

Subsec. (j) (5) (B) (i). Pub. L. 100-647, Sec. 1002(1)(21), amended cl. (i) generally. Prior to amendment, cl. (i) read as follows: 'which has 35 or more partners each of whom is a natural person or an estate, and'.

Subsec. (j) (6). Pub. L. 100-647, Sec. 1002(1)(22), inserted '(or interest therein)' after 'disposition of building' in heading, and in text inserted 'or an interest therein' after 'of a building'.

Subsec. (k) (2) (B). Pub. L. 100-647, Sec. 1002(1)(23), inserted before period at end ', except that this subparagraph shall not apply in the case of a federally assisted building described in subsection (d) (6) (B) if - ' and cls. (i) and (ii).

Subsec. (l). Pub. L. 100-647, Sec. 1002(1)(24) (B), substituted 'Certifications and other reports to Secretary' for 'Certifications to Secretary' in heading.

Subsec. (l) (2), (3). Pub. L. 100-647, Sec. 1002(1)(24) (A), added par. (2) and redesignated former par. (2) as (3).

Subsec. (n). Pub. L. 100-647, Sec. 4003(b) (3), amended subsec. (n) generally, substituting a single par. for former pars. (1) and (2).

Subsec. (n) (1). Pub. L. 100-647, Sec. 1002(1)(25), inserted ', and, except for any building described in paragraph (2) (B), subsection (h) (4) shall not apply to any building placed in service after 1989' after 'year after 1989'.

1986 - Subsec. (k) (1). Pub. L. 99-509 substituted 'subparagraphs (D) (ii) (II) and (D) (iv) (I)' for 'subparagraph (D) (iv) (I)'.

## Effective Date Of 1990 Amendment

Section 11407(a) (3) of Pub. L. 101-508 provided that: 'The amendments made by this subsection (amending this section and repealing provisions set out below) shall apply to calendar years after 1989.'

Section 11407(b) (10) of Pub. L. 101-508 provided that:

'(A) In general. - Except as otherwise provided in this paragraph, the amendments made by this subsection (amending this section) shall apply to -

'(i) determinations under section 42 of the Internal Revenue Code of 1986 with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1990, or

'(ii) buildings placed in service after December 31, 1990, to

the extent paragraph (1) of section 42(h) of such Code does not apply to any building by reason of paragraph (4) thereof, but only with respect to bonds issued after such date.

'(B) Tenant rights, etc. - The amendments made by paragraphs (1), (6), (8), and (9) (amending this section) shall take effect on the date of the enactment of this Act (Nov. 5, 1990).

'(C) Monitoring. - The amendment made by paragraph (2) (amending this section) shall take effect on January 1, 1992, and shall apply to buildings placed in service before, on, or after such date.

'(D) Study. - The Inspector General of the Department of Housing and Urban Development and the Secretary of the Treasury shall jointly conduct a study of the effectiveness of the amendment made by paragraph (5) (amending this section) in carrying out the purposes of section 42 of the Internal Revenue Code of 1986. The report of such study shall be submitted not later than January 1, 1993, to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.'

Section 11701(a)(3)(B) of Pub. L. 101-508 provided that: 'In the case of a building to which (but for this subparagraph) the amendment made by subparagraph (A) (amending this section) does not apply, such amendment shall apply to -

'(i) determinations of qualified basis for taxable years beginning after the date of the enactment of this Act (Nov. 5, 1990), and

'(ii) determinations of qualified basis for taxable years beginning on or before such date except that determinations for such taxable years shall be made without regard to any reduction in gross rent after August 3, 1990, for any period before August 4, 1990.'

Section 11701(n) of Pub. L. 101-508 provided that: 'Except as otherwise provided in this section, any amendment made by this section (amending this section and sections 148, 163, 172, 403, 1031, 1253, 2056, 4682, 4975, 4978B and 6038 of this title, and provisions set out as notes under this section and section 2040 of this title) shall take effect as if included in the provision of the Revenue Reconciliation Act of 1989 (Pub. L. 101-239, title VII) to which such amendment relates.'

Section 11812(c) of Pub. L. 101-508 provided that:

'(1) In general. - Except as provided in paragraph (2), the amendments made by this section (amending this section and sections 56, 167, 168, 312, 381, 404, 460, 642, 1016, 1250, and 7701 of this title) shall apply to property placed in service after the date of the enactment of this Act (Nov. 5, 1990).

'(2) Exception. - The amendments made by this section shall not apply to any property to which section 168 of the Internal Revenue Code of 1986 does not apply by reason of subsection (f)(5) thereof.

'(3) Exception for previously grandfather expenditures. - The amendments made by this section shall not apply to rehabilitation expenditures described in section 252(f)(5) of the Tax Reform Act of 1986 (Pub. L. 99-514) (as added by section 1002(l)(31) of the Technical and Miscellaneous Revenue Act of 1988 (see Transitional Rules note below)).'

Amendment by section 11813(b)(3) of Pub. L. 101-508 applicable to property placed in service after Dec. 31, 1990, but not applicable to any transition property (as defined in section 49(e) of this title), any property with respect to which qualified progress expenditures were previously taken into account under section 46(d)

of this title, and any property described in section 46(b)(2)(C) of this title, as such sections were in effect on Nov. 4, 1990, see section 11813(c) of Pub. L. 101-508, set out as a note under section 29 of this title.

## Effective Date Of 1989 Amendment

Section 7108(r) of Pub. L. 101-239, as amended by Pub. L. 101-508, title XI, Sec. 11701(a)(11), (12), Nov. 5, 1990, 104 Stat. 1388-507, provided that:

'(1) In general. - Except as otherwise provided in this subsection, the amendments made by this section (amending this section and section 142 of this title) shall apply to determinations under section 42 of the Internal Revenue Code of 1986 with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989.

'(2) Buildings not subject to allocation limits. - Except as otherwise provided in this subsection, to the extent paragraph (1) of section 42(h) of such Code does not apply to any building by reason of paragraph (4) thereof, the amendments made by this section shall apply to buildings placed in service after December 31, 1989 but only with respect to bonds issued after such date.

'(3) One-year carryover of unused credit authority, etc. - The amendments made by subsection (b) (amending this section) shall apply to calendar years after 1989, but clauses (ii), (iii), and (iv) of section 42(h)(3)(C) of such Code (as added by this section) shall be applied without regard to allocations for 1989 or any preceding year.

'(4) Additional buildings eligible for waiver of 10-year rule. - The amendments made by subsection (f) (amending this section) shall take effect on the date of the enactment of this Act (Dec. 19, 1989).

'(5) Certifications with respect to 1st year of credit period. - The amendment made by subsection (p) (amending this section) shall apply to taxable years ending on or after December 31, 1989.

'(6) Certain rules which apply to bonds. - Paragraphs (1)(D) and (2)(D) of section 42(m) of such Code, as added by this section, shall apply to obligations issued after December 31, 1989.

'(7) Clarifications. - The amendments made by the following provisions of this section shall apply as if included in the amendments made by section 252 of the Tax Reform Act of 1986 (Pub. L. 99-514, enacting this section and amending sections 38 and 55 of this title):

'(A) Paragraph (1) of subsection (h) (relating to units rented on a monthly basis) (amending this section).

'(B) Subsection (1) (relating to eligible basis for new buildings to include expenditures before close of 1st year of credit period) (amending this section).

'(8) Guidance on difficult development areas and posting of bond to avoid recapture. - Not later than 180 days after the date of the enactment of this Act (Dec. 19, 1989) -

'(A) the Secretary of Housing and Urban Development shall publish initial guidance on the designation of difficult development areas under section 42(d)(5)(C) of such Code, as added by this section, and

'(B) the Secretary of the Treasury shall publish initial guidance under section 42(j)(6) of such Code (relating to no recapture on disposition of building (or interest therein) where bond posted).'

Amendment by section 7811(a) of Pub. L. 101-239 effective, except as otherwise provided, as if included in the provision of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100-647, to which such amendment relates, see section 7817 of Pub. L. 101-239, set out as a note under section 1 of this title.

Amendment by section 7831(c) of Pub. L. 101-239 effective as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 7831(g) of Pub. L. 101-239, set out as a note under section 1 of this title.

## **Effective Date Of 1988 Amendment**

Amendment by sections 1002(l)(1)-(25), (32) and 1007(g)(3)(B) of Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

Section 4003(c) of Pub. L. 100-647 provided that: 'The amendments made by this section (amending this section and provisions set out as a note under section 469 of this title) shall apply to amounts allocated in calendar years after 1987.'

Section 4004(b) of Pub. L. 100-647 provided that:

'(1) In general. - The amendment made by subsection (a) (amending this section) shall take effect as if included in the amendments made by section 252 of the Reform Act (section 252 of Pub. L. 99-514, enacting this section and amending sections 38 and 55 of this title).

'(2) Period for election. - The period for electing not to have section 42(j)(5) of the 1986 Code apply to any partnership shall not expire before the date which is 6 months after the date of the enactment of this Act (Nov. 10, 1988).'

## **Effective Date Of 1986 Amendment**

Section 8072(b) of Pub. L. 99-509 provided that: 'The amendment made by subsection (a) (amending this section) shall take effect as if included in the amendment made by section 252(a) of the Tax Reform Act of 1986 (enacting this section).'

## **Effective Date**

Section 252(e) of Pub. L. 99-514 provided that:

'(1) In general. - The amendments made by this section (enacting this section and amending sections 38 and 55 of this title) shall apply to buildings placed in service after December 31, 1986, in taxable years ending after such date.

'(2) Special rule for rehabilitation expenditures. - Subsection (e) of section 42 of the Internal Revenue Code of 1986 (as added by this section) shall apply for purposes of paragraph (1).'

## **Savings Provision**

For provisions that nothing in amendment by sections 11812(b)(3) and 11813(b)(3) of Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 29 of this title.

## **Election To Accelerate Credit Into 1990**

Section 11407(c) of Pub. L. 101-508 provided that:

'(1) In general. - At the election of an individual, the credit determined under section 42 of the Internal Revenue Code of 1986 for the taxpayer's first taxable year ending on or after October 25, 1990, shall be 150 percent of the amount which would (but for this paragraph) be so allowable with respect to investments held by such individual on or before October 25, 1990.

'(2) Reduction in aggregate credit to reflect increased 1990 credit. - The aggregate credit allowable to any person under section 42 of such Code with respect to any investment for taxable years after the first taxable year referred to in paragraph (1) shall be reduced on a pro rata basis by the amount of the increased credit allowable by reason of paragraph (1) with respect to such first taxable year. The preceding sentence shall not be construed to affect whether any taxable year is part of the credit, compliance, or extended use periods.

(3) Election. - The election under paragraph (1) shall be made at the time and in the manner prescribed by the Secretary of the Treasury or his delegate, and, once made, shall be irrevocable. In the case of a partnership, such election shall be made by the partnership.'

## **Exception To Time Period For Meeting Project Requirements In Order To Qualify As Low-Income Housing**

Section 11701(a)(5)(B) of Pub. L. 101-508 provided that: 'In the case of a building to which the amendment made by subparagraph (A) (amending this section) does not apply, the period specified in section 42(g)(3)(A) of the Internal Revenue Code of 1986 (as in effect before the amendment made by subparagraph (A)) shall not expire before the close of the taxable year following the taxable year in which the building is placed in service.'

## State Housing Credit Ceiling For Calendar Year 1990

Section 7108(a)(2) of Pub. L. 101-239, which provided that in the case of calendar year 1990, section 42(h)(3)(C)(i) of the Internal Revenue Code of 1986 be applied by substituting '\$.9375' for '\$1.25', was repealed by Pub. L. 101-508, title XI, Sec. 11407(a)(2), (3), Nov. 5, 1990, 104 Stat. 1388-474, applicable to calendar years after 1989.

## Transitional Rules

Section 252(f) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, Sec. 1002(1)(28)-(31), Nov. 10, 1988, 102 Stat. 3381, provided that:

'(1) Limitation to non-acrs buildings not to apply to certain buildings, etc. -

'(A) In general. - In the case of a building which is part of a project described in subparagraph (B) -

'(i) section 42(c)(2)(B) of the Internal Revenue Code of 1986 (as added by this section) shall not apply,

'(ii) such building shall be treated as not federally subsidized for purposes of section 42(b)(1)(A) of such Code,

'(iii) the eligible basis of such building shall be treated, for purposes of section 42(h)(4)(A) of such Code, as if it were financed by an obligation the interest on which is exempt from tax under section 103 of such Code and which is taken into account under section 146 of such Code, and

'(iv) the amendments made by section 803 (enacting section 263A of this title, amending sections 48, 267, 312, 447, 464, and 471 of this title, and repealing sections 189, 278, and 280 of this title) shall not apply.

'(B) Project described. - A project is described in this subparagraph if -

'(i) an urban development action grant application with respect to such project was submitted on September 13, 1984,

'(ii) a zoning commission map amendment related to such project was granted on July 17, 1985, and

'(iii) the number assigned to such project by the Federal Housing Administration is 023-36602.

'(C) Additional units eligible for credit. - In the case of a building to which subparagraph (A) applies and which is part of a project which meets the requirements of subparagraph (D), for each low-income unit in such building which is occupied by individuals whose income is 30 percent or less of area median gross income, one additional unit (not otherwise a low-income unit) in such building shall be treated as a low-income unit for purposes of such section 42.

'(D) Project described. - A project is described in this subparagraph if -

- '(i) rents charged for units in such project are restricted by State regulations,
- '(ii) the annual cash flow of such project is restricted by State law,
- '(iii) the project is located on land owned by or ground leased from a public housing authority,
- '(iv) construction of such project begins on or before December 31, 1986, and units within such project are placed in service on or before June 1, 1990, and
- '(v) for a 20-year period, 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income.

'(E) Maximum additional credit. - The maximum present value of additional credits allowable under section 42 of such Code by reason of subparagraph (C) shall not exceed 25 percent of the eligible basis of the building.

'(2) Additional allocation of housing credit ceiling. -

'(A) In general. - There is hereby allocated to each housing credit agency described in subparagraph (B) an additional housing credit dollar amount determined in accordance with the following table:

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	The additional allocation is:
'For calendar year:	
1987	\$3,900,000
1988	\$7,600,000
1989	\$1,300,000.

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'(B) Housing credit agencies described. - The housing credit agencies described in this subparagraph are:

- '(i) A corporate governmental agency constituted as a public benefit corporation and established in 1971 under the provisions of Article XII of the Private Housing Finance Law of the State.
- '(ii) A city department established on December 20, 1979, pursuant to chapter XVIII of a municipal code of such city for the purpose of supervising and coordinating the formation and execution of projects and programs affecting housing within such city.
- '(iii) The State housing finance agency referred to in subparagraph (C), but only with respect to projects described in subparagraph (C).

'(C) Project described. - A project is described in this subparagraph if such project is a qualified low-income housing project which -

- '(i) receives financing from a State housing finance agency from the proceeds of bonds issued pursuant to chapter 708 of the Acts of 1966 of such State pursuant to loan commitments from such agency made between May 8, 1984, and July 8, 1986, and
- '(ii) is subject to subsidy commitments issued pursuant to a program established under chapter 574 of the Acts of 1983 of such State having award dates from such agency between May 31, 1984, and June 11, 1985.

'(D) Special rules. -

'(i) Any building -

'(I) which is allocated any housing credit dollar amount by a housing credit agency described in clause (iii) of subparagraph (B), and

'(II) which is placed in service after June 30, 1986, and before January 1, 1987,

shall be treated for purposes of the amendments made by this section as placed in service on January 1, 1987.

'(ii) Section 42(c)(2)(B) of the Internal Revenue Code of 1986 shall not apply to any building which is allocated any housing credit dollar amount by any agency described in subparagraph (B).

'(E) All units treated as low income units in certain cases. -

In the case of any building -

'(i) which is allocated any housing credit dollar amount by any agency described in subparagraph (B), and

'(ii) which after the application of subparagraph (D)(ii) is a qualified low-income building at all times during any taxable year,

such building shall be treated as described in section 42(b)(1)(B) of such Code and having an applicable fraction for such year of 1. The preceding sentence shall apply to any building only to the extent of the portion of the additional housing credit dollar amount (allocated to such agency under subparagraph (A)) allocated to such building.

'(3) Certain projects placed in service before 1987. -

'(A) In general. - In the case of a building which is part of a project described in subparagraph (B) -

'(i) section 42(c)(2)(B) of such Code shall not apply,

'(ii) such building shall be treated as placed in service during the first calendar year after 1986 and before 1990 in which such building is a qualified low-income building (determined after the application of clause (i)), and

'(iii) for purposes of section 42(h) of such Code, such building shall be treated as having allocated to it a housing credit dollar amount equal to the dollar amount appearing in the clause of subparagraph (B) in which such building is described.

'(B) Project described. - A project is described in this subparagraph if the code number assigned to such project by the Farmers' Home Administration appears in the following table:

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'The code number is:	The housing credit dollar amount is:
(i) 49284553664	\$16,000
(ii) 4927742022446	\$22,000
(iii) 49270742276087	\$64,000
(iv) 490270742387293	\$48,000
(v) 4927074218234	\$32,000
(vi) 49270742274019	\$36,000
(vii) 51460742345074	\$53,000.

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'(C) Determination of adjusted basis. - The adjusted basis of any building to which this paragraph applies for purposes of section 42 of such Code shall be its adjusted basis as of the

close of the taxable year ending before the first taxable year of the credit period for such building.

'(D) Certain rules to apply. - Rules similar to the rules of subparagraph (E) of paragraph (2) shall apply for purposes of this paragraph.

'(4) Definitions. - For purposes of this subsection, terms used in such subsection which are also used in section 42 of the Internal Revenue Code of 1986 (as added by this section) shall have the meanings given such terms by such section 42.

'(5) Transitional rule. - In the case of any rehabilitation expenditures incurred with respect to units located in the neighborhood strategy area within the community development block grant program in Ft. Wayne, Indiana -

'(A) the amendments made by this section (enacting this section and amending sections 38 and 55 of this title) shall not apply, and

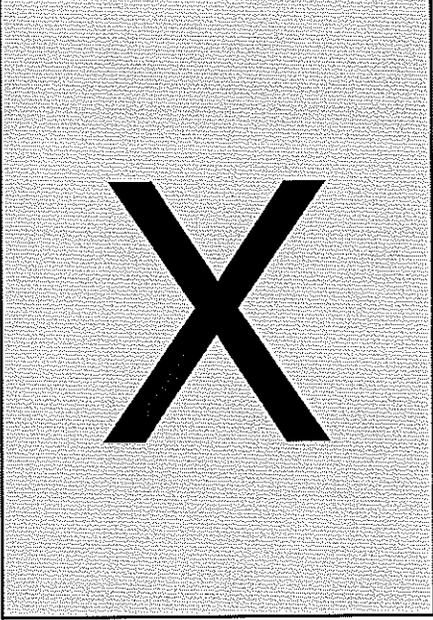
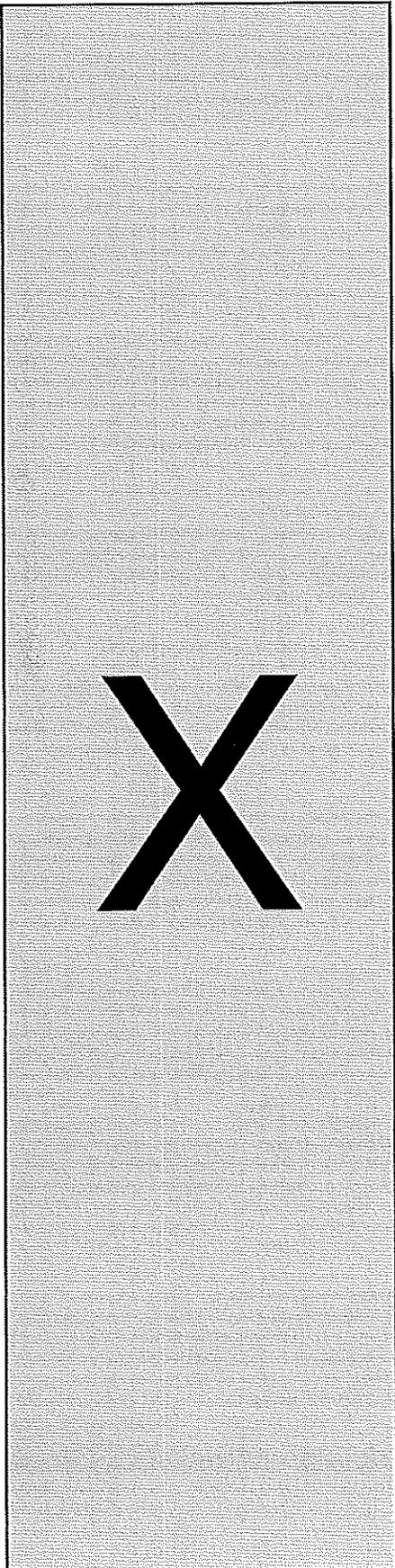
'(B) paragraph (1) of section 167(k) of the Internal Revenue Code of 1986, shall be applied as if it did not contain the phrase 'and before January 1, 1987'.

The number of units to which the preceding sentence applies shall not exceed 150.'

## **SECRET**

### **Section Referred To In Other Sections**

This section is referred to in sections 38, 39, 55, 469 of this title; title 42 sections 1437, 1485, 12745.



**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Parts 1 and 602**

**[TD 8859]**

**RIN 1545-AV44**

**Compliance Monitoring and Miscellaneous Issues Relating to the Low-Income Housing Credit**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations regarding the procedures for compliance monitoring by state and local housing agencies (Agencies) with the requirements of the low-income housing credit; the requirements for making carryover allocations; the rules for Agencies' correction of administrative errors or omissions; and the independent verification of information on sources and uses of funds submitted by taxpayers to Agencies. The final regulations affect owners of low-income housing projects who claim the credit and the Agencies who administer the credit.

**DATES:** *Effective Dates:* The regulations are effective January 1, 2001, except that the amendments made to §§ 1.42-5(c)(5) and ( ) (3)(i), and 1.42-13 are effective January 14, 2000, and the amendment made to § 1.42-6(d)(4)(ii) is effective January 1, 2000.

*Applicability Dates:* For dates of applicability of the amendments to § 1.42-5, see § 1.42-5(h). For dates of

applicability of the amendments made to § 1.42-6, see § 1.42-12(c). For dates of applicability of the amendments made to § 1.42-13, see § 1.42-13(d). For dates of applicability of § 1.42-17, see § 1.42-17(b).

**FOR FURTHER INFORMATION CONTACT:** Paul Handelman, (202) 622-3040 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Paperwork Reduction Act**

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545-1357. Responses to these collections of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For § 1.42-5, the estimated annual burden per respondent varies from .5 hour to 3 hours for taxpayers and 250 to 5,000 hours for Agencies, with an estimated average of 1 hour for taxpayers and 1,500 hours for Agencies. For § 1.42-13, the estimated annual burden per respondent varies from .5 hour to 10 hours for taxpayers and Agencies, with an estimated average of 3.5 hours for taxpayers and 3 hours for Agencies. For § 1.42-17, the estimated annual burden per respondent varies from .5 hour to 2 hours for taxpayers and .5 hour to 5 hours for Agencies, with an estimated average of 1 hour for taxpayers and 2 hours for Agencies.

Comments concerning the accuracy of these burden estimates and suggestions for reducing these burdens should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Office, OP:FS:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as the records may be material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

**Background**

On January 8, 1999, the IRS published proposed regulations (REG-114664-97) in the Federal Register (64 FR 1143) inviting comments under section 42. A

public hearing was held May 27, 1999. Numerous comments have been received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury Decision.

## Public Comments

### A. Compliance Monitoring

#### 1. Inspection Requirement for New Buildings

The proposed regulations require that, by the end of the calendar year following the year the last building in a project is placed in service, the Agency conduct on-site inspections of the projects and review with low-income certification, the documentation supporting such certification, and the record for each tenant in the project. Most commenters view the requirement for review of all tenants in a project as unnecessary and burdensome. Most commenters suggest limiting inspections for new buildings to 20 percent of the project's low-income units.

Commenters also suggest extending the time limit for inspecting new buildings to the end of the calendar year following the first year of the credit period or at least until a reasonable time after the Agency issues Form 8609, "Low-Income Housing Credit Allocation Certification." This additional flexibility would allow the Agency to combine a physical inspection with a review of the first year of the credit period.

In response to the comments, the final regulations reduce the inspection burden for new buildings by requiring the Agency to conduct on-site inspections of all new buildings in the project and, for at least 20 percent of the project's low-income units, to inspect the units and review with low-income certification, the documentation supporting the certifications, and the records for the tenants in those units. To allow the Agency sufficient time to review with tenants in the first year of the credit period, the final regulations extend the time limit for inspecting new buildings to the end of the second calendar year following the year the last building in the project is placed in service.

#### 2. Third-Year Inspection Requirement

The proposed regulations require that, at least once every 3 years, each Agency conduct on-site inspections of all buildings in each low-income housing project and, for each tenant in at least 20 percent of the project's low-income units selected by the Agency, review with low-income certification, the

documentation supporting such certification, and the record.

Most commenters agree with requiring physical inspections of the buildings at least once every 3 years. However, commenters recommend review with tenants in the records once every 5 years, which is one of the options under the current compliance monitoring regulations (§ 1.42-5(c)(2)(ii)(B)) requiring an Agency to review with tenants for 20 percent of the low-income housing projects each year. Commenters also recommend review with tenants either on-site or at other locations, including desk audits.

Although the physical inspection and review with tenants for new buildings are relaxed in the final regulations, the final regulations retain the 3-year inspection cycle for existing buildings. The final regulations do not separate the physical inspection and review cycle (every 3 years for physical inspections and every 5 years for review with tenants) as suggested by commenters because it is administratively complex to do both during the same year. The tenant income and renter restrictions in section 42(g) are equally important as the habitability standards for a low-income unit in section 42(i)(3)(B)(ii). The final regulations adopt the suggestion that the review with tenants will be maintained.

#### 3. Health, Safety, and Building Code Inspections

The proposed regulations require the Agency to determine whether the project is suitable for occupancy, taking into account local health, safety, and building code.

Many commenters object to this requirement as too costly and unadministrable because building codes vary considerably within states. Commenters also asked for guidance as to what constitutes an "inspection." Some commenters proposed finding an inspection as looking at selected units in the building and common areas for visible problems or defects without applying the local health, safety, and building code standards. One commentator suggests inspections based on a complaint from the local jurisdiction or from a tenant. Some commenters suggest using a uniform physical standard such as the uniform physical condition standards for public housing established by the Department of Housing and Urban Development (HUD) in 24 CFR 5.703.

Section 42(i)(3)(B)(i) excludes from the definition of a "low-income unit" a unit that is not suitable for occupancy. Under section 42(i)(3)(B)(ii), suitability of a unit for occupancy shall be

determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes. Recognizing that these codes vary considerably within states, the final regulations require an Agency to determine whether a low-income housing project satisfies these codes, or satisfies the HUD uniform physical condition standards. The HUD standards are intended to ensure that housing is decent, safe, sanitary, and in good repair. Though it would be appropriate that an Agency use HUD's inspection protocol under 24 CFR 5.705, the final regulations do not mandate use of HUD's inspection protocol because to do so could increase costs to the Agencies as well as limit their latitude in applying standards consistent with their own operating procedures and practices. The final regulations exempt a building from the inspection requirement if the building is financed by the Rural Housing Service (RHS) under the section 515 program, the RHS inspects the building (under 7 CFR part 1930(c)), 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. Irrespective of the physical inspection standards selected by the Agency, a low-income housing project under section 42 must continue to satisfy local health, safety, and building code.

The proposed regulations limit an Agency's delegation of the physical inspection of a project to only a state or local government unit responsible for making building code inspections. Commenters suggest expanding the delegation of inspections to professional firms. The final regulations remove the delegation limitation and Agencies may delegate the physical inspection requirement to state or local government agencies, HUD, or private contractors.

#### 4. Local Reports of Building Code Violations

The proposed regulations require the owner of a low-income housing project to certify that for the preceding 12-month period the state or local government unit responsible for making building code inspections did not issue a report of a violation for the project. If the governmental unit issued a report of a violation, the owner is required to attach a copy of the report of the violation to the annual certification submitted to the Agency.

A commentator noted that the number of violations attached to the annual owner certification would be highly sensitive

quality rental housing operations do not have an inspection without a report or notice of some violation. Two commentators suggest attaching reports only for violations that have not been corrected prior to filing the annual owner certification or requiring that owners only attach reports for "major" violations. The commentators suggest defining major violations as violations not corrected within 90 days of the notice of violation or violations where the cost to comply exceeds \$2,500. A commentator suggests that Agencies be allowed to distinguish between minor technical violations and serious violations (i.e., lack of heat or hot water, hazardous conditions, and security) in reporting noncompliance.

Though a minor violation will not lead to the disallowance or recapture of section 42 credits, a series of minor violations may be the equivalent of a major violation resulting in disallowance or recapture of credits. Determining the difference between a major and minor violation is subjective. The final regulations do not exclude minor violations from the reporting and recordkeeping requirements. However, to reduce the inspection violation paperwork, the final regulations require that the owner must either attach a statement summarizing the violations or a copy of each violation report to the annual owner certification submitted to the Agency. The owner must state on the certification whether the violation has been corrected. In addition, the final regulations require that the owner retain the original violation report for the Agency's physical inspection. Retention of the original violation report is not required once the Agency reviews the violation and completes its inspection, unless the violation remains uncorrected.

#### 5. Correction of Noncompliance or Failure to Certify

The final regulations adopt commentators' suggestion to limit to a 3-year period after the end of the correction period in § 1.42-5(c)(4) the requirement that Agencies file Form 8823, "Low-Income Housing Credit Agencies Report of Noncompliance," with the IRS reporting the correction of the noncompliance or failure to certify.

#### 6. Compliance Monitoring Effort Dates

Commentators suggest an effort date of at least one year after the final regulations are published in the Federal Register. Commentators also recommend on-site inspections apply only to new buildings allocated section

42 credits after the effective date of the final regulations.

Because the amendments to the compliance monitoring regulations will require amendments to qualified allocation plans, the final regulations relating to compliance generally contain a January 1, 2001, effective date. Thus, the requirements to attach local health, safety, or building code violations to the annual owner certification and to inspect buildings and review tenant files for existing projects are effective January 1, 2001. The inspection requirements and tenant file review for new buildings is effective for buildings placed in service on or after January 1, 2001.

#### 7. Section 8 and Federal Civil Rights Laws

Two commentators state that insufficient controls are in place to ensure that low-income housing projects adhere to the requirements of section 42(h)(6)(B)(iv) of nondiscrimination against Section 8 voucher or certification holders. The commentators suggest that the IRS could help compensate for lack of controls by working with HUD to ensure that Section 8 voucher or certification holders are aware of, and have access to, low-income housing projects. The commentators also suggest that Agencies provide regional HUD office a list of low-income housing projects in that state, with information that would be helpful for prospective tenants. One commentator suggests that the prohibition on discrimination based on Section 8 status be clarified to exclude policies that bar Section 8 tenants but have no substantial business justification. For example, low-income housing projects should not be permitted to exclude Section 8 voucher or certification holders through a rule that requires every applicant to have income equal to at least three times the total rent.

The commentators also suggest that the Agencies should be required to develop a plan for educating applicants and owners of projects of the prohibition against discrimination on the basis of Section 8 voucher or certification status. They recommend that the Agencies should be required to have a procedure for accepting and processing complaints about discrimination against Section 8 voucher or certification holders. They also recommend that IRS and HUD should work together to study the circumstances under which Section 8 voucher or certification holders are, or are not, accessing projects.

Section 42(h)(6)(A) provides that no credit shall be allowed by reason of

section 42 with respect to any building for the taxable year unless an extended low-income housing commitment is in effect as of the end of such taxable year. Section 42(h)(6)(B)(iv) defines the term "extended low-income housing commitment" to include any agreement between the taxpayer and the housing credit agency that prohibits the refusal to allow a holder of a voucher or certification of eligibility under section 8 of the United States Housing Act of 1937 because of the status of the prospective tenant as such a holder. To help monitor compliance with section 42(h)(6)(B)(iv), the final regulations amend the annual owner certification relating to extended low-income housing commitment under § 1.42-5(c)(1)(xi) to require owners to certify that the owner has not refused to allow a unit in the project to a Section 8 applicant because the applicant holds a Section 8 voucher or certification.

The IRS has informed HUD of the commenters' concern about preventing discrimination based on Section 8 status. Agencies should provide HUD with publicly available information on section 42 low-income housing projects if HUD requests it.

A commentator also suggests that the compliance monitoring regulations be amended to acknowledge the authority of Title VIII of the 1968 Civil Rights Act, as well as HUD's Title VIII regulations; specify the civil rights obligations of the Agencies; and specify what developers and owners of projects must do to satisfy their civil rights obligations.

To monitor for compliance with the Fair Housing Act, the final regulations amend the annual owner certification relating to the general public use requirement in § 1.42-5(c)(1)(v) to require owners to certify that no finding of discrimination under the Fair Housing Act has occurred for the project (a finding of discrimination includes an adverse final decision by HUD, an adverse final decision by a substantially equivalent state or local fair housing agency, or an adverse judgment from a Federal court).

#### B. Sources and Uses of Funds

Section 42(m)(2)(A) requires Agencies to limit the housing credit dollar amount allocated to a project to only the amount necessary for the financial feasibility of a project and its viability as a qualified low-income project through the credit period. The proposed regulations require an Agency to value the housing credit dollar amount at four times: (1) at application for the housing credit dollar amount, (2) the allocation of the housing credit dollar amount, (3) the date the building

is placed in service, and (4) after the building is placed in service, but before the Agency issues the Form 8609. Commentators recommend limitation of the valuation at the placed-in-service date. In practice, Agencies currently value the credit amount at the shorter time. The final regulations adopt the recommendation by delaying the fourth time requirement and clarifying that the placed-in-service valuation may occur not later than the date the Agency issues the Form 8609.

Commentators are concerned that the opinion by a certified public accountant, based upon the accountant's audit or examination, on the financial deductions and certifications required in the proposed regulations, could have significant cost implications, particularly for small revolving loans. Commentators suggest limiting the requirement to projects with 25 or more units, or projects with total revolving loan costs of \$5 million or more.

The third-party validation on financial information was recommended in the report by the General Accounting Office (GAO), "Tax Credits: Opportunities to Improve Oversight of the Low-Income Housing Program," (GAO/GGD/RCED-97-55), dated March 28, 1997. The GAO report states on page 93 that an accounting firm with a tax credit speciality would charge in the \$5,000 to \$7,500 range per engagement for tax credit certifications (opinion on total costs, eligible basis, and tax credit amount) prepared on the basis of an audit done in accordance with AICPA audit standards versus for projects costing upwards of \$5 million to \$10 million. As a percentage of revolving loan costs, the CPA tax credit certifications represent a minimal cost for validating financial information. However, in recognition that the cost may be burdensome for small revolving loans, the final regulations limit the requirement for an audit schedule of costs for projects with more than 10 units.

Two commentators were concerned that the meaning of the term "financial deductions and certifications" is unclear. A CPA would not be able to value what needs to be audited and whether the arrangement and liability criteria against which the information can be valued. To conduct an audit or attestation engagement, CPAs require that the subject matter be defined and that such subject matter be capable of valuation against reasonable criteria. Reasonable criteria are essential so that CPAs using the same criteria will be able to arrive at similar conclusions.

Another concern expressed by commentators involved uncertainty as

to whether the CPA is being asked to report on financial information that is only historical or whether the CPA is also being asked to examine prospective financial information. CPAs can compile or examine and report on certain types of prospective financial information. However, such engagements generally are more costly than audits of historical information because of minimum professional guidelines required by professional standards as well as increased risk associated with futuristic information. The commentators believe that if an Agency were to require CPAs to be associated with prospective financial information, the related costs to the taxpayer may far exceed any perceived benefits to the Agency. Accordingly, the final regulations have been revised to specify that the CPA's opinion only relates to historical project costs.

#### *C. Correction of Administrative Errors and Omissions*

Commentators recommend filing the corrected allocation document with the current year's Form 8610, "Annual Low-Income Housing Credit Agency Report," instead of amending the Form 8610 for the year the allocation was made. Because the administrative errors covered by the automatic approval provision will not have an effect on the total amount of credit the Agency allocated to the building(s) or project, commentators view an amended Form 8610 as unnecessary. Agency recordkeeping would be simplified if all corrected allocation documents could be submitted with the current year's Form 8610. The final regulations adopt this recommendation.

#### **Special Analysis**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collections of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the burden on taxpayers is minimal and the burden on small entity Agencies is not significant. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these

regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting information. The principal author of these regulations is Paul F. Handlman, Office of the Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

#### **List of Subjects**

##### *26 CFR Part 1*

Income taxes, Reporting and recordkeeping requirements.

##### *26 CFR Part 602*

Reporting and recordkeeping requirements.

#### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

#### **PART 1—INCOME TAXES**

**Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

Section 1.42-17 also issued under 26 U.S.C. 42(n); \* \* \*

**Par. 2.** Section 1.42-5 is amended by:

1. Moving the word "Revenue" in paragraph (b)(1)(iv) and adding "Omnibus Budget" in its place.
2. Adding paragraph (b)(3).
3. Revising paragraphs (c)(1)(v), (c)(1)(vi), (c)(1)(xi), (c)(2)(ii), and (c)(2)(iii).
4. Moving the word "project" in paragraph (c)(1)(x) and adding "building" in its place.
5. Moving the word "and" at the end of paragraph (c)(1)(x).
6. Adding paragraph (c)(1)(xii).
7. Moving the language "paragraph (c)(2)(ii)(A), (B), and (C) of this section" from the first sentence in paragraph (c)(4)(i) and adding "paragraph (c)(2)(ii) of this section" in its place.
8. Moving the language "Farmers Home Administration (FmHA)" in the first sentence in paragraph (c)(4)(i) and adding "Rural Housing Service (RHS), formerly known as Farmers Home Administration," in its place.
9. Moving the language "FmHA" in paragraph (c)(4)(ii) and adding "RHS" in its place in each applicable place.
10. Moving the language "An Agency chooses the reviewer requirement of paragraph (c)(2)(ii)(A) of this section and some of the buildings selected for review" from the first sentence in

the example in paragraph (c)(4)(iii) and adding "An Agency's limits for review" in its place.

11. Removing the language "FmHA" in paragraph (c)(4)(iii) *Example* and adding "RHS" in its place in each place it appears.

12. Adding paragraph (c)(5).

13. Removing paragraph (d).

14. Removing the language "(c)(2)(ii)(A), (B), or (C) of this section (which version is applicable)" from paragraph ( ) (2) and adding the language "(c)(2)(ii) of this section" in its place.

15. Adding a sentence at the end of paragraph ( ) (3)(i).

16. Removing the language "paragraph ( ) (3) of this section" in the third sentence in paragraph (f)(1)(i) and adding "paragraphs (c)(5) and ( ) (3) of this section" in its place.

17. Adding the sentences at the end of paragraph (h).

The revisions and additions read as follows:

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

\* \* \* \* \*

(b) \* \* \*

(3) *Inspection of rental provision.* Under the inspection of rental 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) \* \* \* (1) \* \* \*

(v) All units in the project were for use by the general public (as defined in § 1.42-9), including the requirement that no finding of discrimination under the Fair Housing Act, 42 U.S.C. 3601-3619, 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 government 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;

\* \* \* \* \*

(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 certification of eligibility under section 8 of the United States Housing Act of 1937, 42 U.S.C. 1437s (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 as 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) \* \* \*

(ii) Requirement 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 that 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 rental 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 rental records for the tenants in those units; and

(iii) Requirement 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 whether or not 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 a reasonable notice that an inspection of the building and low-income units or tenant records review will occur so that the owner may notify tenants of the inspection or assessment of tenant records for review (for example, 30 days notice of inspection or review).

\* \* \* \* \*

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

(d) *Inspection provision.*—(1) *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 Secretary. However, provided the Agency determines by inspection that the HUD standards remain 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 under paragraph (f) of this section. Such Authorized Delegate, which may include HUD, must notify the Agency of the inspection results.

( ) \* \* \*  
(3) \* \* \*  
(i) \* \* \* 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.

(h) \* \* \* In addition, the requirements in paragraphs (b)(3) and (c)(1)(v), (vi), and (xi) of this section (involving record keeping 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 requirements 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 ( ) (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.

**Par. 3.** Section 1.42-6 is amended by: 1. In paragraph (c)(3), second sentence, remove the language "Annual Low-Income Housing Credit Agency's Report" and add the language "Annual Low-Income Housing Credit Agency's Report" in its place.

2. In paragraph (d)(1), first sentence, remove the language "Low-Income Housing Credit Allocation

Certification," and add the language "Low-Income Housing Credit Allocation Certification," in its place. 3. Revising the first sentence in paragraph (d)(4)(ii).

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

\* \* \* \* \*  
(d) \* \* \*  
(4) \* \* \*  
(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. \* \* \*

**Par. 4.** Section 1.42-11 is amended by revising the last sentence in paragraph (b)(3)(ii)(A) to read as follows:

**§ 1.42-11 Provision of services.**  
\* \* \* \* \*  
(b) \* \* \*  
(3) \* \* \*  
(ii) \* \* \* (A) \* \* \* 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 single-room occupancy), a supportive service includes any service provided to assist tenants in locating and retaining permanent housing.

**Par. 5.** Section 1.42-12 is amended by adding paragraph (c) to read as follows:

**§ 1.42-12 Effective dates and transitional rules.**  
\* \* \* \* \*  
(c) *Carryover allocations.* The rule set forth in § 1.42-6(d)(4)(ii) relating to the requirements that State and local housing agencies file Schedule A (Form 8610), "Carryover Allocation of the Low-Income Housing Credit," is applicable for carryover allocations made after December 31, 1999.

**Par. 6.** Section 1.42-13 is amended by:

- 1. Revising the introductory text of paragraph (b)(3)(iii).
- 2. Adding paragraphs (b)(3)(vi), (b)(3)(vii), and (b)(3)(viii).
- 3. Adding a sentence at the end of paragraph (d).

The revisions and additions read as follows:

**§ 1.42-13 Rules necessary and appropriate; housing credit agencies' correction of administrative errors and omissions.**

\* \* \* \* \*  
(b) \* \* \*  
(3) \* \* \*  
(iii) *Secretary's prior approval required.* Except as provided in

paragraph (b)(3)(vi) of this section, an Agency must obtain the Secretary's prior approval to correct an administrative error or omission, as described in paragraph (b)(2) of this section, if the correction is not made before the close of the calendar year of the error or omission and the correction—

(vi) *Secretary's automatic approval.* The Secretary grants automatic approval to correct an administrative error or omission described in paragraph (b)(2) of this section if—

(A) The correction is not made before the close of the calendar year of the error or omission and the correction is a numerical change to the housing credit dollar amount allocated for the building or multiple-building project;

(B) The administrative error or omission resulted in an allocation document (the Form 8609, "Low-Income Housing Credit Allocation Certification," or the allocation document under the requirements of section 42(h)(1)(E) or (F), and § 1.42-6(d)(2)) that either did not accurately reflect the number of buildings in a project (for example, an allocation document for a 10-building project only reflected 8 buildings instead of 10 buildings), or the correction information (other than the amount of credit allocated on the allocation document);

(C) The administrative error or omission does not affect the Agency's ranking of the building(s) or project and the total amount of credit the Agency allocated to the building(s) or project; and

(D) The Agency corrects the administrative error or omission by following the procedures described in paragraph (b)(3)(vii) of this section.

(vii) *How Agency corrects errors or omissions subject to automatic approval.* An Agency corrects an administrative error or omission described in paragraph (b)(3)(vi) of this section by—

(A) Amending the allocation document described in paragraph (b)(3)(vi)(B) of this section to correct the administrative error or omission. The Agency will indicate on the amended allocation document that it is making the "correction under § 1.42-13(b)(3)(vii)." If correcting the allocation document requires including any additional B.I.N.(s) in the document, the document must include any B.I.N.(s) already existing for buildings in the project. If possible, the additional B.I.N.(s) should be sequentially numbered from the existing B.I.N.(s);

(B) Amending, if applicable, the Schedule A (Form 8610), "Carryover

Allocation of the Low-Income Housing Credit," and attaching a copy of this schedule to Form 8610, "Annual Low-Income Housing Credit Allocation Report," for the year the correction is made. The Agency will indicate on the schedule that it is making the "correction under § 1.42-13(b)(3)(vii)." For a carryover allocation made for January 1, 2000, the Agency must complete Schedule A (Form 8610), and indicate on the schedule that it is making the "correction under § 1.42-13(b)(3)(vii)";

(C) Amending, if applicable, the Form 8609 and attaching the original of this amended form to Form 8610 for the year the correction is made. The Agency will indicate on the Form 8609 that it is making the "correction under § 1.42-13(b)(3)(vii)"; and

(D) Mailing or otherwise delivering a copy of any amended allocation document and any amended Form 8609 to the affected taxpayer.

(viii) *Other approval procedures.* The Secretary may grant automatic approval to correct other administrative errors or omissions as designated in one or more documents published either in the Federal Register or in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

\* \* \* \* \*

(d) \* \* \* Paragraphs (b)(3)(vi), (vii), and (viii) of this section are effective January 14, 2000.

Par. 7. Section 1.42-17 is added to read as follows:

**§ 1.42-17 Qualified allocation plan.**

(a) *Requirements*—(1) *In general.* [Reserved]

(2) *Separate criteria.* [Reserved]

(3) *Agency valuation.* 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 production 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 on a liability 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 deficiencies, syndication and legal fees, and development 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 interest payments. 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 development and operational costs of the project.

(4) *Timing of Agency valuation*—(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.

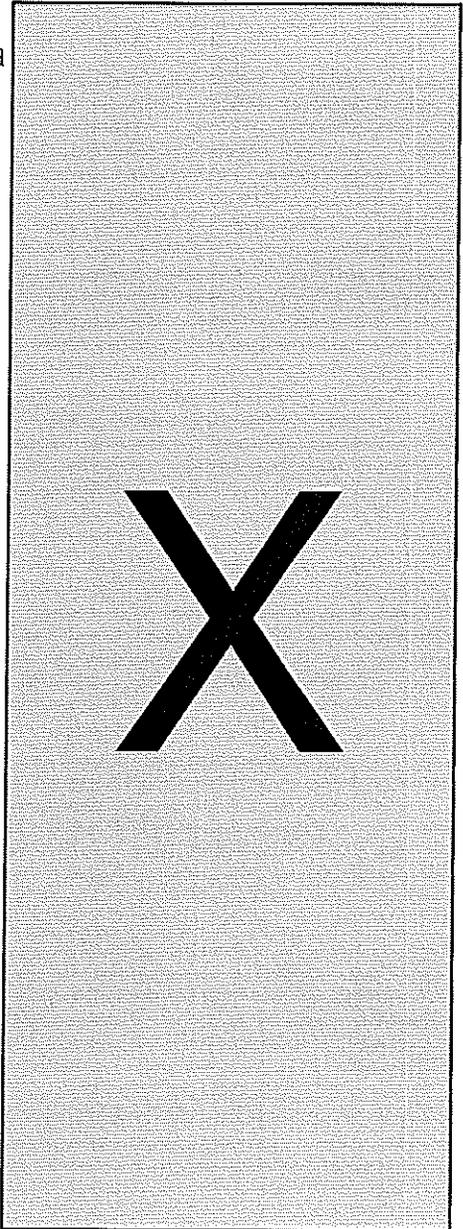
(ii) *Time limit for placement-in-service valuation.* For purposes of paragraph (a)(4)(i)(C) of this section, the valuation for when a building is placed in service must be made not later than the date the Agency issues the Form 8609, "Low-Income Housing Credit Allocation Certification." The Agency must value 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 the date the Agency issues the Form 8609.

(5) *Special rule for final determinations and certifications.* For the Agency's valuation 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 on a liability 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 audit 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 bonds (or one-half of which the bonds were issued), or the Agency responsible for issuing the Form(s) 8609 to the project, make certain 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.



**Internal Revenue Service Notice**  
**88-80**  
**(Income Determination)**

**Notice 88-80**

The purpose of this notice is to inform taxpayers that regulations to be issued under section 42(g)(1) of the Internal Revenue Code of 1986 (the "Code") (relating to the determination of a qualified low-income housing project) will provide that the income of individuals and area median gross income (adjusted for family size) are to be made in a manner consistent with the determination of annual income and the estimates for median family income under section 8 of the United States Housing Act of 1937 (H.U.D. section 8).

For the purpose of H.U.D. section 8, annual income is defined under 24 CFR 813.106 (1987). HUD section 8 median family income estimates (i.e., area median gross income estimates) are based on decennial Census data P-60 income data and Department of Commerce County Business Patterns employment and earnings data. The determination of annual income and median family income estimates are based on definitions of income that include some items of income that are not included in a taxpayer's gross income for purposes of computing Federal Income Tax liability. Thus, the income of individuals and area median gross income (adjusted for family size) for purposes of section 42(g)(1) of the Code will NOT be made by reference to items of income used in determining gross income for purposes of computing Federal Income Tax liability.

This document serves as an "administrative pronouncement" as that term is described in section 1.661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a

revenue ruling or revenue procedure.

The principal author of this Notice is Christopher J. Wilson of the Legislation and Regulations Division. For further information regarding this Notice contact Mr. Wilson on (202) 566-4336 (not a toll-free call).

**Internal Revenue Service**  
**Revenue Ruling 91-38**  
**(Low Income Housing Credit**  
**Questions and Answers)**

**Rev. Rul. 91-38**

**PURPOSE**

This revenue ruling answers certain questions about the low-income housing credit provided for in section 42 of the Internal Revenue Code.

**LAW**

Section 38(a) of the Code provides for a general business credit against tax that includes the amount of the current year business credit. Section 38(b)(5) provides that the amount of the current year business credit includes the low-income housing credit determined under section 42(a). The low-income housing credit that may be claimed in any year is subject to the general business tax credit limitation of section 38(c).

Section 42(a) of the Code, added by section 252 of the Tax Reform Act of 1986 (the "1986 Act"), 1986-3 (Vol. 1) C.B. 106, provides that, for purposes of section 38, the amount of the low-income housing credit determined under section 42 for any tax year in the credit period shall be an amount equal to the "applicable percentage" of the qualified basis of each qualified low-income building.

*Credit Period*

Section 42(f)(1) of the Code, as amended by section 1002(1)(2)(B) of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), 1988-3 C.B. 1, 34, defines the credit period of any building as the period of 10 tax years beginning with the tax year in which the building is placed in service, or at the taxpayer's irrevocable election, the succeeding tax year, but in

either case only if the building is qualified low-income building as of the close of the first year of the credit period.

For purposes of calculating the credit allowable for the first tax year of the credit period, section 42(f)(2) of the Code reduces the credit by applying the following first-year convention: the fraction used to determine qualified basis at the end of the first year is the sum of applicable fractions determined at the end of each full month the building was in service during that year, divided by 12. In the first tax year following the credit period, a taxpayer may recover any reduction in credit caused by applying the first-year convention during the first year of the credit period.

*Applicable Percentage*

In the case of any qualified low-income building placed in service by the taxpayer after 1987, section 42(b)(2)(A) of the Code provides that the term "applicable percentage" means the appropriate percentage prescribed by the Secretary for the earlier of (i) the month in which the building is placed in service, or (ii) at the election of the taxpayer (I) the month in which the taxpayer and the housing credit agency enter into an agreement with respect to the building (which is binding on the agency, the taxpayer, and all successors in interest) as to the housing credit dollar amount to be allocated to the building, or (II) in the case of any building to which section 42(h)(4)(B) applies, the month in which the tax-exempt obligations are issued. Section 42(b)(2)(B) provides that the percentages prescribed by the Secretary for any month shall be percentages that will yield over a 10-year period amounts of credit that have a present value equal to: (i) 70 percent of the qualified basis, in the case of new buildings that are not federally subsidized for the tax year (70 percent present value credit), and (ii) 30 percent of the

qualified basis, in the case of new buildings that are federally subsidized for the tax year and existing buildings (30 percent present value credit). The appropriate credit percentages for each month are published monthly in the revenue ruling containing the applicable federal rates.

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

Under section 42(b)(1) of the Code, for any qualified low-income building placed in service by the taxpayer during 1987, the applicable percentage for new buildings not federally subsidized is 9 percent and the applicable percentage for existing or federally subsidized buildings is 4 percent.

After calendar year 1989, existing buildings that receive moderate rehabilitation assistance under section 8(e)(2) of the United States Housing Act of 1937, 42 U.S.C. 1437f (1988), at any time during the credit period, generally are not eligible for an allocation of credit. See section 7108(h)(5) of the Revenue Reconciliation Act of 1989 (the "1989 Act"), 1990-1 C.B. 214, 222. The provisions of the 1989 Act generally are effective for buildings allocated housing credit dollar amounts after calendar year 1989. If no allocation is necessary by reason of section 42(h)(4) of the Code because the building is substantially financed with certain tax-exempt obligations, the

provisions are generally effective for buildings placed in service after December 31, 1989.

The Revenue Reconciliation Act of 1990 (the "1990 Act"), (Pub. L. No. 101-508), provides a limited exception from the exclusion of buildings receiving moderate rehabilitation assistance under section 8(e)(2) of the United States Housing Act of 1937. Beginning with allocations made after 1990, buildings receiving assistance under the Stewart B. McKinney Homeless Assistance Act of 1988 (as in effect on the date of enactment of the 1990 Act) may be eligible for an allocation of credit.

#### *Rehabilitation Expenditures*

Under section 42(e)(3)(A) of the Code as in effect prior to the 1989 Act, rehabilitation expenditures paid incurred by the taxpayer with respect to any building could be treated as a separate new building only if the qualified basis attributable to rehabilitation expenditures incurred during any 24-month period, when divided by the number of low-income units in the building, was \$2,000 or more. For calendar years after 1989, rehabilitation expenditures with respect to a building may be treated as a separate new building eligible for the credit under section 42(e)(3)(A) only if (i) the expenditures are allocable to one or more low-income units or substantially benefit such units, and (ii) the amount of such expenditures during any 24-month period meets the greater of the following requirements: (I) the amount is not less than 10 percent of the adjusted basis of the building, or (II) the qualified basis attributable to such expenditures, when divided by the number of low-income units in the building, is \$3,000 or more. Under section 42(e)(2)(B), as in effect both before and after the 1989 Act, the term "rehabilitation

expenditures" does not include the cost of acquisition of any building.

Former section 42(d)(5)(C) of the Code, which was added by TAMRA, and which is now section 42(d)(5)(B), provides that the eligible basis of any building shall not include any portion of the building's adjusted basis attributable to amounts with respect to which an election is made under section 167(k). The election under section 167(k) is an election to depreciate rehabilitation expenditures incurred with respect to low-income rental housing after July 24, 1969, and before January 1, 1987, under a straight line method using a useful life of 60 months. If no election is made under section 167(k), rehabilitation expenditures incurred by a taxpayer with respect to a low-income rental housing building may be included in the building's eligible basis. Section 1.167(k)-1(b)(1) of the Income Tax Regulations provides rules governing when a taxpayer will be treated as having paid or incurred rehabilitation expenditures.

Under section 1.167(k)-1(b)(1) of the regulations, a taxpayer generally is treated as having paid or incurred rehabilitation expenditures if the rehabilitation is performed by or for the taxpayer or in accordance with the taxpayer's specifications, or if the taxpayer acquires the property attributable to the expenditures (or an interest therein) before the property is placed in service. Section 1.167(k)-1(b)(2) provides that the amount of rehabilitation expenditures treated as paid or incurred by the taxpayer is the lesser of (i) the rehabilitation expenditures paid or incurred before the date on which the taxpayer acquired an interest in the property attributable to the expenditures, or (ii) the taxpayer's cost or other basis for the property attributable to the rehabilitation expenditures paid or incurred before such date. Rehabilitation

expenditures treated as having been paid or incurred by the taxpayer are deemed to have been paid or incurred on the date on which the expenditures were actually paid or incurred, determined in accordance with the method of accounting used by the person that actually paid or incurred the expenditures.

A taxpayer acquiring a building from a governmental unit may elect, under section 42(e)(3)(B) of the Code, to meet only the requirement that the qualified basis attributable to the rehabilitation expenditures incurred with respect to the building will be \$3,000 or more when divided by the number of low-income units in the building. A taxpayer making this election may claim only the 30 percent present value credit on those expenditures.

Section 42(e)(4)(A) of the Code provides, in part, that expenditures treated as a separate new building under section 42(e) are considered placed in service at the close of the 24-month period during which the expenditures were incurred. According to section 42(e)(4)(B), the applicable fraction for the rehabilitation expenditures is the applicable fraction for the building with respect to which the expenditures were incurred.

#### *Qualified Basis*

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 (i) the "applicable fraction" (determined as of the close of the tax year) of (ii) the eligible basis of the building (determined under section 42(d)). Under section 42(c)(1)(B), the "applicable fraction" is the smaller of the unit fraction (the number of low-income units divided by the number of all residential rental units) or the floor space fraction (the floor space of the low-income

units divided by the floor space of all residential rental units).

In general, the eligible basis of a building under section 42(d) of the Code is its adjusted basis at the close of the first tax year of the credit period. However, a number of limitations apply. For example, if an existing building does not meet the requirements of section 42(d)(2)(B) (as described below), its eligible basis is zero under section 42(d)(2)(A)(ii). In addition, under section 42(e)(5), rehabilitation expenditures that a taxpayer elects to treat as a separate new building under section 42(e) may not be considered part of the eligible basis of an existing building under section 42(d)(2)(A)(i).

#### *Requirements for Existing Buildings*

Section 42(d)(2)(A) and (B) of the Code provides that the eligible basis of an existing building will be zero unless the building meets the following requirements: (i) the building is acquired by purchase (as defined in section 179(d)(2)); (ii) there is a period of at least 10 years between the date of the building's acquisition by the taxpayer and the later of (I) the date the building was last placed in service, or (II) the date of the building's most recent nonqualified substantial improvement (as defined in section 42(d)(2)(D)(i)); and (iii) the building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time the building was previously placed in service. Furthermore, existing buildings are eligible for a credit allocation after calendar year 1989 only if a credit is allowable by reason of substantial rehabilitation of the building under section 42(e).

In determining when a building was last placed in service for purposes of satisfying the

requirement in section 42(d)(2)(B)(ii) of the Code, section 42(d)(2)(D)(ii) provides that certain placements in service are not taken into account. The 1990 Act provides that as of November 5, 1990 (the date of its enactment), any placement in service of a single-family residence by any individual who owned and used the residence for no other purpose than as a principal residence is not taken into account for purposes of determining whether the 10-year requirement is met. See section 42(d)(2)(D)(ii)(V).

#### *Transfers During the Compliance Period*

Section 42(d)(7)(A) and (B) of the Code provides, in general, that the requirements of section 42(d)(2)(B) do not apply if a taxpayer acquires an existing building (or interest therein) for which a credit was allowed to any prior owner under section 42(a) and the taxpayer acquires the building (or interest therein) before the end of the building's compliance period. In that case, section 42(d)(7)(A)(ii) provides that the credit allowable to the taxpayer for any period after the acquisition is equal to the amount of credit that would have been allowable for that period to the prior owner had the owner not disposed of the building (or interest therein).

In general, a transfer of the property results in a new placed in service date if, on the date of the transfer the property is ready and available for its intended purpose. See 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-91 (1986), 1986-3 (Vol. 4) C.B. 91. However, if section 42(d)(7) of the Code applies to a transfer of the property, the fact that the transfer results in a new placed in service date does not jeopardize the purchaser's eligibility to claim the low-income housing credit, because the requirements of section 42(d)(2)(B)

do not apply. According to section 42(f)(4), the credit will be allocated among the parties on the basis of the number of days the building (or interest) was held by each.

#### *Definition of a Qualified Low-Income Housing Project*

Under section 42(g)(1) of the Code, a "qualified low-income housing project" is 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 area median gross income, 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 area median gross income, as adjusted for family size. Once the taxpayer elects which requirement the project will meet, the election is irrevocable.

For buildings not subject to the amendments of the 1989 Act, section 42(g)(2)(A) of the Code provides that a unit is rent-restricted if the gross rent (defined in section 42(g)(2)(B)) that is paid for the unit does not exceed 30 percent of the income limits applicable to the occupants under section 42(g)(1). For buildings subject to the amendments of the 1989 Act, a residential rental 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 under section 42(g)(2)(C). Furthermore, section 42(g)(2)(A) provides that for buildings subject to the amendments of the 1989 Act, the amount of the income limitation for any period shall not be less than the limitation applicable for the earliest period the building (which contains the unit) was included in the determination of whether the

project is a qualified low-income housing project.

Under section 42(i)(3)(B) of the Code, low-income units must be suitable for occupancy and used other than on a transient basis. Additionally, section 42(i)(3)(C) provides that no unit in a building that has four or fewer residential rental units shall be treated as a low-income unit if the owner of the units is (i) the occupant of a residential unit in the building, or (ii) is related to an occupant of a unit (as "related" is defined in section 42(d)(2)(D)(iii)). However, for calendar years after 1989, if a building is acquired or rehabilitated under a development plan of action sponsored by a State or local government or a qualified nonprofit organization (as defined in section 42(h)(5)(C)), the owner-occupant restriction of section 42(i)(3)(C) is inapplicable. In this case, the applicable fraction shall not exceed 80 percent of the unit fraction and any unit that is not rented for 90 days or more shall be treated as occupied by the owner of the building as of the 1st day it is not rented.

#### *Recapture of Credit*

According to section 42(j)(1) and (2) of the Code, if at the close of any tax year in the compliance period the building's qualified basis with respect to the taxpayer is less than the basis as of the close of the preceding tax year, then the taxpayer is liable for additional tax in an amount equal to the accelerated portion of credits allowed in earlier years with respect to the reduction in qualified basis, plus interest. The accelerated portion of the credit under section 42(j)(3) is the excess of (A) the aggregate credit allowed for those years for that basis, over (B) the aggregate credit that would be allowable for those years for that basis if the aggregate credit that would have been allowable for the

entire compliance period were allowable ratably over 15 years, rather than 10 years.

If a building fails to remain part of a qualified low-income housing project (for example, because of non-compliance with the minimum set-aside requirement or the rent restrictions or other requirements imposed on the units constituting the set-aside) during the building's 15-year compliance period, the taxpayer or taxpayers that owned the building (or interests therein) must repay the entire accelerated portion of the credit, with interest, for all prior years. Generally, any change in ownership of a building during the building's compliance period is also a recapture event. See 2 H.R. Conf. Rep. No. 841, at II-96.

Section 42(j)(6) of the Code permits the taxpayer to avoid recapture upon disposition of the building or an interest therein by furnishing a bond to the Secretary in an amount satisfactory to the Secretary and for the period required by the Secretary, if the building is reasonably expected to continue to be operated as a qualified low-income building. Furthermore, for partnerships consisting of 35 or more partners, unless the partnership elects otherwise, no change in ownership will be deemed to occur if within a 12-month period at least 50 percent (in value) of the original ownership is unchanged. See 2 H.R. Conf. Rep. No. 841, at II-96, and H.R. Conf. Rep. No. 1104, 100th Cong., 2d Sess. II-83 (1988), 1988-3 C.B. 473, 573. A de minimis rule may apply to certain dispositions of interests in partnerships (other than large partnerships described in section 42(j)(5)) that own buildings for which a credit was claimed. See Rev. Rul. 90-60, 1990-2 C.B. 3, for additional information.

#### *Allocation of Credit by Housing Credit Agencies*

Under section 42(h)(1) of the Code, a taxpayer may not claim a credit on a qualified low-income building in excess of the housing credit dollar amount allocated to the building by the state or local housing agency in whose jurisdiction the building is located. However, under section 42(h)(4) a taxpayer need not obtain a credit allocation for the portion of a building's eligible basis financed by an obligation which is subject to the volume cap of section 146 and the interest on which is exempt from tax under section 103. Prior to the 1989 Act, if such an obligation financed 70 percent or more of the aggregate basis of the building and the land on which it was located, the entire building was exempt from the limits of section 42(h)(1). Under the 1989 Act, buildings placed in service after calendar year 1989 are exempt from the limits of section 42(h)(1) if 50 percent or more of the aggregate basis of the building and the land on which it is located are financed with such tax-exempt obligations.

Section 42(h)(2)(A) of the Code provides that the housing credit dollar amount allocated to a building for any calendar year applies to the building for all tax years in its compliance period that end during or after the year of allocation. However, under section 42(h)(1)(B), as amended by TAMRA, an allocation is taken into account only if it occurs not later than the close of the calendar year in which the building is placed in service, unless one of the exceptions in section 42(h)(1)(C), (D), (E), or (F) apply. Under section 42(h)(2)(B), the allocation reduces the credit agency's allocable housing credit dollar amount only for the year of the allocation.

## QUESTIONS AND ANSWERS

### A. DETERMINATION OF CREDIT PERIOD ISSUES

#### QUESTION 1.

How do taxpayers make the election under section 42(f)(1) of the Code to defer the start of the credit period?

#### ANSWER 1.

The building owner may elect under section 42(f)(1) of the Code to begin the credit period (and the compliance period) the year after the building is placed in service by checking the appropriate box on line 5a in Part II of Form 8609, Low-Income Housing Credit Allocation Certification. Form 8609 must be attached to the owner's federal income tax return for each year of the 15-year compliance period, which begins with the first year of the credit period. If the owner does not claim a low-income housing credit on its timely filed federal income tax return (taking any extensions into account) for the year in which the building is placed in service, or fails to timely file its federal income tax return for that year, the owner is deemed to have made the irrevocable election to begin the credit period (and the compliance period) the succeeding tax year. In the case of buildings held by flow-through entities, only the entity may file a Form 8609 to make the election under section 42(f)(1). Only one election may be made per building. If there are multiple owners that are not members of a flow-through entity, and each owner files a Form 8609 with respect to a building, all of the Form 8609s for that building must be consistent with regard to whether the election is made. Unless all the owners of a particular building make the section 42(f)(1) election, the credit period and compliance period for that building will begin with the year in

which the building is placed in service. Once made, an election under section 42(f)(1) is binding on the owner and all successors in interest.

#### QUESTION 2.

X, a calendar year corporation, was created on June 1, 1987. On July 1, 1987, X placed in service a qualified low-income building. If X chooses not to defer the beginning of the credit period under section 42(f)(1) of the Code, when does the credit period for the building begin?

#### ANSWER 2.

A building's credit period is the period of 10 years (120 months) beginning with the first day of the tax year in which the building is placed in service, or the succeeding tax year if the election under section 42(f)(1) of the Code is made. The tax year that a building is placed in service is determined, at the time of placement in service, by the tax year of the owner who placed the building in service and is not affected by subsequent changes in the tax year of that owner or by the introduction of subsequent owners with different tax years.

Each building has only one credit period. For purposes of section 42(f) of the Code, when the first tax year of the credit period is a short tax year, the credit period begins 12 months before the end of the short tax year. In other words, the credit period begins on what would have been the first day of the tax year, had the tax year not been a short tax year.

Because X came into existence on June 1, 1987, X had a short tax year for calendar year 1987. Because X did not elect to defer the start of the credit period to the succeeding year, which would have been its first full tax year, the building's credit period began 12 months before the end of X's short tax year. Therefore, the credit period began January 1, 1987,

rather than the first day of the short tax year, June 1, 1987. The credit for the first year of the credit period is computed according to the first-year convention in section 42(f)(2) of the Code.

### B. CREDIT COMPUTATION ISSUES

#### QUESTION 3.

X, a calendar year corporation, placed a newly constructed qualified low-income building in service on February 1, 1987. X received a \$90,000 housing credit allocation for 1987 from the state Y housing credit agency based upon the 9 percent applicable credit percentage and had a qualified basis in the building as of December 31, 1987, of \$1,000,000. X did not elect to defer the start of the credit period under section 42(f)(1) of the Code. For calendar year 1987, X claimed a credit using the first-year convention of section 42(f)(2).

During calendar year 1988 (the second year of the credit period), because of a change in annual accounting period permitted under section 442 of the Code, X made a short-period return for the 8-month period beginning January 1, 1988, and ending August 31, 1988. May X claim any low-income housing credit on its short-period return?

#### ANSWER 3.

Yes. As Answer 2 explains, the building's credit period is determined, at the time of placement in service, by reference to the tax year of the owner who placed the building in service, and is not affected by subsequent changes in the owner's tax year. The amount of credit that a particular owner may claim on its return for a tax year is determined on the last day of that owner's tax year. Because X was a calendar year taxpayer and did not elect to defer the start of the credit period, the building's credit period begins

January 1, 1987, and ends December 31, 1996.

In accordance with section 42(a) of the Code, the amount of credit that X may claim on the short-period return is an amount equal to the product of the applicable percentage of 9 percent and 8/12 of the building's qualified basis as of August 31, 1988. X is entitled to only 8/12 of the applicable percentage of the qualified basis on the last day of the short-period tax year because the short period includes only 8 months. If the qualified basis was \$1,000,000 on August 31, 1988, X would be allowed to claim a credit on its short-period return of \$60,000  $[(.09) \times (8/12 \times \$1,000,000)]$ . Assuming X retains ownership of the building, continues to comply with the requirements of section 42 of the Code and remains on an August 31 tax year, for each succeeding tax year in the credit period the credit is based upon the qualified basis as of August 31 of that tax year. If the qualified basis on August 31, 1989, is \$1,000,000, X may claim a credit of \$90,000  $[(\text{the applicable percentage, } .09) \times (\$1,000,000)]$  on its federal income tax return for the tax year ending August 31, 1989.

The last 4 months in the credit period (September 1996 through December 1996) are included in X's tax year beginning September 1, 1996, and ending August 31, 1997. The credit for those 4 months is based upon 4/12 of the qualified basis as of August 31, 1997. The credit for X's tax year ending August 31, 1997, consists of the credit for the last 4 months of the credit period plus the disallowed first year credit amount that is carried over to the 11th year under section 42(f)(2)(B) of the Code. See Question and Answer 5 below.

#### **C. AVAILABILITY OF CREDIT TO SUBSEQUENT PURCHASERS**

#### **QUESTION 4.**

What is the meaning of the word "allowed" as used in section 42(d)(7)(B)(i) of the Code, which permits a subsequent owner to step into the shoes of a prior owner and claim a credit on a qualified low-income building, but only if the credit was "allowed" to a prior owner?

#### **ANSWER 4.**

For purposes of section 42(d)(7)(B)(i) of the Code, the term "allowed" may also mean "allowable." If a qualified low-income building is acquired during the building's compliance period, section 42(d)(7)(B)(i) requires that a credit must have been allowed to a prior owner of the building if the new owner is to continue claiming the credit. In this manner, credits may be transferred to the new purchaser of a building (or interest therein) during the period for which the property is eligible to receive the credit, with the new purchaser "stepping into the shoes" of the seller as to credit percentage, basis, and liability for compliance and recapture. See 2 H.R. Conf. Rep. No. 841, at II-87. The purchaser's basis upon acquisition of the building (or interest therein) for section 42 purposes equals the eligible basis of the building (or interest therein) whether the purchase price is greater or less than that basis.

A credit need not actually have been claimed by a prior owner in order for a subsequent owner to claim the credit under section 42(d)(7) of the Code. If a taxpayer transfers a qualified low-income building (or an interest therein) before actually claiming a credit, but after having received an allocation or having qualified for the credit without an allocation (as provided in this ruling) under section 42(h)(4)(B), the credit will be considered allowed to the prior owner for purposes of section 42(d)(7)(B)(i). However, in order

to be treated as having been allowed a credit, a prior owner must have actually received a low-income housing credit allocation for the building from a state housing credit agency before the transfer or must have actually qualified for the credit under section 42(h)(4)(B).

A state credit agency makes an allocation after reviewing the application submitted by the building owner and determining that the building will probably qualify as a qualified low-income building. A state credit agency may issue a reservation of a credit amount or a binding commitment to allocate credit in a later year as a preliminary step to issuing a credit allocation but, unlike a credit allocation, a reservation or a binding commitment may be revoked (for example, if specified conditions are not met by the building owner). Therefore, if a taxpayer transfers a qualified low-income building (or an interest therein) after the state agency reserves a low-income credit for that building but before the agency actually allocates that credit to that building, the credit will not be considered allowed to the prior owner within the meaning of section 42(d)(7)(B)(i) of the Code. If the credit is not considered allowed to the prior owner but the building has not been placed in service so that there is no violation of the 10-year rule in section 42(d)(2)(B)(ii) (and if the requirements of section 42 are otherwise met), the purchaser may apply to the state housing credit agency for an allocation of credit.

If a taxpayer receives an allocation with respect to a new building during the construction period of the building, as may be the case where the taxpayer expects to use the 10 percent carryover allocation rule in section 42(h)(1)(E) of the Code, and transfers the building (or an interest therein) before the building is

placed in service, the purchaser will take an eligible basis in the building (or interest therein) equal to the transferor's eligible basis in the building (or interest) at the time of transfer, whether the purchase price is greater or less than that basis. Because the property has not yet been placed in service, the eligible basis of the building has not yet been determined. The purchaser's eligible basis is determined at the end of the first tax year of the credit period. That eligible basis consists of both the transferor's eligible basis at the time of transfer and any additional costs incurred by the purchaser after the transfer, to the extent includible in eligible basis.

In the case of buildings placed in service after 1989 and financed with tax-exempt bonds issued after 1989, if a credit allocation is not necessary because the building meets the requirements of section 42(h)(4)(B) of the Code, the credit will be considered allowed to the prior owner for purposes of section 42(d)(7)(B)(i) when the following conditions are met: (1) the tax-exempt obligations have been issued; (2) the building has met the requirements for allocation of a housing credit dollar amount under the qualified allocation plan applicable to the area in which the project is located as required by section 42(m)(1)(D); (3) the governmental unit issuing the bonds has determined the credit dollar amount necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period as required by section 42(m)(2)(D); and (4) the state housing credit agency has assigned a building identification number (B.I.N.) to the building as is customarily done when an allocation of credit is made by the state housing credit agency.

In the case of buildings financed with tax-exempt bonds issued before 1990, if a credit

Month	Number of occupied low-income units	Total number of units
March	2	10
April	2	10
May	2	10
June	2	10
July	4	10
August	6	10
September	7	10
October	9	10
November	10	10
December	10	10

allocation is not necessary because the building meets the requirements of section 42(h)(4)(B) of the Code, the credit will be considered allowed to the prior owner for purposes of section 42(d)(7)(B)(i) when the following conditions are met: (1) the tax-exempt obligations have been issued; and (2) the state housing credit agency has assigned a B.I.N. to the building as is customarily done when an allocation of credit is made by the state housing credit agency.

**QUESTION 5.**

On March 1, 1987, developer D, a calendar-year taxpayer, placed in service a newly completed qualified low-income building. The building consisted of 10 units, all of which were expected to be occupied by low-income tenants. The qualified basis of the building was \$100,000. D received a \$9,000 housing credit dollar amount allocation for 1987 from the state housing credit agency based upon the 9 percent applicable percentage for newly constructed non-federally-subsidized buildings. D chose not to make the election under section 42(f)(1) of the Code to defer the start of the credit period. On July 20, 1987, D sold the building to T, whose tax year ends August 31. At the time of sale, D had not yet claimed any credit

with respect to the building for the period preceding the transfer. Table 1 shows the number of units in the

building that were occupied by low-income tenants at the close of each full month between March 1, 1987, and December 31, 1987, the close of the tax year during which the building was placed in service.

Is T eligible for the low-income housing credit under section 42 of the Code?

**ANSWER 5.**

Yes. Although D had not claimed any of the low-income housing credit prior to the transfer, D received a housing credit dollar amount allocation before the sale of the property, and D would have been allowed to claim a credit if D had retained ownership of the property and had complied with the requirements of section 42 of the Code. Therefore, under section 42(d)(7), T may "step into the shoes" of D and may claim the tax credit that would have been allowable to D for the period after the acquisition, provided that T complies with the requirements of section 42. See Question and Answer 4.

The building's credit period is determined by reference to the tax year (at the time of placement in service) of D, the owner who

placed the building in service, and is not affected by differing tax years of succeeding owners. However, the amount of credit that a particular owner may claim on a return for a tax year is determined on the last day of that owner's tax year. Had D, a calendar-year taxpayer, chosen to make the election under section 42(f)(1) of the Code to defer the start of the credit period, T would have calculated the credit as of January 1, 1988, the first day of the first year of the building's credit period, even though T owned the building prior to the start of the credit period.

For purposes of section 42(f)(4) of the Code, the owner who has held the property for the longest period during the month in which a transfer occurs is deemed to have held the property for the entire month and may claim a credit accordingly. In cases in which the transferor and transferee have held the property for the same amount of time during the month of the transfer, the transferor is deemed to have held the property for the entire month and the transferee's ownership of the property is deemed to begin the first day of the following month. In this example, for purposes of calculating the credit that T is entitled to claim, T does not immediately "step into the shoes" of D when the transfer occurs on July 20, 1987. Instead, because D held the property for more than half of the month of July, T may not begin claiming the credit that would have been allowable to D until August 1, 1987. Thereafter, T may claim the credit that would have been allowable to D until the end of the credit period (assuming T retains ownership of the property and the requirements of section 42 of the Code are otherwise met).

Because D, the taxpayer that placed the building in service, was a calendar year taxpayer and because D chose not to make the

election under section 42(f)(1) of the Code to defer the start of the credit period, the building's credit period begins the first day of calendar year 1987 (January 1, 1987) and continues for 120 months (until December 31, 1996). The first year of the building's credit period is the period from January 1, 1987, through December 31, 1987.

Under section 42(f)(2) of the Code, the applicable fraction used for determining the credit with respect to any building for the first tax year of the credit period is 1/12 of the sum of the applicable fractions determined under section 42(c)(1) as of the close of each full month of that year during which the building was in service. The sum of the applicable fractions determined under section 42(c)(1) for the period between March 1, 1987 (the date the building was placed in service), and July 31, 1987 (the date through which D is deemed to have owned the property), is  $2/10 + 2/10 + 2/10 + 2/10 + 4/10$ , for a total of twelve-tenths (12/10), which when divided by 12, yields 1/10 or 0.1. Under section 42(f)(2), the credit amount that pertains to the portion of the tax year from March 1, 1987, to July 31, 1987, is \$900 (the applicable fraction of 0.1 times the eligible basis of \$100,000 times the applicable percentage of .09). Whether D may claim this credit amount will be determined under section 42(j) (relating to recapture of the credit and the posting of a bond). See Rev. Rul. 90-60, 1990-2 C.B. 3, for additional information on recapture of the credit and the posting of a bond. T is not entitled to claim this credit amount because T may claim the credit only for the period after T acquires the property. However, during the month that T owns the property during its tax year ending August 31, 1987, the applicable fraction is 6/10. Therefore, T may claim a credit on its federal income tax return for the tax year ending

August 31, 1987, in the amount of \$450 (the applicable fraction of 0.05 or (6/10 times 1/12) times the eligible basis of \$100,000 times the applicable percentage of .09).

The credit for the first 4 months of T's succeeding tax year, which begins September 1, 1987, and ends August 31, 1988, still must be determined according to the first-year convention in section 42(f)(2) of the Code. This is because those months are still part of the first year of the building's credit period. The sum of the monthly applicable fractions determined under section 42(c)(1) for the period from September 1, 1987, to December 31, 1987, is 36/10 or 3.6, which, when divided by 12 and multiplied by the eligible basis of \$100,000 and the applicable percentage of .09, yields a credit amount of \$2,700.

If on August 31, 1988, in T's succeeding tax year, the applicable fraction under section 42(c)(1) of the Code is 10/10 or 1.0, then T's qualified basis at the end of that tax year is \$100,000 (1.0 times \$100,000 of eligible basis). The credit for the remaining 8 months in T's tax year beginning September 1, 1987, and ending August 31, 1988, is \$6,000 (8/12 times \$100,000 of qualified basis times the applicable percentage of .09). T's total credit amount for the tax year beginning September 1, 1987, and ending August 31, 1988, is \$8,700 (\$2,700 + \$6,000).

For each of T's succeeding tax years in the credit period, the credit is based upon the qualified basis as of the last day of T's tax year (August 31). The last 4 months in the credit period (September 1996 through December 1996) are included in T's tax year beginning September 1, 1996, and ending August 31, 1997. The credit for those 4 months is based upon 4/12 of the qualified basis as of August 31, 1997. The credit for T's tax year ending August 31, 1997, consists of the credit for the last 4 months of

the credit period plus the disallowed first-year credit amount that is carried over to the 11th year under section 42(f)(2)(B) of the Code.

The disallowed first-year credit amount is calculated in the following manner: if the first-year convention of section 42(f)(2) of the Code had not applied to the calculation of the credit for the first year of the building's credit period, the credit amount would have been \$9,000 based upon an applicable fraction for that building of 10/10 as of December 31, 1987, multiplied by the eligible basis on that date of \$100,000, multiplied by the applicable percentage of .09. However, because of the first-year convention of section 42(f)(2), the allowable credit with respect to the building for the first tax year in the credit period was only \$4,050 (\$900 allowable to D for the period prior to T's acquisition of the building + \$450 allowable to T for its tax year ending August 31, 1987, + \$2,700 for the period between September 1, 1987, and December 31, 1987, allowable to T for part of its tax year ending August 31, 1988). Therefore, the carryover credit amount is \$4,950 (the difference between \$9,000 and \$4,050).

This carryover credit is allowable for the first tax year ending after December 31, 1996, the date the credit period ends. Accordingly, for T's tax year ending August 31, 1997, T calculates the credit for the last 4 months of the credit period (the period between August 31, 1996, and December 31, 1996), and adds to this the carryover credit. For T's tax year ending August 31, 1997, T may claim \$3,000 for the 4 month period between September 1, 1996, and December 31, 1996, plus the carryover amount of \$4,950, for a total credit in that year of \$7,950.

D. *REHABILITATION  
EXPENDITURES ISSUES*

*QUESTION 6:*

If a taxpayer begins the rehabilitation of an existing building in January 1987 and completes the rehabilitation in December 1987, less than 24 months after the rehabilitation began, must the taxpayer wait until December 1988, a 24-month period, before the rehabilitation expenditures are treated as placed in service under section 42(e)(4)(A) of the Code?

*ANSWER 6.*

No. Under section 42(e)(3)(A) of the Code, a taxpayer may aggregate all rehabilitation expenditures incurred during any 24-month period for purposes of meeting the minimum expenditures requirement of section 42(e)(3)(A). Although section 42(e)(4)(A) treats the expenditures aggregated under section 42(e)(3)(A) as placed in service at the close of the 24-month period permitted for aggregating such expenditures, if the rehabilitation is completed and the minimum expenditures requirement of section 42(e)(3)(A) is met in less than 24 months, the expenditures may be treated as placed in service at the close of that period; however, in no event may the aggregation period exceed 24 months. Therefore, rehabilitation expenditures are treated as placed in service at the close of the 24-month or shorter aggregation period in which the rehabilitation is completed and the expenditures requirement of section 42(e)(3)(A) is met. Only those rehabilitation expenditures subject to the amendments made by section 201(a) of the 1986 Act (requiring 27.5 year depreciation of residential rental property) are eligible for the low-income housing credit under section 42. Expenditures incurred prior to 1987 and not placed in service prior to 1987 may be eligible for the credit, if the expenditures are subject to

the amendments made by section 201(a) of the 1986 Act. See section 42(c)(2)(B).

*QUESTION 7.*

During the period from March 1, 1987, through December 31, 1987, A, the owner of an existing building, incurred substantial rehabilitation expenditures in amounts that met or exceeded the minimum expenditures requirement of section 42(e)(3)(A) of the Code. These expenditures were not federally subsidized. On January 1, 1988, A sold the building to B. On that date, the building did not meet the requirements for an existing building under section 42(d)(2)(B) (in particular, the 10-year requirement of section 42(d)(2)(B)(ii)); however, B bought the property before the rehabilitation expenditures were placed in service. May B receive a housing credit dollar amount in 1988 based upon the 9 percent applicable percentage (the 70 percent present value credit) for the rehabilitation expenditures?

*ANSWER 7.*

Yes. Because A had not received a housing credit dollar amount allocation for the rehabilitation expenditures A had incurred before selling the property to B, no credit was "allowed" to A as a prior owner and, therefore, the rules of section 42(d)(7) of the Code do not apply. See Question and Answer 4. However, section 1.167(k)-1(b)(1) of the regulations provides rules governing when a taxpayer is treated as having paid or incurred rehabilitation expenditures. Although the election under section 167(k) of the Code may no longer be made with respect to rehabilitation expenditures on a low-income rental housing building, rules similar to those of section 1.167(k)-1(b)(1) will generally still apply in determining when rehabilitation

expenditures are treated as paid or incurred by the taxpayer under section 42. Because B acquired the property attributable to the rehabilitation expenditures before such property was placed in service, section 1.167(k)-1(b)(1) treats B as having paid or incurred the expenditures to the extent of the lesser of the rehabilitation expenditures paid or incurred before B's acquisition or B's cost or other basis attributable to the rehabilitation expenditures. Accordingly, for purposes of section 42, B's basis in the rehabilitation expenditures is the lesser of A's basis in the rehabilitation expenditures at the time of transfer (in general, A's actual cost paid or incurred for the rehabilitation expenses prior to January 1, 1988), or B's cost or other basis for the property attributable to the rehabilitation expenditures paid or incurred before that date. When B places the rehabilitated property in service, that property's original use is considered to begin with B.

If A had placed the rehabilitation expenditures in service for depreciation purposes before selling the building to B, B would not be treated as having paid or incurred the expenditures under section 42 of the Code or section 1.167(k)-1(b)(1) of the regulations because B would have acquired the property attributable to the rehabilitation expenditures after that property was placed in service. In order for B to be eligible to receive a housing credit dollar amount for the cost of acquiring the building, the building would have to meet the requirements for an existing building under section 42(d)(2)(B) of the Code (including the requirement that there be a period of at least 10 years between the date of the building's acquisition and the later of (I) the date the building was last placed in service, or (II) the date of the most recent nonqualified substantial

improvement of the building as defined in section 42(d)(2)(D)).

#### *QUESTION 8.*

Assume the same facts as in Question 7, except that A incurred rehabilitation expenditures that did not equal or exceed the minimum prescribed by section 42(e)(3)(A) of the Code. Is B eligible to receive an allocation of credit with regard to the rehabilitation expenditures that A incurred?

#### *ANSWER 8.*

Yes. Section 1.167(k)-1(b)(1) of the regulations treats B as having paid or incurred the expenditures, and a similar rule will be applied for purposes of section 42 of the Code. Under section 42(e)(5), B may elect to treat A's expenditures either as (a) part of the eligible basis of an existing building that meets the requirements of section 42(d)(2)(B), or (b) part of a series of expenditures treated as a separate new building under section 42(e).

(a) If the existing building that B purchased met the requirements of section 42(d)(2)(B) of the Code, B could include the rehabilitation expenditures in the building's eligible basis under section 42(d)(2)(A)(i) but only to the extent the cost of the expenditures is not already reflected in the purchase price for the building. B would be eligible to receive an allocation of credit, based upon the 30 percent present value credit for existing buildings, with respect to the building's entire eligible basis. However, see Note, below.

(b) Alternatively, regardless of whether the building meets the requirements of section 42(d)(2)(B) of the Code, B may continue to make rehabilitation expenditures and may count the expenditures made by A toward the amount prescribed by section 42(e)(3). Because the expenditures were not federally subsidized, once the rehabilitation

expenditures meet the requirements of section 42(e), B would be eligible to receive an allocation of credit, based upon the 70 percent present value credit for new buildings, with respect to the eligible basis attributable to the aggregate rehabilitation expenditures.

NOTE: Under section 7108(d)(1) of the 1989 Act, generally effective for allocations of credit after December 31, 1989, an existing building is not eligible for the credit unless an allocation of credit is allowable by reason of substantial rehabilitation of the building under section 42(e) of the Code. Therefore, the rehabilitation expenditures would have to equal at least the minimum amount prescribed by section 42(e)(3)(A) if the building is to be eligible for any credit.

#### *E. 10-YEAR OWNERSHIP REQUIREMENT FOR EXISTING BUILDINGS*

#### *QUESTION 9.*

Section 42(d)(2)(B)(ii)(I) of the Code requires that there be a minimum of 10 years between the date a taxpayer acquires an existing building and the date the building was last placed in service. Does this requirement apply only if the building was last placed in service as residential rental property?

#### *ANSWER 9.*

No. Except as provided in section 42(d)(2)(D)(ii) of the Code, for purposes of section 42(d)(2)(B)(ii)(I), there must be a minimum of 10 years between the date a taxpayer acquires an existing building and the date the building was last placed in service for any purpose, whether in a trade or business, in the production of income, in a tax-exempt activity, or in a personal activity.

#### *F. QUALIFIED RESIDENTIAL RENTAL PROPERTY*

**QUESTION 10.**

If a taxpayer owned a home and used it as a personal residence can the taxpayer in 1987 convert the property into residential rental property for low-income housing and claim a tax credit for an existing building under section 42(d) of the Code without substantially rehabilitating the building as described in section 42(e)?

**ANSWER 10.**

No. In this situation, the taxpayer previously placed the building in service as a personal residence. Under section 42(d)(2)(A)(ii) and (B)(iii) of the Code, an existing building has an eligible basis of zero if it was previously placed in service by the taxpayer or by any person who was a related person (as defined in section 42(d)(2)(D)(iii)) with regard to the taxpayer as of the time the building was previously placed in service. This is the case regardless of whether the taxpayer placed the building in service as a personal residence more than 10 years ago (i.e., regardless of whether the 10-year requirement of section 42(d)(2)(B)(ii) is met).

However, if the taxpayer converts the property into residential rental property for low-income housing and, in so doing, incurs substantial rehabilitation expenditures in the amount prescribed by section 42(e)(3) of the Code, the taxpayer may treat the rehabilitation expenditures as a separate new building under section 42(e)(1). Because the requirements of section 42(d)(2)(B) do not apply to new buildings, the taxpayer would be eligible for a low-income housing credit allocation based on the qualified basis attributable to the aggregate rehabilitation expenditures.

**QUESTION 11.**

Taxpayer A bought a newly-constructed, single-family home in 1979 and placed it in service as residential rental property. The property was residential rental property from 1979 to 1985, when A sold the property to B who used it solely as a personal residence from 1985 to 1991. In 1991, if C purchases the property, substantially rehabilitates the property, and converts it into residential rental property for low-income housing, may C receive a tax credit for acquisition and rehabilitation of an existing building under section 42(d) of the Code?

**ANSWER 11.**

Yes. Although there has only been a period of 6 years between the date C acquired the property and the date the property was last placed in service by B, section 42(d)(2)(D)(ii)(V) of the Code, as added by the 1990 Act, provides that for allocations of credit made after 1990, there shall not be taken into account, in determining when a building was last placed in service, any placement in service of a single-family residence by any individual who owned and used such residence for no other purpose than as a principal residence. Under this provision, B's placement in service is not taken into account for purposes of the 10-year requirement of section 42(d)(2)(B)(ii). Therefore, there has been at least 10 years between the date C acquired the property in 1991, and the date the building was last placed in service by A in 1979 as residential rental property. Assuming the building meets the other requirements of section 42(d)(2)(B) applicable to existing buildings (including the requirement that a credit is allowable to the building for substantial rehabilitation under section 42(e), unless the exception in section 42(f)(5)(B) applies), C may be eligible to receive a

housing credit dollar amount for acquisition and rehabilitation of the single-family home.

**G. RENT-RESTRICTED RESIDENTIAL-RENTAL UNIT**

**QUESTION 12.**

Must the cost of meals provided in a common dining facility of a low-income project be included in gross rent under section 42(g)(2)(A) of the Code?

**ANSWER 12.**

Section 42(g)(2)(A) of the Code provides that a residential rental unit is rent-restricted if the gross rent (defined in section 42(g)(2)(B)) that is paid for the unit does not exceed 30 percent of the income limits applicable to the tenants under section 42(g)(1).

Notice 89-6, 1989-1 C.B. 625, provides that the furnishing of services other than housing (whether or not such services are significant) will not prevent property from qualifying as residential rental property. However, 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) of the Code. A service is optional if payment for the service is not required as a condition of occupancy.

In the case of a qualified low-income building with a common dining facility, if a practical alternative exists for tenants to obtain meals other than from the dining facility, and if payment for the meals in the facility is not required as a condition of occupancy, the cost of the meals will not be included in gross rent for purposes of section 42(g)(2)(A) of the Code.

The requirement that a practical alternative exists for tenants to obtain meals other than from the dining facility shall apply to projects receiving allocations of housing credit dollar amounts after

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calendar year 1991, and for projects not subject to the allocation limits, the requirement shall apply to projects placed in service after calendar year 1991.

#### EFFECTIVE DATE

The Internal Revenue Service may issue regulations addressing some of the points covered by this ruling. To the extent the regulations are inconsistent with the guidance provided by this ruling, the regulations will have prospective effect. Taxpayers may therefore rely on the provisions of this ruling until further guidance is published.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is Donna Young of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Ms. Young on (202) 377-6349 (not a toll-free call).

under section 9 of the Act, and that precedent already exists for allowing HUD to make certain interpretations relating to the section 42 program. The final regulations do not adopt this suggestion. The IRS and Treasury believe they should retain the ability to determine what costs are appropriately characterized as operating costs that require a reduction in a building's eligible basis under section 42(d)(5) of the Code.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Drafting Information:** The principal author of these regulations is Christopher J. Wilson, Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

#### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

**Paragraph 1.** The authority citation for part 1 is amended by removing the entry for Section 1.42-16T and adding an entry in numerical order to read as follows:

**Authority:** 26 U.S.C. 7805 \* \* \* Section 1.42-16 also issued under 26 U.S.C. 42(n); \* \* \*

**Par. 2.** Section 1.42-16 is added to read as follows:

#### § 1.42-16 Eligible basis reduced by federal grants.

(a) *In general.* If, during any taxable year of the compliance period (described in section 42(i)(1)), a grant is made with respect to any building or the operation thereof and any portion of the grant is funded with federal funds (whether or not includible in gross income), the eligible basis of the building for the taxable year and all succeeding taxable years is reduced by the portion of the grant that is so funded.

(b) *Grants do not include certain rental assistance payments.* A federal rental assistance payment made to a building owner on behalf or in respect of a tenant is not a grant made with respect to a building or its operation if the payment is made pursuant to—

(1) Section 8 of the United States Housing Act of 1937 (42 U.S.C. 1437f)

(2) A qualifying program of rental assistance administered under section 9 of the United States Housing Act of 1937 (42 U.S.C. 1437g); or

(3) A program or method of rental assistance as the Secretary may designate by publication in the **Federal Register** or in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(c) *Qualifying rental assistance program.* For purposes of paragraph (b)(2) of this section, payments are made pursuant to a qualifying rental assistance program administered under section 9 of the United States Housing Act of 1937 to the extent that the payments—

(1) Are made to a building owner pursuant to a contract with a public housing authority with respect to units the owner has agreed to maintain as public housing units (PH-units) in the building;

(2) Are made with respect to units occupied by public housing tenants, provided that, for this purpose, units may be considered occupied during periods of short term vacancy (not to exceed 60 days); and

(3) Do not exceed the difference between the rents received from a building's PH-unit tenants and a pro rata portion of the building's actual operating costs that are reasonably allocable to the PH-units (based on square footage, number of bedrooms, or similar objective criteria), and provided that, for this purpose, operating costs do not include any development costs of a building (including developer's fees) or the principal or interest of any debt incurred with respect to any part of the building.

(d) *Effective date.* This section is effective September 26, 1997.

#### § 1.42-16T [Removed]

Par. 3. Section 1.42-16T is removed.  
Michael P. Dolan,  
Acting Commissioner of Internal Revenue.

Approved: August 26, 1997.  
Donald C. Lubick,  
Acting Assistant Secretary of the Treasury.  
[FR Doc. 97-25490 Filed 9-25-97; 8:45 am]  
BILLING CODE 4830-01-U

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[TD 8732]

RIN 1545-AT60

#### Available Unit Rule

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations concerning the treatment of low-income housing units in a building that is occupied by individuals whose incomes increase above 140 percent of the income limitation applicable under section 42(g)(1). These regulations affect owners of those buildings who claim the low-income housing tax credit.

**DATES:** These regulations are effective September 26, 1997.

For dates of applicability of these regulations, see § 1.42-15(i).

**FOR FURTHER INFORMATION CONTACT:** David Selig, (202) 622-3040 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

On May 30, 1996, the IRS published a notice of proposed rulemaking in the **Federal Register** (PS-29-95 at 61 FR 27036) proposing amendments to the Income Tax Regulations (26 CFR part 1) under section 42(g)(2)(D) of the Internal Revenue Code. A public hearing was scheduled for September 17, 1996, pursuant to a notice of public hearing published simultaneously with the notice of proposed rulemaking. However, the IRS received no requests to speak at the public hearing, and no public hearing was held. Written comments responding to the notice were received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

##### Explanation of Revisions and Summary of Comments

The general rule in section 42(g)(2)(D)(i) provides that if the income

of an occupant of a low-income unit increases above the income limitation applicable under section 42(g)(1), the unit continues to be treated as a low-income unit. This general rule only applies if the occupant's income initially met the income limitation and the unit continues to be rent-restricted. Section 42(g)(2)(D)(ii), however, provides an exception to the general rule in section 42(g)(2)(D)(i). Under this exception, the unit ceases being treated as a low-income unit when two conditions occur. The first condition is that the occupant's income increases above 140 percent of the income limitation applicable under section 42(g)(1), or above 170 percent for a deep rent skewed project described in section 142(d)(4)(B) (applicable income limitation). When this occurs, the unit becomes an over-income unit. The second condition is that a new occupant, whose income exceeds the applicable income limitation (nonqualified resident), occupies any residential unit in the building of a comparable or smaller size (comparable unit).

#### *Rules and Definitions*

One commentator suggested that the available unit rule under the proposed regulations did not clearly indicate whether the aggregate income of all occupants of a unit is taken into account. Accordingly, the final regulations clarify that an 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).

Commentators requested that the final regulations specify whether a comparable unit is measured by floor space or number of bedrooms. The final regulations provide that a comparable unit must be measured by the same method the taxpayer used to determine qualified basis for the credit year in which the comparable unit became available.

Some commentators stated that the provision in the proposed regulations that all available comparable units (not just the "next available" unit) must be rented to qualified residents to continue treating an over-income unit as a low-income unit is inconsistent with the title of section 42(g)(2)(D)(ii). Although the title of that provision uses the term next available unit, the text of the rule provides that if any available comparable unit is occupied by a nonqualified resident, the over-income

unit ceases to be treated as a low-income unit. This means that if a building has more than one over-income unit, renting any available comparable unit (a comparably sized or smaller unit) to a qualified resident preserves the status of all over-income units as low-income units. Similarly, if any available comparable unit is rented to a nonqualified resident, all over-income units for which the available unit was a comparable unit lose their status as low-income units; thus, comparably sized or larger over-income units would lose their status as low-income units. In operation, this means that the owner must continue to rent any available comparable unit to a qualified resident until the percentage of low-income units in a building (excluding the over-income units) is equal to the percentage of low-income units on which the credit is based. At that point, failure to maintain the over-income units as low-income units has no immediate significance. (However, the failure to maintain an over-income unit as a low-income unit may affect the owner's decision of whether or not to rent a particular available unit at market rate at a later time.) Consequently, the final regulations provide that all available comparable units in the building, not only the next available comparable unit, must be rented to qualified residents to retain the low-income status of the over-income units.

#### *Application of Rules on a Building by Building Basis*

The proposed regulations provide that in a project containing more than one low-income building, the available unit rule applies separately to each building. Some commentators suggested that the regulations should permit residents of over-income units to move to available units in different buildings within the same low-income housing project without violating the available unit rule. However, because the requirements under section 42 must be satisfied on a building by building basis, the final regulations provide that the available unit rule only permits a current resident to move to another unit within the same building of a low-income housing project.

In addition, in response to requests from several commentators, the final regulations make clear that when a current resident moves to a different unit within the same low-income building, the units exchange status. (See example 2 of § 1.42-15(g) of the proposed regulations and § 1.42-15(h) of the final regulations.) Thus, the newly occupied unit adopts the status of the vacated unit, and the vacated unit

assumes the status the newly occupied unit had immediately prior to its occupancy by the qualifying residents.

#### *Timing Issues*

The methods of committing rental units to tenants varies in different jurisdictions. However, it is a common rental practice to have some form of preliminary reservation for a unit prior to the date on which a lease is signed or the unit is occupied. Thus, several commentators have requested clarification that once a unit is reserved for a prospective tenant, it is no longer treated as available for purposes of the available unit rule. Accordingly, the final regulations provide that a unit is not available for purposes of the available unit rule when the unit is no longer available for rent due to a reservation that is binding under local law.

Finally, financing arrangements using obligations 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). The requirements under section 142(d) may differ from those under section 42. Accordingly, the final regulations provide that the rules under the final regulations are not intended as an interpretation of the applicable rules under section 142.

#### *Special Analyses*

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information: The principal author of these regulations is David Selig, Office of the Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

**PART 1—INCOME TAXES**

**Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*  
Section 1.42-15 is also issued under 26 U.S.C. 42(n); \* \* \*

**Par. 2.** Section 1.42-15 is added to read as follows:

**§ 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 of 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.

Michael P. Dolan,

Acting Commissioner of Internal Revenue.

Approved: August 26, 1997.

Donald C. Lubick,

Acting Assistant Secretary of the Treasury.

[FR Doc. 97-25493 Filed 9-25-97; 8:45 am]

BILLING CODE 4830-01-U

## DEPARTMENT OF TRANSPORTATION

### Coast Guard

#### 33 CFR Part 100

[CGD8-97-038]

RIN 2115-AE46

#### Special Local Regulations; 1997 Galveston Offshore Powerboat Festival, Galveston, TX

**AGENCY:** Coast Guard, DOT.

**ACTION:** Temporary final rule.

**SUMMARY:** Special local regulations are being adopted for the Galveston Offshore Powerboat Festival. This event will be held on October 11, 1997 from 11 a.m. to 5 p.m. in the Galveston Ship Channel and on October 12, 1997 from 10 a.m. to 6 p.m. offshore of Galveston Island at Galveston, Texas. These regulations are needed to provide for the safety of life on the navigable waters during the event.

**DATES:** These regulations become effective on October 11, 1997 at 10:30

a.m. until 5:30 p.m. and on October 12, 1997 at 9:30 a.m. until 6:30 p.m.

**FOR FURTHER INFORMATION CONTACT:** LT Harry Schmidt, Operations Officer, U.S. Coast Guard Group Galveston. Tel: (409) 766-5603.

#### SUPPLEMENTARY INFORMATION:

##### Regulatory History

In accordance with 5 U.S.C. 553, a notice of proposed rule making for these regulations has not been published, and good cause exists for making them effective in less than 30 days from the date of publication. Following normal rule making procedures would be impracticable. The details of the event were not finalized in sufficient time to publish proposed rules in advance of the event or to provide for a delayed effective date.

##### Background and Purpose

The marine event requiring this regulation is a power boat race called the "1997 Galveston Offshore Powerboat Festival". This event is sponsored by Texas Gulf Coast Racing, Inc. It will consist of an inshore powerboat race in the Galveston Ship Channel on October 11, 1997 and an offshore race on October 12, 1997. Approximately 60 offshore V-hull and catamaran-hull outboard and inboard race boats from 22 to 50 feet in length operating at high speeds are expected to participate in the races. The courses to be followed by the races will be marked by patrol vessels positioned at various points along each route. Fifty to two hundred spectator boats are expected for this event.

While viewing the event at any point outside the regulated area is not prohibited spectators will be encouraged to congregate within areas designated by the sponsor. Non-participating vessels will be permitted to transit the area every hour on the hour at No Wake Speed with the permission of the patrol commander.

##### Regulatory Evaluation

This rule is not a significant regulatory action under section 3(f) of Executive Order 12866 and does not require an assessment of potential costs and benefits under section 6(a)(3) of the order. It has not been reviewed by the Office of Management and Budget under that order. It is not significant under the regulatory policies and procedures of the Department of Transportation (DOT) (44 FR 11040; February 26, 1979). The Coast Guard expects the economic impact of this rule to be so minimal that a full Regulatory Evaluation under paragraph 10e of the regulatory policies and procedures of DOT is unnecessary because of the event's short duration.

##### Small Entities

The Coast Guard finds that the impact on small entities, if any, is not substantial. Therefore, the Coast Guard certifies under section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq*) that this temporary rule will not have a significant economic impact on a substantial number of small entities because of the event's short duration.

##### Collection of Information

This rule contains no information collection requirements under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq*.)

##### Federalism Assessment

The Coast Guard has analyzed this action in accordance with the principles and criteria of Executive Order 12612 and has determined that this rule does not raise sufficient federalism implications to warrant the preparation of a Federalism Assessment.

##### Environmental Assessment

The Coast Guard considered the environmental impact of this rule and concluded that under section 2.B.2.e (34) (h) of Commandant Instruction M16475.1B, (as revised by 61 FR 13563; March 27, 1996) this rule is excluded from further environmental documentation.

##### List of Subjects In 33 CFR Part 100

Mine safety, Navigation (water), Reporting and recordkeeping requirements, Waterways

##### Temporary Regulations

In consideration of the foregoing, Part 100 of Title 33, Code of Federal Regulations, is amended as follows:

1. The authority citation for part 100 continues to read as follows:

**Authority:** 33 U.S.C. 1233, 49 CFR 1.46 and 33 CFR 100.35.

2. A temporary § 100.35-T08-038 is added to read as follows:

##### § 100.35-T08-038 Galveston, TX.

(a) **Regulated Area:** The Galveston Ship Channel from the Pelican Island Bridge to Pier 9 on October 11, 1997 and The Gulf of Mexico within the area bounded by a point on the shoreline at 29-18.7N, 094-45.5W southeast to 29-18.2N, 094-45.0W thence southwest to 29-16.0N, 094-46.4W thence west to 29-14.8.0N, 094-49.6W thence northwest to the shoreline at 29-15.7N, 094-52.0W on October 12, 1997.

(b) **Special Local Regulation:** All persons and vessels not registered with the sponsors as participants or official patrol vessels are considered spectators.

**Internal Revenue Service**  
**Revenue Ruling 92-61**  
**(Treatment of Resident  
Manager's Unit)**

**Rev. Rul. 92-61**

**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).

Section 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).

**Internal Revenue Service**  
**Revenue Procedure 94-65**  
**(Documentation of Income**  
**from Assets)**

**Rev. Proc. 94-65**

**SECTION 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.

**SECTION 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 W-2, 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).

**SECTION 3. SCOPE**

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

**SECTION 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.

**SECTION 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) 622-3040 (not a toll-free call).

## 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, § 42; 1.42-5.)

Rev. Proc. 2005-37

#### SECTION 1. PURPOSE

This revenue procedure establishes a safe harbor under which housing credit agencies and project owners may meet the requirements of § 42(h)(6)(B)(i) of the Internal Revenue Code as described in Q&A-5 of Rev. Rul. 2004-82, 2004-35 I.R.B. 350, concerning extended low-income housing commitments (commitments).

#### SECTION 2. BACKGROUND

Section 42(a) provides for a credit for investment in qualified low-income buildings (as defined in § 42(c)(2)). Under § 42(l)(3)(A), low-income units in a building must be occupied by individuals who meet the income limitation applicable under § 42(g)(1) to the project of which the building is a part. The building owner must elect under § 42(g)(1) to rent a percentage of the residential units to individuals whose income is 50 percent or less of area median gross income or 60 percent or less of area median gross income.

Section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless a 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) requires commitments to include the prohibitions against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) during the extended use period, that is, prohibitions against eviction or termination of tenancy of an existing tenant of any low-income unit (other than for good cause) and any increase in the gross rent with respect to a low-income unit not otherwise permitted by § 42, applicable throughout the entire commitment period.

Section 42(h)(6)(B)(ii) provides that a commitment must allow individuals who meet the income limitation applicable to the building under § 42(g) (whether prospective, present, or former occupants of the building) the right to enforce in any state court the prohibitions of § 42(h)(6)(B)(i).

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

Section 1.42-5(c)(1)(xi) of the Income Tax Regulations 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, a commitment as described in § 42(h)(6) was in effect (for buildings subject to § 7108(c)(1) of the Omnibus Budget Reconciliation Act of 1989, 1990-1 C.B. 210),

including the requirement under § 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 § 13142(b)(4) of the Omnibus Budget Reconciliation Act of 1993, 1993-3 C.B. 1).

On August 30, 2004, the Service ruled in Q&A-5 of Rev. Rul. 2004-82 that § 42(h)(6)(B)(i) requires commitments to include the prohibitions against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) during the extended use period, that is, prohibitions against eviction or termination of tenancy of an existing tenant of any low-income unit (other than for good cause) and any increase in the gross rent with respect to a low-income unit not otherwise permitted by § 42, applicable throughout the entire commitment period. This requirement for commitments extends back to the effective date of § 42(h)(6)(B)(i). See § 11701(a)(7)(A) of the Omnibus Budget Reconciliation Act of 1990, 1991-2 C.B. 481, 531.

Q&A-5 provided that if it is determined by the end of a taxable year that a taxpayer's commitment does not meet the requirements for a 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 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.

Q&A-5 required each Agency to review its existing commitments by December 31, 2004, to ensure that the no-cause eviction protection and the prohibition against improper increases in gross rent apply throughout the extended use period. If during that review, an Agency determined that a commitment did not comply with these requirements, the 1-year period described under § 42(h)(6)(J) will commence on the date of that determination.

### SECTION 3. SAFE HARBOR

.01 The Service has determined that Agencies may satisfy the review requirements under Q&A-5 for commitments entered into before January 1, 2006, under § 42(h)(6)(B)(i) in the following manner:

(1) Commitments entered into before January 1, 2006, that contain general language requiring building owners to comply with the requirements of § 42 (catch-all language) satisfy the requirements under Q&A-5, if:

(a) Agencies notify building owners in writing on or before December 31, 2005, that consistent with the interpretation in Q&A-5, the catch-all language prohibits the owner from evicting or terminating the tenancy of an existing tenant of any low-income unit (other than for good cause) throughout the entire commitment period. Further, Agencies must notify building owners that the catch-all language prohibits the owner from making an increase in the gross rent with respect to a low-income unit not otherwise permitted by § 42 throughout the entire commitment period;

(b) The owner must, as part of its certification under § 1.42-5(c)(1)(xi), certify annually that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants

had an increase in the gross rent with respect to a low-income unit not otherwise permitted under § 42;

(c) If the owner fails to make the certifications in (b) above or the Agency learns that the owner has evicted tenants in low-income units or terminated their tenancies other than for good cause or has increased the gross rent of a tenant with respect to a low-income unit not otherwise permitted under § 42, the Agency shall report the owner to the Internal Revenue Service using Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition; and

(d) Section 3.02 shall also apply to any amendment to any commitment containing catch-all language if the amendment is executed after December 31, 2005.

(2) Commitments entered into before January 1, 2006, that do not contain specific language on the § 42(h)(6)(B)(i) prohibition against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) or catch-all language do not satisfy the requirements of Q&A-5 and must be amended to clearly provide for the § 42(h)(6)(B)(i) prohibition against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii) by December 31, 2005.

.02 The Service has determined that Agencies may satisfy the review requirements under Q&A-5 for commitments executed after December 31, 2005, under § 42(h)(6)(B)(i) in the following manner:

(1) Commitments executed after December 31, 2005, must clearly provide for the § 42(h)(6)(B)(i) prohibition against the actions described in subclauses (I) and (II) of § 42(h)(6)(E)(ii);

(2) The owner must, as part of its certifications under § 1.42-5(c)(1)(xi), certify annually that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under § 42; and

(3) If the owner fails to make the certifications in (2) above or the Agency learns that the owner has evicted tenants in low-income units or terminated their tenancies other than for good cause or has increased the gross rent of a tenant with respect to a low-income unit not otherwise permitted under § 42, the Agency shall report the owner to the Internal Revenue Service using Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition.

#### EFFECTIVE DATE

This revenue procedure is effective on June 21, 2005, the date this revenue procedure was released to the tax services.

#### DRAFTING INFORMATION

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

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

# Guide for Completing Form 8823 Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition

The scope of this guide is limited to guidelines for preparing Form 8823 for submission to the IRS. Taxpayers are responsible for evaluating the tax consequences of noncompliance with IRC §42.

Under no circumstances should the contents of this guide be used or cited as authority for setting or sustaining a technical position.



**Internal  
Revenue  
Service**

Revised January 2007



## **IRS Mission**

**Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.**

## **Small Business/Self-Employed Mission**

**The mission of the Small Business/Self-Employed (SB/SE) Division is to provide SB/SE customers top-quality service by educating and informing them of their tax obligations, developing educational products and services, and helping them understand and comply with applicable laws, and to protect the public interest by applying the tax law with integrity and fairness to all.**

Prepared by

Internal Revenue Service  
Small Business/Self-Employed Division

In collaboration with the  
National Council of State Housing Agencies and  
It's member States Housing Credit Agencies

This revision of the guide was released in  
advance of distribution on the IRS web. Updates and  
future revisions will be accessible on [www.irs.gov](http://www.irs.gov)

Questions or comments regarding the Guide should be  
addressed to Grace Robertson at [Grace.F.Robertson@irs.gov](mailto:Grace.F.Robertson@irs.gov)

Revised January 2007

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# Chapter 1

## Introduction

### Background

#### State Agency Responsibilities

State and local housing credit agencies (herein referred to as “state agencies”) are responsible for monitoring low-income housing credit (LIHC) properties for compliance with the requirements of Internal Revenue Code (IRC) §42; for example, health and safety standards, rent ceilings and income limits, and tenant qualifications. State agencies perform desk audits, inspect housing, and review tenant files.<sup>1</sup> When noncompliance is identified or there has been a disposition of a building (or interest therein), the state agencies are required to notify the Internal Revenue Service using Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition.

Briefly, a state agency performs a desk audit, conducts a site visit, or reviews the owner’s tenant files and provides the owner with a summary report of its findings. If the report indicates noncompliance, the owner is expected to respond to the state agency within a maximum of 90 days to provide clarification or document that issues of noncompliance have been addressed. Then, the state agency determines whether the owner was always in compliance, has corrected the noncompliance, or remains out of compliance. The time to correct the noncompliance may be extended up to a total of 6 months with state agency approval. If the state agency determines that the owner either remedied the noncompliance or remains out of compliance, then a Form 8823 must be filed with the IRS.

If the state agency reports that the owner is out of compliance, the IRS sends a notification letter to the owner identifying the type of noncompliance reported on Form 8823. The notification letter also states that the owner should not include any nonqualified low-income housing units when computing the tax credit under IRC §42 and that the noncompliance may result in the recapture of previously claimed credits. The notification letter also instructs the owner to contact the state agency to resolve the issue.

Once the noncompliance is resolved, the state agency should file a “back in compliance” Form 8823. If the noncompliance is corrected within three years after the end of the correction period, the state agency must file a Form 8823.<sup>2</sup> See Exhibit 1 at the end of this chapter for a complete description of the process.

#### IRS Analysis of Forms 8823 Submitted by State Agencies

Forms 8823 are routinely analyzed by the IRS. Based on categories of noncompliance, and without regard to subsequent “back in compliance” Forms 8823, taxpayers are evaluated to determine whether an audit of the owner’s tax return is needed.<sup>3</sup> The taxpayer’s tax returns and all Forms 8823 filed for the property are evaluated. If it is determined that an audit is warranted, the complete file is sent to the appropriate IRS field office. The taxpayer is then notified that an audit has been scheduled. It should be noted that this is

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<sup>1</sup> State agencies perform “desk audits” of information submitted to their office rather than inspecting the documents at the property site; e.g., annual reports required under Treas. Reg. §1.42-5(c).

<sup>2</sup> Treas. Reg. §1.42-5(e)(3).

<sup>3</sup> Forms 8823 are immediately analyzed for audit potential when received from the state agencies. Subsequent receipt of Forms 8823 noting correction of previously reported noncompliance do not impact the original evaluation. Under Treas. Reg. §1.42-5(e)(3), if the noncompliance is corrected within three years, the state agency is required to file another Form 8823 reporting the corrected noncompliance and documenting the date the taxpayer was back in compliance. From the owner’s perspective, the best strategy is to address noncompliance identified by the state agency quickly so that the initial Form 8823 will indicate that the

not the only method for selecting for audit tax returns on which the low-income housing credit has been claimed and, at the examiner's discretion, the audit may be expanded to include additional issues or tax returns.

## **Purpose of Guide**

The fundamental purpose of this guide is to provide standardized operational definitions for the noncompliance categories listed on Form 8823. It is important that noncompliance is consistently identified and categorized. Resulting benefits include:

1. Consistent interpretation and application of IRC §42 requirements among states;
2. Consistent reporting of noncompliance to the IRS; and
3. Enhanced program administration by the IRS; i.e., timely processing of the forms and identification of appropriate follow-up actions by the IRS.

## **Content of Guide**

The guide includes instructions for completing Form 8823, and guidelines for determining noncompliance and reporting property dispositions. The guide reflects current rules under IRC §42, Treasury regulations under IRC §42, other guidance published by the Department of Treasury and the IRS, and IRS administrative procedures for the LIHC program.

Generally, the noncompliance categories listed on Form 8823 are addressed in separate chapters. There are three categories of noncompliance for which there are two chapters because multiple issues are reported under the same category. They are:

1. Category 11e, Changes in Eligible Basis or the Applicable Percentage
2. Category 11h, Project not available to the general public
3. Category 11q, Other

For convenience, the term "owner" in the singular is used, although low-income housing properties often have more than one owner and state agencies must identify each owner in a schedule attached to the Form 8823 when filing the form.

Depending on the problem, noncompliance may extend to one or more housing units within an LIHC building, may apply to the whole building, or may encompass the entire project. Units, buildings, or projects that are out of compliance with the requirements of IRC §42 are referred to as "nonqualified" units, buildings, or projects.

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noncompliance was corrected. From the IRS' point of view, the owner's responsiveness is indicative of due diligence, but does not preclude initiating an audit.

## **Organization of Chapters**

Generally (as applicable) each chapter includes the following sections.

*Definitions* - Brief descriptions are provided to explain the basic compliance issue being addressed. The intent is to sufficiently define the category of noncompliance so that state agencies will uniformly select the same category for the same issues.

*In Compliance* - Descriptions and examples are used to illustrate fundamental compliance with IRC §42 and its regulations.

*Out of Compliance* - Descriptions and examples are used to illustrate common noncompliance issues.

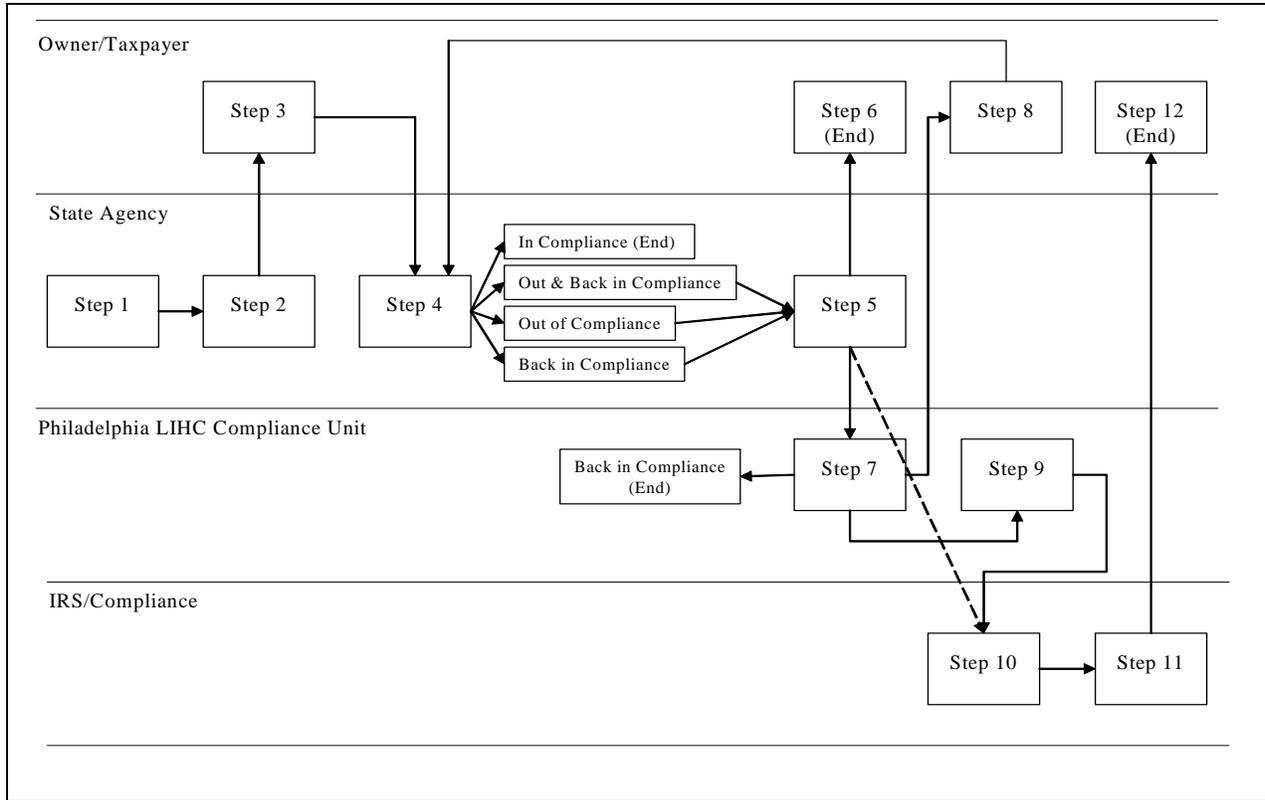
*Back in Compliance* - This section includes explanations and examples illustrating how noncompliance can be corrected. Treas. Reg. §1.42-5(e)(4) allows a corrective action period, not to exceed 90 days, for the owner to remedy the noncompliance. The state agency can extend this period for up to a total of 6 months if there is good cause. Suggested correction periods are noted in the discussions.

*References* - A list of references is included at the end of each chapter. Specific references or explanations of relevant rules under IRC §42, the Treasury regulations under IRC §42, or other published guidance, may be included in the text or identified in footnotes.

## **Reference**

Treas. Reg. §1.42-5

## Exhibit 1-1 Reports of Noncompliance (Form 8823) Process Map & Explanations



- Step 1** The state agency performs a desk audit, conducts a site visit, or reviews the owner’s tenant files.
- Step 2** The state agency prepares and promptly provides the owner with a summary report describing issues of noncompliance. The letter may also identify administrative or technical issues, recommend changes to improve future management of the property, or suggest corrective actions to remedy noted noncompliance issues.
- Step 3** The owner responds to the state agency within a maximum of 90 days, which can be extend up to a total of 6 months with the state agency’s approval. Generally, the state agency specifies a time period appropriate for the type of noncompliance. The owner’s response may provide clarifications and document that corrective actions have been implemented; i.e., how the noncompliance issues have been addressed.
- Step 4** When the owner’s response is received, the state agency determines whether the owner provided:
1. clarification establishing that the owner was always in compliance,
  2. documentation that issue(s) of noncompliance have been remedied within the correction period (out and back in compliance).

3. no documentation that issue(s) of noncompliance had been remedied within the correction period (out of compliance), or
4. documentation that issue(s) of noncompliance have been remedied, but the noncompliance was not corrected until after the end of the correction period. A Form 8823 had been submitted to the IRS only to report the correction of previously reported noncompliance (back in compliance).

**Step 5** If the state agency determines that the owner was always in compliance, findings are not required to be reported to the IRS. However, the state agency should notify the owner that the issue is considered closed and no Form 8823 will be filed.

If the state agency determines that either the owner remedied the issue of noncompliance or remains out of compliance, then a Form 8823 must be filed with the Internal Revenue Service at the Philadelphia Service Center (PSC). As noted by the dashed line between steps five and ten, the state agency may send a copy of the Form 8823 directly to IRS Headquarters.

**Step 6** The state agency sends the owner a copy of the Form 8823 concurrent to filing the Form 8823 with the IRS.

**Step 7** Upon receipt of the Form 8823 at the PSC, the “back in compliance” Forms 8823 are processed without contacting the owner. The “out of compliance” Forms 8823 are assigned to technicians to prepare owner notification letters. The letters are specific to the type of noncompliance reported on Form 8823, and explain that noncompliance may result in the loss and recapture of the tax credit.

**Step 8** The owner receives the notification letter. The letter instructs the owner to contact the state agency to resolve the issue (Step Four). If the noncompliance is resolved within three years, a “back in compliance” Form 8823 must be filed with the IRS and a copy sent to the owner concurrently. (Note: some issues of noncompliance cannot be remedied.)

**Step 9** Simultaneous to notifying the owner, the PSC processes the Forms 8823 and transcribes the information into a database.

**Step 10** Forms 8823 are immediately evaluated when received from the state agencies and IRS databases are routinely analyzed to determine whether an audit of the owner’s tax return is needed. The taxpayer’s three latest filed income tax returns and all Forms 8823 filed for the property are evaluated.

**Step 11** If it is determined that an audit is warranted, the case file is sent to the appropriate field office for examination.

**Step 12** The taxpayer is notified that an audit has been scheduled.

# Exhibit 1-2 Form 8823 and Instructions

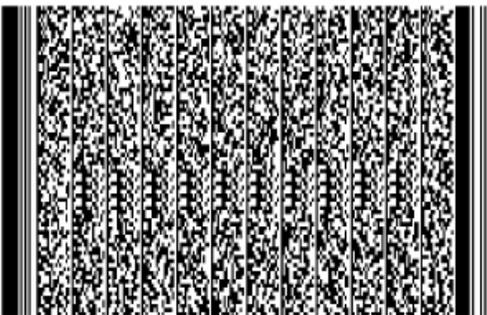
Form **8823**  
(Rev. Oct. 2005)  
Department of the Treasury  
Internal Revenue Service

## Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition

*Note: File a separate Form 8823 for each building that is disposed of or goes out of compliance.*

OMB No. 1545-1204

Check here if this is an amended return

<p><b>1</b> Building name (if any). Check if item 1 differs from Form 8609 <input type="checkbox"/></p> <p>Street address</p> <p>City or town, state, and ZIP code</p> <p><b>2</b> Building identification number (BIN)</p> <p><b>3</b> Owner's name. Check if item 3 differs from Form 8609 <input type="checkbox"/></p> <p>Street address</p> <p>City or town, state, and ZIP code</p> <p><b>4</b> Owner's taxpayer identification number <input type="checkbox"/> EIN <input type="checkbox"/> SSN</p>	<p>IRS Use Only</p> 																																																						
<p><b>5</b> Total credit allocated to this BIN <span style="float: right;">\$</span></p> <p><b>6</b> If this building is part of a multiple building project, enter the number of buildings in the project <span style="float: right;">▶</span></p> <p><b>7 a</b> Total number of residential units in this building <span style="float: right;">▶</span></p> <p><b>b</b> Total number of low-income units in this building <span style="float: right;">▶</span></p> <p><b>c</b> Total number of residential units in this building determined to have noncompliance issues <span style="float: right;">▶</span></p> <p><b>d</b> Total number of units reviewed by agency (see instructions) <span style="float: right;">▶</span></p> <p><b>8</b> Date building ceased to comply with the low-income housing credit provisions (see instructions) (MMDDYYYY) <span style="float: right;">▶</span></p> <p><b>9</b> Date noncompliance corrected (if applicable) (see instructions) (MMDDYYYY) <span style="float: right;">▶</span></p> <p><b>10</b> Check this box if you are filing only to show correction of a previously reported noncompliance problem <input type="checkbox"/></p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 70%;"></th> <th style="width: 15%; text-align: center;">Out of compliance</th> <th style="width: 15%; text-align: center;">Noncompliance corrected</th> </tr> </thead> <tbody> <tr><td><b>11 a</b> Household income above income limit upon initial occupancy</td><td style="text-align: center;"><input type="checkbox"/></td><td style="text-align: center;"><input type="checkbox"/></td></tr> <tr><td><b>b</b> Owner failed to correctly complete or document tenant's annual income recertification</td><td style="text-align: center;"><input type="checkbox"/></td><td style="text-align: center;"><input type="checkbox"/></td></tr> <tr><td><b>c</b> Violation(s) of the UPCS or local inspection standards (see instructions) (attach explanation)</td><td 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<p><b>12</b> Additional information for any item above. Attach explanation and check box <input type="checkbox"/></p> <p><b>13 a</b> Building disposition by <input type="checkbox"/> Sale <input type="checkbox"/> Foreclosure <input type="checkbox"/> Destruction <input type="checkbox"/> Other (attach explanation) <span style="float: right;">▶</span></p> <p><b>b</b> Date of disposition (MMDDYYYY)</p> <p><b>c</b> New Owner's Name</p> <p>Street address</p> <p>City or town, state, and ZIP code</p>	<p><b>d</b> New owner's taxpayer identification number <input type="checkbox"/> EIN <input type="checkbox"/> SSN</p> <p><b>14</b> Name of contact person</p> <p><b>15</b> Telephone number of contact person ( ) Ext.</p>																																																						

Under penalties of perjury, I declare that I have examined this report, including accompanying statements and schedules, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of authorizing official Date (MMDDYYYY)

Print name and title

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 12308D

Form **8823** (Rev. 10-2005)

## General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

### Purpose of Form

Housing credit agencies use Form 8823 to fulfill their responsibility under section 42(m)(1)(B)(iii) to notify the IRS of noncompliance with the low-income housing tax credit provisions or any building disposition.

The housing credit agency should also give a copy of Form 8823 to the owner(s).

### Who Must File

Any authorized housing credit agency that becomes aware that a low-income housing building was disposed of or is not in compliance with the provisions of section 42 must file Form 8823.

### When To File

File Form 8823 no later than 45 days after (a) the building was disposed of or (b) the end of the time allowed the building owner to correct the condition(s) that caused noncompliance. For details, see Regulations section 1.42-5(e).

### Where To File

File Form 8823 with the:  
Internal Revenue Service  
P.O. Box 331  
Attn: LIHC Unit, DP 607 South  
Philadelphia Campus  
Bensalem, PA 19020

## Specific Instructions

**Amended return.** If you are filing an amended return to correct previously reported information, check the box at the top of page 1.

**Item 2.** Enter the building identification number (BIN) assigned to the building by the housing credit agency as shown on Form 8609.

**Items 3, 4, 13b, and 13d.** If there is more than one owner (other than as a member of a pass-through entity), attach a schedule listing the owners, their addresses, and their taxpayer identification numbers. Indicate whether each owner's taxpayer identification number is an employer identification number (EIN) or a social security number (SSN).

Both the EIN and the SSN have nine digits. An EIN has two digits, a hyphen, and seven digits. An SSN has three digits, a hyphen, two digits, a hyphen, and four digits and is issued only to individuals.

**Item 7d.** "Reviewed by agency" includes physical inspection of the property, tenant file inspection, or review of documentation submitted by the owner.

**Item 8.** Enter the date that the building ceased to comply with the low-income housing credit provisions. If there are multiple noncompliance issues, enter the

date for the earliest discovered issue. **Do not** complete item 8 for a building disposition. Instead, skip items 9 through 12, and complete item 13.

**Item 9.** Enter the date that the noncompliance issue was corrected. If there are multiple issues, enter the date the last correction was made.

**Item 10.** Do not check this box unless the sole reason for filing the form is to indicate that previously reported noncompliance problems have been corrected.

**Item 11c.** Housing credit agencies must use either (a) the local health, safety, and building codes (or other habitability standards) or (b) the Uniform Physical Conditions Standards (UPCS) (24 C.F.R. section 5.703) to inspect the project, but not in combination. The UPCS does not supersede or preempt local codes. Thus, if a housing credit agency using the UPCS becomes aware of any violation of local codes, the agency must report the violation. Attach a statement describing either (a) the deficiency and its severity under the UPCS, i.e., minor (level 1), major (level 2), and severe (level 3) or (b) the health, safety, or building violation under the local codes. The Department of Housing and Urban Development's Real Estate Assessment Center has developed a comprehensive description of the types and severities of deficiencies entitled "Dictionary of Deficiency Definitions" found at [www.hud.gov/reac](http://www.hud.gov/reac) under Library Section, Physical Inspections, Training Materials. Under Regulations section 1.42-5(e)(3), report all deficiencies to the IRS whether or not the noncompliance or failure to certify is corrected at the time of inspection. In using the UPCS inspection standards, report all deficiencies in the five major inspectable areas (defined below) of the project: (1) Site; (2) Building exterior; (3) Building systems; (4) Dwelling units; and (5) Common areas.

**1. Site.** The site components, such as fencing and retaining walls, grounds, lighting, mailboxes, signs (such as those identifying the project or areas of the project), parking lots/driveways, play areas and equipment, refuse disposal equipment, roads, storm drainage, and walkways, must be free of health and safety hazards and be in good repair. The site must not be subject to material adverse conditions, such as abandoned vehicles, dangerous walkways or steps, poor drainage, septic tank back-ups, sewer hazards, excess accumulation of garbage and debris, vermin or rodent infestation, or fire hazards.

**2. Building exterior.** Each building on the site must be structurally sound, secure, habitable, and in good repair. Each building's doors, fire escapes, foundations, lighting, roofs, walls, and windows, where applicable, must be free of health and safety hazards, operable, and in good repair.

**3. Building systems.** Each building's domestic water, electrical system, elevators, emergency power, fire protection, HVAC, and sanitary system must be free of health and safety hazards, functionally adequate, operable, and in good repair.

**4. Dwelling units.** Each dwelling unit within a building must be structurally sound, habitable, and in good repair. All areas and aspects of the dwelling unit (for example, the unit's bathroom, call-for-aid (if applicable), ceilings, doors, electrical systems, floors, hot water heater, HVAC (where individual units are provided), kitchen, lighting, outlets/switches, patio/porch/balcony, smoke detectors, stairs, walls, and windows) must be free of health and safety hazards, functionally adequate, operable, and in good repair. Where applicable, the dwelling unit must have hot and cold running water, including an adequate source of potable water (note: single room occupancy units need not contain water facilities). If the dwelling unit includes its own bathroom, it must be in proper operating condition, usable in privacy, and adequate for personal hygiene and the disposal of human waste. The dwelling unit must include at least one battery-operated or hard-wired smoke detector, in proper working condition, on each level of the unit.

**5. Common areas.** The common areas must be structurally sound, secure, and functionally adequate for the purposes intended. The basement, garage/carport, restrooms, closets, utility rooms, mechanical rooms, community rooms, day care rooms, halls/corridors, stairs, kitchens, laundry rooms, office, porch, patio, balcony, and trash collection areas, if applicable, must be free of health and safety hazards, operable, and in good repair. All common area ceilings, doors, floors, HVAC, lighting, outlets/switches, smoke detectors, stairs, walls, and windows, to the extent applicable, must be free of health and safety hazards, operable, and in good repair.

**Health and Safety Hazards.** All areas and components of the housing must be free of health and safety hazards. These include, but are not limited to: air quality, electrical hazards, elevators, emergency/fire exits, flammable materials, garbage and debris, handrail hazards, infestation, and lead-based paint. For example, the buildings must have fire exits that are not blocked and have hand rails that are not damaged, loose, missing portions, or otherwise unusable. The housing must have no evidence of infestation by rats, mice, or other vermin. The housing must have no evidence of electrical hazards, natural hazards, or fire hazards. The dwelling units and common areas must have proper ventilation and be free of mold as well as odor (e.g., propane, natural, sewer, or methane gas). The housing must comply with all requirements related to the evaluation and reduction of lead-based paint hazards and have available proper certifications of such (see 24 C.F.R. part 35).

Project owners must promptly correct exigent and fire safety hazards. Before leaving the project, the inspector should provide the project owner with a list of all observed exigent and fire safety hazards. Exigent health and safety hazards include: air quality problems such as propane, natural gas, or methane gas detected; electrical hazards such as exposed wires or

open panels and water leaks on or near electrical equipment; emergency equipment, fire exits, and fire escapes that are blocked or not usable; and carbon monoxide hazards such as gas or hot water heaters with missing or misaligned chimneys. Fire safety hazards include missing or inoperative smoke detectors (including missing batteries), expired fire extinguishers, and window security bars preventing egress from a unit.

**Item 11d.** Report the failure to provide annual certifications or the provision of certifications that are known to be incomplete or inaccurate as required by Regulations section 1.42-5(c). As examples, report a failure by the owner to include a statement summarizing violations (or copies of the violation reports) of local health, safety, or building codes; report an owner who provided inaccurate or incomplete statements concerning corrections of these violations.

**Item 11e.** Report any federal grant made with respect to any building or the operation thereof during any taxable year in the compliance period. Report changes in common areas which become commercial, when fees are charged for facilities, etc. In addition, report any below market federal loan or any obligation the interest on which is exempt from tax under section 103 that is or was used (directly or indirectly) with respect to the building or its operation during the compliance period and that was not taken into account when determining eligible basis at the close of the first year of the credit period.

**Item 11f.** Failure to satisfy the minimum set-aside requirement for the first year of the credit period results in the permanent loss of the entire credit.

Failure to maintain the minimum set-aside requirement for any year after the first year of the credit period results in recapture of previously claimed credit and no allowable credit for that tax year. No low-income housing credit is allowable until the minimum set-aside is restored for a subsequent tax year.

**Item 11h.** All units in the building must be for use by the general public (as defined in Regulations section 1.42-9), including the requirement that no finding of discrimination under the Fair Housing Act occurred for the building. Low-income housing credit properties are subject to Title VIII of the Civil Rights Act of 1968, also known as the Fair Housing Act. It prohibits discrimination in the sale, rental, and financing of dwellings based on race, color, religion, sex, national origin, familial status, and disability. See 42 U.S.C. sections 3601 through 3619.

It also mandates specific design and construction requirements for multifamily housing built for first occupancy after March 13, 1991, in order to provide accessible housing for individuals with disabilities. The failure of low-income housing credit properties to comply with the requirements of the Fair Housing Act

will result in the denial of the low-income housing tax credit on a per-unit basis.

Individuals with questions about the accessibility requirements can obtain the Fair Housing Act Design Manual from HUD by calling 1-800-245-2691 and requesting item number HUD 11112, or they can order the manual through [www.huduser.org](http://www.huduser.org) under Publications.

**Item 11i.** The owner must rent to low-income tenants all comparable units that are available or that subsequently become available in the same building in order to continue treating the over-income unit(s) as a low-income unit. All units affected by a violation of the available unit rule may not be included in qualified basis. When the percentage of low-income units in a building again equals the percentage of low-income units on which the credit is based, the full availability of the credit is restored. Thus, only check the "Noncompliance corrected" box when the percentage of low-income units in the building equals the percentage on which the credit is based.

**Item 11q.** Check this box for noncompliance events other than those listed in 11a through 11p. Attach an explanation. For projects with allocations from the nonprofit set-aside under section 42(h)(5), report the lack of material participation by a non-profit organization (i.e., regular, continuous, and substantial involvement) that the housing credit agency learns of during the compliance period.

**Paperwork Reduction Act Notice.** We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

- Recordkeeping** . . . . . 7 hr., 39 min.
- Learning about the law or the form** . . . . . 3 hr., 16 min.
- Preparing and sending the form to the IRS** . . . . . 3 hr., 32 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave., NW, IR-6406, Washington, DC 20224. Do not send Form 8823 to this address. Instead, see Where To File on page 2.

**Exhibit 1-3**  
**IRS Noncompliance Notification Letter**  
**Letter 3464 (SC/CG) 5-2001**

DEPARTMENT OF THE TREASURY  
P.O. Box 331, Drop Point 607 South  
Bensalem, PA 19020  
Attn: LIHC Unit

INTERNAL REVENUE SERVICE

Person to Contact:  
Employee I.D. Number:  
Fax Number:

Date:

Owner TIN:  
Building Identification Number:  
Reference:  
Year:

Dear [Name]

The state housing credit agency referenced above has reported, on Form 8823, Low Income Housing Credit Agencies Report of Noncompliance or Building Disposition, that you are not in compliance with Internal Revenue Code Section 42 requirements and regulations for the Building Identification Number (BIN) shown above. (If multiple BINs are referenced, please see the list at the end of this letter.)

The noncompliance issues are:

1. \_\_\_\_\_  
\_\_\_\_\_
2. \_\_\_\_\_  
\_\_\_\_\_
3. \_\_\_\_\_  
\_\_\_\_\_
4. \_\_\_\_\_  
\_\_\_\_\_

Therefore, you should not include the non-qualified units when calculating the credit for the year shown above. Additionally, Sections 42(j)(1) and (2) require that prior credits you claimed are subject to recapture to the extent that any accelerated credit is attributable to the units, plus interest.

If you are subject to recapture, you must use Form 8611, Recapture of Low Income Housing Credit. If you filed this form with your tax return and have not claimed any credit for the year, no further action may be necessary. If you have not, please amend your return to include the recapture, and remove the credit claimed for the year of disposition. Flow-through entities should advise distributive share recipients of applicable credit and recapture requirements.

IRS receipt of Forms 8823 can increase the potential for audit of the reported projects. Therefore, IRS may conduct review and audit activity subsequent to this letter.

If you have questions, you may call the IRS contact listed above between the hours of 9 a.m. and 3 p.m. Eastern Time.

Although this employee may be able to help you, it is your responsibility to resolve all noncompliance issues with the appropriate state housing credit agency. Therefore, if you have questions regarding the issue(s) cited, please contact the referenced state agency.

Sincerely,

**Additional Properties**

BIN	Noncompliance Date
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## Chapter 2

### Instructions for Completing Form 8823

#### Overview

State agencies use Form 8823 to notify the IRS of noncompliance with the requirements of IRC §42 or fulfill other reporting requirements. This chapter includes instructions for completing Form 8823.

#### After Building is Approved

Form 8823 should be used to report noncompliance *after* Form 8609, Low Income Housing Credit Allocation Certification, has been signed by the state agency and issued to the owner.

#### Before Building is Approved

There may be instances where noncompliance is identified *before* the issuance of Form 8609. For such cases, Form 8823 should be completed, but sent directly to the IRS Headquarter analyst responsible for the Low-Income Housing Credit program, rather than filing the form with the Philadelphia Service Center. The IRS will consider these forms 8823 timely filed.

#### Correction Period

The correction period is the period of time during which the owner of an LIHC property must correct any noncompliance identified by the state agency. The correction period begins with the date the state agency provides written notification *to the owner* that the building is not in compliance.<sup>1</sup> Under Treas. Reg. §1.42-5(e)(2), state agencies must provide *prompt* written notice to the owner.

The correction period begins as of the date the written notice of noncompliance is issued by the state agency to the owner. Generally, the correction period may not exceed 90 days from the date of the owner's notification; there is no minimum correction period. However, the correction period can be extended for up to a total of 6 months if there is a good cause for granting the extension.

Form 8823 must be filed with the IRS within 45 days following the end of the correction period, whether or not the noncompliance has been corrected.

#### Example 1: Annual Certification Under Treas. Reg. §1.42-5(c)(1)

An owner failed to submit the annual certification that the building was in compliance with IRC §42 requirements; e.g., that annual income certifications had been received from each low-income tenant and that the units were rent-restricted, etc. The certification was due March 1, 2005 and the state agency notified the owner in writing on April 1, 2005 that the certification had not been received.

The correction period began on April 1<sup>st</sup> and ended on June 29<sup>th</sup>. The owner had 90 days, until June 29, 2005, to provide the annual certification. The Form 8823, noting noncompliance with category 11d, Owner failed to provide annual certification or provided incomplete or inaccurate certifications, must be file after June 29<sup>th</sup>, but no later than August 15, 2005.

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<sup>1</sup> See Treas. Reg. §§1.42-5(e)(4) and 1.42-5(a)(2).

## Example 2: Extending the Correction Period

A state agency completed a physical inspection and identified noncompliance that required longer than 90 days to correct. The owner received notice of the noncompliance and the correction period began on January 15, 2004.

The state agency may extend the correction until July 15, 2004, giving the owner a total of 6 months to correct the problem. The Form 8823 must be filed with the IRS after July 15, 2004, but no later than August 25, 2004.

## General Guidelines for Completing Form 8823

1. Select all applicable categories of noncompliance.

Example 1: The state agency determined that 1 out of 10 low-income units in a building had been rented to a household with incomes that did not meet the income eligibility restrictions. Category 11a, Household income above income limit upon initial occupancy, should be selected.

Example 2: The state agency determined that 7 out of 10 low-income units in a one-building project were rented to households with incomes that did not meet the income eligibility restrictions. As a result, the owner did not meet the 40/60 minimum set-aside for that year. Category 11a, Household income above income limit upon initial occupancy, should be selected, and category 11f, Project failed to meet minimum set-aside requirement, should be selected.

2. A separate Form 8823 must be filed for each BIN. The form must be prepared using the fillable PDF file as revised October 2005 (or later) with the bar codes.
3. When filing a “back in compliance” Form 8823, all the instances of noncompliance for a specific category must be remedied before the building is considered “back in compliance” for that category. For example, if four units are cited for violations of the UPCS inspection standards, all four units must be repaired before the building is considered back in compliance for that issue.
4. All categories of noncompliance must be resolved before filing a “back in compliance” Form 8823. Be sure to mark the “noncompliance corrected” boxes for each of the resolved issues. If more than one “noncompliance corrected” box is marked, enter the date of the most recent correction on line 9 of Form 8823.
5. An amended Form 8823 is identified by checking the box at the top of the form under the title. An amended Form 8823 should be filed with the IRS only if it is necessary to correct an error on a Form 8823 that was previously filed with the Service. For example, the wrong category is selected or an address is incorrect. A copy of the amended Form 8823 should be sent to the owner concurrent to filing the form with the IRS.

6. Descriptions of noncompliance or additional information submitted with the Form 8823 should be concise; however, avoid the use canned or repetitive statements. It is helpful to identify the unit number, the date out of compliance and the date corrected, and summarize the problems with a brief description. Copies of reports and notification letters sent to the owner describing the noncompliance, electronic pictures, and newspaper articles are also helpful.

Concisely describe the content of any additional information maintained by the state agency; e.g., physical inspection reports, photographs, written statements from tenants, etc. Do *not* send photocopies of pictures; they are not useful.

State agencies should also include explanations when they suspect owners, managing agents, or other parties may have misrepresented factual information such as falsifying income verifications or altering tenant files.

7. State agencies should report all noncompliance of which they are aware as a result of the annual certification or periodic review of tenant files and physical inspection of the property, without regard to whether the initially outstanding noncompliance is subsequently corrected. See chapter 3 for additional discussion.

Independently, state agencies must also report any change in the applicable fraction (such as converting LIHC units to market rate units) or eligible basis (such as converting common area to commercial space) that results in a decrease in the qualified basis as noncompliance.

8. There is no “noncompliance corrected” block available for category 11p, Project is no longer in compliance nor participating in the program. Should the state agency decide to reinstate the property, the state agency should contact the IRS Low-Income Housing Credit program analyst.

## Line-By-Line Instructions

- Line 1** Building Information: Ensure that the complete building (or project) name and address, including ZIP code is identified.
- Line 2** Owner Information: Remember to check the box if the current owner's name is different than the owner shown on Form 8609. Ensure that the current owner's EIN/SSN is correct. If there is more than one owner, attach a schedule listing the name, address, and EIN/SSN of each owner.
- Line 3** BIN: Ensure that building identification number is correct. It should consist of the two letter state abbreviation, two-digit year and five-digit number assigned.
- Line 4** EIN: Ensure that the identification number for the owner is correct and check the box SSN for individual taxpayers (xxx-xx-xxxx) or EIN for business entities (xx-xxxxxxx) such as corporations and partnerships.
- Line 5** Total credit allocated to this BIN: Provide the total allowable LIHC allocated to this BIN. This is computed by adding the amounts of credit allocated to the BIN on all Forms 8609, line 1b. Do not include Forms 8609 for which the compliance period has

expired.

**Line 6** Number of buildings in the project: Enter the number of buildings that house residential living units and have BIN numbers assigned to the project. Do not include recreational facilities or other amenities.

**Line 7**

- a. Number of residential units in the building: Enter the total number of both LIHC units and all other residential units. But do not include managers' units. See footnote for special rules regarding buildings placed in service prior to September 9, 1992.<sup>2</sup>
- b. Number of low-income units in the building.
- c. Number of residential units with noncompliance problems: Count each unit for which noncompliance is being identified *in this report*; do not include previously reported, but still outstanding, noncompliance. Count each unit only once, even if there are multiple compliance problems.
- d. Indicate the total number of units reviewed in this building for which the Form 8823 is being filed. Count each unit being reviewed once, even if you reviewed the same unit for both the annual certification and simultaneously performed an on-site review.

**Line 8** Date building ceased to comply: Enter the date that the building ceased to comply with the IRC §42 low-income housing credit requirements. If there are multiple noncompliance issues, enter the date of the earliest discovered issue. Do not complete this item to indicate the date a building (or an interest therein) was disposed of.

**Line 9** Date noncompliance corrected: If entering a corrected date, make sure the appropriate "noncompliance corrected" block in lines 11a through 11o, or 11q is checked. If there are multiple categories, the date the last issue was resolved should be entered. (Note: there is no "noncompliance corrected" block for category 11p, Project is no longer in compliance nor participating in the program.)

**Line 10** Correction of previously reported noncompliance: Check this box if the sole reason for filing the form is to indicate that previously reported noncompliance problems have been corrected.

**Line 11a-p** Noncompliance categories: Select the category that best describes the issue being reported. Be sure to check the correct box for "out of compliance" and/or "noncompliance corrected," as applicable.

**Line 11q** This category is used only for those issues that do not fit into the categories specified in 11a through 11p. Be sure to attach an explanation.

**Line 12** Additional Information: Extensive detail is not necessary, but a summary is desirable to indicate the nature and extent of the noncompliance.

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<sup>2</sup> Note that, in some instances involving buildings placed in service, receiving an allocation of credit, or described in IRC §42(h)(4) with respect to which tax-exempt bonds were issued prior to September 9, 1992, managers' units may be included in the total number of residential units. See Rev. Rul. 92-61, 1992, 32 I.R.B. 4. The IRS will not, however, apply Rev. Rul. 92-61 unless the owner files, or has filed, a return that is consistent with the ruling.

**Line 13**

- a. Building disposition: Check the box for the appropriate type of disposition (sale, foreclosure, destruction, or other). For “other” dispositions, attach an explanatory statement.
- b. New owner’s name and address: Ensure that the owner’s name, address and ZIP code are correct.
- c. Date of disposition: The date the ownership actually transferred should be used. If the exact date is unknown, enter the best approximation.
- d. New owner’s EIN: Ensure that the identification number for the owner is correct and check the SSN for individual taxpayers (xxx-xx-xxxx) or EIN for business entities (xx-xxxxxxx) such as corporations and partnerships.

**Line 14**

Contact Person: Identify the person the IRS should call if there are any questions and include that person’s telephone number.

**Signature**

Signature of authorizing official: The authorizing official is a state agency official who is authorized by the state agency to sign such documents. The person need not be an executive, but may be a lower level employee within the state agency organization.

## Chapter 3 Guidelines for Determining Noncompliance

### Overview

State agencies are responsible for determining whether owners are compliant with the requirements of IRC §42 and its regulations. Professional judgment should be used to identify significant noncompliance issues, establish the scope and depth of the project/building review, and apply the law and regulations to the facts and circumstances of the case in a fair and impartial manner. This chapter includes guidelines to assist the state agencies meet these responsibilities.

### Current Noncompliance Issues

#### Initial Physical Inspection and Tenant File Review

Treas. Reg. §1.42-5(c)(2)(ii)(A) requires state agencies to conduct on-site inspections of all buildings in the project, and for at least 20 percent of the low-income units, inspect the units and review the certifications, the documentation supporting the certifications, and the rent records for the tenants in those units, by the end of the second calendar year following the year the last building is placed in service.

Under Treas. Reg. §1.42-14(d)(2)(ii), an allocation of credit may not be returned any later than 180 days following the close of the first tax year of the credit period. Therefore, it is highly recommended that the first review of the LIHC project be conducted within that timeframe. Under specific circumstances, previously allocated credits can be reclaimed and returned to the state's credit ceiling if necessary.<sup>1</sup> Timely review of the initial lease-up provides owners an opportunity to correct problems early in the compliance period.

#### Subsequent Physical Inspections and Tenant File Reviews

Treas. Reg. §1.42-5(c)(2)(ii)(B) requires that, at least once every 3 years, state agencies 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 certifications, documentation supporting the certifications, and the rent records for all the tenants living in the units.

#### Example 1: Current Tenant Income (Re)Certification and Documentation

An LIHC building was placed in service and the first tax year of the credit period was 2000. The state agency inspected the property and reviewed tenant certification in May 2001; no noncompliance issues were identified. The next inspection and review were conducted in April 2004; the tenant files were reviewed using the most recent recertification, or initial income certifications for tenants moving into the building within the last year.

#### Reporting Current Noncompliance

Under Treas. Reg. §1.42-5(a), state agencies are required to report any noncompliance of which the agency becomes aware. Agencies should report all noncompliance, without regard to whether the identified outstanding noncompliance is subsequently corrected.

The inspection standard for on-site inspections of buildings and LIHC units generally requires state agencies to determine whether the building and units are suitable for

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<sup>1</sup> See chapter 21.

occupancy based on local health, safety, and building codes or whether the buildings and units satisfy the uniform physical condition standards established by HUD.<sup>2</sup>

The state agency is required to review the low-income certifications, the documentation supporting the certifications (and recertifications<sup>3</sup>), and the rent records for the tenants in the units selected for the physical inspection.<sup>4</sup> Therefore, the state agency should be reviewing the initial income certification if the tenant moved in within the last year or the most recent income recertification.

In addition, state agencies must report any change in the applicable fraction (such as converting LIHC units to market rate units) or eligible basis (such as converting common area to commercial space) that results in a decrease in the qualified basis as noncompliance.

Noncompliance issues identified and corrected by the owner prior to notification of an upcoming compliance review or inspection by the state agency need not be reported; i.e., the owner is in compliance at the time of the state agency's inspection and/or tenant file review. Small Business/Self-Employed (SB/SE) considers the date of the notification letter a "bright line" date comparable to the rules for requesting a PLR or the disclosure on Form 1040X that an amended tax return is being filed after being audited by the IRS or subsequent to notification that it will be audited. See Form 1040X, line B.

## Sampling Requirements

The review (or sampling) of 20 percent of the LIHC units in a project and the associated tenant files is required under the Treasury regulations. The purpose is to estimate the compliance level of all the tenant income (re)certifications by providing a "snap shot" view of the owner's activities and compliance level at a specific moment in time. Sampling reduces the labor costs, and enables state agencies to meet time constraints when dealing with large LIHC properties.

### Selecting a Sample

A random selection of tenant files or LIHC units is required. The method of choosing the sample of files or units to be inspected must not give the owner advance notice of which units and tenants records are to be inspected and reviewed<sup>5</sup>. There is no advantage to selecting different units over the 15-year compliance monitoring cycle.

If the sample includes a currently vacant unit, then the last (re)certification for the last tenant should be reviewed. The "snap shot" is indicative of current compliance.

### Interpreting the Results

The IRS uses the results of the state agencies' reviews as an indicator of the owner's level of compliance with IRC §42 requirements. If audited, the IRS can also use the results to make adjustments to the LIHC on a unit-by-unit basis as identified on Form 8823. However, the IRS cannot project the results to the entire population of LIHC units<sup>6</sup>.

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<sup>2</sup> See Treas. Reg. 1.42-5(d)(2).

<sup>3</sup> Treas. Reg. 1.42-5(c)(1)(iii) refers to an "annual income certification" which for clarity purposes is often referred to as a "recertification".

<sup>4</sup> See Treas. Reg. 1.42-5(c)(2)(ii)(A) and (B).

<sup>5</sup> Treas. Reg. 1.42-5(c)(2)(iii).

<sup>6</sup> The IRS has specific requirements for using sampling techniques as part of an income tax audit. A state agency is not required to use these more stringent techniques for random selection and sample size when conducting a compliance review.

### Example 1: Applying Tenant File Review Results

A state agency conducts a tenant file review and physical inspection of a 100% LIHC single building project with 100 units. The LIHC associated with each unit is \$3,000. Twenty units are inspected and the associated tenant files are reviewed. Various noncompliance issues were identified for fifteen, or 75 percent, of the twenty sampled units.

The IRS can make an LIHC adjustment of \$45,000 (15 units x \$3,000) for the year of the review, with a recapture of \$15,000 plus interest for each of the prior years of the credit period. Although the sample results indicate significant noncompliance, the results cannot be projected to the entire population; i.e., the IRS cannot conclude that 75 of the 100 units are out of compliance and, therefore, disallow the entire LIHC because the taxpayer did not meet the minimum set-aside.

#### **Expanding the Sample Size**

In the event that extensive noncompliance is identified, state agencies should consider expanding the number of units inspected/files reviewed beyond the 20 percent sample required under Treas. Reg. 1.42-5(c)(2)(ii). Circumstances warranting consideration of expanding the sample of LIHC units reviewed include (but are not limited to):

1. Poor internal controls (significant risk of error)
2. Multiple problems
3. Significant number of nonqualified units
4. Significant number of households are not income-qualified
5. Credible information from a reliable source

### **Determining the Scope of the State Agency's Inspection/Review**

#### **Large, Unusual and Questionable Items (Materiality)**

Large, unusual, or questionable items (LUQ's) may be material in determining whether noncompliance exists, and thus affect the scope of the state agency's inspection/review. Some factors to consider when determining the materiality of items include:

1. Comparative nature of the issue – two of one hundred of a building's rental units out of compliance for a month is not as important as a project failing the 40/60 minimum set-aside.
2. Absolute nature of the issue – violations of the physical conditions standards should be investigated thoroughly whether one or one hundred units are impacted.
3. Inherent nature of the issue – a permanent decrease in the eligible basis of the property is more significant than two units that are not available for rent for two months.
4. Evidence of intent to mislead – this may include missing, misleading or incomplete documentation.
5. Extenuating circumstances – the issue cited is very temporary or in the process of being fixed at the time of inspection.

## Determining the Depth of the State Agency's Inspection/Review

**Issue Development** Depth is the extent to which an issue of potential noncompliance is developed. It demonstrates the degree of intensity and thoroughness applied to make a determination of noncompliance. State agencies must use judgment to determine the depth required to satisfactorily develop an issue of noncompliance. The following factors should be considered:

1. The type and reliability of evidence available or expected,
2. Complexity of the issue, and
3. Techniques used.

It is important to obtain sufficient evidence for evaluating the owner's compliance with IRC §42 requirements. Determining the proper amount of evidence to accumulate is a judgmental decision. Factors to consider include the risk that the owner may have made errors that are individually or collectively material and the risk that tests (such as sampling) will fail to uncover material errors.

## Consideration of Taxpayer Due Diligence

For most taxpayers, voluntary compliance consists of preparing an accurate tax return, filing it timely, and paying any taxes due. Compliant behavior can be demonstrated when a LIHC property owner exercises ordinary business care and prudence in fulfilling its obligations. Due diligence can be demonstrated in many ways, including (but not limited to) establishing strong internal controls (policies and procedures) to identify, measure, and safeguard business operations and avoid material misstatements of LIHC property compliance or financial information. Internal controls include:

1. Separation of duties,
2. Adequate supervision of employees,
3. Management oversight and review (internal audits),
4. Third party verifications of tenant income,
5. Independent audits, and
6. Timely recordkeeping.

## Evidence

State agencies gather information to determine the owner/taxpayer's compliance with IRC §42. This determination must be made on the basis of all available facts, including facts supporting the owner's position. Evidence is something that tends to prove a fact or point in question.

Owners have the right to expect that the information they provide will be safeguarded and used only in accordance with the law. To promote and maintain owners' confidence in the privacy, confidentiality, and security protections provided by the state and IRS, the following principles should be followed.

1. No information will be collected or used (with respect to owners/taxpayers) that is not necessary and relevant for tax administration and other legally mandated or authorized purposes.
2. Information will be collected, to the greatest extent practicable, directly from the taxpayer to whom it relates.
3. Information about taxpayers collected from third parties will be verified, to the extent practicable, with the taxpayers before a determination of compliance is made using the information.

## Types of Evidence

The Internal Revenue Code requires all taxpayers to keep adequate records to support the items on their tax returns. However, not all evidence need be “books and records.” The following discussion is an overview of different types of acceptable evidence of taxpayer compliance.

### 1. Documentary Evidence

Physical documentation is generally regarded as providing proof or evidence. Writings made contemporaneously with the happening of an event generally reflect the actual facts and indicate what was in the minds of the parties to the event. If possible, original documentary evidence should be reviewed.

The records to be retained by the LIHC property owner are described in Treas. Reg. §1.42-5(b). The records must be retained 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.

Owners may use electronic storage systems instead of hardcopy (paper) books and records to retain the required records.<sup>7</sup> However, the electronic storage system must satisfy the requirements of Rev. Proc. 97-22. In addition, the owner must satisfy any additional recordkeeping and record retention requirements of the monitoring procedure adopted by the state agency. For example, the housing agency may require the owner to maintain hardcopy books and records.

While documentary evidence has great value, it should not be relied upon to the exclusion of other facts. Facts can also be established by oral testimony. There will be times when greater weight should be given to oral testimony than to conflicting documentary evidence. The owner should not be considered noncompliant simply because documentary evidence is incomplete to establish precise compliance when there is some evidence to support compliance.

The “Cohan Rule,” as it is known, originated in the decision of Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930). In Cohan, the court made an exception to the rule requiring taxpayers to substantiate their business expenses. George M. Cohan, the famous entertainer, was disallowed a deduction for travel and business expenses because he was unable to substantiate any of the expenses. The judge wrote that “absolute certainty in such

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<sup>7</sup> Rev. Rul. 2004-82, I.R.B. 2004-35, Q&A #11.

matters is usually impossible and is not necessary, the Board should make as close an approximation as it can.” In general, the Tax Court has interpreted this ruling to mean that in certain situations “best estimates” are acceptable in order to approximate expenses. The Cohan Rule is a discretionary standard and can be used to support a reasonable estimate of compliance requirements.

State agencies may allow owners to reconstruct records when the situation warrants, consider incomplete or imperfect documentation, and accept credible oral testimony to determine the owner/taxpayer’s overall compliance with the requirements of IRC §42.

#### Example 1: Incomplete Documentation

A couple’s current income recertification was timely signed by the wife, but the husband’s signature is missing because he is on active military duty and stationed out of the country. The husband’s income is included in the recertification and the reporting instructions for his overseas assignment are included in the file. The state agency may consider the unit in compliance, even though the husband’s signature is missing.

#### Example 2: Reconstructing Evidence

The tenant’s income recertification was timely completed and signed. The summary records are in the file, but the income verification from the employer is missing. The state agency may allow the property manager to perfect the documentation.

## 2. Oral Testimony

There are times, due to taxpayer-specific circumstances, when records may not exist or are incomplete. In such cases, oral testimony may be the only evidence available. Therefore, oral statements made by the owner to the state agency represent direct evidence that must be considered. Although self-serving, *uncontradicted* statements that are *not improbable* or *unreasonable* should not be disregarded.

#### Example 1: Plausible Oral Testimony

During a compliance review, an issue involving the income certification for a household was noted. However, the tenant had moved out and could not be located. The manager remembers discussing the item with the tenant, but there is no third party that can corroborate the manager’s statement. If the manager’s statement is plausible, the oral testimony can be considered sufficient.

The degree of reliability placed on an owner’s oral testimony should be based on the credibility of the owner and surrounding circumstantial evidence supporting the owner’s testimony. The following concepts are helpful when evaluating oral testimony.

- a. Oral evidence should not be used in lieu of available documentary evidence
- b. If the issue involves specific recordkeeping required by law, then oral testimony alone cannot be substituted for necessary written documentation

- c. Oral testimony need not be accepted without further inquiry. If in doubt, or there are inconsistencies, attempts should be made to verify the facts from another source.

### 3. Third Party Evidence

Third party evidence is evidence obtained from someone other than the taxpayer. Credible third party evidence is used when the owner is unable to provide the information or it is necessary to verify information provided by the owner. Information about owners collected from third parties will be verified, to the extent practicable, with the owner before determinations are made using the information provided by third parties.

## Evaluating Evidence

The state agencies should exercise sound judgment to make reasonable determinations and ensure that there is a basis for each item considered. This may involve considering the extent to which detailed documentation is required, examining all existing documentation, and determining the weight that should be given to oral testimony. *All* the information needed to definitively resolve an issue will seldom be available; state agencies will need to determine when there is sufficient information, or substantially enough, to make a proper determination of compliance with IRC §42.

State agencies are expected to arrive at definite conclusions based on a balanced and impartial evaluation of all available evidence. The state agencies should employ independent and objective judgment in reaching conclusions and should decide all things on their merit; free from bias and conflicts of interest. Fairness may be demonstrated by:

1. Making decisions impartially and objectively based on consistent application of procedures and tax law;
2. Treating individuals equitably;
3. Being open-minded and willing to seek out and consider all relevant information, including opposing perspectives;
4. Voluntarily correcting mistakes and refusing to take advantage of mistakes or ignorance on the part of the owner; and
5. Employing open, equitable, and impartial processes for gathering and evaluating information necessary for making decisions.

Factors to consider when evaluating evidence include the following:

1. Number and type of noncompliance issues,
2. Elements missing from the documentation,
3. Reasons why documentation is incomplete,
4. Availability of other information to substantiate compliance, and
5. Materiality of unsubstantiated documentation.

In the event that an owner provides clarification or evidence that the potential violation *does not exist*, it is not necessary to report the incident to the IRS; i.e., the owner has clarified that they are in compliance.

## Workpapers

### Content and Purpose

Workpapers are the state agencies' written records that provide the principal support for their project audits and the filing of Forms 8823. They should include all the information needed to conduct the inspection/review, and document contacts with the owner, the procedures applied, tests performed, information obtained, and the conclusions reached. Workpapers serve the following purposes<sup>8</sup>:

1. A record of the evidence gathered, procedures completed, tests performed, and analyses conducted;
2. Provide support for technical conclusions;
3. Basis for internal reviews by state agency management; and
4. Support for IRS audits of the owner's tax returns.

State agency workpapers may be used by IRS examiners to support conclusions regarding the accuracy of the owner's tax return. These papers and other documents in files may be reviewed to help establish the scope and depth of an IRS audit, establish a pattern of noncompliance, or provide evidence to support adjustments to the tax return. In some cases, the workpapers may be the only evidence.

While there are no requirements for the form or style of workpapers or documentation, workpapers should include certain "identifying" information to support IRS examinations. Workpapers should include:

1. Identity of the owner of the building being reviewed,
2. Name (or initials) of person preparing the workpapers, and
3. Date the workpapers were prepared.

### Required Recordkeeping and Retention Provisions – State Agencies

For monitoring compliance with low-income housing credit requirements, Treas. Reg. §1.42-5(a)(2)(i)(A) provides that a procedure for monitoring for noncompliance must include the recordkeeping and record retention provisions of Treas. Reg. §1.42-5(b).

Under Treas. Reg. §1.42-5(e)(3)(ii), a state agency must retain the original records of noncompliance or failure to certify for 6 years beyond the state agency's filing of the respective Form 8823. In all other cases, the state agency must retain the certifications and records for 3 years from the end of the calendar year in which the state agency received the certifications and records.

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<sup>8</sup> Internal Revenue Manual 4.10.9(3).

**Availability of  
Workpapers to  
Owners**

IRS agents can informally provide taxpayers with access to the workpapers associated with their own audit *that would otherwise be made available under the Freedom of Information Act*. If consistent with the state's disclosure rules, similar access to the workpapers for the compliance monitoring review can be helpful to owners; e.g., clarifying facts or preparing relevant evidence to resolve issues.

**Chapter 4**  
**Category 11a**  
**Household Income Above**  
**Income Limit upon Initial Occupancy**

**Definition**

This category is used to report units that have been rented to households with incomes that do not meet income eligibility restrictions. According to IRC §42(g)(1), an owner of a tax credit property must elect to serve tenant populations with gross incomes that are either 50% or less of Area Median Gross Income (AMGI) or the National Nonmetropolitan Median Gross Income (NNMGI) when applicable<sup>1</sup>, or 60% or less of AMGI or NNMGI when applicable, as adjusted for family size.<sup>2</sup> Under the terms of an extended use agreement, an owner may agree to service tenant populations at AMGI levels lower than identified in IRC §42(g); nonperformance of such agreements is not a reportable noncompliance event.

Annual Household Gross Income is the gross income (with no adjustments or deductions) the household anticipates it will receive in the 12-month period *following* the effective date of the income certification. The combined income of all occupants of a unit, whether or not legally related, is compared to the appropriate percentage of the AMGI for a family with the same number of members<sup>3</sup>.

If information is available on changes expected to occur during the year, that information is used to most accurately determine the anticipated income from all known sources during the year. Unanticipated income received after the household moves in will not affect the original determination that a household is eligible for LIHC housing.

State agencies are required to review the low-income certifications, and the supporting documentation, for the tenants in a sample of LIHC units.<sup>4</sup> Therefore, the state agency must review the initial income certification if the tenant moved in within the last year and the most recent income recertification for continuing tenants.

Where the owner has received a waiver of the annual income recertification requirements, the state agency will always review the initial income certification.<sup>5</sup>

**Determining Income Limits (Area Median Gross Income)**

To determine the appropriate household income limit figure, refer to the HUD-published table relating to “very low income,” which is an income level at or below 50 per cent of the Area Median Gross Income (AMGI). HUD prepares tables and provides income

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<sup>1</sup> IRC §1400N(c)(4), Special Rule for Applying Income Tests: In the event of property placed in service (A) during 2006, 2007, or 2008, (B) in the Gulf Opportunity Zone, and (C) in a nonmetropolitan area (as defined in section 42(d)(5)(C)(iv)(IV)), section 42 shall be applied by substituting ‘national nonmetropolitan median gross income (determined under rules similar to the rules of section 142(d)(2)(B))’ for ‘area median gross income’ in subparagraphs (A) and (B) of section 42(g)(1).

<sup>2</sup> Note: Once made, this election is irrevocable and applies to all low-income units. See IRC §§42(g)(1) and 42(i)(3)(A)(ii).

<sup>3</sup> See Rev. Rul. 90-89, 1990-2 C.B. 8.

<sup>4</sup> See Treas. Reg. 1.42-5(c)(2)(ii)(A) and (B).

<sup>5</sup> See Rev. Proc. 2004-38, section 5.07, 2004-2 C.B. 10.

figures for family sizes ranging from one to eight persons.

If the owner elected the 40/60 minimum set-aside, then the published income figures for the 50 per cent of AMGI should be multiplied by 1.2.<sup>6</sup> There should be no rounding of these figures, as HUD has already rounded up the figures in the tables.

## Households and Family Size

As a general rule, a “household” consists of all individuals (or tenants) residing in a unit. To determine the household income limit, all applicable income standards are adjusted for family size. For LIHC purposes, all occupants of a unit are considered in the determination of family size except the following (refer to HUD Handbook 4350.3 for complete discussion):<sup>7</sup>

1. Live-in aides. A person who resides with one or more elderly persons, near-elderly persons, or persons with disabilities, and who is determined to be essential to the care and well-being of the person(s); is not obligated for the support of the person(s); and would not be living in the unit except to provide the necessary supportive services. While a relative may be considered to be a live-in aide/attendant, they must meet the above requirements. The income of live-in aides is not included in the household’s income.
2. Foster children or foster adults
3. Guests

When determining family size for income limits, the owner must include the following individuals who are not living in the unit:

1. Children temporarily absent due to placement in a foster home;
2. Children in joint custody arrangements who are present in the household 50% or more of the time;
3. Children who are away at school but who live with the family during school recesses;
4. Unborn children of pregnant women (as self-certified by the woman);
5. Children who are in the process of being adopted;
6. Temporarily absent family members who are still considered family members. For example, the owner may consider a family member who is working in another state on assignment to be temporarily absent;

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<sup>6</sup> Rev. Rul. 89-24, 1989-1 C.B. 24.

<sup>7</sup> IRC §142(d)(2)(B) refers to the income of individuals. The combined income of all occupants of an apartment, whether or not legally related, is compared to the appropriate percentage of the median family income for a family with the [same] number of members. See Rev. Rul. 90-89, 1990-2 C.B. 8.

7. Family members in the hospital, or a rehabilitation facility, for periods of limited or fixed duration are considered a family member. These persons are temporarily absent; and
8. Persons permanently confined to a hospital or nursing home. The family decides if such persons are included when determining family size for income limits. If the family chooses to include the permanently confined person as a member of the household, the owner must include income received by the confined person in calculating family income.

## Changes in Family Size

Changes in the size of an existing household after the initial tenant income certification must also be addressed.

### Family Size Increases

The addition of new member(s) to an existing low-income household requires the income certification for the new member of the household, including third party verification. The new tenant's income is added to the income disclosed on the existing household's tenant income certification.<sup>8</sup> The household continues to be income-qualified, and the income of the new member is taken into consideration with the income of the existing household for purposes of the Available Unit Rule under IRC §42(g)(2)(D). See chapter 14.

#### Example 1: Additional Person Joins Household During the Year

Jim and his two children initially income qualified and moved into an LIHC unit on March 1, 2001. The household continued to qualify at the annual income recertification for 2002, 2003, and 2004. Jim then met Jane, and they decided to marry in October 2004. The new couple would like to live in the LIHC unit Jim occupies. Jane completes a tenant income certification.

The certification effective date continues to be March 1, 2001 and the next annual income recertification is due within 120 days before March 1, 2005.

If the household's income, when Jane's income is added, exceeds 140 percent of the income limit (170 percent in deep rent skewed projects), then the Available Unit Rule applies.

A household may continue to add members as long as at least one member of the original low-income household continues to live in the unit. Once all the original tenants have moved out of the unit, the remaining tenants must be certified as a new income-qualified household unless the remaining tenants were income qualified at the time they moved into the unit.

If a state agency determines that the tenants manipulated the income limitation

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<sup>8</sup> Under Treas. Reg. 1.42-5(c)(iii), owners must obtain an *annual* income certification from each low-income tenant. Interim income recertifications are not contemplated under IRC §42.

requirements, then the unit should not be treated as a low-income unit as of the date the household initially occupied the unit.

#### Example 2: New Tenants Manipulated Income Limitations

An income-qualified household consisting of one person moved into a two bedroom unit on March 15, 2005. A second tenant completed an initial income certification and joined the household soon thereafter. The combined income of the two tenants is above in income limit for a household with two members. The unit is out of compliance as of March 15, 2005.

### Family Size Decreases

Decreases in family size do not trigger the immediate income certification of a new household. Subsequent annual income recertifications will be based on the income of the remaining members of the household. If the remaining household's income is more than 140 percent (170 percent in deep rent skewed projects) of the income limit at the time of the annual income recertification, then the Available Unit Rule is applicable.<sup>9</sup>

#### Example 1: Member of the Household Leaves

A married couple, with their two children, was initially income qualified and occupied a three bedroom unit. After four years, the oldest child, now 18 years old, moves out of the unit. It is not necessary to certify the remaining household as a new household. If the household's income exceeds the limit for a family with three members at the next income recertification, the Available Unit Rule is applicable.

#### Example 2: Unborn Children

A household was originally income qualified based on the inclusion of an unborn child. Four months later, the pregnancy ended in miscarriage. It is not necessary to certify the remaining household as a new tenant at the time of the miscarriage. If the income of the remaining household members exceeds the income at the next income recertification, the Available Unit Rule is applicable.

## Verifying Income and Assets

Owners must verify all known income and assets that affect eligibility. However, if the total assets for a household are \$5,000 or less, the applicants may satisfy the asset requirement by signing a statement attesting to such fact.<sup>10</sup>

Acceptable methods of verifying information include third party verifications, reviews of documents submitted by the tenant (such as check stubs), and tenant certifications made under penalties of perjury.<sup>11</sup>

<sup>9</sup> See the legislative history for IRC §42, which notes that if the tenant's income increases to a level more than 140 percent above the otherwise applicable ceiling (*or if the tenant's family size decreases so that a lower maximum family income applies to the tenant*), that tenant is no longer counted in determining whether the project satisfies the set-aside requirement. The explanation continues, stating that there is no penalty in such cases if the Next Available Unit Rule is applied.

<sup>10</sup> See Rev. Proc. 94-65, 1994-2 C.B. 798.

<sup>11</sup> Treas. Reg. §§ 1.42-5(b)(vii) and 1.42-5(c)(1)(iii).

Third party contacts are preferred. Owners should obtain the tenant's consent for the release of information before contacting third parties. Verification forms should be directly sent to and received from third parties. If third party contacts are by telephone or interview, the conversation should be documented in the tenant's file and include all the information that would have been included in a written verification. The owner may obtain acceptable third party written verification by facsimile, e-mail, or Internet.

Owners can accept tenant-provided documents (e.g., pay stubs, Forms W-2, bank statements, etc.) when third party contacts are impossible or delayed, or third party verifications are not needed (e.g., birth certificates or divorce decrees).<sup>12</sup>

There will be situations where it will be difficult to estimate income. For example, the tenant may work sporadically or seasonally. In such cases, owners are expected to make a reasonable judgment as to how to the most reliable approach to estimating what the tenant will receive in the coming year.

## Determining Annual Income

Household income is defined as the gross income (with no adjustments or deductions) the household anticipates it will receive in the 12-month period following the effective date of the household's certification of income.<sup>13</sup> Income includes, but is not limited to, earned and unearned income from all household members age 18 and older (adults), unearned income of minor children, and income from assets. Emancipated minors are treated as adults. As noted in chapter 5 of HUD Handbook 4350.3, "In all instances, owners are expected to make a reasonable judgment as to the most reliable approach to estimating what the tenant will receive during the year."<sup>14</sup>

Common sources of income are discussed below. Refer to HUD Handbook 4350.3 for additional information.

### Employment Income

Employment income includes (but is not limited to) hourly wages, salaries, overtime pay, tips, bonuses, and commissions before any payroll deductions. Payments in lieu of employment income are also included; e.g., workers compensation, severance pay, unemployment and disability compensation. Income from employment of children (including foster children) is excluded.

Maximum benefits and annualized payments should not be used unless the source of funds is expected to continue throughout the certification period or for an indeterminable length of time. For example, if the third party does not indicate the length of time for which the tenant will be receiving a certain income, then the income should be annualized. In the event that the family cannot provide documentation that access to a specific source of income is for a limited and determinable time period, the benefits should be considered to be available for an indefinite time period and annualized.

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<sup>12</sup> Third party contacts are considered impossible if an employer does not respond, third party charges a fee, or no third party is available. Generally a third party contact is considered delayed if a response will not be received within two weeks, but can be less if it is determined that the third party will not respond.

<sup>13</sup> As explained in Treas. Reg. §1.42-5(b)(vii), gross income for purposes IRC §42 is not gross income for purposes of determining a federal income tax liability.

<sup>14</sup>The HUD Handbook 4350.3, Chapter 5, paragraph 5-5(C).

#### Example 1: Benefits for Indefinite Time Period

John works as a telemarketer for \$9.00 an hour, 40 hours a week. He does not work overtime, has no other source of income, and is not planning to leave his job. His anticipated income is computed as:

$$(\$9.00/\text{hour}) \times (40 \text{ hours/week}) \times (52 \text{ weeks/year}) = \$18,720/\text{year}$$

#### Example 2: Benefits for Definite Time Period

A teacher's assistant works nine months annually and receives \$1,300 per month. During the summer recess, the teacher's assistant works for the Parks and Recreation Department for \$600 a month. The teacher's anticipated income is computed as:

$$(\$1,300 \times 9 \text{ months}) + (\$600 \times 3 \text{ months}) = \$13,500$$

If information is available on changes in income expected to occur during the year, use that information to determine the total anticipated income from all know sources during the year.<sup>15</sup>

#### Example 3: Anticipated Changes in Income

In May 2004, an unemployed plumber applies for LIHC housing. At that time, the plumber is receiving unemployment benefits of \$250.00 per month and will qualify for benefits for 4 more months.<sup>16</sup> Beginning in October, the plumber will be employed at \$1,000 per month. The plumber's anticipated income is computed for the period from May to September, 2004 plus the income for October 2004 through May 2005.

$$(\$250.00 \times 5 \text{ months}) + (\$1,000 \times 7 \text{ months}) = \$8,250$$

Military employment may include (but is not limited to) base and longevity pay, proficiency pay, sea and foreign duty pay, hazardous duty pay, subsistence and housing allowances, and clothing allowances. All these are includable in income. Hostile fire pay, however, is excluded from income. *Note:* a temporarily absent individual on active military duty must be removed from the family and his or her income must not be included in the computation of household income, unless that person is the head of the family, spouse, or co-head.

Payments received under the Domestic Volunteer Service Act of 1973 are excluded from income. This includes employment through VISTA, Retired Senior Volunteer Program, Foster Grandparents Program, youthful offender incarceration alternatives, and senior companions. Payment received under Title V of the Older Americans Act (Green Thumb, Senior Aides, Older American Community Service Employment Program) is also excluded.

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<sup>15</sup> See Footnote #2.

<sup>16</sup> The HUD Handbook 4350.3, Chapter 5, paragraph 5-5(A)(1) refers to unemployment compensation as an example of income that *may* not last for a full 12 months.

## **Income from Training Programs**

Compensation from state or local employment training programs or training of a family member as resident management staff is not included in income. Income from training programs not affiliated with a local government and income from the training of a family member resident to serve on the management staff are also excluded. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for a limited period as determined in advance under the program by the state or local government.

Amounts received under training programs funded by HUD are not included in income. Similarly, payments received under programs funded in whole or in part under the Workforce Investment Act (WIA – formerly the Job Training Partnership Act) are excluded from income. These are employment and training programs for Native Americans and migrant and seasonal farm workers, Job Corps, veterans employment programs, state job training programs, career intern programs, and AmeriCorps. Amounts received by a person with a disability that are disregarded for a limited time for purposes of supplemental security income eligibility and benefits because they are set-aside for use under a Plan to Attain Self-Sufficiency (PASS) are excluded from income.

Excluded compensation includes stipends, wages, transportation or childcare payments received, or reimbursements of out-of-pocket costs and which are made solely to allow participation in a specific program. Income received as compensation for employment is excluded only if the employment is a component of a job-training program. Once training is completed, the employment income is included in the computation of annual income. Amounts received during the training period from unrelated sources (public assistance, social security payments, other employment) are not excluded from income.

## **Income from a Business**

The net income from the operation of a business, profession, or sole proprietorship businesses is included in income. Net income is gross income less business expenses, interest on loans, and depreciation computed on a straight-line basis. Salaries paid to the applicant or other household members from the business must also be identified and included in income.

Business expenses do *not* include principal payments on loans, interest on loans for business expansion or capital improvements, or other expenses for business expansion or outlays for capital improvements.

If the net income from a business is negative, it must be counted as zero income. A negative amount cannot be used to offset other family income.

### **Example 1: Negative Income from Sole Proprietorship**

John and Mary, a married couple, apply for LIHC housing. John operates a sole proprietorship business; the net income from the business after expenses last year was -\$3,500. Mary earns \$27,000 each year as an employee, as shown on the W-2 from her employer. The household's income is \$27,000. The \$3,500 loss generated by John's business cannot be used to offset Mary's wages.

Income from a sole proprietorship can be estimated by reviewing the individual's prior year tax returns and Schedules C. If necessary, the owner can ask the potential tenant to

provide a signed Form 8821, which will allow the owner to verify the information with the IRS.

Example 2: Using the Prior Year Tax Return

A potential LIHC tenant is self-employed and expects the business to continue indefinitely. The potential tenant submitted the tax return for the last year. The net income from the sole proprietorship was \$13,000. The \$13,000 figure can be used as income anticipated for the next 12 months.

Alternatively, the potential tenant can annualize income from self-employment for the current year business activity based on the number of full months in business. The formula is:

$$\frac{(\text{Net Income Year to Date}) \times 12 \text{ months}}{\text{Number of Months in Business during the Current Year}}$$

Example 3: Annualized Current Year Self-Employment Income

In September, a potential tenant prepared a Schedule C showing the income and expenses for the current year, from January 1 through August 31, using the tax form from the prior year. To date, the potential tenant has net income of \$24,000. The anticipated income is determined by multiplying \$24,000 by 12/8, which equals \$36,000. This is an acceptable estimate of future earnings.

**Income from Rental Property, Partnerships, S-Corporations, and Royalties**

Rental property may be real estate or personal property such as equipment or vehicles. The tenant may have income from enterprises doing business as partnerships or s-corporations, or receive royalties for copyrights or patents.

**Assets**

There is no limit on the amount of assets a household may hold and a household is not required to convert an asset to cash.

Assets include bank accounts, trusts, stocks and bonds, the surrender value of life insurance policies, and cash kept in safety deposit boxes or at home. One time, lump sum distributions are considered assets; e.g., inheritances, capital gains, victim's restitution and settlements on insurance claims. Lottery winnings paid in one lump payment are treated as assets. Lottery winnings paid in periodic payments must be counted as income. Lump sum payments of deferred periodic payments of supplemental security income and social security benefits are also considered assets.

For non-cash assets held for investment, the cash value is the net amount the household would receive if the assets were converted to cash. The cash value is the market value, or the amount another person would pay to acquire the asset, less the cost to turn the asset into cash.

Assets do not include necessary personal items such as clothes, furniture, cars, wedding rings, or vehicles specially equipped for persons with disabilities. Assets used in a business are not assets included in the computation of the tenant's income. If an asset is

held in the tenant's name, but the income generated by the asset accrues to someone who is not a member of the household and the other person is responsible for income taxes on the accrued income, then the asset is not included in the tenant's income.

Lump-sum additions to the household's assets, such as inheritances, insurance proceeds (including payments under health and accident insurance and worker's compensation), capital gains, and settlements for personal or property losses are excluded from income.

#### Example 1: Exhausting an Asset

A tenant receives a lump sum inheritance of \$12,000 and deposits the money in a savings account. The asset is disclosed and the income from the asset correctly accounted for at the time of the initial income certification. The tenant subsequently withdraws \$1,000 each month to pay personal living expenses. A year later, when the annual income recertification is completed, the bank account balance is zero.

The monthly withdraws retain their character of an asset; i.e., they are not considered income. There is no need to include the bank account as an asset in subsequent annual income recertifications since the balance is zero.

Assets disposed of for less than fair market value within two years of the effective date of a tenant's initial certification or recertification, including assets placed in irrevocable trusts, are included in the tenant's income. Assets are considered to be disposed of for less than fair market value if the cash value of the assets disposed of exceeds the gross amount the tenant received by more than \$1,000. Do not include assets disposed of for less than fair market value as the result of a foreclosure, bankruptcy, or divorce or separation agreement if the applicant or tenant receives valuable consideration not measurable in dollars.

Assets must be verified, the income generated from assets must be determined, and the income included in the computation of the household's income.

1. If the total cash value of a household's assets is more than \$5,000, imputed income must be calculated using the current HUD passbook rate<sup>17</sup> and the greater of the actual income or imputed income must be included in the household's income. Refer to the HUD Handbook 4350.3, paragraph 5-7F, for the current passbook rate.
2. If the total cash value of the household's assets is \$5,000 or less, the actual income the tenant receives from assets is the amount included in annual income as income from assets. An owner may satisfy asset verification requirements by *annually* obtaining a signed, sworn statement from the tenant certifying that the tenant's net family assets are \$5,000 or less and disclosing the tenant's annual income from net assets. Owners, however, may not rely on a low-income tenant's signed, sworn statement of income from assets if a reasonable person<sup>18</sup> in the owner's position would conclude that the

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<sup>17</sup> Projects receiving a tax credit allocation for rehabilitation of USDA Rural Development properties typically use the USDA Rural Development passbook rate if imputed interest must be included in the income computation.

<sup>18</sup> The "reasonable person" concept is part of the definition of due diligence. Due diligence is defined (*Black's Law Dictionary [6<sup>th</sup> ed. 1990]*) as: "Such measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstances; not measured by any absolute standard, but

tenant's income is higher than the amount presented by the tenant. In such cases, the owner must obtain other documentation of the low-income tenant's annual income from assets to satisfy documentation requirements.<sup>19</sup>

**Contract Sales  
of Real Estate  
Assets**

A tenant may sell real estate using an installment contract (or similar agreement) that provides a stream of payments over a period of time. A portion of the payment will be applied to the principal and a portion will be interest income. The interest should be included in income; the outstanding principal is considered an asset.

**Pensions and  
Trusts**

No Return of Capital

The full amount of periodic payments from Social Security, pensions and annuities, Supplemental Security Income (SSI), insurance policies, death benefits, long-term care insurance (in excess of \$180 a day) and disability payments should be included in income, including lump sum amounts or prospective monthly amounts for the delayed start of a periodic amount.

Periodic amounts from *supplemental* security income and social security benefits that are received in a lump sum amount or in prospective monthly amounts are excluded; e.g., Black Lung Sick benefits, Veterans Disability, Dependent Indemnity Compensation, and payments to the widow of a serviceman killed in actions.

Return of Capital

Individual Retirement Accounts (IRAs), 401K's and Keogh plans are considered assets. The amount that the tenant can withdraw from a pension plan without retiring or terminating employment, less any penalties but not after tax, is considered an asset. Note: Distributions from an IRA, 401k, or Keogh are *not* periodic payments and are not counted as income as long as the individual can provide documentation that the distribution(s) are a return of capital; i.e., a return of funds the tenant paid into the retirement account.

Trust Amount

The tenant may be the recipient of earning from a trust amount, in which case the gross amount of the trust should be considered an asset. Actual income distributed from the earnings of the trust (that are not revocable by, or under the control of, any member of the tenant household) is included in income. Include only the actual income distributed.

Documentation

Benefit letters or annual statements prepared by third parties are sufficient documentation. Verification may also include bank statements noting the transfers of funds.

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depending upon the relative facts of the special case." In short, the due diligence standard is a judicially created test to determine the adequacy of the efforts exerted throughout all phases of any activity.

<sup>19</sup> See Rev. Proc. 94-65, 1994-2 C.B. 798.

**Public Assistance**

Amounts specified for shelter and utilities should be separately stated. They may be excluded from income. Special computations are needed; consult the HUD Handbook 4350.3 for details. Payments, rebates or credits received under the Federal Low-Income Home Energy Assistance Programs are excluded from income. Also exclude any winter differentials given to the elderly.

Special calculations of public assistance income are required for as-paid state, county or local public assistance programs. Consult the HUD Handbook for detailed instructions.

**Recurring Gifts, Grants, Scholarships and Contributions**

Regular, recurring monetary and nonmonetary gifts or contributions to residents from persons not living in the unit must be included in income. This can include the payments of bills on behalf of a resident. For example, if a parent or family member will be paying a resident's utility bill each month directly to the utility company, those payments are still counted as income for the tenant. However, the value of groceries provided by someone outside the household, and the food portion of public assistance, even if provided routinely, is *not* included.

**Example 1: Use of Vehicle**

A tenant uses her ex-husband's car to transport their son to medical examinations conducted on a regular basis. The title to the car is in the ex-husband's name, he makes the car payment, and he is responsible for maintenance.

The use of the car should not be considered a regular non-cash contribution to the household unless the tenant has exclusive use of the vehicle.

Grants received specifically for medical expenses, set aside for use under a Plan to Attain Self Sufficiency (PASS) and excluded for purposes of Supplemental Social Security (SSI) eligibility, or for out-of pocket expenses for participation in publicly assisted programs (expenses include the costs for special equipment, clothing, transportation, child care, etc.) are excluded.

For any student under the age of 24 who is seeking housing without his or her parent, financial assistance in excess of amounts received for tuition under the Higher Education Act of 1965<sup>20</sup>, from private sources, or from an institution of higher education<sup>21</sup> shall be considered income to that individual, except for persons over the age of 23 with dependent children. Financial assistance does not include loan proceeds for the purpose of determining income.<sup>22</sup>

For any student residing with his or her parents, scholarships, grants, fellowships, educational entitlement, or any other student financial assistance paid directly to a full-time student or directly to an institution, no matter how the assistance is used, is excluded from income. Amounts of scholarships funded under title IC of the Higher Education Act of 1965, including awards under federal work-study programs or under the Bureau of Indian Affairs student assistance programs are also excluded.

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<sup>20</sup> See 20 U.S.C. 10001 *et seq.*

<sup>21</sup> See 20 U.S.C. 1002.

<sup>22</sup> Page 18146, Federal Register Vol. 71.

Generally, contributions that are paid directly to a childcare provider by persons not living in the unit are not included in income. This exclusion is based on a handbook interpretation of reimbursed childcare expenses under the definition of Adjusted Income and its bearing on Annual Income. See 24 CFR Parts 813.1, 215.1, and 236.1. In relevant part, the regulations define childcare expenses to include “amounts to be paid by the family for [child care]...to the extent [they are] not reimbursed.” Handbook 4350.3 indicates that childcare expenses that are not reimbursed are not included as annual income. However, if such childcare is paid by a *non-custodial* parent in lieu of all, or part, of child support payments, then it should be included in income.

**Temporary,  
Nonrecurring, or  
Sporadic  
Income**

Irregular, nonrecurring monetary gifts or contribution to resident are not included in income.

**Alimony or Child  
Support**

Alimony or child support that is court ordered or supported by a written agreement should be included in income unless the recipient certifies that the funds were not received and reasonable efforts have been made to collect the amount due, including filing with courts or agencies responsible for enforcing payments. When no documentation of child support, or alimony stipulated in a divorce decree or separation is available, the owner may require the family to sign a certification stating the amount received. The certification must be notarized. Documentation of the collection efforts made may be requested.

A signed, sworn self-certification by a tenant is sufficient documentation under Treas. Reg. 1.42-5(b)(1)(vii) to show that a tenant is not receiving child support payments and is consistent with the documentation requirements in Rev. Proc. 94-65.<sup>23</sup> 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; i.e., a divorce decree or court documents. Also, the self-certification should indicate that the tenant will notify the owner of any changes in the status of child support.<sup>24</sup>

A state agency 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 Treas. Reg. 1.42-5(b)(1)(viii).

A state agency’s monitoring procedure may 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.

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<sup>23</sup> The signed, sworn self certification under Rev. Proc. 94-65 is equivalent to the notarized certification under HUD Handbook 4350.3, Chapter 5, paragraph 5-6E. See also paragraph 5-13D.

<sup>24</sup> See Rev. Rul. 2004-82, Q&A #12, 2004-2 C.B. 350.

**Unearned  
Income of Minor  
Children**

Any unearned income of children under the age of 18 is included in income. This is any income other than employment income; e.g., interest income from bank accounts or dividends from mutual funds held in their name. Unearned income of minor children should be included even if the child is temporarily absent.

**Items Excluded  
from Income  
(Miscellaneous)**

This section includes a description of miscellaneous sources of funds and how they should be treated for purposes of determining the household's income. Refer to HUD Handbook 4350.3, Chapter 5, and Exhibit 5-1 for additional information.

1. Lunches and food received through food programs such as Women, Infants and Children (WIC), amounts received under the School Lunch Act, Meals on Wheels, or food stamps are not included in income.
2. Amounts paid to a family to offset the costs of services or equipment needed to keep a developmentally disabled family member at home are excluded. By Federal statute, the value of food stamps is not included in income.
3. Amounts received by the household that are specifically for, or in reimbursement of, the cost of medical expenses for any member of the household are not included in income.
4. Earnings in excess of \$480 for each dependent, full-time student 18 years or older living with his or her parents is excluded from income.
5. Adoption assistance payments in excess of \$480 per adopted child are not included in income.
6. Payments received for the care of foster children or foster adults are not included in income.
7. Personal loans, since they must be repaid, are not included in income.
8. Amounts received by the household in the form of refunds or rebates under state or local law for property taxes paid on the dwelling unit are not included in income.
9. Resident service stipends are not included in income. A resident service stipend is a modest amount (not to exceed \$200 per month) received by a resident for performing a service for the owner, on a part-time basis, that enhances the quality of life in the LIHC housing. Such services include, but are not limited to, fire patrol, hall monitoring, lawn maintenance, and resident initiatives coordination. No resident may receive more than one such stipend during the same period of time.
10. Reparation payments paid by a foreign government pursuant to claims filed under the laws of that government by persons who were persecuted during the Nazi era are not included in income. Examples include payments by the German or Japanese governments for atrocities committed during the Nazi era.
11. Any amount of crime victim compensation (under the Victims of Crime Act) received through crime victim assistance (or payment or reimbursement of the cost of such assistance) as determined under the Victims of Crime Act because of the commission of crime against the applicant under the Victims of Crime Act (42 U.S.C. 10602) is

not included in income.

12. Income from assets, and amounts received on behalf of, someone who does not reside in the household are not included in income, as long as (1) the amounts are not intermingled with the household's funds and (2) the amounts are used solely to benefit the person who does not reside within the household. For such amounts to be excluded from income, the individual must provide the owner with an affidavit stating that the amounts are received on behalf of someone who does not reside with the family and that the amounts meet the conditions stated above.
13. Interests of individual Native Americans in trust or restricted lands, and the first \$2,000 per year of income received by individual Native American that is derived from a trust or restricted lands are not included in income. Amounts received under the Maine Indian Claims Settlement Act of 1980 are also excluded. In addition, all or a portion of the payments under the Alaska Native Claims Settlement Act, judgments of the Indian Claims Commission or U.S Court of Claims may be excluded from income. See HUD Handbook 4350.3 for details.
14. Payments received after January 1, 1989 from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in the Agent Orange product liability litigation are not included in income. M.D.L. No 236 (E.D.N.Y)
15. Any Earned Income Tax Credit to the extent it exceeds the tenant's income tax liability is not included in income. See IRC §32(j). For example, a tenant may have a tax liability of \$400, and an Earned Income Credit of \$700. The credit will not only eliminate that \$400 tax liability, but the tenant will receive a \$300 refund. The \$300 is not included in income. Alternatively, the tenant may receive payments directly from his/her employer during the year. These periodic payments are not included in income.
16. The value of any childcare provided or arranged for under the Child Care and Development Block Grant Act of 1990 (CCDBG) (42 U.S.C. 9858q) is not included in income. Participating families may either pay a reduced amount based on a sliding fee scale or they may receive a certificate for child care services. Note that funds received through CCDBG for providing childcare services are included in income.

## **Tenant Income Certification Effective Date**

Once all sources of income and assets have been properly verified, owners or managers perform an income calculation using the applicant's tenant income certification to determine whether the applicant qualifies for IRC §42 housing.

The effective date of the tenant's income certification is the date the tenant actually moves into the unit. All adult members of the household should sign the certification. HUD Handbook 4350.3, 5-17B. If the certification is more than 120 days old, the tenant must provide a new certification.. The income recertifications must be completed annually based on the anniversary of the effective date.

#### Example 1: Determining the Tenant Income Certification Effective Date

A potential household consisting of John and Jane Doe and their two children completed a rental application and income certification on April 12, 2004. The property manager completed the third party verifications and determined that the household was income eligible on April 21, 2004. John and Jane signed the rental lease on April 25<sup>th</sup>, and took possession of the unit on May 1, 2004.

The effective date of the tenant income certification is May 1, 2004. All subsequent tenant income recertifications must be performed within 120 days before May 1<sup>st</sup> of each subsequent year of the 15-year compliance period.

When additional adult individuals join the household, the effective day will remain the same until the unit is completely vacated.

#### Example 2: Effective Date After Move In of Additional Adult Member

Jane and her daughter were income qualified and moved into an LIHC unit on September 5, 2003. On March 15, 2004, Jane's widowed mother joined the household.

The tenant income certification continues to be based on the original certification date. All subsequent annual income recertifications will be completed within 120 days before September 5<sup>th</sup> each year until the household vacates the unit.

### **Signatures**

Generally, all adult members of the household should sign the income certification before, or when, the household moves into the rental unit. However, there will be circumstances where obtaining the signatures is impractical. In these situations, the owner should document the reason for the delay in the tenant's file and secure the signature as soon as possible.

#### Example 1: Household Member is Serving in the Military

Mary, with her two children, applies for an LIHC unit and completes a tenant income certification. She discloses and includes the income her husband earns for military service in the Marines. He is currently on active duty and stationed overseas. The owner determines that Mary's household is income qualified for low-income housing

Mary signs the income certification two days before moving in. Because her husband is not available to sign the certification, the owner included documentation in the tenant file that he is in the military and stationed overseas. Mary's husband returns stateside five months later and signs the income certification as soon as he joins his family.

The owner is in compliance. The household's income is properly accounted for and the file sufficiently documents the reason why the husband could not timely sign the income certification. In this case, the file will also indicate that the signature was obtained within a reasonable time after his return.

## Tenant Moves to Another Low-Income Unit

A household may move to another unit within a low-income project.

### **In the Same Building**

When a household moves to a different unit within the building, the newly occupied unit adopts the status of the vacated unit.<sup>25</sup> Thus, if a current household, 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.

### **In a Different Building**

As noted in Rev. Rul. 2004-82, Q&A #8, a similar rule applies when a household whose income is no greater than 140% of the income limit (or 170% for deep rent skewed projects) moves to a low-income unit in a different building within the project during any year of the 15-year credit period.<sup>26</sup> The vacated unit assumes the status the newly occupied unit had immediately before it was occupied by the current resident.

#### Example 1: Household is First Occupant of Low-Income Unit

On May 31, 2004, of the first year of the credit period, an income qualified household moved into a new, never-occupied, low-income unit in Building A. On October 19, 2004, the household moved to a similar rent-restricted unit in Building B, which had never been occupied, and continued to occupy the unit until the end of the first credit year. The unit in Building A was not rented again until February 2005.

Only the unit the household actually occupies qualifies as a low-income unit.

- The unit in Building A would qualify for May, June, July, August and September. The unit would not qualify as a low-income unit in October, November, or December for purposes of computing the Applicable Fraction for the first year under IRC §42(f)(2). The unit will continue to be treated as a never occupied unit until a qualified household moves in.
- The unit in Building B is a qualified low-income unit for October, November, and December.

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<sup>25</sup> See Treas. Reg. 1.42-15(d).

<sup>26</sup> See IRC §42(g)(1) and IRC §142(d)(4)(B).

## Income Certifications Where Owner Acquires or Rehabilitates Existing Building

### Income Qualifying Households Before the Beginning of the 10-Year Credit Period

Under Rev. Proc. 2003-82, a unit occupied before the beginning of the credit period will be considered a low-income unit at the beginning of the credit period, even if the household's income exceeds the income limit at the beginning of the first year of the credit period, if two conditions related to income qualifications are met, and the unit must be rent restricted.<sup>27</sup>

For households occupying a unit at the time of acquisition<sup>28</sup> by the owner, the initial tenant income certification is completed within 120 days after the date of acquisition using the income limits in effect on the day of acquisition. The effective date of the tenant income certification is the date of acquisition since there is no move-in date.

In the event that the household occupies a unit at the time of acquisition, but the tenant income certification is completed more than 120 after the date of acquisition, the household is treated as a new move-in. Owners use the income limits in effect at the time of the tenant income certification and the effective date is the date the last adult member of the household signed the certification (this is an exception to the general rule for effective dates because there is no move-in date).

When the household moves into a unit after the building is acquired but before the beginning of the first year of the compliance period, the tenant income certification is completed using the income limits in effect at the time of the certification and the effective date is the date the household moves into the unit.

### Testing for Purposes of the Next Available Unit Rule

For purposes of Rev. Proc. 2003-82, the incomes of the individuals occupying a unit occupied before the beginning to the first credit year are first tested for purposes of the Next Available Unit Rule under IRC §42(g)(2)(D)(ii) and Treas. Reg. 1.42-15 at the beginning of the first year of the building's credit period.<sup>29</sup>

1. The test must be completed within 120 days before the beginning of the first year of the credit period.
2. The "test" consists of confirming with the household that sources and amounts of anticipated income included on the tenant income certification are still current. If additional sources or amounts of income are identified, the tenant income certification will be updated based on the household's documentation. It is not necessary to complete third party verifications.
3. If the household is over-income based on current income limits, the Next Available Unit Rule is applied.

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<sup>27</sup> Rev. Proc. 2003-82, 2003-2 C.B. 1097, provides a safe harbor under which, if certain conditions are met, a residential rental unit in an existing building acquired by a new owner or in rehabilitated building will be treated as a low-income unit even though the occupants' incomes exceed the income limit at the beginning of the building's 10-year credit period. In order to qualify, the household must have been income-qualified at the time the owner acquired the building or the date the household started occupying the unit, whichever is later. The owner must maintain documentation of the income qualification and the unit must be rent restricted. See chapter 10 for further discussion of the requirement for units to be rent-restricted.

<sup>28</sup> The date of acquisition is the date the building is acquired by purchase under IRC §179(d)(2).

<sup>29</sup> See chapter 14 for detailed discussion of the Next Available Unit Rule.

If the effective date of the initial tenant income certification is 120 days or less before the required “test”, it is not necessary to “test” for purposes of the Next Available Unit Rule because the time period for completing the initial tenant income certification and the time period for completing the “test” is the same. The annual tenant income recertification will be completed each year on the anniversary of the original tenant income certification’s effective date.

**Example 1: The Effective Date of Initial Tenant Income Certification is 120 Days or Less Before the Test Date**

An owner purchased an existing building on September 1, 2004 and anticipated beginning the credit period on January 1, 2005. Household A occupied a unit at the time of the purchase and was determined to be income qualified on September 22, 2004. Because the household was determined to be income-qualified within 120 days of January 1, 2005, it is not necessary to “test” for purposes of the Next Available Unit Rule.

If the effective date of the original tenant income certification is more than 120 days before the required “test,” the household’s income must be tested within 120 days before the beginning of the first year of the credit period.

**Example 2: The Effective Date of Original Tenant Income Certification is More Than 120 Days Before the Beginning of the First Year of the Credit Period**

An owner purchased an existing building on March 1, 2004 and anticipated beginning the credit period on January 1, 2005. Household A, an income qualified household, moved into a rent-restricted unit on April 1, 2004. Because the household was determined to be income-qualified more than 120 days before the beginning of the credit period on January 1, 2005, the household’s income must be tested no earlier than 120 days before January 1, 2005 to determine whether the Next Applicable Unit Rule should be applied.

**Income Qualifying Households During the First Year of the 10-Year Credit Period**

Under IRC §42(f)(2), the applicable fraction for the first year of the credit period is computed based on a month-by-month accounting of units or floor space occupied by income-qualified households. In the case of buildings that were acquired and then rehabilitated, there are two separate allocations of credit documented on two Forms 8609; one for the acquisition credit and a separate allocation for the rehabilitation credit. However, the owner is not required to determine two applicable fractions. Under IRC §42(e)(4)(B), the applicable fraction for the substantial rehabilitation credit will be the same as the applicable fraction for the acquisition credit. Therefore, for purposes of computing the applicable fraction under IRC §42(f)(2), the following units are considered low-income units;

1. Units occupied before the beginning of the credit period, which are determined to be low-income unit at the beginning of the credit period under Rev. Proc. 2003-82.
2. Units initially occupied after the beginning of the credit period by newly certified income-qualified households (regardless of whether rehabilitation costs have been incurred for the unit).

3. Units occupied by income-qualified households that moved from other units within the project. The household's lease and tenant income certification (with effective date) move with the household. See the section above titled "Tenant Moves to Another Low-Income Unit" for complete discussion.
4. Vacant units that are suitable for occupancy under IRC §42(i)(3)(B)(ii) and were previously occupied by an income-qualified household, regardless of whether rehabilitation costs have been incurred for the unit during the first year of the credit period.

Units are *not* included in the numerator of computation of the applicable fraction if:

1. The unit is occupied by a nonqualified household;
2. The unit is vacant and was last occupied by a nonqualified household;
3. The unit is not suitable for occupancy under IRC §42(i)(3)(B)(ii). These units, including units being rehabilitated, are considered "out of compliance." The noncompliance is corrected when the unit is again suitable for occupancy. The unit's character will be determined based on the household that occupied the unit immediately preceding the rehabilitation during the first year of the credit period. See #4 on the list above.

#### Example 1: Units Rehabilitated During the First Year of the Credit Period

An owner acquired a building with 10 units and determined that 6 of the units (1-6) were occupied by nonqualifying households at the beginning of the first year of the credit period, on January 1, 2005. Four units (7-10) were occupied by income-qualified households. The nonqualifying households moved out and the owner rehabilitated the six vacant units. Five of the rehabilitated units (1-5) were rented to new households that moved into the units in August of 2005. The sixth rehabilitated unit (6) was rented in August to an existing tenant who transferred from unit 7, one of the four units qualifying on January 1, 2005

1. The owner may include units 1-5, the rehabilitated units occupied by new low-income tenants in the applicable fraction computation under IRC 42(f)(2) for August, September, October, November, and December of 2005
2. For the tenant who transferred between units within the building, the owner may include the unrehabilitated unit 7 that the tenant occupied from January through July in the computation of the applicable fractions for those months, but the unit is no longer a low-income unit when the household moves to the rehabilitated unit 6 in August; Unit 6 is a low-income unit for August through December.

Therefore, for purposes of computing the applicable fraction for August, 2005, there are three low-income units that have not been rehabilitated (units 8, 9, and 10) and six low-income units that have been rehabilitated (units 1-6). Unit 7 is not a low-income unit.

During September, unit 7 was rehabilitated and the tenant from unit 8 moved in; therefore, unit 8 is no longer a low-income unit. To expedite completion of the rehabilitation of the remaining units, the owner also temporarily located the households in 9 and 10 in off-site quarters (and paid all expenses) and started rehabilitation of units 8, 9, and 10. For purposes of determining the applicable fraction for September, units 1-7 are low-income units and units 8, 9, and 10 are out of compliance.

The owner completed the rehabilitation of the final three units (8, 9, and 10) in October and moved the two temporarily displaced households back into units 9 and 10 during October 2005. Unit 8 is a low-income unit because it was previously occupied by an income-qualified household. For purposes of computing the applicable fraction for October, units 1-10 are all low-income units.

The following chart summarized the status of each unit for each month during 2005.

Unit	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
1								LIHC	LIHC	LIHC	LIHC	LIHC
2								LIHC	LIHC	LIHC	LIHC	LIHC
3								LIHC	LIHC	LIHC	LIHC	LIHC
4								LIHC	LIHC	LIHC	LIHC	LIHC
5								LIHC	LIHC	LIHC	LIHC	LIHC
6								LIHC	LIHC	LIHC	LIHC	LIHC
7	LIHC		LIHC	LIHC	LIHC	LIHC						
8	LIHC		LIHC	LIHC	LIHC							
9	LIHC		LIHC	LIHC	LIHC							
10	LIHC		LIHC	LIHC	LIHC							

## Documentation Requirements

For a unit to be included as a low-income unit, documentation of the household's initial eligibility must be on file with the owner. Under IRC §6001, every taxpayer is required to maintain records sufficiently detailed to prepare a proper tax return. This requires the maintenance of such permanent books and records sufficient to establish the amounts of gross income, deductions, *credits*, or other matters to be shown on the taxpayer's return. This requirement extends to the preparation and maintenance of tenant files sufficiently documented to support household eligibility for purposes of claiming the low-income housing credit under IRC §42.

A tenant income certification and supporting documentation are not sufficient unless, at a minimum, the following documents are included:

1. Application/Income and Asset Questionnaire - A document completed by the household that the owner uses to gather information relevant to establishing all aspects of eligibility including, but not limited to, household composition, income, income from assets, and student status.
2. Verification of Income and Assets - All sources of income and assets must be verified to establish move-in eligibility.<sup>30</sup> Each tenant file must contain an annual statement of income, household composition, and student status.

The preferred verification method is through third parties, and such verifications must be no older than 120 days before the effective date of the Tenant Income Certification. Where applicable, there should be further evidence to support the third party verifications; e.g., a copy of a divorce decree showing award of maintenance or child support, a realtor's statement of market value for a home, a self-employed tenant's tax return, etc. When third party verification has been attempted, but is not possible, documentation may be by check stubs, W-2's, bank statements, etc. Self-certification may be accepted if third party verification or other documentation cannot be obtained. Documentation of attempts to obtain verification, however, must be kept on file.

3. Student Status - Depending upon the student status of each household member, student verification may be required. (See chapter 17 for more information.)
4. Tenant Income Certification – Documents must be signed by all the adult members of a household prior to move-in and at the time of the annual recertification, and must state the anticipated annual gross income of the household.

**Sufficient But Imperfect Documentation**

If eligibility documentation is imperfect, yet sufficient for the monitoring agency to make a reasonable determination that a household is eligible, the owner should be advised of the imperfections and the need to implement procedures ensuring that similar imperfections do not occur in the future. Imperfections are not of a nature that would cause the unit to be considered out of compliance and will not result in reportable noncompliance.

**Use of Standardized Forms**

The compliance monitoring regulations under Treas. Reg. §1.42-5 establish the minimum monitoring requirements. State agencies can determine how documents are maintained and may mandate the use of standardized forms to document an owner's compliance with the requirements under Treas. Reg. §1.42-5.

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<sup>30</sup> Rev. Proc. 94-65, 1994-2 C.B. 798, allows building managers to obtain a tenant's signed, sworn statement if the total combined cash value of household assets is less than \$5,000. Some states have not implemented this procedure and will require third party verification. The states that allow this have an appropriate form.

## In Compliance

In order to establish a unit as a qualified housing tax credit unit, the household's Gross Annual Household Income must be at or below the elected area median income (AMGI) limit or national nonmetropolitan median gross income (NNMGI) limit when applicable, adjusted for family size. Household income is calculated in a manner consistent with the determination of annual income under section 8 of the United States Housing Act of 1937. Therefore, the definitions of income of individuals and AMGI for purposes of IRC §42(g)(1) include items of income that are not included in a taxpayer's gross income for purposes of computing a federal tax liability.

Documentation of the household's initial eligibility must be on file with the owner. The initial tenant income certification must be completed and signed by all the tenants on or before the move-in date.

### Example 1: Unrelated Parties Sharing an Apartment

Sally and Jane are unrelated individuals who want to rent a two-bedroom apartment in an LIHC building. Sally and Jane's combined income does not exceed 60% of the AMGI for a two-individual family.

In this case, Sally and Jane are qualified tenants for low-income credit housing. For purposes of computing the Gross Annual Household Income, the combined income of all the occupants of an apartment, whether or not legally related, is compared to the median family income for a household with the same number of members.

State agencies may determine that, even though the documentation at the time a certification was performed was insufficient, sufficient documentation was subsequently obtained by the owner *before* the state agency's notification of a compliance review, which allowed the monitoring agency to make a reasonable determination that the unit was in compliance. Such self-corrected documentation should not be reported to the IRS as noncompliance. The owner has demonstrated due diligence and reasonable attempts to maintain sufficient documentation of tenant eligibility.

### Example 2: Failure to Obtain Third Party Verification

An owner initially failed to verify or include documentation of court-ordered child support when the household moved in. The oversight was identified nine months later when the owner's management company conducted a quality review of the file. The management company immediately corrected the deficiency by obtaining a copy of the court order for the child support. When the amount of child support was added to the move-in income, the annual income did not exceed move-in eligibility. The unit is in compliance with IRC §42 requirements.

### Example 3: Correction After Notification of Upcoming Compliance Review

Unit A in an LIHC building went out of compliance on January 15, 2004, when a household with income exceeding the limit moved in. The owner was notified on March 15, 2004, that the state agency would be conducting a

tenant file review on May 1, 2004. The owner realized the problem while preparing for the review and paid the moving costs for the over-income household to move out immediately. A new income-qualified household moved into Unit A on April 13, 2004.

The state agency selected Unit A as part of the 20% sample and reviewed the new tenant's income certification. Because the effective date of this certification was after the date of the notification of the upcoming review, the state agency requested the file for the previous tenant and determined that Unit A was out of compliance from January 15 to April 13, 2004.

#### Example 4: Tenant Income Increases After Move In

John and Mary are newly married, in their early 20's, and have moved to a new city where John has accepted a job. The couple is income-qualified based on John's anticipated salary for the next 12 months. Three weeks after they move in, Mary starts working. If her wages are added to the tenant income certification, the couple's income exceeds the limit.

There is no noncompliance if the state agency determines that the owner used due diligence in accepting John and Mary as a qualified low-income household based on their initial tenant income certification. For example, the owner can demonstrate that due diligence was exercised by asking whether Mary intended to seek employment. However, the next available unit rule may apply. See chapter 14.

By itself, the fact that a tenant's actual income exceeds the anticipated income identified during the income certification is not a reportable noncompliance event (hindsight is always perfect). However, the state agency should consider expanding the sample size if multiple instances are identified. Collectively, multiple errors are indicative of poor internal control and increased risk of noncompliance.

The tenant income certification should be based on the best information available at the time of the certification. It represents the income the household anticipates it will receive in the 12-month period *following* the effective date of certification of income. If information is available on changes expected to occur during the year, that information should be used to most accurately determine the anticipated income from all known sources during the year. Owners should use due diligence by asking follow-up questions when the income certification process reveals unusual circumstances suggesting additional sources of income.

## Out of Compliance

Units are considered out of compliance as of the date an ineligible household moves into a unit. A unit will also be considered out of compliance if the initial tenant income certification is inaccurate, documentation of initial eligibility is insufficient, or no initial tenant file is on record.<sup>31</sup>

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<sup>31</sup> A determination by the IRS (during an examination) that the taxpayer has not maintained adequate books and records may result in the issuance of an Inadequate Records Notice. The notice informs taxpayers that their recordkeeping practices are insufficient and must be improved to meet the requirements of the law. The issuance of an Inadequate Records Notice may result in a follow-up examination.

#### Example 1: Specific Source of Income Omitted

Annual Income was not properly calculated. The manager/owner did not include a source of income, such as a raise, overtime, or bonus. When reviewed, a correct calculation indicates that the household was not income eligible at move-in.

#### Example 2: Household Incorrectly Determined to be Eligible

The owner calculated annual household income correctly, but the household is over the appropriate income limit at move-in. For example, the owner may have used the income limit for the 40/60 minimum set-aside when the income limit for the 20/50 minimum set-aside income limit was required, or the wrong county AMGI, or the income limits used were not in effect as of the date of the tenant income certification.

#### Example 3: Unrelated Parties Sharing an Apartment

Tom and Jack are unrelated individuals who want to rent a two-bedroom apartment in an LIHC building. Tom and Jack individually have incomes that do not exceed 60% of AMGI for one individual. However, Tom's and Jack's combined income exceeds 60% of the AMGI for a two-individual family.

In this case, Tom and Jack do not qualify for LIHC housing. For purposes of computing the Gross Annual Household Income, the combined income of all the occupants of an apartment, whether or not legally related, is compared to the median family income for a household with the same number of members.

#### Example 4: No Initial Tenant Income Certification on File

A household moves into a unit that the owner wishes to include as an LIHC unit. However, the owner does not provide documentation of initial eligibility at the time the state agency reviews the tenant's file. The owner cannot substantiate that the unit qualifies for the LIHC.

#### Example 5: No Initial Tenant Income Certification on File for New Member of Household

An income qualified household moved into an LIHC unit. Six month later, an adult friend moved into the unit with the household, but no initial tenant income certification was completed for the additional member of the household.

Example 6: Initial Tenant Income Certification Performed After Move-In  
(Late Certification)

A household moved into a unit that the owner wanted to include as a low-income unit. However, the certification of income eligibility, including the third party verification, was not performed until after the household moved in.

Example 7: Insufficient Documentation of Initial Eligibility

A household moves into a unit that the owner wishes to include as a low-income unit. Income eligibility was not properly documented. The state agency could not reasonably determine that the household was income qualified. The following are possible documentation noncompliance issues:

- a. Application/questionnaire is not sufficiently detailed to disclose all sources of income and/or assets,
- b. Not all sources of income are verified,
- c. Not all sources of assets are verified,
- d. Verifications are insufficient,
- e. Not all adult household members' income and/or assets are disclosed and included;
- f. Tenant income certification form is not prepared, signed and/or dated; and
- g. Other state-required forms designed to document compliance with IRC §42 are not in file.

## Back in Compliance

Units are back in compliance when it is determined that an income-qualified household occupies the unit. Evidence of corrected noncompliance includes copies of certification paperwork such as the tenant's application, income and asset questionnaire, third party verifications, and tenant income certification.

### Insufficient Documentation

In the event that income eligibility was not properly documented and the state agency cannot reasonably determine that the household is eligible, the noncompliance can be corrected in either of two ways:

1. A new certification can be performed using current income and asset sources and current income limits. Assuming the household is eligible, the unit would be out of compliance on the date of move in and back in compliance on the date the new certification signed (Form 8823 should be filed); or
2. A retroactive certification can be performed which completely and clearly documents the sources of income and assets that were in place at the time the *initial certification* should have been effective, and applies income limits that were in effect on that date. Assuming the owner can document that the household was income eligible at the time of move in, the unit should not be considered out of compliance. The owner has clarified the noncompliance; Form 8823 should not be filed.

Evidence of corrected noncompliance may include a copy of the full certification, including application, third party verifications, and/or the tenant income certification.

**Income Ineligible Households**

The household may be income certified as if it were a new move-in. If the household is eligible under the applicable move-in income limit in place on the date of the new certification, then the unit would be considered back in compliance.

**Example 1: Ineligible Household Occupies LIHC Unit**

The household was over the appropriate income limit at move-in on June 1, 2002. The error was discovered during the state agency's review on April 3, 2003.

The owner may treat the household as a new tenant and complete a new income certification using the income limits in effect on April 3, 2003. If the household is qualified, the noncompliance is corrected. The unit is out of compliance from June 1, 2002 until April 3, 2003. If, upon certification, the household is not income-eligible, the unit is considered back in compliance when a new income-qualified household moves into the unit. In either scenario, a Form 8823 noting the noncompliance must be filed.

**Initial Tenant Income Certification is Late**

If the initial certification is late, the unit is considered out of compliance as of the date the tenant moved into the LIHC unit and back in compliance on the date the completed income certification, indicating the household is income qualified, is signed by all the tenants.

**Example 1: Initial Tenant Income Certification Performed After Move-In (Late Certification)**

A household moved into an LIHC unit on August 4, 2003. However, certification of eligibility, including the third party verification, was not completed until September 15, 2004. If the tenant income certification meets all the requirements, the unit is considered in compliance beginning on September 15, 2004.

Note: Noncompliance with the initial income certification requirements that is identified and corrected by the owner retroactive to move-in and *prior to notification* of the compliance review by the state agency need not be reported; i.e., the owner has demonstrated due diligence by addressing noncompliance issues independently. See chapter 3.

**Revoking a Waiver of the Annual Income Recertification Requirement**

If noncompliance with the tenant income certification requirements is sufficiently serious for a building with a waiver of the annual income recertification requirements, consideration should be given to revoking the waiver.<sup>32</sup> Revocation is not required, but the Service will revoke the waiver at the state agency's request.

Instructions for requesting the revocation of a annual income recertification waiver are included with the instructions for completing Form 8877, Request for Waiver of Annual Income Recertification Requirement for the Low-Income Housing Credit.

<sup>32</sup> See Rev. Proc. 2004-38, which supersedes Rev. Proc. 94-64.

## References

1. IRC § 42(g)(1)
2. Treas. Reg. 1.42-5(b)(1)(vii) states that “[t]enant income is calculated in a manner consistent with the determination of annual income under Section 8 of the U.S. Housing Act of 1937.”
3. HUD Handbook 4350.3 is the authority for further information on calculation of annual income. HUD publishes updated 50% Median Family Income limits annually. Other income limit schedules such as the 60% limits are based on an extrapolation of the 50% limits. HUD’s Summary of Questions on Handbook 4350.3 Rev-1 was also used as a resource.
4. Rev. Rul. 89-24, 1989-1 C.B. 24
5. Rev. Rul. 90-89, 1990-2 C.B. 8
6. Rev. Rul. 91-38, 1991-2 C.B. 3
7. Rev. Rul. 2004-82, 2004-2 C.B. 350
8. Rev. Proc. 94-65, 1994-2 CB 798
9. Rev. Proc. 2004-38, 2004-2 C.B. 10, which supersedes Rev. Proc. 94-64, 1994-2 C.B. 797
10. Rev. Proc 2003-82, 2003-2 C.B. 1097
11. Notice 88-80, 1988-2 C.B. 396

**Chapter 5**  
**Category 11b**  
**Owner Failed to Correctly Complete or**  
**Document Tenant's Annual Income Recertification**

**Definition**

Owners are required to recertify each low-income household at least annually. The recertification process is identical to the initial certification in terms of documenting household composition, income, and income from assets. State agencies are required to review the tenant income recertifications and the supporting documentation for the tenants in the units.<sup>1</sup> Therefore, the state agency should be reviewing the most recent income recertification.

**Noncompliance Corrected by Owner Prior to Notification of State Agency's Compliance Review**

Noncompliance with the annual income recertification requirements that is identified and corrected by the owner *prior to notification* of the compliance review by the state agency need not be reported; i.e., the owner has demonstrated due diligence by addressing noncompliance issues independently. See chapter 3.

**Example 1: Noncompliance Corrected Before Notification of Compliance Review**

On January 15, 2004, the owner of a LIHC building incorrectly completed a household's income recertification. The owner identified the problem and corrected the documentation deficiency on March 30, 2004. The owner was notified on April 20, 2004, that the state agency would be conducting a tenant file review on May 1, 2004.

The state agency selected Unit A as part of the 20% sample and reviewed the household's income certification and noted the corrections. Because the owner corrected the noncompliance before the April 20, 2004 notification date, the owner is in compliance.

**100% LIHC Building**

If the building is 100 percent LIHC housing and the owner has received a waiver of the annual income recertification requirement under either Rev. Proc. 94-64 or 2004-38, this chapter is not applicable; i.e., the owner is no longer required to complete annual tenant recertifications. State agencies must, however, review the initial tenant income certifications and report any noncompliance under the appropriate category on Form 8823.

**Mixed-Use Buildings**

*Note:* For buildings with both LIHC units and market rate units, the state agencies must also determine whether the owner appropriately applied the Available Unit Rule when a household's income exceeds 140 percent of the income limit at the time of recertification. See chapter 14.

**In Compliance**

Owners are in compliance if the recertification is completed within 120 days before the anniversary of the effective date of the original tenant income certification.

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<sup>1</sup> See Treas. Reg. 1.42-5(c)(2)(ii)(B).

**Household  
Vacates Unit**

If an owner has sent a timely notice informing the household that the annual recertification is due, but the household does not provide the certification and supporting documentation prior to vacating the unit, the vacated unit will not be considered out of compliance with the recertification requirements. Owners should document attempts to obtain the recertification and the date the tenant actually moved out.

**Example 1: Household Gives Notice of Departure Before Recertification is Due**

The owner provided timely notice to a household (on July 15<sup>th</sup>, 2004) that the annual income recertification was due on October 1, 2004. The household informed the owner on September 13, 2004 that they would be vacating the unit on October 15, 2004.

Since the household gave notice in advance and will not occupy the unit in the coming year, there is no reason to complete the income recertification and the unit remains in compliance. Should the household later decide to stay in the unit, a late recertification must be completed.

**Owner Takes  
Action to  
Remove  
Noncompliant  
Household**

If the owner initiates an eviction proceeding and the household vacates the unit, no recertification is necessary. If, for any reason, it is determined that the household will not vacate the unit as anticipated, a recertification will be necessary within 120 days of the determination.

**Example 1: Court Failed to Sustain Request for Eviction**

Income recertification was due on July 1, 2004. The owner initiated the recertification process on April 15, 2004, and documented attempts to obtain recertification information. The household did not complete the recertification and the owner initiated eviction proceedings on July 29, 2004. The court did not sustain the owner's filing for eviction on September 15, 2004. The owner must secure the tenant income recertification.

**Households  
Determined to  
be Over the  
Income Limit at  
Recertification**

In the event that a household's income exceeds the income limit at the time of recertification, state agencies must determine whether the household was income qualified at the time of move in. The initial tenant income certification should be reviewed.

**Example 1: Household Qualified at Move In**

An income qualified household moved into a rent restricted unit on June 23, 1997 and timely completed their tenant income recertifications each year. In 2005, for the first time, the recertification indicates that that same household's income exceeds the income limit.

The state agency must review the initial tenant income certification. If the household qualified at move in, no further action is necessary and the unit is in compliance with the annual income recertification requirements. If the household's income is 140% or more of the income limit, compliance with the Available Unit Rule must also be evaluated. See chapter 14.

If the state agency identifies an issue of noncompliance on the initial tenant income certification, the state agency must review the intervening tenant income recertifications to determine whether the noncompliance was corrected at some

intervening point.

## Out of Compliance

A unit will be considered out of compliance if the annual recertification was not performed, or the annual recertification was performed late *and after notification* of a state agency compliance review.

### Example 1: Annual Recertification Was Not Performed

Household was initially qualified and properly certified at move-in. However, it has been more than 12 months from the previous recertification and there is no recertification on file. This unit is out of compliance as of the date the recertification is due.

### Example 2: Insufficient Documentation of Eligibility at Recertification

Household was initially qualified and properly certified at move-in; however, recertification was not properly documented and the state agency cannot reasonably determine the household's continuing eligibility. The following are possible documentation noncompliance issues:

- a. Application/questionnaire is not sufficiently detailed to disclose all sources of income and/or assets;
- b. Not all sources of income are verified;
- c. Not all sources of assets are verified;
- d. Verifications are insufficient;
- e. Not all adult household members' incomes and/or assets are disclosed and/or included;
- f. Tenant income certification form is not prepared, signed and/or dated; and
- g. Other state-required forms designed to document compliance with IRC §42 are not in file.

## Back in Compliance

Owners may use the following methods to self-correct noncompliance. Evidence of corrected noncompliance may include a copy of the full recertification, including application, verifications, and/or tenant income recertification. Owners must submit copies of the documents required by the monitoring agency.

1. A recertification can be performed using current income and asset sources and current income limits. If there is no resulting noncompliance (e.g., violation of the Available Unit Rule), the unit would be out of compliance on the date the recertification was due and back in compliance on the date the tenant signs the recertification.
2. A retroactive recertification can be performed which completely and clearly documents the sources of income and assets *that were in place at the time the recertification should have been completed* and applies income limits that were in effect on that date. If there is no resulting noncompliance (e.g., violation of the Available Unit Rule), the unit would be out of compliance on the date the recertification was due, and back in

compliance on the date the tenant signs the recertification.

While the recertification has been performed retroactively, the recertification documents should be dated with the current date. All the adult members of the household should sign the recertification using the current date. In other words, the recertification documents should not be backdated.

The advantage of the retroactive recertification is that the owner may avoid violating the Available Unit Rule.

In either case, the effective date for recertification continues to be the anniversary of the actual date of move in.

#### Example 1: New Recertification is Performed After Notification

An owner failed to complete a tenant's annual income recertification, which was due February 10, 2004. The mistake was identified during a state agency compliance review conducted November 1, 2004. The management company completed the recertification on November 12, 2004 using the income limits available on that date. The recertification was completed based on the tenant's anticipated future income for the period November 12, 2004 through November 12, 2005.

The unit is out of compliance from February 10<sup>th</sup> to November 12<sup>th</sup>, 2004. The next annual income recertification is due on February 10, 2005. Since the noncompliance was corrected after notification of a state agency review, the noncompliance must be reported on Form 8823.

#### Example 2: Household Determined to be Over-Income

An owner failed to complete a tenant's annual income recertification, which was due February 10, 2004. The mistake was identified during a state agency compliance review conducted November 1, 2004. The management company completed the recertification on November 12, 2004 using the income limits available on that date. The recertification was completed based on the tenant's anticipated future income for the period November 12, 2004 through November 12, 2005. The household's income was determined to be more than 140% of the income limit.

Since the recertification was corrected after notification of a state agency review, the noncompliance must be reported on Form 8823. The unit is out of compliance with the recertification requirements from February 10<sup>th</sup> to November 12<sup>th</sup>, 2004. The next annual income recertification is due on February 10, 2005. Further, the Available Unit Rule may have been violated if any unit was rented to a nonqualified household after February 10, 2004.

## References

1. Notice 88-80, 1988-2 CB 396.
2. HUD Handbook 4350.3.

3. Under IRC §6001, taxpayers are required to keep records and comply with regulations as prescribed. To claim the low-income housing credit, taxpayers must substantiate that the tenants were income qualified.
4. Rev. Proc. 94-65, 1994-2 C.B. 798.
5. Rev. Proc. 2004-38, 2004-2 C.B. 10, which supersedes Rev. Proc. 94-64, 1994-2 C.B. 797.

**Chapter 6**  
**Category 11c**  
**Violation(s) of the UPCS or**  
**Local Inspection Standards**

**Definition**

This category is used to report noncompliance when rental units, building exteriors and systems, common areas, and the property site in a project are not suitable for occupancy. State agencies should assess whether low-income housing tax credit properties are in safe, decent, sanitary condition and in good repair, according to either the Uniform Physical Conditions Standards<sup>1</sup> (UPCS) established by HUD<sup>2</sup>, or local inspection standards. The standards to be used should be identified in the Qualified Allocation Plan<sup>3</sup> (QAP).

1. State agencies are not required to use the REAC protocol in using the UPCS.
2. State agencies cannot combine selected portions of the UPCS with portions of local standards; only one inspection standard can be selected and used.

**Identifying Noncompliance**

Certification Reviews

Noncompliance may be identified when the agency reviews an owner's annual certification that the buildings and units in an LIHC project were suitable for occupancy. (See Treas. Reg. §1.42-5(c)(1)(vi).) The owner must also certify that state or local authorities responsible for making inspections did not issue a violation report for any building or low-income unit in the project. If a violation notice or report was issued, the owner must attach a statement summarizing the violation report/notice (or a copy) to the annual certification submitted to the state agency. The owner must also state whether the violation was corrected.

Physical Inspections

State agencies must inspect LIHC properties to ensure that LIHC buildings and units are suitable for occupancy.<sup>4</sup> Under Treas. Reg. §1.42-5(C)(2)(ii)(B), on-site inspections must be made at least once every three years.

**HUD's Uniform Physical Condition Standards (UPCS)**

The UPCS requires housing to be decent, safe, sanitary and in good repair. The major areas of consideration include:

1. Site: The site components such as fencing and retaining walls, grounds, lighting, mailboxes/project signs, parking lots and driveways, play areas and equipment, refuse disposal equipment, roads, storm drainage, and walkways must be free of health and safety hazards and in good repair. The site must not be subject to material adverse conditions, such as abandoned vehicles, dangerous walks or steps, poor drainage, septic tank back-ups, sewer hazards, excess accumulations

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<sup>1</sup> The Uniform Physical Conditions are available at [www.gpoaccess.gov](http://www.gpoaccess.gov). On the main page, select the "Code of Federal Regulations" option and then enter "24CFR5.703" into the search feature using the quotes ("...").

<sup>2</sup> Department of Housing and Urban Development

<sup>3</sup> See IRC §42(m)(1)(B)(iii).

<sup>4</sup> See Treas. Reg. §1.42-5(d)(2)

of trash, vermin or rodent infestation, or fire hazards.

2. **Building Exterior:** Each building on the site must be structurally sound, secure, habitable, and in good repair. Each building's door, fire escapes, foundations, lighting, roofs, walls, and windows must be free of health and safety hazards, operable, and in good repair.
3. **Building Systems:** Each building's domestic water, electrical systems, elevators, emergency power, fire protection, HVAC, and sanitary system must be free from health and safety hazards, functionally adequate, operable and in good repair.
4. **Dwelling Units:** Each dwelling unit within a building must be structurally sound, habitable, and in good repair. The dwelling unit must be free from health and safety hazards, functionally adequate, operable and in good repair. This includes all areas and aspects of the dwelling unit; i.e., bathroom, call-for-aid (if applicable), ceiling, doors, electrical systems, floors, hot water heater, HVAC, kitchen, lighting, outlets/switches, patio/porch/balcony, smoke detectors, stairs, walls and windows.

Where applicable, the unit must have hot and cold running water, including an adequate source of drinkable water. (Note: single room occupancy units need not contain water facilities.) If the unit includes its own sanitary facility, it must be in operating condition, usable in privacy and adequate for personal hygiene and the disposal of human waste. The unit must include at least one battery-operated or hard-wired smoke detector in proper working condition on each level of the unit.

5. **Common Areas:** The common areas must be structurally sound, secure, and functionally adequate for the purposes intended. The basement/garage/carport, restrooms, closets, utility, mechanical, community rooms, day care, halls and corridors, stairs, kitchens, laundry rooms, office, porch, patio, balcony and trash collection areas, if applicable, must be free from health and safety hazards, operable, and in good repair. All common area ceilings, doors, floors, HVAC, lighting, outlets/switches, smoke detectors, stairs, walls, and windows must be free of health and safety hazards, operable, and in good repair.
6. **Health and Safety Concerns:** All areas and components of the housing must be free of health and safety hazards. These areas include, but are not limited to, air quality, electrical hazards, elevators, emergency/fire exits, flammable materials, garbage and debris, handrail hazards, infestation and lead based paint.

For example, buildings must have fire exits that are not blocked and have hand rails that are not damaged, loose, missing portions, or otherwise unusable. The housing must have no evidence of infestation by rats, mice, or other vermin. The housing must have no evidence of electrical hazards, natural hazards, or fire hazards. The dwelling units and common areas must have proper ventilation and be free of mold as well as odor (e.g., propane, natural, sewer or methane gas) or other observable deficiencies. The housing must comply with all requirements related to the evaluation and reduction of lead-based paint hazards and have available proper certifications of such.<sup>5</sup>

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<sup>5</sup> As defined in Subpart J of 24 CFR part 35.

**Local Standards**

Although there is considerable variability among local codes, inspection of the LIHC property using local codes should entail an inspection of the project site, building exteriors, building systems, common areas, dwelling units, and health and safety concerns.

**Differences between Local Codes and the Uniform Physical Condition Standards (UPCS)**

The UPCS do not supersede or preempt<sup>6</sup> local health, safety and building codes; i.e., a low-income housing project under IRC §42 must satisfy the local standards and the state agency must report known violations to the IRS. However, if the state agency uses the UPCS to conduct inspections and determines that they are met, the state agency is not required to determine *by inspection* whether the project meets local standards.

There will be situations when using the UPCS for the state agency's inspection standard may result in a conflict with the local standards. For example, the local code may require bars on windows to prevent children from falling out whereas the bars may be viewed under the uniform physical condition standards as blocking access/exists in case of emergencies. The conflict should be brought to the attention of the state agency by a governmental entity or individual such as a fire marshal's office or municipal building inspector who must provide a written submission explaining the nature of the conflict. When conflicts are presented in this manner, the local code will be evaluated by the state agency in determining whether the project or unit is in compliance.

**In Compliance**

A building is in compliance if, during an inspection of the building, it meets the requirements of the UPCS or local code. Exhibit 6-1 is a sample checklist that may be useful (it is not required) in helping document physical inspections of LIHC properties. Owners should be notified of the state agency's findings. Exhibit 6-2 is a sample letter that may be used.

**Out of Compliance**

An LIHC unit, building and/or entire project is out of compliance if:

1. The owner discloses violations of local standards or incorrectly certifies that the buildings and units in an LIHC project were suitable for occupancy, taking into account local standards (or other habitability standards). See Treas. Reg. §1.42-5(c)(1)(vi).
2. During a physical inspection by the state agency, the property had elements that failed to meet the requirements.
3. Otherwise fails to comply with the requirements of the UPCS or local codes at any time.

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<sup>6</sup> In other words, the UPCS do not replace or preempt local health, safety, and building codes.

To ensure consistent evaluation of the property's physical condition, the definitions of physical deficiencies used for the Real Estate Assessment Center System (REAC) by the Department of Housing and Urban Development (HUD) will be used to determine whether noncompliance has occurred. The dictionary is divided into six sections:

1. Site Inspection
2. Building Exterior Inspectable Items
3. Building Systems Inspectable Items
4. Common Areas Inspectable Items
5. Unit Inspectable Items
6. Health and Safety Inspectable Items

Each section identifies specific components, which are then defined in ascending levels of severity (level 1, level 2 or level 3), and a fourth category is health and safety hazards and fire safety hazards. All levels of deficiencies must be reported. State agencies using local codes as their inspection standard may find the UPCS levels of violation helpful in categorizing reported violations. The Dictionary of Deficiency Definitions is available at HUD's website:

[www.hud.gov/offices/reac/products/pass/pass\\_def.cfm](http://www.hud.gov/offices/reac/products/pass/pass_def.cfm).

**Level 1  
Violations of  
UPCS**

Examples of Level 1 violations include:

1. At least one screen door or storm door is damaged or is missing screens or glass. The noncompliance would be evidenced by an empty frame or frames.
2. The roofs of a project where up to one square (100 square feet) of surface material or shingles is missing from roof areas.
3. In one room in a dwelling unit, a permanent lighting fixture is missing or not functioning, and no other switched light source is functioning in the room.

**Level 2  
Violations of  
UPCS**

Examples of Level 2 violations include:

1. Evidence of water stain, mold, or mildew, such as darkened areas, over a small area of floor (1-4 square feet). Water may or may not be visible. The affected area is estimated to be less than 10% of the floors.
2. In two rooms in a dwelling unit, a permanent lighting fixture is missing or not functioning, and no other switched light source is functioning in the rooms.

**Level 3  
Violations of  
UPCS**

Example of Level 3 violations include:

1. A common area where a large portion of one or more floors –more than 4 square feet- has been substantially saturated or damaged by water, mold, or mildew. Cracks mold, and flaking are visible and the floor surface may have failed.
2. A sink or other related hardware in a kitchen may be missing, which creates unsanitary living conditions.
3. A permanent light fixture in more than two rooms is missing or not functioning, and no other switched light sources are functioning in the rooms.

**Health and Safety Violations and Fire Hazard Violations of UPCS**

Health and safety violations can be divided into non-life threatening and exigent, life threatening conditions.

Non-life threatening events include items such as pavement and walkway problems that create the potential for tripping and falling; missing or non-functioning sinks and bathroom components in individual units that impair human sanitation; missing exterior doors; and floor covering damage.

Exigent health and safety and fire hazards require immediate attention because of their life-threatening potential. Exigent health and safety violations include exposed electrical wires or water leaks on or near electrical equipment; propane /natural gas/methane gas detected; emergency/fire exits that are blocked; unusable fire escapes; gas or oil fired hot water heaters with missing or misaligned chimneys that pose carbon monoxide hazards. Fire safety hazards include missing or inoperative smoke detectors; fire extinguishers expired or window security bars preventing egress from a building.

**Casualty Losses**

A casualty loss is defined as the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual. A sudden event is one that is swift, not gradual or progressive. An unexpected event is one that is ordinarily unanticipated and unintended. An unusual event is one that is not a day-to-day occurrence and that is not typical for low income housing credit properties. Casualty losses may result from a number of different sources: e.g., car accidents, fires, government-ordered demolitions, hurricanes, mine cave-ins, sonic booms, storms, tornadoes, vandalism, etc. Property damage is not considered a casualty loss if the damage occurred during normal use, the owner willfully caused the damage or was willfully negligent, or was progressive deterioration such as damage caused by termites.

Physical damage to LIHC properties caused by casualty events and which render LIHC residential rental units or buildings, or common areas associated with the property, unsuitable for occupancy is reported as noncompliance with the UPCS or local standards.

**Date of Noncompliance**

The reportable “out of compliance” date is the date the property failed to meet the inspection standard, if known; otherwise, at the earliest documented date that the standard was not met.

**Example 1: Factual Determination**

The state agency determined that some vacant LIHC residential units were not suitable for occupancy for new tenants when they conducted a physical inspection of the property. The owner explained that because of the high vacancy rate, there were a sufficient number of empty units suitable for occupancy. All vacant LIHC units that are not suitable for occupancy are out of compliance. The out of compliance date is a factual determination reflecting the earliest date that any of the noncompliant units was vacated.

### Example 2: Noncompliance Date Identified by Inspection

The state agency inspected the property site and determined that a dilapidated wooden fence on the exterior of the property represented a UPCS violation because it was about to fall down and nails were protruding out of the boards. The date of noncompliance is the date of the inspection.

### Example 3: Noncompliance Date Identified by Documentation

HUD performed an inspection and determined that there were significant safety hazards on an LIHC property site. The owner was notified, but when HUD revisited the property six months later, the hazards had not been corrected. HUD provided the state agency with a copy of their report. The state agency conducted an inspection and confirmed HUD's information. The date of noncompliance is the date of HUD's initial inspection.

### Notice to Owner

The state agency is required to provide prompt *written* notice to the *owner* of a low-income housing project if the state agency discovers that the project is not in compliance with the state agency's inspection standard, or the annual certification is inaccurate. Notification letters establish and document the beginning of the correction period for any "out of compliance" issues. See Exhibit 6-3.

When state agencies determine that the violations involve life-threatening problems, a critical notification letter requiring immediate corrective action should be sent to the owner. *To ensure prompt correction of exigent, life threatening health and safety deficiencies*, the project representative should be provided a list of every observed life threatening violation and fire safety hazard that needs immediate attention or remedy, before the inspector leaves the project site. See Exhibit 6-4. To document receipt, the project representative should sign the state agency's copy of the list of deficiencies.

### Back in Compliance

Property is back in compliance when noted violations are corrected. The correction date is the date of the repair, the date of the inspection at which the repair was observed, or the date of the certification that the repair had occurred; whichever evidenced the correction to the agency's satisfaction.

Acceptable evidence of the corrected violations includes items such as a certification from an appropriate licensed professional that the item now complies with the inspection standard, or other documentation demonstrating that the violation has been corrected. Alternatively, the state agency may determine that the owner is back in compliance by visual inspection.

**Reporting  
Noncompliance**

Under Treas. Reg. §1.42-5(a), state agencies are required to report any noncompliance of which the agency becomes aware.<sup>7</sup> State agencies must file Form 8823 no later than 45 days after the end of the correction period (including permissible extensions), whether or not the identified noncompliance is corrected. See Chapter 2.

**Example 1: Extenuating Circumstances**

A state agency conducted a physical inspection of an LIHC building on October 3, 2004. When inspecting the laundry room located in the basement, the state agency noted that water pipes to three of the six washing machines had frozen and burst during a recent snow storm. The correction period started on October 6, 2004, the date on which the notice of noncompliance was sent to the owner. The correction period ends 90 days later on January 5, 2005.

The damage was extensive and could not be repaired immediately because the ground was frozen, so the owner requested an extension of time. The state granted the maximum extension of an additional 90 days (180 days total), so that the correction period ended April 5, 2005. At that time, the ground was still frozen and the repair had not been completed.

The state agency must file form 8823 within 45 days of the end of the correction period, or May 17, 2005, noting the noncompliance. A second Form 8823 should be filed when the noncompliance is corrected.

**Submitting  
Documentation  
to the IRS**

Documenting noncompliance with the physical inspection standards with sufficient detail to support IRS audit adjustments is particularly important because, at the time of a subsequent IRS audit, there may be no visible indication that the noncompliance ever occurred. Narratives describing the cause, nature and extent of the violations are helpful and should also clarify if the issue is a unit, common area, building exterior or system, or site problem.

Copies of reports summarizing unit-by-unit noncompliance originally given to the owner and electronic pictures are adequate when documenting noncompliance even though the violations may have been corrected after the filing of the report of noncompliance. Note: do not include photocopies of photographs; they are not useful.

**References**

1. 24 CFR 5.703, HUD's Uniform Physical Condition Standards
2. IRC §42(i)(3)(B)(i)
3. Treas. Reg. §1.42-5
4. Dictionary of Deficiency Definitions

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<sup>7</sup> In addition to information submitted as part of the owner's annual certification and the physical inspection of the property, information may be received from other sources such as (but note limited to) governmental agencies, tenants affected by the noncompliance, or public documents such as newspaper articles.

**Exhibit 6-1**  
**Checksheet for the Physical Inspection of LIHC Properties**

<b>Physical Inspection Review Summary</b>	
<b>Development Name and Address:</b> Name: Address: City/State/Zip Code Owner Contact                      Phone: Fax #:	Project #: Inspection Date: Asset Manager Conducting Inspection:  Total # Bldgs/Units Inspected: # / # Lead Risk: (Yes / No)
<b>SITE:</b>	<b>Finding</b>
Fencing & Gates	
Grounds	
Mailboxes/Project Signs	
Parking Lots/Driveways/Roads	
Play Areas & Equipment	
Refuse Disposal	
Retaining Walls	
Storm Drainage	
Walkways/Stairs	
<b>BUILDING SYSTEMS:</b>	<b>Finding</b>
Domestic Water	
Electrical System	
Elevators	
Emergency Power	
Exhaust System	
Fire Protection	
Heating/Ventilation/Air Conditioning	
Sanitary System	
<b>COMMON AREAS:</b>	<b>BUILDING EXTERIOR:</b>
Basement/Garage/Carport	Doors
Closet/Utility/Mechanical	Fire Escapes
Community Room	Foundation
Day Care	Lighting
Halls/Corridors/Stairs	Roof
Kitchen	Walls
Laundry Room	Windows
Lobby	<b>UNITS:</b>
Office	Bathroom
Other Community Spaces	Call-For-Aid
Patio/Porch/Balcony	Ceiling
Pools & Related Structures	Doors
Restrooms	Electrical Systems
Storage	Floors
Trash Collection Area	Heating/Ventilation/Air Conditioning
	Hot water Heater
	Kitchen
	Laundry Area (Room)
	Lighting
	Outlets/Switches
	Patio/Porch/Balcony
	Smoke Detectors
	Walls
	Windows
	<b>HEALTH &amp; SAFETY:</b>
	Air Quality
	Electrical Hazards
	Elevator
	Emergency/Fire Exits
	Flammable Material
	Garbage and Debris
	Hazards
	Infestation
	Mold
	Lead-based Paint
<b>Severity of Violation</b>	
Items should be marked "1", "2" or "3" to identify the severity level of the violation that reflects the extent of damage associated with the deficiency.	



**Exhibit 6-2**  
**Notification Letter – No Violations Noted**

Date

Owner  
Address  
City State ZIP

RE:  
Project:  
BIN Numbers:

Dear Owner:

On   [date]  , a physical inspection of the project listed above was conducted.

The review included a walk-through of the building, common areas, mechanical rooms, and grounds, as well as 20% of the qualified units. This review considered whether the building and its units were suitable for occupancy, taking into account   [local health, building and safety codes]   or   [the Uniform Physical Condition Standards as specified in Treas. Reg. § 1.42-5(d)].

The buildings and units inspected were all found to be in good condition. Based on this finding, no response is necessary.

Thank you for the cooperation and courtesies extended by members of your staff.

Please call me at   [telephone number]   if you have any questions. Or you may reach me by e-mail at   [e-mail address]  . Thank you for your commitment to providing quality affordable housing in the state of   [state]  .

Sincerely,

Name-Signature  
Title

CC: Management Contact

**Exhibit 6-3**  
**Notification Letter – Noncompliance**

Date

Owner  
Address  
City State ZIP

RE:  
Project:  
BIN Numbers:

Dear Owner:

On   [date]  , a physical inspection of the project listed above was conducted. The units inspected and property were, in general, in good condition with my findings noted on the following pages.

Enclosed you will find a copy of the Physical Inspection Report and a document titled “Addressing the Physical Inspection Report”, which will explain the violation categories, set forth required correction periods and provide additional information for responding to the inspection results.

Thank you for the cooperation and courtesies extended by members of your staff.

Please call me at   [telephone number]   if you have any questions. Or you may reach me by e-mail at   [e-mail address]  . Thank you for your commitment to providing quality affordable housing in the state of   [state]  .

Sincerely,

Name-Signature  
Title

CC: Management Contact

**Exhibit 6-4**  
**Notification Letter – Critical Violations**

**Notice of Critical Violations**  
**72 Hour Correction Period**

Inspection Date: \_\_\_\_\_ Tax Credit Project Number: \_\_\_\_\_

Property Name: \_\_\_\_\_

Property Location: \_\_\_\_\_

Based on the physical inspection completed on the date referenced above, one or more **critical violations have been identified and need to be corrected immediately.**

Within [time] hours of the inspection, the cited item(s) must be repaired and [state agency] must be provided with written notification of the action taken to complete the correction. Refer to the “Addressing the Physical Inspection Report” for further information.

**Critical Violations**

Buildings:

Units:

Inspections by: \_\_\_\_\_ Telephone: \_\_\_\_\_

E-Mail: \_\_\_\_\_ FAX: \_\_\_\_\_

Received By: \_\_\_\_\_ Signature: \_\_\_\_\_

**Chapter 7**  
**Category 11d**  
**Owner Failed to Provide Annual Certifications**  
**or Provided Incomplete or Inaccurate Certification**

**Definition**

This category is used to report owners of low-income housing properties who fail to submit annual certifications, or any other required reports and documentation, to the state agency as described in Treas. Reg. §1.42-5(c). Monitoring procedures require certifications (and state agency reviews of the certifications) at least annually for each year of the 15-year compliance period. Monitoring procedures may require certifications (and state agency reviews) more frequently than annually, provided that all months within each 12-month period are subject to certification.

Owners are responsible for reporting to the state agency annually that their projects were in compliance with IRC §42 for the preceding 12-month period. They must report in the form and manner the state agency specifies and must certify, under the penalty of perjury, that the information provided is true, accurate, and in compliance with the requirements of IRC §42. The owner must certify that:

1. The project met the requirements of the minimum set-aside test applicable to the project; i.e., the 20-50 test, the 40-60 test, or the 25-60 test for New York City.<sup>1</sup> See chapter 10.
2. If applicable, the 15-40 test under IRC §§42(g)(4) and 142(d)(4)(B) for deep rent skewed projects was met.
3. There has been no change in the applicable fraction (as defined in IRC §42(c)(1)(B)) of any building in the project, or that there was a change and a description of the change is included with the certification.
4. The owner has an annual income certification from each low-income tenant (Tenant Income Certification) and documentation to support that certification at initial occupancy and subsequent years during the compliance period. Tenants receiving Section 8 housing assistance payments may satisfy the documentation requirement by submitting a statement provided by a public housing authority (see Treas. Reg. §1.42-5(b)(1)(vii)). For an exception to this requirement, see IRC 42(g)(8)(B) and Rev. Proc. 94-64<sup>2</sup>, or Rev. Proc. 2004-38<sup>3</sup>, which provide rules for 100 percent low-income buildings when the owner has received a waiver from the annual recertification requirements.
5. Each low-income unit in the project was rent restricted.
6. All units in the project were for use by the general public<sup>4</sup>, including the requirement that no finding of discrimination under the Fair Housing Act, 42

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<sup>1</sup> See IRC §§42(g)(1)(A) and (B), 42(g)(4), 42(g)(4) and 142(d)(6).

<sup>2</sup> Rev. Proc. 94-64, 1994-2 C.B. 797.

<sup>3</sup> Rev. Proc. 2004-38, 2004-2 C.B. 10.

<sup>4</sup> As defined in Treas. Reg. §1.42-9.

U.S.C. 3601-3619, has occurred for the project. A finding of discrimination includes an adverse final decision by the Secretary of the Department of Housing and Urban Development, 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.

7. The buildings and low-income units in the project were suitable for occupancy, taking into account local health, safety and building codes (or other habitation 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 attach a *copy* of the violation notice or notice to the annual certification submitted to the state agency. In addition, the owner must state whether the violation has been corrected.
8. There has been no change in the eligible basis (as defined in IRC §42(d)) of any building in the project (determined at the end of the first credit year), 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).
9. All tenant facilities included in the eligible basis of any building in the project (such as swimming pools, other recreational facilities, or parking areas, etc.) were provided on a comparable basis without charge to all tenants in the buildings.
10. If a low-income unit in the project became vacant during the year, reasonable attempts<sup>5</sup> 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.
11. If the income of tenants of a low-income building in the project increased above 140% of the applicable income limit (or 170% for deep rent skewed projects), the next available unit of comparable or smaller size in the building was or will be rented to tenants having a qualifying income. See IRC §42(g)(2)(D)(ii), Treas. Reg. §1.42-15, and chapter 14 for guidance on the available unit rule.
12. An extended low-income housing commitment is in effect including the requirement<sup>6</sup> 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. This requirement is not applicable to buildings receiving allocations before 1990 or bond-financed buildings placed in service before 1990.

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<sup>5</sup> See Rev. Rul. 2004-82, 2004-2 C.B. 350, Q&A #9.

<sup>6</sup> See IRC §42(h)(6)(B)(iv), effective August 10, 1993.

13. All low-income units in the project were used on a non-transient basis, except for transitional housing for the homeless<sup>7</sup> or single-room occupancy units rented on a month-by-month basis<sup>8</sup>.

The state agency may also require additional reporting items. However, unless noncompliance with these reporting requirements constitutes noncompliance with IRC §42, noncompliance with these state agency reporting requirements should not be reported to the IRS.

## In Compliance

Owners are in compliance, for federal tax purposes, when annual certifications have been submitted timely<sup>9</sup>, accurately, and completely.

### Disclosure of Noncompliance

If the owner's certification discloses noncompliance with the requirements under IRC §42, the noncompliance must be reported to the IRS using Form 8823 and identifying the appropriate category of noncompliance.

#### Example 1: Owner Discloses Decrease in Eligible Basis

The owner of an LIHC building correctly submitted the annual certification and reported that the swimming pool had been closed and would no longer be available for use by the tenants. The owner is in compliance with the annual certification requirements, but the reduction in eligible basis should be reported to the IRS on Form 8823, line 11e, Changes in Eligible Basis or the Applicable Percentage.

#### Example 2: Compliance With Extended Use Agreement Requirements

As documented in the extended use agreement, the owner of an LIHC building agreed to dedicate 25 percent of the units in a 100 unit building to households with incomes less the 30 percent of the Area Median Gross Income. For purposes of IRC §42, the owner elected the 40/60 minimum set-aside on Form 8609. On the 2006 annual certification, the owner noted that the minimum set-aside had been met, but that only 20 of the units were occupied by households with incomes less than 30% of AMGI.

The nonperformance of the terms of the extended use agreement should not be reported to the IRS.

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<sup>7</sup> See IRC 42(i)(3)(B)(iii).

<sup>8</sup> See IRC §42(i)(3)(B)(iv).

<sup>9</sup> The state agencies should establish timeframes for submission of annual certifications.

**Documentation Requirements**

State agencies may require the use of standardized forms or submission of additional documentation to ensure compliance with the certification requirements. The state agencies may establish administrative policies and procedures such as requiring the original signature of the managing general partner or allowing facsimiles, the manner in which certifications are perfected if errors are identified, submission of additional information to clarify issues, etc.

**Example 1: Change in Eligible Basis**

To help evaluate the owner's compliance with the eligible basis certification, the state agency requires owners to provide information on any modification to the building that may result in changes to eligible basis. The owner failed to provide the information.

The state agency should report the owner's failure to provide a complete annual certification. The owner has not certified to the state agency's satisfaction that there has been non change in the eligible basis under IRC §42(d) of any building in the project as required under Treas. Reg. 1.42-5(c)(1)(vii).

**Out of Compliance**

If the owner fails to certify as required under Treas. Reg. §1.42-5(c)(1), submits inaccurate or incomplete certifications, or the certifications and documentation discloses noncompliance with the requirements under IRC §42, the state agency must report the owner using Form 8823. Similarly, an owner must be reported if the state agency does not receive or is not permitted to inspect the tenant income certifications, supporting documentation, and rent records described in Treas. Reg. §1.42-5(c)(2)(ii), or if the state agency learns that the project is not in compliance with the provisions of IRC §42.

To the extent that inadequate documentation from the owner prevents a state agency from determining whether a project is in compliance with IRC §42, the state agency can treat the project as out of compliance.

**Out of Compliance Date**

If an owner fails to complete or submit any of the certification items listed above, the date each building ceased to comply would be the first day of the reporting year for which such information was due. For example, if an owner does not submit the annual certification package for the 2006 calendar year, the first day of the reporting year date of noncompliance is January 1, 2006.

**Back In Compliance**

The owner is considered back in compliance when a perfected annual certification (and any other required documentation) is received by the state agency. Corrections may include submission of the required documentation or answering all the questions.

## References

1. IRC § 42(m)(1)(B)(iii).
2. Treas. Reg. §1.42-5(c).

## Chapter 8 Category 11e Changes in Eligible Basis

### Definition

This category is used to report violations associated with the Eligible Basis of a building or any occurrence that result in a decrease in the Applicable Percentage of a building, which is discussed in chapter 9. This chapter addresses noncompliance affecting the Eligible Basis.

The low-income housing credit amount is based on certain costs associated with a building (*eligible basis*) and the portion of the building (*applicable fraction*) that low-income households occupy. The cost of acquiring and rehabilitating, or constructing a building constitutes the building's *Eligible Basis*. The portion of the Eligible Basis attributable to low-income units is the building's *Qualified Basis*. The Qualified Basis is multiplied by a factor (*Applicable Percentage*) so that the credit is limited to 70 percent or 30 percent of the Qualified Basis.<sup>1</sup> In summary, the annual credit is:

$$\text{Eligible Basis} \times \text{Applicable Fraction} = \text{Qualified Basis}$$

$$\text{Qualified Basis} \times \text{Applicable Percentage} = \text{Annual Credit}$$

Generally, under IRC §42(f)(1), the annual credit can be claimed for 10 taxable years, beginning with the taxable year in which the building is placed in service; or, at the election of the taxpayer, the succeeding year<sup>2</sup>. Under IRC §42(f)(2)(A), there is a special rule for the first year of the credit period. Any reduction in the credit allowable for the first year of the credit period by reason of the rule is allowable for the first taxable year following the credit period. (See IRC §42(f)(2)(B).) In addition, under IRC §42(f)(3), if the qualified basis as of any taxable year in the 15-year compliance period (after the first year) exceeds the qualified basis as of the close of the first year of the credit period, then the applicable percentage applied to the excess Qualified Basis is two-thirds of the Applicable Percentage that would otherwise apply.

A cost incurred in the construction of a low-income housing building is includable in Eligible Basis under IRC §42(d)(1) if the cost is:

1. Included in the adjusted basis of depreciable property subject to IRC §168 and the property qualifies as residential rental property under IRC §103, or
2. Included in the adjusted basis of depreciable property subject to IRC §168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building, or
3. Included in the adjusted basis of depreciable property under IRC §168 (other than 1 or 2 above) that is used throughout the tax year in providing any community service facility, as described in IRC §42(d)(4)(C)(iii).

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<sup>1</sup> IRC §42(b)(2)(B).

<sup>2</sup> IRC §42(f)(1)(B).

Eligible Basis may include the cost of facilities for use by tenants to the extent there is no separate fee for using the facilities and the facilities are available on a comparative basis to all tenants. It may also include the cost of amenities if the amenities are comparable to the cost of amenities in other units.

**Example 1: Laundry Room and Coin Operated Washers and Dryers**

An owner included the cost of a building housing a laundry facility in the eligible basis. For security reasons, the room kept locked, but every household has a key and has access at any time. The owner installed coin operated washers and dryers.

The owner should include the cost of the building in eligible basis; i.e., all tenants have access to the facility. However, because the tenants must pay an additional fee to use the washers and dryers, the appliances should not be included in eligible basis.

**Commercial Use**

Eligible Basis cannot include any parts of the property used for commercial purposes. Residential rental property may qualify for the credit even though a portion of the building in which the residential rental units are located is used for a commercial use; i.e., commercial office space. No portion of the cost of such nonresidential rental property may be included in eligible basis.

The cost of mixed-use property; i.e., commercial and the residential rental units, must be allocated according to any reasonable method that properly reflects the proportionate benefit to be derived, directly or indirectly, by the qualifying residential rental units and the nonqualifying commercial property. Proposed Treas. Reg. §1.103-8(b)(4)(v)(c) provides two examples of methods generally considered to be reasonable when allocating costs:

1. Allocating the cost of common elements based on the ratio of the total floor space in the building that is to be used for nonqualifying property to all other floor space in the building is generally a reasonable method. For example, in the case of a mixed-use building where a part is to be used for commercial purposes, the cost of the building's foundation must be allocated between the commercial portion and residential rental units based on floor space.
2. In the event that an allocation of costs based on floor space does not reasonably reflect the relative benefits to be derived (directly or indirectly) by the residential rental units and the nonqualifying property, then another method must be used. For example, based on the floor space computation, a building is 50 percent residential rental property and 50 percent commercial space used as a shopping center. However, only 25 percent of the parking lot space will be used to service tenants of the residential units. The cost of constructing the parking lot must be allocated based on the proportion of parking lot used by the tenants of the residential units (25%) and for the commercial portion of the building (75%).

**Federal Grants**

Under IRC §42(d)(5)(A), the Eligible Basis must be reduced if a federal grant is made to fund the cost or operation of a building. Federal grants are funds which originate from a federal source and which do not require repayment. The Eligible Basis of the building must be reduced by the amount of the grant that is federally funded. The

Eligible Basis is reduced in the year the grant is made for the building and all subsequent years in the compliance period. A building is out of compliance as of the date the federal grant is made if the Eligible Basis is not reduced.

Eligible Basis is not reduced if the proceeds of a federal grant are used as a rental assistance payment under section 8 of the United States Housing Act of 1937 or any comparable rental assistance program. Under Rev. Rul. 2002-65, rental assistance payments made to a building owner on behalf or in respect of a tenant under the Rent Supplement Payment program (12 U.S.C. §1701s) or the Rental Assistance Payments program (12 U.S.C. §1715z-1(f)(2)) are not grants made with respect to a building or its operation under IRC §42(d)(5). Thus, proceeds from these programs do not require a reduction of Eligible Basis.

**Resident  
Managers and  
Maintenance  
Personnel**

Residential rental property, for low-income housing credit purposes, includes residential rental units, facilities for use by the tenants, and other facilities reasonably required by the project.<sup>3</sup> Under Treas. Reg. §1.103-8(b)(4), facilities that are functionally related and subordinate to residential rental projects are considered residential rental property. Treas. Reg. §1.103-8(b)(4)(iii) provides that facilities functionally related and subordinate to residential rental projects 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 included in Treas. Reg. §1.103-8(b)(4)(iii) of facilities reasonably required by a project specifically include units for resident managers or maintenance personnel.

Rev. Rul. 92-61 holds that 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 IRC §42(d)(1), but the unit is excluded from the applicable fraction under IRC §42(c)(1)(B) for purposes of determining the building's Qualified Basis. The unit is considered a facility reasonably required for the benefit of the project and the resident manager and/or maintenance personnel are not required to be income qualified. If the owner is charging rent for the unit, the Service may determine that the unit is not reasonably required by the project because the owner is not requiring the manager to occupy the unit as a condition of employment.<sup>4</sup> Later conversion of the unit into a residential rental unit will not change the Eligible Basis.

**Security  
Officers**

For deterring crime in and around an LIHC project, it may be necessary and reasonably required by the project for the owner to provide a security presence by leasing a residential rental unit to a Security Officer, who may be an off-duty law enforcement officer, security person in private industry, or *other qualified person*. In return for performing safety and security services that contribute to the management and control of the LIHC property, the Security Officer may be provided an on-site unit.

Typically, a security officer provides on-site presence during the evening and nighttime hours to respond to any emergencies and disturbances, and to respond to residents' requests for assistance, including complaints, unauthorized visitors, improper parking, and unauthorized use of community facilities. Other encouraged

<sup>3</sup> H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89.

<sup>4</sup> The rental value of the housing provided to a full-time resident manager required to live onsite as a condition of employment is considered to be wages. In this situation, however, these wages are not taxable income and are not subject to employment taxes. See IRC §§ 119(a)(2) and 3121(a)(19).

activities may include conducting resident criminal background investigations, neighborhood watch programs, and educational activities for primary school-age residents.

The adjusted basis of the unit occupied by a security officer is includable in the Eligible Basis of the building under IRC §42(d)(1) as a facility reasonably required for the benefit of the project. However, the unit is excluded from the Applicable Fraction of the building under IRC §42(c)(1)(B). The security officer is not required to be income qualified. If the owner is charging rent for the unit, the Service may determine that the unit is not reasonably required by the project because the owner is not requiring the security officer to occupy the unit as a condition of employment. (See footnote 4.) Later conversion of the unit into a residential rental unit will not change the Eligible Basis.

### **Model Units**

Model units are maintained primarily during a project's rent-up period to show prospective tenants the desirability of the project's units. If the project maintains full occupancy thereafter, the model can be dismantled and the unit rented. This makes economic sense because model units do not generate rental income for a project owner. However, at a large apartment complex, it is standard industry practice to continuously maintain a model unit for marketing purposes and to be competitive. The unit can be shown immediately to prospective tenants at any time without disturbing tenants in occupied units. By increasing competitiveness, model units contribute to the economic viability of the LIHC project

A model unit is considered a rental unit under IRC §42; see e.g., PLR 9330013, Issue # 3, July 30, 1993. Therefore, a model unit's cost is included in the building's eligible basis and in the denominator of the applicable fraction when determining a building's qualified basis.

#### **Example 1: Model Unit Never Rented as LIHC Unit**

An owner included the cost of a model unit in the eligible basis for a 100% LIHC building with 49 units (other than the model unit). The owner anticipates that the model unit will be maintained throughout the compliance period and will never be rented to an income qualified household.

The cost of the unit should be included in the building's eligible basis. However, the maximum applicable fraction that the owner can ever claim is 49/50, or 98%.

#### **Example 2: Model Unit Converted to LIHC Unit**

An owner included the cost of a model unit in the eligible basis for a 100% LIHC building with 49 units (other than the model unit). The owner used the unit as a model for the first three years, but in April of year four of the compliance period, the unit was rented to an income qualified tenant.

The cost of the unit should be included in the building's eligible basis and in years one through three of the credit period, the maximum applicable

fraction that the owner can claim is 49/50, or 98%. In year four and subsequent years, the owner will follow the rules outlined in IRC §42(f)(3) for increases in qualified basis; i.e., the “2/3 credit” rules.

**Community  
Service  
Facilities**

As part of the Community Renewal Tax Relief Act of 2000, a new IRC §42(d)(4)(C) was added to include property used to provide services to nontenants as part of the eligible basis used for determining the LIHC amount.

There are specific requirements:

1. The property must be located in a qualified census tract. (See IRC §42(d)(5)(C)(ii).)
2. The property must be subject to the allowance for depreciation and not otherwise accounted for.
3. The property must be used throughout the taxable year in providing any community service facility.
4. Under IRC §42(d)(4)(C)(iii), a community service facility must be designed to service primarily individuals whose income is 60 percent or less of the area median income. According to Rev. Rul. 2003-77, the requirement is satisfied if the following conditions are met:
  - The facility must be used to provide services that will improve the quality of life for community residents; i.e., day care, career counseling, literacy training, education (including tutorial services), recreation, and out-patient clinical health care.
  - The owner 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 area median income. This may, for example, be demonstrated in the market study required under IRC §42(m)(1)(A)(ii), or a similar study.
  - The facility must be located on the same tract of land as one of the buildings that comprises the qualified low-income housing project.
  - If fees are charged for the services provided, they must be affordable to individuals whose income is 60 percent or less of the area median income.

Under IRC §42(d)(4)(C)(ii), the increase in the adjusted basis of any building that includes the community service facility cannot exceed 10 percent of the eligible basis of the qualified low-income housing project of which it is a part. All community service facilities that are part of the same qualified low-income housing project are treated as one facility.

### Example 1: LIHC Project Includes Community Service Facility

An owner received a credit allocation in 2001. The project is located in a qualified census tract and consists of six residential rental buildings. There are five floors in each building with 5,000 square feet each, for a total of 25,000 square feet per building. The square footage for the entire project is 150,000 square feet. The cost per square foot is \$100 and, assuming that the costs are not disproportionately distributed in the building, the total Eligible Basis is \$15,000,000. The cost of any community service facilities included in Eligible Basis is limited to  $\$15,000,000 \times .10 = \$1,500,000$ .

The entire first floor of one building is a day care facility for children of residents in the community. Half of the first floor of a second building is a facility used to provide activities and medical services for seniors in the community. The combined square footage of the two facilities is  $5,000 + 2,500 = 7,500$  square feet. The cost is  $\$100 \times 7,500$  square feet = \$750,000. Since the combined cost of the two facilities is less than 10% of the total Eligible Basis, the entire cost of the facilities is included in Eligible Basis.

### **In Compliance**

The Eligible Basis of a building is determined at the end of the first year of the credit period. As long as there is no reduction in the Eligible Basis amount upon which the credit is based, the property is in compliance.

### **Out of Compliance**

The Eligible Basis of a property is reduced when space that originally qualified as residential rental property changes character or space that was originally designated for use by qualified tenants is no longer available to them. Typical noncompliance may involve converting common areas to commercial property, or charging fees for facilities (such as a swimming pool), the cost of which were included in the Eligible Basis.

The date of noncompliance is the specific date the residential space is converted to commercial space or when a fee is charged.

### **Back in Compliance**

Common areas and tax credit rental units may be converted to commercial space. Whether the cost of these converted spaces can be restored to Eligible Basis by changing the properties back into common areas or tax credit rental units has not been determined. In these instances, the state agency should not report the building back in compliance. Instead, the state agency should contact the IRS National Office LIHC Program Analyst for instructions.

## References

1. IRC §42(d).
2. Proposed Treas. Reg. §1.103-8(b)(4)(iii).
3. Proposed Treas. Reg. §1.103-8(b)(4)(v)(c).
4. Rev. Rul. 92-61, 1992-2 C.B. 7.
5. Rev. Rul. 2002-65, 2002-43 I.R.B. 729.
6. Rev. Rul. 2003-77, 2003-29 I.R.B. 75.
7. Rev. Rul. 2004-82, 2004-35 I.R.B. 350.

## Chapter 9 Category 11e Changes in the Applicable Percentage

### Definition

This category is used to report violations associated with the Eligible Basis of a building (discussed in chapter 8) or any occurrence that result in a decrease in the Applicable Percentage of a building. This chapter addresses noncompliance affecting the Applicable Percentage of a building.

The low-income housing credit amount is based on certain costs associated with a building (*eligible basis*) and the portion of the building (*Applicable Fraction*) that low-income households occupy. The cost of acquiring and rehabilitating, or constructing a building constitutes the building's *Eligible Basis*. The portion of the Eligible Basis attributable to low-income units is the building's *Qualified Basis*. The Qualified Basis is multiplied by a factor (*Applicable Percentage*) so that the credit is limited to 70 percent or 30 percent of the Qualified Basis.<sup>1</sup> In summary, the annual credit is:

$$\text{Eligible Basis} \times \text{Applicable Fraction} = \text{Qualified Basis}$$

$$\text{Qualified Basis} \times \text{Applicable Percentage} = \text{Annual Credit}$$

Generally, under IRC §42(f)(1), the annual credit can be claimed for 10 taxable years, beginning with the taxable year in which the building is placed in service; or, at the election of the taxpayer, the succeeding year<sup>2</sup>. Under IRC §42(f)(2)(A), there is a special rule for the first year of the credit period. Any reduction in the credit allowable for the first year of the credit period by reason of the rule is allowable for the first taxable year following the credit period. (See IRC §42(f)(2)(B).) In addition, under IRC §42(f)(3), if the qualified basis as of any taxable year in the 15-year compliance period (after the first year) exceeds the qualified basis as of the close of the first year of the credit period, then the applicable percentage applied to the excess Qualified Basis is two-thirds of the Applicable Percentage that would otherwise apply.

IRC §42(b)(2)(B) provides that a new building that is not federally subsidized is eligible for an Applicable Percentage equal to a 70 percent present value credit while a new building that is federally subsidized and an existing building are eligible for a 30 percent present value credit.

Monthly credit tables published in the Internal Revenue Bulletin provide the actual Applicable Percentages to be used in calculating the credit. These tables effectively adjust the rates on a monthly basis so that the present value over the ten-year credit period will continue to yield the 70 percent and 30 percent figures.

### Federal Subsidies

IRC §42(b)(2)(B)(ii) provides that the Applicable Percentage for new buildings that are federally subsidized is the 30 percent present value credit. Section 42(i)(2)(A) provides that a new building is federally subsidized for any tax year if, at any time during such tax

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<sup>1</sup> IRC §42(b)(2)(B).

<sup>2</sup> IRC §42(f)(1)(B).

year or any prior tax 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 its operation. However, the building will become eligible for the 70 percent present value credit if (1) by the close of the first year of the credit period the taxpayer elects (on Part II of Form 8609) to reduce the Eligible Basis of the building by the principal amount of the loan or by the proceeds of the tax-exempt bond, or (2) before the building is placed in service, the taxpayer repays the loan or redeems the tax-exempt bond.

**Assistance  
Provided  
Under the  
HOME  
Investment  
Partnership  
Act**

IRC §42(i)(2)(E)(i) generally provides that assistance provided under the HOME Investment Partnership Act (HOME) with respect to any building will not be treated as a below market Federal loan if 40 percent or more of the residential units *in the building* are occupied by individuals whose income is 50 percent or less of the Area Median Gross Income (AMGI).

Example 1<sup>3</sup>: Qualifying for the 70 Percent Present Value Credit Under IRC §42(b)

A new qualified low-income housing project consists of Building 1 and Building 2, each containing 100 residential rental units. Forty percent of the units in each building are low-income units. The owner elected the 40/60 minimum set-aside under IRC §42(g)(1)(B). Also, the owner elected, on Form 8609, Low-Income Housing Credit Allocation Certification, to treat the buildings as part of a multiple building project. The owner obtained a HOME loan at less than the AFR for the project.

The rule under IRC §42(i)(2)(E)(i) applies on a building-by-building basis. To qualify for the 70 percent present value credit, the taxpayer must rent at least 40 units in both Building 1 and Building 2 to tenants whose income is 50 percent or less of AMGI throughout the 15-year compliance period.

In addition:

- a. The units used to satisfy the rules under IRC §42(i)(2)(E)(i) are also counted toward the project's minimum set-aside under IRC §42(g)(1).
- b. The rent restriction for all the low-income units, including the units used to satisfy the rules under IRC §42(i)(2)(E)(i), is based on the applicable income limitation under IRC §42(g). In this example, the imputed income limitation applicable to the units in the project is 60 percent of AMGI and the rent may not exceed 30 percent of that amount.

## **In Compliance**

A new building receiving the 70 percent present value credit is in compliance if no federal subsidy is used (directly or indirectly) for the building or for its operation. If a federal subsidy is used (directly or indirectly) for the building or for its operation, the building is in compliance if (1) the taxpayer elected (on Part II, Form 8609) to reduce the Eligible Basis of the building and this reduction is properly reflected in the Eligible Basis

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<sup>3</sup> This example is based on Rev. Rul. 2004-82, Q&A #6.

determined at the close of the first year of the credit period, or (2) the federal subsidy is redeemed or paid before the building is placed in service.

## **Out of Compliance**

A new building receiving a 70 percent present value credit is out of compliance if a federal subsidy is used (directly or indirectly) for the building or for its operation and:

1. The taxpayer fails to elect (on Part II, Form 8609) to reduce the Eligible Basis of the building,
2. The taxpayer elects (on Part II, Form 8609) to reduce the Eligible Basis of the building but the reduction is not properly reflected in the Eligible Basis of the building determined at the close of the first year of the credit period, or
3. The federal subsidy is not redeemed or paid before the building is placed in service and the taxpayer did not elect to reduce the Eligible Basis as described above.

A new building receiving the 70 percent present value credit is also out of compliance if it otherwise meets the “In Compliance” requirements above, but a federal subsidy is subsequently used with respect to the building or its operation during years 2 through 15 of the compliance period.

A building is out of compliance as of the date the federal subsidy is used.

## **Back in Compliance**

In general, a violation of the federal subsidy rules is a noncompliance event that cannot be corrected. For example, a federal subsidy used (directly or indirectly) with respect to a new building receiving the 70 percent present value credit during years 2 through 15 of the compliance period results in a decrease in the Applicable Percentage of the building from the 70 percent to the 30 percent present value credit, beginning with the year the subsidy is used and for all remaining years in the compliance period. Following the close of the first year of the credit period, a taxpayer cannot elect to reduce the Eligible Basis of the building in an attempt to qualify for the 70 percent present value credit.

If a state agency identifies the receipt of a federal subsidy during years 2 through 15 of the compliance period for the operation of a building or project where the Applicable Percentage is the 70 percent present value credit rate, noncompliance should be reported under category 11e. No attempt should be made to determine whether the taxpayer correctly lowered the Applicable Percentage.

Under unusual circumstance, it might be possible to correct a noncompliance event occurring during the first year of the credit period. For example, the owner receives a favorable private letter ruling from the IRS allowing the taxpayer to make a late election on Part II, Form 8609, to reduce Eligible Basis to the extent of a federal subsidy. The owner should not be considered back in compliance unless documented by a favorable determination by the IRS.

## References

1. IRC §42(i)(2)(E).
2. Rev. Rul. 2004-82, 2004-35 I.R.B. 350.

**Chapter 10**  
**Category 11f**  
**Project Failed to Meet**  
**Minimum Set-Aside Requirement**

**Definition**

This category is used to report projects that have violated the minimum set-aside rules; i.e., the number of qualifying units falls below the minimum requirement.

Under IRC §42(g)(1), a “qualified low-income housing project” means any *project* for residential rental property if the project meets one of the two requirements below, whichever is elected by the owner on Form 8609, line 10c.

1. At least 20% of the available rental units in the development are rented to households with incomes not exceeding 50% of Area Median Gross Income (AMGI) adjusted for family size.
2. At least 40%<sup>1</sup> of the available rental units in the development are rented to households with incomes not exceeding 60% of AMGI adjusted for family size.

The choice of minimum set-aside also establishes the income limit and rent limit applicable to low-income units in the project.

**Project Defined**

Each building is considered a separate project under IRC §42(g)(3)(D) unless, before the close of the first calendar year in the project period<sup>2</sup>, each building that is, or will be, part of a multiple-building project is identified by attaching a statement to the owner’s tax return (see instructions for Form 8609, line 8b for details). Each building included in the multiple building project is also identified on Form 8609, line 8b. The minimum set-aside documented on Form 8609, line 10c, must be the same for all buildings in a multiple-building project.

Two or more qualified low-income buildings may be included in a multiple-building project only if they:

1. are located on the same tract of land (unless all of the dwelling units in all of the buildings being aggregated in the multiple-building project are low-income units (see IRC §42(g)(7));
2. are owned by the same person for Federal tax purposes;
3. are financed under a common plan of financing; and
4. have similarly constructed residential units.

**Deep Rent Skewing Under IRC §142(d)(4)**

In addition to the election of a minimum set-aside, the owner may elect on Form 8609, line 10d, to provide housing to households with incomes of 40 percent or less of the AMGI under IRC §142(d)(4)(B). Under this “deep-rent skewing” set-aside, at least 15% of the low-income units in the project must be occupied by individuals with

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<sup>1</sup> For the boroughs of New York City, 25% is substituted for 40%. See IRC §42(g)(4) and IRC §142(d)(6).

<sup>2</sup> Defined in IRC §42(h)(1)(F)(ii).

incomes at 40% or less of the AMGI (adjusted for family size) applicable to the units. Also, gross rent for each low-income unit cannot exceed (1) 30% of the AMGI applicable to the unit, and (2) 50% of the average gross rent for market rate units of comparable size in the project.

**Irrevocable Elections**

Once made, the minimum set-aside and deep-rent skewing elections are irrevocable.<sup>3</sup> Thus, the applicable minimum set-aside, deep-rent skewing, and the corresponding rent restrictions apply for the duration of the 15-year compliance period.

**Assistance Provided Under the HOME Investment Partnership Act<sup>4</sup>**

IRC §42(i)(2)(E)(i) generally provides that assistance provided under the HOME Investment Partnership Act (HOME) with respect to any building will not be treated as a below market Federal loan if 40 percent or more of the residential units *in the building* are occupied by individuals whose income is 50 percent or less of the Area Median Gross Income (AMGI).<sup>5</sup> The units used to satisfy the rules under IRC §42(i)(2)(E)(i) also counted toward the project's minimum set-aside under IRC §42(g)(1).

**Suitability for Occupancy**

For purposes of computing the minimum set-aside, the low-income units must be physically maintained in a manner suitable for occupancy under IRC §42(i)((3)(B)(ii). See chapter 6 for complete discussion.

**Example 1: Vacant LIHC Rental Unit Suitable for Occupancy at the End of the Taxable Year Within the Compliance Period**

The owner of a 100% LIHC building elected the 40/60 minimum set-aside and placed the building in service in July of 2003; 2003 is the first year of the credit (and compliance) period. An income-qualified tenant moved into a unit in October 2003 and moved out in November of 2004. The unit was cleaned and ready for occupancy on December 1, 2004. The unit is in compliance as of the end of the of the owner's 2004 taxable year and is, therefore, included in the count of qualified low-income units to determine whether the minimum set-aside requirement is satisfied.

**Vacant Units**

A rental unit is considered an LIHC unit beginning on the date that the first qualified tenant moved in and continues to be eligible for the LIHC even though it is vacant if the character of the last household to inhabit the unit qualified as a low-income household. Unless a specific noncompliance issue is identified for the unit, qualifying units that are vacant at the end of the owner's taxable year of the credit (and compliance) period are included in determining that the minimum set-aside has been met.

**Example 1: Qualified LIHC Rental Unit Vacant at End of the Taxable Year of the Compliance Period**

An income-qualified tenant moved into a unit on April 15, 2003, but the owner did not reduce the rent to account for a utility allowance.

<sup>3</sup> In rare circumstances the IRS has granted an owner an extension of time to make the correct election (see IRC §42(g)(8)). The owner must request a private letter ruling and receive express permission to do this.

<sup>4</sup> See Rev. Rul. 2004-82, Q&A #6.

<sup>5</sup> The designation is shown on Form 8609 (beginning with the Nov. 2003 revision. Line 6f is completed by the state agency.

The tenant moved out on November 15, 2003. The unit was not rented again until February 2004. At that time, the owner correctly accounted for the utility allowance.

The unit was out of compliance beginning on April 15, 2003 and remains out of compliance until February 2004, when the utility allowance is correctly accounted for. Assume that the close of the first year of the credit (and compliance period) is December 31, 2003. Since the unit is out of compliance on December 31, 2003, the unit is not included in the count of qualified low-income units to determine whether the minimum set-aside requirement is satisfied.

## **In Compliance**

A property is in compliance if the elected minimum set aside requirement (20/50 or 40/60) and the elected deep-rent skewing requirement (15/40) is met by the end of the first year of the owner's credit (and compliance) period and continues to be met each year throughout the compliance period. The LIHC residential units must also be rent-restricted.

## **Out of Compliance**

The initial analysis of compliance with the minimum set-aside requirement is generally based on a sample of tenant files. In the event that the sample does not meet the minimum set-aside, the owner must be given the opportunity to demonstrate that the minimum set-aside is met in the project. Noncompliance should be reported only if the owner cannot demonstrate compliance for the minimum number of units. The burden is on the owner to show that the minimum set-aside was met.

Noncompliance with the minimum set-aside should also be reported if systemic errors affecting all the LIHC units are identified; e.g., using incorrect income or rent limits for all the units.

### **Example 1: Single Building Project**

20 units in a 100 unit building with a 40/60 minimum set-aside were reviewed. To satisfy the minimum set-aside test, 8 of the selected units must be in compliance.

If there are multiple buildings, and the owner elects to treat them collectively as one project, then combine the samples for each building to determine whether the minimum set-aside has been met.

### **Example 2: Multi-Building Project**

A project consists of three buildings with 75 units in each building. The owner elected a 40/60 minimum set-aside. In total, there are 225 units and at least 90 must be qualified LIHC units to meet the minimum set-aside. The state agency must review 45 files. To satisfy

the minimum set-aside test, 18 of the selected units must be in compliance.

**Date of Noncompliance** In the event that noncompliance results in the failure to meet the minimum set-aside for the first year of the credit period, the taxpayer is prohibited from ever claiming the LIHC; the date of noncompliance is the last day of the taxable year of the first year of the credit period.

**Example 1: First Year Lease Up**

The owner did not lease the minimum number of units to income eligible tenants by the end of the first year of the credit period.

The date of noncompliance is the last day of the first year of the credit period. The state agency should issue Form 8823 indicating Category 11f, Project failed to meet minimum set-aside requirements, and Category 11p, Project is no longer in compliance nor participating in the program, if Form 8609 has been filed with the IRS.

If the project meets the minimum set-aside by the end of the first year, but fails to meet the minimum set-aside at the close of the taxable year for a subsequent year in the compliance period, the entire credit is lost for that year. The date of noncompliance is the last day of the taxable year for which the minimum set-aside was not met.

**Back in Compliance**

**First Year of the Credit Period** If a project failed the first year minimum set-aside requirement, the noncompliance cannot be corrected and the owner is prohibited from ever claiming the LIHC. The date of noncompliance is the last day of the taxable year of the first year of the credit period for that project. The state agency should issue Form 8823 indicating Category 11f, Project failed to meet minimum set-aside requirements and Category 11p, Project is no longer in compliance and is no longer participating in the program.

**Years Subsequent to the First Year of the Credit Period** If the minimum set-aside violation occurs *after* the first year of the compliance period, the project is back in compliance for the taxable year in the compliance period in which the minimum set-aside is met, determined as of the close of that taxable year.

**Example 1: Fees for Assisted Living Services**

The first year of the credit period ended December 31, 1998 for a 100 percent LIHC building. The units were all rented to income qualified households. Subsequently, in 2003, the owner charged all households a fee for mandatory assisted-living services. This fee, when added to the rent, exceeded the gross rent limitation for all the units and resulted in a violation of the minimum set-aside requirement for year 2003. The state agency conducted a review on February 2004 and noted the violation of the rent rules. The owner stopped charging the fee on March 1, 2004.

The owner did not meet the minimum set-aside and should not claim any credit for 2003. The date of noncompliance with the minimum set-aside requirement is December 31, 2003. The owner will be back in compliance at the end of the taxable year in the compliance period in which the minimum set-aside is again met.

The submission of a Form 8823 identifying noncompliance with the minimum set-aside should not be delayed even if the taxpayer demonstrates that the minimum set-aside will be restored by the end of the taxable year in the compliance period. State agencies should file Form 8823 within 45 days after the end of the correction period. A second Form 8823 should be filed after the end of the first taxable tax year in which the minimum set-aside is restored.

**Documentation  
of Corrected  
Noncompliance**

Documentation of corrected noncompliance with the minimum set-aside requirement will be specific to the noncompliance issue resulting in failure to satisfy the set-aside.

**Example 1: Rental to Ineligible Tenants Violates Minimum Set-Aside Requirement**

Upon inspection, it is determined that the number of units qualifying as LIHC units did not satisfy the minimum set-aside requirement during a year following the first year of the credit period because the owner rented to ineligible tenants. To correct the minimum set-aside violation, the owner must rent units to IRC §42 eligible income-qualified households until the minimum set-aside is restored.

At a minimum, documentation should include the tenant's application/eligibility questionnaire, income verifications, tenant income certification, and student verification, if necessary.

**References**

1. IRC §42(g).
2. Rev. Rul. 90-89, 1990-2 C.B. 8.
3. Rev. Rul. 2004-82, 2004-35 I.R.B. 350.

**Chapter 11**  
**Category 11g**  
**Gross Rent(s) Exceed Tax Credit Limits**

**Definition**

This category is used to report noncompliance with the rent restrictions outlined in IRC §42(g)(2). A unit qualifies as an LIHC unit when the gross rent does not exceed 30 percent of the imputed income limitation applicable to such unit under IRC §42(g)(2)(C). The income limit for a low-income housing unit is based on the minimum set-aside election made by the owner under IRC §42(g)(1).

Items to consider when determining whether the rent is correctly restricted include services provided, revisions to HUD income limits, rent calculation methods, changes in the tenant's income, Section 8 tenants, Rural Housing Service (formerly FmHA) rents, supportive services, and deep rent skewing.

**Fees -  
Provision of  
Services**

Units may be residential rental property notwithstanding the fact that services *other than housing* are provided. However, any charges to low-income tenants for services that are not optional generally must be included in gross rent (Treas. Reg. 1.42-11). A service is optional when the service is not a condition of occupancy and there is a reasonable alternative. Charges for non-optional services such as a washer and/or dryer hookup fee and built-in/on storage sheds (paid month-to-month or a single payment) would always be included within gross rent. No separate fees should be charged for tenant facilities (i.e., pools, parking, recreational facilities) if the costs of the facilities are included in eligible basis. *Assuming they are optional*, charges such as pet fees, laundry room fees, garage, and storage fees may be charged in addition to the rent; i.e., they are not included in the rent computation.

**Fees –  
Condition of  
Occupancy**

Under Treas. Reg. §1.42-11(a)(3), the cost of services that are required as a condition of occupancy must be included in gross rent even if federal or state law required that the services be offered to tenants by building owners.

1. Refundable fees associated with renting an LIHC unit are not included in the rent computation. For example, security deposits and fees paid if a lease is prematurely terminated<sup>1</sup> are one-time payments that are not considered in the rent calculation.
2. Required costs or fees, which are not refundable, are included in the rent computation. Examples include fee(s) for month-to-month tenancy and renter's insurance.

Fees for preparing a unit for occupancy must not be charged; owners are responsible<sup>2</sup> for physically maintaining LIHC units in a manner suitable for occupancy.

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<sup>1</sup> Leases commonly include fees for early termination of the rental agreement. The fact that the lease contains terms for this contingency is not indicative of transient use.

<sup>2</sup> See IRC §42(i)(3)(B)(i) and Treas. Reg. §1.42-5(g).

**Fees –  
Application  
Processing**

Application fees may be charged to cover the actual cost of checking a prospective tenant’s income, credit history, and landlord references. The fee is limited to recovery of the actual out-of-pocket costs. No amount may be charged in excess of the average expected out-of-pocket costs of checking tenant qualifications at the project. It is also acceptable for the applicant to pay the fee directly to the third party actually providing the applicant’s rental history. See PLR 9330013, Issue 1, for an example.

**Changes to  
HUD Income  
Limits**

Rents must be calculated using HUD<sup>3</sup> income limits. The lowest rents owners will be required to charge (gross rent floor) are based on the income limits in effect when the building is allocated credits, unless the owner elects<sup>4</sup> (and notifies the housing credit agency of the election) to treat the rent floor as taking effect on the date the building is placed in service. This rule applies to properties receiving credit allocations or determination letters under IRC §42(m)(2)(D) after October 6, 1994. For allocations and determination letters after 1989 and before October 7, 1994, owners and state agencies may use a date based on a reasonable interpretation of IRC §42. Before 1990, the gross rent floor took effect at the time the building was placed in service. See IRC §42(g)(2)(A). If the income limits increase, there is no noncompliance as long as the rents are at or below the maximum rents in effect at that time. However, if the income limits are reduced, the maximum rent charged, as well as the gross rent floor, should be reviewed.

Example 1: HUD Income Limit Reduced (Credit Allocation Date)

The owner elected the 40/60 minimum set-aside on Form 8609. HUD issues reduced income limits effective 1/1/2000. The revised maximum 60% gross rent is \$400, which is *below* the calculated maximum rent floor of \$500 in effect at the time the owner received the credit allocation. The owner has been charging \$450 rent and a \$50 utility allowance. There is no noncompliance; owner may rely on his gross rent floor and continue to charge \$500 in total rent.

Example 2: HUD Income Limit Reduced (Placed-in-Service Date)

The owner elected the 40/60 minimum set-aside on Form 8609 and elected to treat the rent floor as taking effect on the date the building was placed in service on July 12, 1999. HUD then issued reduced income limits effective 1/1/2000. The revised maximum 60% gross rent is \$400, which is *above* the calculated rent floor of \$300 at the time the owner placed the building in service. The owner *may* charge rent of \$350 and a \$50 utility allowance, for a total of \$400.

**Rent  
Calculation  
Methods**

Pre-1990: Gross rent for properties receiving tax credit allocations or bond-financed buildings placed in service before January 1, 1990 and for which the election<sup>5</sup> to determine rents based on number of bedrooms was not made, may not exceed thirty percent (30%) of the HUD-determined median income limit adjusted for the actual number of people in the household for the area in which the property is located. Under

<sup>3</sup> Owners have 45 days to implement revised income limits after they are published by HUD or HUD’s effective date for the new list, whichever is later. See Rev. Rul. 94-57, 1994-2 C.B. 5.

<sup>4</sup> See Rev. Proc. 94-57, 1994-2 C.B. 774.

<sup>5</sup> See Rev. Proc. 94-9, 1994-1 C.B. 555.

this method, the maximum allowable rent varies with the number of individuals occupying the unit. This is the method used prior to the Revenue Reconciliation Act of 1989.

Post-1989: For properties receiving tax credit allocations or placing bond-financed buildings in service after December 31, 1989<sup>6</sup> and for pre-1990 properties subject to the bedroom election under Rev. Proc. 94-9, maximum gross rents are computed based on the number of bedrooms in the unit. Units with no separate bedroom are treated as being occupied by one person and units with separate bedrooms are treated as being occupied by 1.5 persons per each separate bedroom. Note: The bedroom method calculation may be applied only for households moving into units *after* the date the bedroom election was made. Units with households living in the property before the date of the election will continue to be charged rents based on the number of family members actually living in the unit until such time as a turnover in occupancy occurs.

#### Example 1: Rent Exceed Limit - Bedroom Election

Assume credits were allocated in 1988 and the owner elected by February 7, 1994 to use the bedroom election to calculate rent. A one-person household moved into a 2-bedroom unit on February 1, 1994 and paid the maximum one-person gross rent of \$300 and a \$50 utility allowance. Following the bedroom election, the owner raises this household's rent to the maximum two-bedroom rent of \$500, plus a \$50 utility allowance, for a total rent of \$550.

This is not allowable because the household moved into the unit before the date of the election and the rent of \$550 is over the allowable maximum. Rent in this unit may only be changed to the bedroom calculation method on the date a new household moves in. The owner must immediately reduce the rent charge to \$300 rent, plus a \$50 utility allowance. Date of correction is the date of the lease amendment.

#### **Tenant Income Rises Above Limit**

A unit shall 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<sup>7</sup>. The owner may also be subject to the Available Unit Rule and the Vacant Unit Rule. (See chapters 14 and 15.)

#### **Section 8 Tenants**

The gross rent limit applies only to payments made directly by the tenant. Any rental assistance payments made on behalf of the tenant, such as through section 8 of the United States Housing Act of 1937 or any comparable Federal rental assistance, are not included in gross rent. Congress further intended that any comparable state or local government rental assistance not be included in gross rent. See IRC §42(g)(2)(B)(i) and the General Explanation of the Tax Reform Act of 1986.

#### Example 1: Household Portion of Rent is Below Limit

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<sup>6</sup> IRC §42(g)(2)(C)

<sup>7</sup> IRC § 42(g)(2)(D)(i).

A Section 8 household moved into a unit on January 1, 2000; the maximum LIHC gross rent is \$500 and market rate is \$600. Household pays \$200 and the assistance pays \$400; the total rent is \$600. There is no noncompliance since the household portion of rent is below the maximum LIHC rent allowed.

The portion of the rent paid by Section 8 tenants can exceed the LIHC rent ceiling as long as the owner receives a Section 8 assistance payment on behalf of the resident. If no subsidy is provided, the tenant may not pay more than the LIHC rent ceiling.

#### Example 2: Tenant's Portion of Rent Exceeds Rent Limit

A Section 8 household with an annual income of \$18,000 applies for an LIHC unit for which the rent is restricted to \$500 and for which the market rate rent is \$750. Assistance will pay a maximum of \$500, and the applicant's portion is \$600 (40 percent of income). Since the applicant is required to pay \$600, Section 8 will pay \$150. There is no noncompliance.

Note: This example reflects HUD's requirement under the Section 8 housing choice program. The family share may not exceed 40 percent of the family's share monthly adjusted income when the family initially moves into the unit or signs the first assisted lease for a unit. Additional information available at [www.hudclips.org/sub\\_nonhud/jtml/pdf/forms/7420g06.pdf](http://www.hudclips.org/sub_nonhud/jtml/pdf/forms/7420g06.pdf).

#### **Rural Development (FmHA) Rents**

Originally, the rent restrictions for projects with Rural Development assistance were computed using the general rules for LIHC housing. Beginning in 1991, however, gross rent does not include any rental payment to the owner of the unit to the extent such owner pays an equivalent amount to the USDA Rural Housing Service<sup>8</sup> under section 515 of the Housing Act of 1949. See IRC §42 (g)(2)(B)(iv). In other words, as long as the owner pays Rural Development the rent amount over the limit (all of the overage) that unit is in compliance.

#### Example 1: Rent Above Limit (Owner Pays Rural Development, formerly known as FmHA)

Assume a 1991 credit allocation to a property with Rural Development assistance. The maximum gross LIHC rent is \$500 and the household's calculated rent under Rural Development regulations is \$650, which the owner charges. The owner provides documentation that the \$150 above the tax credit maximum has been remitted directly to Rural Development. There is no noncompliance.

#### **Supportive Services**

After 1989, gross rent does not include any fee for a supportive service paid to the owner by any governmental program or tax-exempt organization if the amounts paid for rent and assistance are not separable.<sup>9</sup> Under Treas. Reg. §1.42-11, supportive services mean any service designed to enable residents to be independent and avoid placement in a hospital, nursing home, or intermediate care facility for the mentally or physically

<sup>8</sup> Formerly known as the Farmer's Home Administration.

<sup>9</sup> IRC §42(g)(2)(B)(iii) and Revenue Reconciliation Act of 1989.

handicapped. Examples of supportive services include transportation, housekeeping, or planned social activities. Supportive services do not include continual or frequent nursing, medical, or psychiatric services.

#### Example 1: 1990 Credit Allocation

Assume a 1990 credit allocation. The maximum gross rent is \$500 and the owner receives a monthly payment of \$600 from a tax-exempt organization to assist the household with the living expense of handicapped persons so that such persons can live independently and avoid placement in a hospital. There is no noncompliance as long as the owner provides documentation that the assistance is inseparable from the rental of the unit and complies with above rule.

#### **Deep Rent Skewing**

Under IRC §142(d)(4)(B)<sup>10</sup>, an owner can elect to provide housing to households with incomes of 40% or less of the Area Median Gross Income (AMGI). The election is made on Form 8609, Low-Income Housing Certification, line 10d. The project qualifies if:

1. 15 percent or more of the low-income units are occupied by individuals whose income is 40 percent or less of the AMGI;
2. The gross rent with respect to each low-income unit in the project does not exceed 30 percent of the applicable income limit which applies to the individuals occupying the unit; and
3. The gross rent with respect to each low-income unit in the project does not exceed ½ of the average gross rent with respect to units of comparable size that are not occupied by individuals who meet the applicable income limit.

#### **Assistance Provided Under the HOME Investment Partnership Act**

IRC §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 if 40 percent or more of the residential units *in the building* are occupied by individuals whose income is 50 percent or less of the Average Median Gross Income (AMGI). The rent restriction for all the low-income units, including the units used to satisfy the rules under IRC §42(i)(2)(E)(i), is based on the applicable income limitation under IRC §42(g). See Rev. Rul. 2004-82, Q&A #6.

#### **In Compliance**

A unit is in compliance when the rent charged does not exceed the limitations.

#### Example 1: Provision of Optional Services

An LIHC property provides hot meals twice a day for the convenience

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<sup>10</sup> IRC §42(g)(4) authorizes the application of deep rent skewing under IRC §142(d)(4)(B) for IRC §42 properties.

of its tenants in a common dining facility. They charge a nominal fee to cover their costs, but do not include the cost in the rent charged for the apartments. Each unit in the property includes a fully functional kitchen.

In this case, a practical alternative exists for tenants to obtain meals other than from the dining facility, and payment for the meals in the common dining facility is not required as a condition of occupancy. Thus, the cost of the meals is not included in gross rent for purposes of IRC §42(g)(2)(A) and Treas. Reg. §1.42-11(b).

#### Example 2: Fee for Late Payment of Rent

A tenant pays the maximum rent of \$525 for a one bedroom unit. The tenant did not pay the rent timely and was charged a late fee of \$35, as stated in the lease.

The \$35 late is a penalty for failure to perform according to the lease agreement and, therefore, the fee is not included in the rent.

## Out of Compliance

A unit is out of compliance when the rent charged exceeds the limitation.

1. If the noncompliance is the result of noncompliance with the utility allowance requirements, the error should be noted under category 11m, Owner did not properly calculate utility allowance.
2. If the noncompliance is the result of a systemic error, also evaluate whether the minimum set-aside under IRC §42(g)(1) was met. See chapter 9.

#### Example 1: Tenant Income Rises Above Limit

A household was initially income qualified and moved into a unit on 1/1/2000. The maximum LIHC gross rent is \$500. At recertification, the owner increased the rent to the market rate of \$1,000.

The unit is out of compliance, beginning on the date the rent was increased above the maximum of \$500.

## Back in Compliance

A unit is back in compliance when the rent charged does not exceed the limit. An owner cannot avoid the disallowance of the LIHC by rebating excess rent to the affected tenants.

#### Example 1: Overcharged Rent

The owner leased the minimum number or units to IRC §42 eligible tenants during the third year of the credit period. However, the owner inadvertently overcharged rent to tenants occupying 3 bedroom apartments. The error impacted 15 out of 75 units.

The unit is back in compliance when the owner correctly limits the rent for all units.

#### Example 2: Overcharged Rent Impacted Minimum Set-Aside

The owner leased the rental units in a 100% LIHC building to IRC §42 eligible tenants by the end of the first year of the credit period. However, the owner overcharged rent for all the units and, as a result, failed to meet the minimum set-aside for the first year of the credit period.

The building does not qualify for LIHC.

#### References

1. Rev. Rul. 91-38, 1991-2 C.B. 3.
2. Rev. Rul. 98-47, 1998-2 C.B. 399.
3. Rev. Rul. 2004-82, 2004-35 I.R.B 350.

**Chapter 12**  
**Category 11h**  
**Project not Available to the General Public**

**Definition**

This category is used to report properties that are not available to the general public. A residential rental unit is for use by the general public if the property conforms to the requirements of Treas. Reg. § 1.42-9. Under Treas. Reg. 1.42-9(b), if a residential 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 IRC §42. The general public use rules are violated any time the general public is denied access to LIHC housings.<sup>1</sup> Residential rental units either designated for a single occupational group, or through a preference for an occupational group, also violate the general public use requirements.

In addition, any residential rental unit that is part of a hospital, nursing home, sanitarium, life care facility, retirement home providing significant services other than housing, dormitory, trailer park, or intermediate care facility for the mentally and physically disabled is not for use by the general public.

**Fair Housing Act**

LIHC properties are also subject to Title VIII of the Civil Rights Act of 1968, which makes it unlawful to discriminate in any aspect relating to the sale, rental, or financing of dwellings because of race, color, religion, sex, or national origin. The Fair Housing Act of 1988 expanded coverage of Title VIII to include familial status and disabilities. Notifications of administrative and legal actions in regards to the Fair Housing Act are also reported to the IRS using Form 8823. See chapter 13 for complete discussion.

**In Compliance**

Owners must rent their units in a manner consistent with the general public use requirements to be in compliance with IRC §42. Residential rental units must be for use by the general public and all of the units in a project must be used on a nontransient basis. 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.

**Out of Compliance**

The failure of LIHC buildings to comply with the general public use requirements will result in the denial of low-income housing credits on a per-unit basis. A unit is out of compliance starting on the date of the event triggering the noncompliance. State agencies will also need to consider whether the problem is systemic and whether owner has met the minimum set-aside under IRC §42(g)(1). See chapter 10.

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<sup>1</sup> General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99<sup>th</sup> Congress; Public Law 99-514.

### Example 1: LIHC Units Restricted to Members of a Social Organization

The owner of an LIHC building started renting only to members of a local fraternal organization in the third year of the compliance period. By the fifth year, all the tenants in the building were members of the organization.

This building is in violation of the general public use requirements under Treas. Reg. § 1.42-9(b), which provides that a residential unit rented only to a member of a social organization is not for use by the general public and is not eligible for the credit under IRC §42. The noncompliance started on the date the first nonqualified tenant moved into a unit in the third year of the credit period.

### Back in Compliance

The owner is back in compliance with the general public use requirements when two conditions are met:

1. The owner demonstrates that marketing and rental practices are no longer in violation of the general public use rules.
2. All the units are made available to the general public.

### Example 1: Units Rented to Members of an Occupational Group

An owner placed a 100% LIHC building in service, began claiming the credit in 2000, and elected the 40/60 minimum set-aside. In 2002, when all 25 units were in compliance with qualifying households, the owner decided to rent units solely to teachers. Starting on January 21, 2002, five vacated units were rented to teachers. During 2003, the owner rented an additional 11 units to teachers. The issue was identified during the state agency's inspection in 2004.

The building is out of compliance as of January 21, 2002, when the first unit is rented to a teacher. The applicable fraction for 2002 is 20/25 or 80%. The applicable fraction for 2003 is 9/25 or 36%, and since the minimum set-aside was not met, no credit is allowable for 2003.

The building is back in compliance when:

1. The owner demonstrates that marketing and rental practices are no longer in violation of the general public use rules, and
2. All the units are made available to the general public.

### References

Treas. Reg. §1.42-9

**Chapter 13**  
**Category 11h**  
**Project not Available to the General Public**  
**(Notifications of Fair Housing Act Administrative and Legal Actions)**

**Definition**

State agencies must report the receipt of notices of Fair Housing Act (FHA) administrative and legal action issued by HUD or the Department of Justice to the Internal Revenue Service.

**The Fair Housing Act**

LIHC properties are subject to Title VIII of the Civil Rights Act of 1968<sup>1</sup>, which makes it unlawful to discriminate in any aspect relating to the sale or rental of dwellings, in the availability of transactions related to residential real estate, or in the provision of services and facilities in connection therewith because of race, color, religion, sex, disability, familial status, or national origin.

**Reasonable Modification and Accommodation**

The FHA specifically makes it unlawful to refuse to permit, at the expense of the person with a disability, reasonable modifications to existing premises if the modifications are necessary to accommodate a person with a disability to occupy the premises. A landlord may, where reasonable, condition permission for a modification on the renter's agreeing to restore the interior of the premises to the condition that existed before the modification.

The FHA also makes it unlawful to refuse to make reasonable accommodations in rules, policies, practices or services to afford a person with a disability equal opportunity to use and enjoy a dwelling.

**Accessibility**

The FHA makes it unlawful to design and construct certain multifamily dwellings for first occupancy after March 13, 1991, in a manner that makes them inaccessible to persons with disabilities. The Fair Housing Act defines multifamily dwellings as buildings consisting of four or more units if such buildings have one or more elevators; and ground floor units in other buildings consisting of four or more units.

All premises within such dwellings are also specifically required to contain features of adaptive design so that the dwelling is readily accessible to and useable by persons with disabilities<sup>2</sup>. The FHA provides a list of the accessibility features necessary for compliance with the design and construction requirements<sup>3</sup>:

1. the public and common use portions of such dwellings are readily accessible to and usable by disabled persons;

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<sup>1</sup> 42 USC 3601 et.seq., as amended

<sup>2</sup> 42 USC §3604(f)(3)(c)(iii)

<sup>3</sup> Refer to the [Fair Housing Act Design Manual: A Manual to Assist Designers and Buildings in Meeting the Accessibility Requirements of the Fair Housing Act](#) for more specific information about these requirements. The manual is available through HUD USER 1-800-245-2691.

2. all the doors designed to allow passage into and within all premises within such dwellings are sufficiently wide to allow passage by disabled persons in wheelchairs;
3. all premises within such dwelling contain the following features of adaptive design:
  - (a) an accessible route into and through the dwelling;
  - (b) light switches, electrical outlet, thermostats, and other environmental controls in accessible locations;
  - (c) reinforcements in bathroom walls to allow later installation of grab bars;
  - (d) usable kitchens and bathrooms such that an individual in a wheelchair can maneuver about the space.

**Citizenship Status**

The FHA does not prohibit discrimination based solely on a person's citizenship status. Therefore, asking housing applicants to provide documentation of their citizenship or immigration status during the screening process would not violate the FHA. Owners implementing citizenship or immigration status screening measures must make sure they are carried out in a uniform, nondiscriminatory fashion.

Example 1: Visa Expiration

A person applying for an LIHC apartment mentions in the interview that he left his native country to study in the United States. The landlord, concerned that the student's visa may expire during tenancy, asks the student for documentation to determine how long he is legally allowed to be in the United States.

If the landlord requests this information, regardless of the applicant's race or specific national origin, the landlord has not violated the Fair Housing Act.

Questions concerning the Fair Housing Act should be referred to the state's HUD regional office. HUD's regional offices are listed in Exhibit 13-1.

**Role of the U.S. Department of Housing and Urban Development (HUD)**

HUD is responsible for enforcing the Fair Housing Act. In so doing, HUD investigates allegations of housing discrimination, attempts to resolve the complaint, and determines whether there is reasonable cause to pursue civil action. If reasonable cause is present, HUD must bring the case before an administrative law judge. In the alternative, if either party elects to have claims or complaints decided in a civil action, HUD must refer the complaint to the U.S. Department of Justice for prosecution in the United States District Court.

**Role of the U.S. Department of Justice**

The Department of Justice (DOJ) may file a lawsuit whenever the Attorney General has reasonable cause to believe that any person or group of persons is engaged in a pattern or practice of discrimination or denial of rights to a group of persons where such denial raises an issue of general public importance. DOJ may also file a lawsuit based upon HUD referrals involving the legality of any state or local zoning, or other land use law or ordinance if the parties agree to a civil action. DOJ may also enter into settlement/consent agreements with property owners to obtain compliance with the Fair Housing Act. DOJ may also seek a court judgment to enforce the terms of a settlement/consent agreement.

**Role of Substantially Equivalent State or Local Fair Housing Agency**

Where HUD has determined that state or local laws are substantially equivalent to the federal Fair Housing Act, a state or local fair housing agency investigates fair housing allegations, attempts conciliation, and determines whether reasonable cause exists to believe a discriminatory housing practice has occurred. If the fair housing agency makes a determination of reasonable cause, then a charge is filed with representation of the complainant provided by a state or local representative.

**Memorandum of Understanding (MOU) Among Treasury , HUD and DOJ**

Treasury, HUD, and DOJ entered into an MOU in a cooperative effort to promote enhanced compliance with the Fair Housing Act for the benefit of residents of LIHC properties and the general public. Key points of the MOU include coordinated procedures for notifying the state agencies and IRS of charges, lawsuits, or other actions under the Fair Housing Act involving an LIHC property. The MOU also calls for interagency assistance and training, training for the state agencies and industry stakeholders, and training for architects on the accessibility requirements. See Exhibit 13-2 for the full text of the MOU.

**Reporting of Fair Housing Act Administrative and Legal Actions**

HUD or DOJ will notify a state agency of:

1. a charge by the Secretary of HUD for a violation of the Fair Housing Act,
2. a probable cause finding under a substantially equivalent fair housing state law or local ordinance by a substantially equivalent state or local agency,
3. a lawsuit under the Fair Housing Act filed by the DOJ, or
4. a settlement agreement or consent decree entered into between HUD or DOJ and the owner of an LIHC property.

Other non-FHA civil rights actions and lawsuits, such as section 504 Rehabilitation Act lawsuits or administrative actions, are not covered under the terms of the MOU and should not be reported to the IRS.

On receipt of such a notification, a state agency should immediately file a Form 8823 with the IRS noting the potential violation using the “out of compliance” box and notify the owner in writing. A sample letter that a state agency should send to the owner is included as Exhibit 13-3.

When a Form 8823 pertaining to the above is received, the IRS will send a letter to the owner notifying the owner that a finding of discrimination, including an adverse final decision by the Secretary of HUD, an adverse final decision by a substantially equivalent state or local fair housing agency, or an adverse judgment by a federal court, will result in the loss of low-income housing credits. Similarly, the IRS will also send a letter to owners notifying them that a judgment enforcing the terms of a settlement agreement or consent decree will result in the loss of low-income housing credits.

**Potential Violations Discovered by State Agencies**

State agencies should report potential Fair Housing Act violations discovered during their compliance monitoring activities to their HUD Regional offices, or other fair housing enforcement agencies, as appropriate. HUD's Regional offices are listed in Exhibit 13-1. Do not submit this information to the IRS via Form 8823.

**State Agency Notified by HUD or DOJ that the Terms of Settlement Agreement, Consent Decree, or Judgment are Satisfied**

Form 8823 should be filed with the IRS when the civil action is completed. HUD or DOJ will notify the state agency of the resolution of an alleged violation of the Fair Housing Act. Documentation that the owner has complied with the court order and/or HUD's requirements and that the violation has been corrected is needed.

## **IRS Determinations**

The state agencies are responsible for reporting their receipt of notifications of administrative and legal action by HUD and the Department of Justice as outlined in the MOU. The IRS is responsible for determining whether the owner is out of compliance for purposes of IRC §42, and the associated out of compliance and back in compliance dates, based on the findings of the court proceeding. The determination will be based on the facts of the individual case.

### **Example 1: Violation of Fair Housing Act**

A LIHC project discriminated against single women in its rental practices. The U.S. Department of Justice initiated a lawsuit and obtained a judgment covering all units in the project. The property violates the Fair Housing Act and is in violation of Treas. Reg. §1.42-9.

Depending on the nature of the violation, noncompliance may be determined at the unit, building, or project level. 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.

## **Reference**

Treas. Reg. §1.42-9(a)

**Exhibit 13-1  
HUD's Regional Offices**

<b>HUD AREA</b>	<b>DIRECTOR</b>	<b>PHONE NUMBER</b>	<b>REGIONAL STATES</b>
<b>REGION I BOSTON</b> Fair Housing Hub U.S. Department of Housing and Urban Development Thomas P. O'Neill, Jr. Federal Building 10 Causeway Street, Room 321 Boston, MA 02222-1092	Marcella Brown	617 994-8320	Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont
<b>REGION II NEW YORK</b> Fair Housing Hub U.S. Department of Housing and Urban Development 26 Federal Plaza - Suite 3532 New York, New York 10278-0068	Stanley Seidenfeld	212 264-1290 Ext. 3501	New Jersey, New York
<b>REGION III PHILADELPHIA</b> Fair Housing Hub U.S. Department of Housing and Urban Development The Wanamaker Building 100 Penn Square East, 12 <sup>th</sup> Floor Philadelphia, PA 19107-3380	Wanda S. Nieves	215-656-0661 Ext. 3265	Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, and West Virginia
<b>REGION IV ATLANTA</b> Fair Housing Hub U.S. Department of Housing and Urban Development Five Points Plaza 40 Marietta Street, 16th Floor Atlanta, Georgia 30303-2806	Gregory King	404 331-5001 Ext. 3660	Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, Puerto Rico, South Carolina, and Tennessee
<b>REGION V CHICAGO</b> Fair Housing Hub U.S. Department of Housing and Urban Development Ralph H. Metcalfe Federal Building 77 West Jackson Boulevard, Rm. 2101 Chicago, Illinois 60604-3507	Barbara Knox	312 353-7776 Ext. 2400	Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin
<b>REGION VI FORT WORTH</b> Fair Housing Hub U.S. Department of Housing and Urban Development 801 Cherry Street, 27 <sup>th</sup> Floor P.O. Box 2905 Fort Worth, Texas 76113-2905	Garry Sweeney	817 978-5868	Arkansas, Louisiana, New Mexico, Oklahoma, and Texas

**Exhibit 13-1  
HUD's Regional Offices**

<p><b>REGION VII KANSAS CITY</b> Fair Housing Hub U.S. Department of Housing and Urban Development Gateway Tower II 400 State Avenue, Room 200 Kansas City, Kansas 66101-2406</p>	<p>Robbie Herndon</p>	<p>913 551-6889</p>	<p>Iowa, Kansas, Missouri, and Nebraska</p>
<p><b>REGION VIII DENVER</b> Fair Housing Hub U.S. Department of Housing and Urban Development 633 17th Street, 13th Floor Denver, Colorado 80202-3690</p>	<p>Evelyn Meininger</p>	<p>303 672-5434 Ext. 1364</p>	<p>Colorado, Montana, North Dakota, South Dakota, Utah, and Wyoming</p>
<p><b>REGION IX SAN FRANCISCO</b> Fair Housing Hub U.S. Department of Housing and Urban Development Philip Burton Federal Building &amp; U.S. Courthouse 450 Golden Gate Avenue, 9<sup>th</sup> Floor P.O. Box 36003 San Francisco, CA 94102-3448</p>	<p>Chuck Hauptman</p>	<p>415 436-8420</p>	<p>Arizona, California, Hawaii, and Nevada</p>
<p><b>REGION X SEATTLE</b> Fair Housing Hub U.S. Department of Housing and Urban Development Seattle Federal Office Building 909 First Avenue, Rm. 205 Seattle, Washington 98104-1000</p>	<p>Judith Keeler</p>	<p>206 220-5170 Ext. 3415</p>	<p>Alaska, Idaho, Oregon, and Washington</p>

**Exhibit 13-2**

**MEMORANDUM OF UNDERSTANDING AMONG  
THE DEPARTMENT OF THE TREASURY,  
THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, AND  
THE DEPARTMENT OF JUSTICE**

**Preamble**

The United States Departments of the Treasury, Housing and Urban Development, and Justice enter into this memorandum of understanding (MOU) in a cooperative effort to promote enhanced compliance with the Fair Housing Act (Act), 42 U.S.C. §§ 3601 et seq., for the benefit of residents of low-income housing tax credit properties and the general public.

It is recognized that the Department of the Treasury's (Treasury) Internal Revenue Service (IRS) is responsible for administering and enforcing the tax laws in the low-income housing tax credit program under § 42 of the Internal Revenue Code, 26 U.S.C. § 42. In accordance with § 1.42-9 of the Income Tax Regulations, 26 C.F.R. § 1.42-9, low-income housing tax credit properties are to be rented in a manner consistent with the Act. Noncompliance of these properties with the low-income housing tax credit provisions is required to be reported to the IRS by state housing finance agencies under 26 U.S.C. § 42(m)(1)(B)(iii).

It is recognized that the Department of Housing and Urban Development (HUD) is responsible for enforcing the Act, 42 U.S.C. §§ 3601 et seq. In doing so, HUD is required to investigate allegations of housing discrimination, attempt conciliation of the complaint, and determine whether there is reasonable cause to believe discrimination has occurred under the Act. Upon finding reasonable cause, HUD must bring the case before an administrative law judge, or if either party elects to have claims or complaints decided in a civil action, HUD must refer the complaint to the Department of Justice for prosecution in the United States District Court.

It is recognized that the Department of Justice (Justice) is responsible for enforcing the Act, 42 U.S.C. §§ 3601 et seq. Pursuant to section 3614 of the Act, Justice may file a lawsuit whenever the Attorney General has reasonable cause to believe that any person or group of persons is engaged in a pattern or practice of discrimination or denial of rights to a group of persons where such denial raises an issue of general public importance. Justice also may file a lawsuit upon referral of matters from HUD involving the legality of any state or local zoning or other land use law or ordinance and after receiving a referral from HUD following an election by a party to a HUD complaint to have the matter decided in a civil action. Justice may enter into

settlement agreements and consent decrees with property owners to obtain compliance with the Act. In the event a property owner fails to comply with the terms of the settlement agreement or consent decree, Justice may seek a court judgment to enforce the terms of the settlement agreement or consent decree.

The parties to this MOU agree to the following:

1) Coordination on Notifying Low-Income Housing Tax Credit Property Owners about Charges, Lawsuits, and Other Actions

HUD and Justice will identify low-income housing tax credit properties for which there is: 1) a charge by the Secretary of HUD for a violation of the Act; 2) a probable cause finding under a substantially equivalent fair housing state law or local ordinance by a substantially equivalent state or local agency; 3) a lawsuit under the Act filed by Justice; or 4) a settlement agreement or consent decree entered into between HUD or Justice and the owner of a low-income housing tax credit property. HUD or Justice will then transmit the address of the property and a summary of these actions to the appropriate state housing finance agency, using a current list of contacts and addresses of state housing finance agencies provided by the IRS.

Upon the state housing finance agencies reporting this information to the IRS (using Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance), the IRS will send a letter to involved property owners notifying them that a finding of discrimination, including an adverse final decision by the Secretary of HUD, an adverse final decision by a substantially equivalent state or local fair housing agency, or an adverse judgment by a federal court, could result in the loss of low-income housing tax credits. Similarly, the IRS will also send notification to property owners that a judgment enforcing the terms of a settlement agreement or consent decree could result in the loss of low-income housing tax credits. The IRS, HUD, and Justice will collaboratively develop the model letters addressed to property owners and other entities. HUD and Justice will also send to the IRS and the appropriate state housing finance agency a summary of the above-referenced actions, describing relevant information such as the precise nature of the violation, the dates of the violation, and proposed corrective actions.

2) Designating Contacts and Interagency Technical Assistance and Training

HUD and Justice will designate personnel to provide the IRS upon request with technical assistance and problem resolution concerning emerging civil rights and discrimination matters involving the administration of the low-income housing tax credit program (e.g., accessibility issues, section 8 vouchers, civil rights interpretative issues, and published guidance). In addition, HUD and Justice will provide training upon request to a few designated IRS personnel about the Act. The IRS will designate personnel to provide technical assistance and training upon request to HUD and Justice personnel on general tax administration issues under the low-income housing tax credit program, in a manner consistent with the IRS's disclosure limitations contained in section 6103 of the Internal Revenue Code.

### 3) Training for State Housing Finance Agencies and Others

HUD and Justice will make training available upon request to state housing finance agencies and other entities (e.g., developers, property management companies, syndicators) on the Act, including training on inspecting for Act accessibility criteria referenced in the uniform physical condition standards in 24 CFR 5.703. HUD will also encourage substantially equivalent state and local fair housing agencies to invite state housing finance agencies and other entities to participate in civil rights training developed by the substantially equivalent agencies.

### 4) HUD=s Pilot Program to Train Architects on the Act=s Accessibility Requirements

HUD has begun the process of developing a pilot program in one region of the country to provide training and technical assistance to architects and others on the accessible design and construction requirements of the Act. HUD has also proposed expanding this program to four regions in FY 2001. HUD will promote participation in the program by members of the American Institute of Architects, including those involved with the design and construction of low-income housing tax credit properties.

### 5) Cooperation in Research Concerning Low-Income Housing Tax Credit Properties

HUD and Treasury will cooperate in research sponsored by either Department concerning low-income housing tax credit properties.

### 6) Cooperation to Identify and Remove Unlawful Barriers to Section 8 Tenants

In consultation with the state housing finance agencies, HUD, Justice, and the IRS will cooperate in identifying and removing unlawful barriers to occupancy of low-income housing tax credit properties by individuals holding section 8 vouchers.

### 7) Cooperation in Assisting Syndicators of Low-Income Housing Tax Credits

HUD, Justice, and the IRS will cooperate in helping the national associations of investment syndicators of low-income housing tax credit properties to enhance practices by syndicators in monitoring and promoting compliance with the Act and the low-income housing tax credit program.

### 8) Annual Civil Rights Meeting Among Federal Agencies and Participation in National Conference of State Housing Finance Agencies

HUD, Justice, Treasury, and other interested federal agencies will meet annually to discuss emerging civil rights issues and new methods and programs to increase civil rights compliance in the low-income housing tax credit program. IRS will encourage the state housing finance agencies to invite HUD and Justice to the annual national conference of state housing finance agencies. HUD and Justice agree to designate personnel to conduct training and discuss emerging civil rights issues at the national

conference.

### Implementation

This MOU will become effective 30 days from the date of the last signature on this document.

The parties agree to confer on the interpretation and application of the memorandum as necessary and to conduct a mutual annual review of its operation.

Nothing in this MOU shall be construed to impair or affect i) HUD's or Justice's authority to enforce the Act, ii) the IRS's authority to administer the low-income housing tax credit program, including complete administrative discretion to deny low-income housing tax credits in the event of a violation of the Act, or iii) the IRS's disclosure limitations under section 6103 of the Internal Revenue Code.

*/signed/  
Lawrence H. Summers*

*/signed/  
Andrew Cuomo*

*/signed/  
Janet Reno*

\_\_\_\_\_  
LAWRENCE H. SUMMERS  
Secretary of the Treasury

\_\_\_\_\_  
ANDREW CUOMO  
Secretary, U.S. Department  
of Housing and Urban  
Development

\_\_\_\_\_  
JANET RENO  
Attorney General

August 9, 2000

August 9, 2000

August 10, 2000

\_\_\_\_\_  
DATE

\_\_\_\_\_  
DATE

\_\_\_\_\_  
DATE

**Exhibit 13-2**

**MEMORANDUM OF UNDERSTANDING AMONG  
THE DEPARTMENT OF THE TREASURY,  
THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, AND  
THE DEPARTMENT OF JUSTICE**

**Preamble**

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It is recognized that the Department of Housing and Urban Development (HUD) is responsible for enforcing the Act, 42 U.S.C. §§ 3601 et seq. In doing so, HUD is required to investigate allegations of housing discrimination, attempt conciliation of the complaint, and determine whether there is reasonable cause to believe discrimination has occurred under the Act. Upon finding reasonable cause, HUD must bring the case before an administrative law judge, or if either party elects to have claims or complaints decided in a civil action, HUD must refer the complaint to the Department of Justice for prosecution in the United States District Court.

It is recognized that the Department of Justice (Justice) is responsible for enforcing the Act, 42 U.S.C. §§ 3601 et seq. Pursuant to section 3614 of the Act, Justice may file a lawsuit whenever the Attorney General has reasonable cause to believe that any person or group of persons is engaged in a pattern or practice of discrimination or denial of rights to a group of persons where such denial raises an issue of general public importance. Justice also may file a lawsuit upon referral of matters from HUD involving the legality of any state or local zoning or other land use law or ordinance and after receiving a referral from HUD following an election by a party to a HUD complaint to have the matter decided in a civil action. Justice may enter into

settlement agreements and consent decrees with property owners to obtain compliance with the Act. In the event a property owner fails to comply with the terms of the settlement agreement or consent decree, Justice may seek a court judgment to enforce the terms of the settlement agreement or consent decree.

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Upon the state housing finance agencies reporting this information to the IRS (using Form 8823, Low-Income Housing Credit Agencies Report of Noncompliance), the IRS will send a letter to involved property owners notifying them that a finding of discrimination, including an adverse final decision by the Secretary of HUD, an adverse final decision by a substantially equivalent state or local fair housing agency, or an adverse judgment by a federal court, could result in the loss of low-income housing tax credits. Similarly, the IRS will also send notification to property owners that a judgment enforcing the terms of a settlement agreement or consent decree could result in the loss of low-income housing tax credits. The IRS, HUD, and Justice will collaboratively develop the model letters addressed to property owners and other entities. HUD and Justice will also send to the IRS and the appropriate state housing finance agency a summary of the above-referenced actions, describing relevant information such as the precise nature of the violation, the dates of the violation, and proposed corrective actions.

2) Designating Contacts and Interagency Technical Assistance and Training

HUD and Justice will designate personnel to provide the IRS upon request with technical assistance and problem resolution concerning emerging civil rights and discrimination matters involving the administration of the low-income housing tax credit program (e.g., accessibility issues, section 8 vouchers, civil rights interpretative issues, and published guidance). In addition, HUD and Justice will provide training upon request to a few designated IRS personnel about the Act. The IRS will designate personnel to provide technical assistance and training upon request to HUD and Justice personnel on general tax administration issues under the low-income housing tax credit program, in a manner consistent with the IRS's disclosure limitations contained in section 6103 of the Internal Revenue Code.

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HUD has begun the process of developing a pilot program in one region of the country to provide training and technical assistance to architects and others on the accessible design and construction requirements of the Act. HUD has also proposed expanding this program to four regions in FY 2001. HUD will promote participation in the program by members of the American Institute of Architects, including those involved with the design and construction of low-income housing tax credit properties.

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HUD and Treasury will cooperate in research sponsored by either Department concerning low-income housing tax credit properties.

### 6) Cooperation to Identify and Remove Unlawful Barriers to Section 8 Tenants

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HUD, Justice, and the IRS will cooperate in helping the national associations of investment syndicators of low-income housing tax credit properties to enhance practices by syndicators in monitoring and promoting compliance with the Act and the low-income housing tax credit program.

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HUD, Justice, Treasury, and other interested federal agencies will meet annually to discuss emerging civil rights issues and new methods and programs to increase civil rights compliance in the low-income housing tax credit program. IRS will encourage the state housing finance agencies to invite HUD and Justice to the annual national conference of state housing finance agencies. HUD and Justice agree to designate personnel to conduct training and discuss emerging civil rights issues at the national

conference.

### Implementation

This MOU will become effective 30 days from the date of the last signature on this document.

The parties agree to confer on the interpretation and application of the memorandum as necessary and to conduct a mutual annual review of its operation.

Nothing in this MOU shall be construed to impair or affect i) HUD's or Justice's authority to enforce the Act, ii) the IRS's authority to administer the low-income housing tax credit program, including complete administrative discretion to deny low-income housing tax credits in the event of a violation of the Act, or iii) the IRS's disclosure limitations under section 6103 of the Internal Revenue Code.

/signed/

*Lawrence H. Summers*

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LAWRENCE H. SUMMERS  
Secretary of the Treasury

August 9, 2000

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DATE

/signed/

*Andrew Cuomo*

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ANDREW CUOMO  
Secretary, U.S. Department  
of Housing and Urban  
Development

August 9, 2000

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DATE

/signed/

*Janet Reno*

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JANET RENO  
Attorney General

August 10, 2000

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DATE

**Exhibit 13-3**  
**Sample Letter to Notify Building Owner**  
**of Potential Fair Housing Act Violations**

Date

Owner  
Address  
City State ZIP

RE:  
Project:  
BIN Numbers:

Dear Owner:

Enclosed are Forms 8823, Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition, concerning certain Fair Housing Act [administrative/legal actions] reported by [the U.S. Department of Housing and Urban Development (HUD)/U.S. Department of Justice] to this agency. Our agency has submitted these Forms 8823 to the Internal Revenue Service.

Low-income housing tax credit properties are subject to Title VIII of the Civil Rights Act of 1968, also known as the Fair Housing Act ("Act"). The Act prohibits discrimination in housing and housing related transactions, including the sale, rental and financing of dwellings, based on race, color, religion, sex, national origin, familial status, and disability. See 42 U.S.C. sections 3601 through 3619. The Act also mandates specific design and construction requirements for multifamily housing built for first occupancy after March 13, 1991, in order to provide accessible housing for individuals with disabilities.

Section 1.42-9 of the Income Tax Regulations provides that the failure of low-income housing tax credit properties to comply with the requirements of the Act results in the denial of credits on a per-unit basis. Thus, an adverse final decision by the Secretary of HUD, an adverse final decision by a substantially equivalent state or local fair housing agency, or an adverse final judgment by a federal court, including a judgment enforcing compliance with the terms of a settlement agreement or consent decree, could result in the disallowance of credits, recapture of credits, and preclusion of future credits on the effected units. If the reduction in the number of the low-income units in the building(s) brings the project below the minimum set-aside requirement defined in section 42(g)(1) of the Internal Revenue Code, the entire amount of the credit for the project could be disallowed.

Your ability to enter into a settlement agreement concerning the particular Fair Housing Act problem with HUD, the Department of Justice, or the state or local fair housing agency may preclude the necessity of loss of low-income housing tax credits. It is incumbent upon you to work with the appropriate agency to resolve the problem.

Sincerely,

Name-Signature  
Title

CC: Management Contact

**Chapter 14**  
**Category 11i**  
**Violations of the Available Unit Rule**  
**Under Section 42(g)(2)(D)(ii)**

**Definition**

This category is used to report violations of the Available Unit Rule (AUR)<sup>1</sup>; i.e., situations where an *initially* qualified household's income subsequently rises above 140 percent (170 percent in deep rent skewed developments) of the current income limit and a household that is not income qualified moves into the next available unit of comparable or smaller size.

The Available Unit Rule under IRC §42(g)(2)(D) states that if the income of the occupants of a low-income unit increases above 140 percent of the income limit (or 170 percent in deep rent skewed developments), the unit will continue to be treated as a low-income unit if the occupants initially met the income limitation and the unit continues to be rent restricted. If the income of the occupants of the unit increases above 140 percent of the applicable income limitation, the unit will cease to qualify as a low-income unit if any residential rental unit in the building (of a size comparable to, or small than, such unit) is occupied by a *new* resident whose income exceeds the income limitation.

**Compliance on a Continuing Basis**

The determination of whether a tenant qualifies for purposes of the low-income set-aside is made on a continuing basis, both with respect to the tenant's income and the qualifying income for the location, rather than only on the date the tenant initially occupies the unit.<sup>2</sup>

**Changes in Area Median Gross Income**

The determination of an over-income household is not limited to instances where the household's income increases. A unit may also become over-income if, subsequent to the initial income qualification, there is a decrease in the Area Median Gross Income (AMGI). Likewise, an increase in AMGI increases the income limitation used to calculate whether an owner must rent any available residential unit of comparable or smaller size to a new low-income tenant. See Rev. Rul. 94-57 for additional information.

**Treatment of Vacated Over-Income Units**

If an over-income household vacates a unit, it will be treated as an over-income unit subject to the Available Unit Rules until the effective date of the tenant income certification for the new income-qualified household that moves into the unit or the unit is rented to a nonqualifying tenant.

**Next Available Unit Defined**

The "next available unit" is any vacant unit, or any unit that is subsequently vacated in the same building, of a comparable or smaller size. Treas. Reg. §1.42-15(c) states that a unit is not available when the unit is no longer available for rent due to contractual arrangements that are binding under local law.

**Comparable or Smaller Unit**

A comparable or smaller unit is defined in § 1.42-15 as "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

<sup>1</sup> The terms Next Available Unit Rule (NAUR) and Available Unit Rule (AUR) are synonymous and can be used interchangeably.

<sup>2</sup> H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89.

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.” Since a comparable unit may need to be identified before the end of the year when the qualified basis is determined, an owner may consider a residential unit with similar square footage and amenities to be a comparable unit.

**Summary** Key concepts of the Available Unit Rule include:

1. The Available Unit Rule is used to replace over-income households with new income-qualified households as available units are rented. Alternatively, over-income units may be returned to low-income status if the household’s income decreases or the AMGI increases.
2. In a project containing more than one low-income building, the Available Unit Rule applies separately to each building.
3. Low-income units containing households whose income rises above 140% (or 170% for deep rent skewed projects) of the *current* income limit are still considered low-income units as long as the rent remains restricted and available units of comparable or smaller size are rented to qualified low-income households.
4. 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. An owner may consider a residential unit with similar square footage and amenities to be a comparable unit.
5. The owner of a low-income building must rent all comparable units that are available or that subsequently become available in the same building to qualified residents in order 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.
6. If any comparable or smaller unit that is available or that subsequently becomes available is rented to a nonqualified resident, all over-income units within the same building for which the available unit is comparable or *larger* lose their status as low-income units. See Treas. Reg. 1.42-15(f).
7. The Available Unit Rule should not be confused with the Vacant Unit Rule, which applies without regard to the income of existing tenants.

## **In Compliance**

A building is in compliance when the current applicable fraction is at the applicable fraction on which credit is based. Units containing households whose incomes originally qualified, but currently exceed 140 percent (170 percent for deep rent skewed projects) of the current income limit are included in the applicable fraction as long as the rents for the units continue to be restricted.

### Example 1: Change in Over-Income Units

A project consists of one building with 10 units of equal size. Units 1 through 8 are low-income units. Unit 9 is a market rate unit. Unit 10 is a vacant market rate unit. The applicable fraction for the credit is 80%. The current percentage of income-qualified tenants is 80% and the building is in compliance.

On July 1, 2000, the income of the tenants in units 6, 7 and 8 were determined to be over 14 percent of the income limit. The rents for these 3 units remained restricted. The current applicable fraction remains at 80% and the building continues to be in compliance.

To determine whether a noncompliance event could potentially occur, the owner calculated the applicable fraction without the over-income households as part of the numerator. This fraction is 50 percent (5/10). To remain in compliance, Unit 10 must be rented to a qualified household to replace one of the over-income households. In addition, if the tenant in Unit 9 (the other market rate unit) vacates, that unit must also be rented to a qualified household.

A qualified household moved into Unit 10 on August 1, 2000. At the time of the move in, the current applicable fraction (excluding all of the over-income units) has increased to 60 percent.

On August 31, 2000, the market rate household in Unit 9 vacated and a qualified household moved into Unit 9 on January 1, 2001. The applicable fraction (excluding all of the over-income units) has increased to 70 percent.

On December 31, 2000, the over-income household in Unit 6 vacated and a qualified household moved on February 1, 2001. The current fraction (excluding all of the over-income units) increases to 80%.

However, since all of the units are rent restricted, the applicable fraction is 100%. Management may now rent Units 7 and 8 to market rate households or they may convert the over-income households to market rents, depending on the terms of the leases. Once the percentage of low-income units in the 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.

### Example 2: Lease Reservation Signed Prior to the Effective Date of a Unit Becoming an Over-Income Unit

A project consists of one building with 10 units of equal size. The project is currently "in compliance" with respect to the qualified basis. Unit 10 is a vacant market rate unit. A market rate household signs a lease on June 25, 2000, for unit 10 and intends to move in on July 5, 2000. The lease term is from July 5, 2000 to June 30, 2001. The household in Unit 6 will be an over-income household effective July 1, 2000.

The building remains "in compliance" even though the available unit was *occupied* after the *effective* date of the over-income unit because a unit is not

available for purposes of the Available Unit Rule if the unit is unavailable due to contractual arrangements that are binding under local law. See Treas. Reg. §1.42-15(c).

## Out of Compliance

Under Treas. Reg. §1.42-15(c), noncompliance occurs when a comparable or smaller unit than the over-income unit is rented to a nonqualified household when the current applicable fraction (excluding all over-income units from the numerator, but not the denominator) is less than the applicable fraction for which the credit is based. The date of a noncompliance event is the date the unit the market unit household moves into the building or the reservation, if earlier.

### Example 1: Moving In Nonqualified Household When Over-Income Households Have Not Been Replaced

A project consists of one building with ten units of equal size. Units 1 through 8 are low-income units. Unit 9 is a market rate unit. Unit 10 is a vacant market rate unit. The applicable fraction for the credit is 80 percent. The current applicable fraction is 80 percent and the building is presently in compliance.

Units 6 and 7 were determined to be over-income. The rents for these two units remain rent restricted. The current applicable fraction remains at 80%.

To determine whether a non-compliance event could potentially occur, the owner calculated the applicable fraction without the over-income households as part of the numerator. The applicable fraction is now 60 percent (6/10). To remain in compliance, Unit 10 must be rented to a qualified household to replace one of the over-income households.

A market rate household moved into Unit 10 on August 1, 2000. At the time of the move in, the current applicable fraction (excluding all of the over-income units) was 60 percent. The event triggered an Available Unit Rule violation. All the over-income units cease to be treated as low-income units. The date of noncompliance is August 1, 2000.

### Example 2: Comparable Units

A mixed income building, with an applicable fraction of 85 percent, contains 85 tax credit units and 15 market rate units. Eleven of the low-income units are occupied by households with incomes that have increased above 140 percent of the income limit. The eleven over-income units consist of 4 three-bedroom, 5 two-bedroom, and 2 one-bedroom units. The next unit to be vacated is #99, a two-bedroom unit (not one of the eleven over-income units). The vacated unit is leased to a market rate tenant.

The building is out of compliance. To comply with the Available Unit Rule, the unit should have been leased to an income eligible household. Because the unit was leased to an ineligible tenant, all over-income units, for which #99 was a comparable or *larger*-sized unit, lose their status as low-income units. Thus, all 4 of the three-bedroom and all 5 of the two-bedroom units of the over-income units are out of compliance. The 2 one-bedroom units

(which are smaller than the rented unit) are not out of compliance (See Treas. Reg. §1.42-15(f).)

**Other Non-Compliance Issues**

Violations of the Available Unit Rule can also result in noncompliance with other IRC §42 requirements. Specifically, consideration should be given to the following:

1. Minimum Set-Aside Requirement – as violation of the AUR may result in multiple over-income units losing the low-income status, the minimum set-aside requirement may not be met; i.e., the number of qualifying units falls below the minimum requirement. See chapter 10.
2. Annual Income Recertifications and the Recertification Waiver – if the building is 100% LIHC and the owner has a waiver of the annual income recertification under IRC §42(g)(8)(B), qualified low-income units in the building continue to be treated as qualified low-income units even if the owner is not completing annual tenant income certification or otherwise documenting that the units are not over-income. However if the building owner rents an available unit in the building to a nonqualified household, the owner will need to determine if any of the units in the building are over-income, despite having a recertification waiver in effect. Further, under Rev. Proc. 94-64 or Rev. Proc. 2004-38, renting a unit to a nonqualified household in a 100% LIHC building will result in the revocation of the waiver. See chapter 5.
3. Annual Certification – the owner may have incorrectly reported compliance with the AUR as part of the annual certification as described in Treas. Reg. §1.42-5(c). See chapter 7.

**Addressing Violations**

Once the Available Unit Rule has been triggered, a building can return to its pre-violation credit amount by renting any combination of market rate units, over-income units, and out of compliance low-income units to qualified households until the applicable fraction upon which the pre-violation credit amount is based is restored. The applicable fraction can also be restored if:

1. The tenant’s income decreases to an amount below 140 percent of the income limit in place, or
2. The AMGI increases to an amount, such that 140 percent of the income limit is more than the tenant’s income.

The date of correction is the date the last household, which restores the applicable fraction, moves into the building or the income of an existing household falls below the current income limit. Bringing a building back into compliance does not remove the adverse effects that may have occurred.

## References

1. IRC §42(g)(2)(D)(ii).
2. Treas. Reg. §1.42-5(c)(I)(x).
3. IRC §42(d)(3)(B).
4. Treas. Reg. §1.42-15.
5. Rev. Rul. 94-57, 1994-2 C.B. 5.
6. Rev. Rul. 2004-82, 2004-35 I.R.B. 350.

**Chapter 15**  
**Category 11j**  
**Violation(s) of the Vacant Unit Rule**  
**Under Reg. 1.42-5(c)(1)(ix)**

**Definition**

This category is used to report violations of the Vacant Unit Rule (VUR); i.e., situations where an owner failed to make reasonable attempts to rent that unit, or the next available unit of comparable or smaller size, before renting units to tenants not having a qualifying income.

As part of the requirements for the annual certification, Treas. Reg. §1.42-5(c)(1)(ix) states, “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.”

**Reasonable Attempts**

As long as reasonable attempts are being made to rent to qualified low income households, vacant LIHC units will continue to be included as qualified low-income units for purposes of determining the minimum set-aside (IRC §42(g)(1)) and calculating the applicable fraction (IRC §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 would be considered reasonable.<sup>1</sup>

**Available Low-Income Unit Defined**

The definition of an available low-income unit for purposes of the Vacant Unit Rule is the same as used for the Available Unit Rule. Treas. Reg. §1.42-15(c) states that a unit is not available when the unit is no longer available for rent due to contractual arrangements that are binding under local law. See Rev. Rul. 2004-82, Q&A #10.

**Comparable Units**

The definition of a comparable or smaller unit for purposes of the Vacant Unit Rule is the same as used for the Available Unit Rule; i.e., a residential unit that is comparably sized or smaller than the vacated unit. For deep rent skewed projects described in section 142(d)(4)(B), any low-income unit is considered a comparable 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. (See Treas. Reg. §1.42-15(a).) Since a comparable unit may need to be identified before the end of the year when the qualified basis is determined, an owner may consider a residential unit with similar square footage and amenities to be a comparable unit.

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<sup>1</sup> Rev. Rul. 2004-82, Q&A #9.

## In Compliance

A project is in compliance when reasonable attempts are made to rent vacant low-income units (comparably sized or smaller than the vacated units) to tenants having a qualifying income before any units are rented to nonqualifying tenants. A state agency's responsibility for reviewing the owner's compliance with the Vacant Unit Rule must include a review of the owner's advertising practices; i.e., a project will be considered in compliance when the owner makes reasonable efforts to rent vacant units to qualified low income households before renting any vacant units to nonqualifying tenants.

### Example 1: Renting Market Rate Unit Before Low-Income Units<sup>2</sup>

Twenty market rate units and ten low-income units previously occupied by income-qualified tenants, in a 200-unit mixed-use housing project are vacant. None of the low-income units are over-income units. The 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's list of section 8 voucher holders. These are customary advertising methods for apartment vacancies in the area where the project is located. Subsequent to the low-income unit vacancies, a market rate unit of comparable size to the low-income units became vacant. The owner rents five market rate units before any of the ten vacant low-income units.

The owner is in compliance with the Vacant Unit Rule. The owner has used reasonable methods of advertising an apartment vacancy in the area of the project before renting a market rate unit. In addition, the Available Unit Rule is not violated by renting the market rate unit because there are no over-income units in the building.

A unit is not available for purposes of the vacant unit rule when the unit is no longer available to 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.

### Example 2: Low-Income Unit Not Available<sup>3</sup>

A building has 10 units, 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, so the owner started advertising to rent the unit to an income-qualified tenant. On March 29, 2004 the owner agreed to rent the unit to an income-qualified household and the parties signed a reservation binding on both parties. The owner ceased advertising efforts for the low-income unit. The vacant market rate unit was rented on April 15, 2004. The low-income household signed their lease on April 30, 2004 and

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<sup>2</sup> Rev. Rul. 2004-82, Q&A #9.

<sup>3</sup> Rev. Rul. 2004-82, Q&A #10.

moved in on May 1, 2004.

Since a reservation had been signed for the vacant low-income unit at the time the market unit was rented, the low-income unit was not available for rent and, therefore, the owner no longer needed to make reasonable efforts to rent the low-income unit.

## Out of Compliance

Noncompliance occurs when the owner does not make reasonable attempts to rent vacant low-income units and rents units to nonqualifying tenants. If the Vacant Unit Rule is violated, all vacant units previously occupied by qualified households lose their low-income status and are not considered qualified units. The date of noncompliance is the date the first low-income tenant moved out of the now vacant units.

### Example 1: Owner Stopped Making Reasonable Efforts to Rent Low-Income Housing Units

The owner of a mixed-use LIHC project with 100 units stopped advertising efforts to attract low-income tenants on January 15, 2004. 15 of the 25 market rate units are vacant and 25 of the 75 low-income units are vacant at the time the state agency conducts a tenant file review. The LIHC units were vacated between September 25, 2003 and March 31, 2004.

The project is out of compliance is September 25, 2003, when the first currently vacant low-income unit was vacated.

### Failure to Provide Information

If it is determine that an owner is not make reasonable attempts to rent vacant low-income units, the owner will need to provide the state agency a list of all vacant low-income units in the project. Under Treas. Reg. §1.42-5(b)(1)(v), owners are required to maintain records identifying vacant low-income units and information that shows, when, and to whom, the next available unit was rented. Failure to provide the needed information will result in a finding of noncompliance under 11f , Project failed to meet minimum set-aside requirement, because the owner has failed to establish that the minimum set-aside has been met.<sup>4</sup> Under IRC §6001, every taxpayer is required to maintain records sufficiently detailed to prepare a proper tax return. This requires the maintenance of such permanent books and records sufficient to establish the amounts of gross income, deductions, *credits*, or other matters to be shown on the taxpayer's return. This requirement extends to the preparation and maintenance of records sufficient for demonstrating compliance with the Vacant Unit Rule.

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<sup>4</sup> The legislative history explains that 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 provided that the owner has not violated the vacant unit rule.

## Addressing Violations

A project may return to its pre-violation status if a sufficient number of vacant units are rented to qualified low-income households.

### Example 1: Owner Restored Applicable Fraction

The owner of a mixed-use LIHC project with 100 units stopped advertising efforts to attract low-income tenants on January 15, 2004. 15 of the 25 market rate units are vacant and 25 of the 75 low-income units are vacant. The LIHC units were vacated between September 25, 2003 and March 31, 2004.

The project violated the Vacant Unit Rule on September 25, 2003, when the first currently vacant low-income unit was vacated. The owner resumes advertising efforts on June 18, 2004, and rented 13 former market rate units and 12 out of compliance low-income units between June 30, 2004 and November 18, 2004 to income-qualified tenants. The building is restored to its pre-violation status when the last household, which restores the applicable fraction, moves into the building; i.e., November 18, 2004, when 75% of the units were restored to the status of low-income units.

## References

1. Reg. 1.42-5(c)(I)(ix).
2. Rev. Rul. 2004-82, I.R.B 2004-350.

**Chapter 16**  
**Category 11k**  
**Owner Failed to Execute**  
**and Record Extended Use Agreement**  
**Within Time Prescribed by Section 42(h)(6)(J)**

**Definition**

This category is used to report buildings for which an extended low-income housing commitment (extended use agreement) is not in effect; i.e., the extended use agreement is not executed, is not recorded, or fails to meet the requirements of IRC §42(h)(6). No credit is allowable for a building in a year unless an extended use agreement is in effect at the end of the year. See IRC §42(h)(6)(A). If it is determined that an extended use agreement was not in effect at the beginning of the year, IRC §42(h)(6)(J) permits the owner to correct the problem within one year from the date of the determination.

For all buildings allocated tax credits after 1989, IRC §42(h)(6) requires owners of tax credit properties to enter into an extended use agreement with the state agency that allocated the credits to the project. Building owners must agree to a long-term commitment beginning on the first day of the 15-year compliance period and ending on the later of (1) the date specified by the state agency in the agreement or (2) the date which is 15 years after the close of the 15-year compliance period. In other words, the owner covenants to maintain the property as a low-income housing project for at least 30 years.

Extended use agreements must:

1. specify that the applicable fraction for the building for each year in the extended use period will not be less than the applicable fraction specified in the extended use agreement and which prohibits the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or any increase in the gross rent with respect to such unit not otherwise permitted under IRC §42.
2. allow individuals (whether prospective, present, or former occupants) who meet the income limitation applicable to the building under IRC §42(g) the right to enforce in state court the requirements and prohibitions under IRC §42(h)(6)(B)(i), including maintaining the applicable fraction and prohibiting the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or any increase in the gross rent with respect to such unit not otherwise permitted under IRC §42. These prohibitions apply through out the extended use period.<sup>1</sup>

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<sup>1</sup> Rev. Rul. 2004-82, 2004-35 I.R.B., Q&A #5 explains that IRC §42(h)(6)(B)(i) requires that an extended use 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 IRC §42. When Congress amended IRC §42(h)(6)(B)(i) to add the language cited, IRC §42(h)(6)(E)(ii) was already part of IRC §42. As a result, Congress must have intended the amendment to IRC §42(h)(6)(B)(i) to add an additional requirement beyond what was contained in IRC §42(h)(6)(E)(ii), which already prohibited the action described in that section for the 3 years following the termination of the extended use period. Because the

3. prohibit the disposition to any person of any portion of the building unless all of the building is disposed of to that person.
4. prohibit the refusal to lease to section 8 voucher holders because of the status of the prospective tenant as such a holder,
5. provide that the agreement is binding on all successors of the taxpayer, and
6. the extended use agreement must be recorded as a restrictive covenant with respect to the property under state law.

## **In Compliance**

The owner is in compliance when the extended use agreement is executed, recorded, and meets the requirements of IRC §42(h)(6). State agencies should require documentation that the extended use agreement has been recorded before issuing the Form 8609.

## **Out of Compliance**

The owner is out of compliance in the absence of a properly executed and recorded extended use agreement and no credit is allowable if the extended use agreement is not in effect as of the end of a taxable year in the credit period. However, if the owner executes and records an extended use agreement within one year after the determination that an extended use agreement is not in effect, the noncompliance is corrected and the taxpayer can claim the low-income housing credit for past taxable years. If the noncompliance is not remedied within one year after the notification, the taxpayer loses the credit for past taxable years until the taxable year in which the extended use agreement is properly in effect.

### **Example 1: Owner did not Execute and Record Extended Use Agreement**

The owner of a LIHC project placed the buildings in service in February 1998 and submitted the documentation for final approval in June 1998. The state agency issued the Form 8609 in September 1998, prior to receiving the executed extended use agreement from the owner. The owner claimed the credit for the 1998 tax year. The state agency later determined that an extended use agreement was not in effect for the 1998 tax year (the first year of the credit period), issued a notice of noncompliance to the owner in February 1999, and submitted Form 8823 to the IRS in May 1999, reporting the absence of the extended use agreement. In December 2000, the owner and state agency executed the extended use agreement, and recorded it.

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requirements of IRC §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 IRC §42(h)(6)(E)(ii) to apply throughout the extended use period. In Rev. Proc. 2005-37, 2005-28 I.R.B. 79, the Service established a safe harbor under which housing credit agencies and project owners could meet the requirements of IRC §42(h)(6)(B)(i) in lieu of an extended use agreement which specifically included the language of subclauses (I) and (II) of IRC §42(h)(6)(E)(ii).

The date of noncompliance is December 31, 1998, when the state agency determined that an extended use agreement was not in effect as of the end of the tax year. Since the owner failed to execute the extended use agreement within one year from the date of the notification, the owner will lose credits for 1998 and 1999, but can resume claiming the credits for 2000.

## **Back in Compliance**

The owner is back in compliance when the extended use agreement is executed and recorded within one year of the determination of noncompliance. If the extended use agreement is not in effect within one year of the determination that an extended use agreement was not in effect, the taxpayer loses low-income housing credits for past taxable years and cannot claim credit with respect to any building for which an extended use agreement is not in effect by the end of the applicable taxable year.

## **References**

1. IRC §42(h)(6)(A), (B) and (J).
2. Rev. Rul. 2004-82, 2004-35 I.R.B. 350.
3. Rev. Proc 2005-37, 2005-28 I.R.B. 79.

**Chapter 17**  
**Category 11I**  
**Low-Income Units Occupied by**  
**Nonqualified Full-Time Students**

**Definition**

This category is used to report LIHC units occupied by nonqualified full-time student households. A unit is *not* considered to be occupied by low-income individuals if all the occupants of such unit are students, no one of whom is entitled to file a joint return.<sup>1</sup>

**Defining  
“Student”**

IRC §151(c)(4) defines, in part, a “student” as an individual, who during each of 5 calendar months during the calendar year in which the taxable year of the taxpayer begins, is a full-time student at an educational organization described in IRC §170(b)(1)(A)(ii). Treas. Reg. §1.151-3(b) further provides that the five calendar months need not be consecutive.

The determination of student status as full or part-time should be based on the criteria used by the educational institution the student is attending.

An educational organization, as defined by IRC §170(b)(1)(A)(ii), is one that normally maintains a regular faculty and curriculum, and normally has an enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The term “educational organization” includes elementary schools, junior and senior high schools, colleges, universities, and technical, trade and mechanical schools. It does not include on-the-job training courses.

**Units  
Comprised  
Entirely of Full-  
Time Students**

Units comprised of full-time students (no one of whom is entitled to file a joint return) do not qualify as low-income units. However, there are exceptions as outlined in IRC §42(i)(3)(D). This section provides that a unit shall not fail to be treated as a low-income unit merely because it is occupied

1. by an individual who is:
  - I. a student receiving assistance under Title IV of the Social Security Act, or
  - II. a student enrolled in a job training program receiving assistance under the Job Training Partnership Act or under other similar Federal, State or local laws, or
2. entirely by full-time students if such students are
  - I. single parents with children all of whom are students and such parents and children are not dependents (as defined in IRC §152) of another individual, or
  - II. married and file a joint return.

In the case of a single parent with children, the legislative history explains that *none* of the tenants (parent or children) can be a dependent of a third party. See S. Prt. No. 103-37, 103d Cong., 1<sup>st</sup> Sess. 74 (1993).

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<sup>1</sup> H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89.

## In Compliance

A unit is in compliance when (1) it is not occupied entirely by full-time students at qualifying educational organizations for five or more months during the calendar year in which the taxable year of the taxpayer begins, or (2) it is occupied entirely by full-time students that meet one of the exceptions identified in IRC §42 (i)(3)(D). Also, a married couple that is *entitled* to file a joint tax return, but has not filed one, still satisfies the exception under IRC §42(i)(3)(D)(ii)(II).

### Example 1: Newly Married Students

A recently married full-time student couple is looking for housing. The couple is income qualified, but they have not yet filed their first tax. Even if the couple does not file a joint tax return, they are still entitled to file a joint return and thus satisfy the exception under IRC §42(i)(3)(D)(ii)(II).

### Example 2: Full Time Students

Two students attending college full time and working part time share a low-income housing unit with a third person who works full time and is not enrolled at the college. The students combined incomes qualify them as a household for low-income housing.

### Example 3: Qualified Educational Organization

An individual is participating in an accreditation program at a research facility. There is no tuition or degree, but the individual receives a small stipend for services provided and an accreditation certificate upon completion of the program. The program is similar to a doctor's residency. The research facility is not an educational organization and the individual would qualify for low-income housing.

## Out of Compliance

A unit is out of compliance when (1) it is occupied entirely by full-time students at qualifying educational organizations for five or more months during a calendar year in which the taxable year of the taxpayer begins, or (2) full-time students do not meet one of the exceptions identified in IRC §42 (i)(3)(D). The out of compliance date is the first day of the fifth month during the calendar year that the full-time student attended a qualifying educational organization.

### Example 1: Continuing Student Status

An otherwise qualifying low-income individual occupies a unit in June. She attended a qualifying educational organization for two months during the calendar year prior to the date she occupied the unit. From September through December of the calendar year she again attends a qualifying educational organization.

The unit is out of compliance on November 1, the first day of the fifth month she attended a qualifying educational organization during the calendar year.

### **Back in Compliance**

The unit is back in compliance when is no longer occupied entirely by full-time students or the tenant qualifies under one of the exceptions under IRC §42(i)(3)(D).

### **References**

1. IRC §151(c)(4).
2. IRC §170(b)(1)(A)(ii).
3. IRC §42(i)(3)(D).

**Chapter 18**  
**Category 11m**  
**Owner Did Not Properly**  
**Calculate Utility Allowance**

**Definition**

This category is used to report noncompliance with the utility allowance requirements outlined in Treas. Reg. §1.42-10. An allowance for the cost of any utilities, other than telephone and cable<sup>1</sup>, paid directly by the tenant(s) is included in the computation of gross rent under IRC §42(g)(2)(B). A separate estimate is computed for each utility and different methods can be used to compute the individual utility allowances. The utility allowance is computed on a building-by-building basis. The maximum rent that may be paid by the tenant must be reduced by utility allowance(s) obtained in the following manner.

1. If a building receives assistance from Farmer's Home Administration (FmHA), or tenants in the building receive FmHA housing assistance, then the FmHA utility allowance is used for all the rent restricted units in the building.
2. Buildings that are both HUD regulated and FmHA assisted use the FmHA utility allowance for all the rent restricted units in the building.
3. HUD regulated buildings use the HUD utility allowances for all rent restricted units in the building.
4. If a building is neither FmHA assisted nor HUD regulated, and no tenants receive FmHA assistance, the units occupied by one or more tenants receiving HUD rental assistance payments must use the applicable public housing authority utility allowances established for the existing Section 8 housing program. Other rent restricted units in the building use the public housing authority allowance as well, unless a utility company estimate is obtained and then that estimate becomes the appropriate allowance *for the building* (except for the HUD assisted units which will continue to use the public housing authority allowance).
5. If neither the building nor tenants are subject to the rules described in 1-4 above, then the local public housing authority (PHA) allowance is used. However, if an estimate is obtained for any unit from a utility company, that estimate is used as the utility allowance for all similar units in the building.

**Utility  
Company  
Estimates**

Under Treas. Reg. §1.42-10(b)(4)(ii)(B), any interested party (tenant, owner, or state agency) may request a written estimated cost of that utility for a unit of similar size and construction *for the geographic area in which the building is located*. This estimate becomes the appropriate utility allowance for all rent-restricted units of similar size and construction in the building. The local utility estimate is not available to buildings/tenants subject to Rural Housing Service or HUD jurisdiction.

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<sup>1</sup> Cable service is not a utility. It is a discretionary cost, similar to telephones, and is not included in the gross rent computation.

Until further guidance is provided through administrative ruling or guidance<sup>2</sup>, the election to use a local utility company estimate is permanent; i.e., the taxpayer cannot switch back and forth between the local PHA and utility company estimates.

State agencies have reported that although utility companies may be willing to provide interested parties (owner, tenant, state agency) with an initial estimate, utility companies are increasingly unwilling to provide estimates on an on-going basis. Accordingly, until further guidance is provided through administrative ruling or regulation, the Service will not challenge the owner's return to using the applicable PHA utility allowance, provided that:

1. The taxpayer has demonstrated to the state agency that the local utility company was unwilling to provide an updated estimate, and
2. The owner has *written* approval from the state agency to use a mutually agreed upon utility allowance.

### **Using Public Housing Authority Estimates**

State agencies have reported that the local PHA utility allowances do not always reflect a fair approximation of actual utility costs for such buildings. Accordingly, until further guidance is provided through administrative ruling or regulation, taxpayers may calculate utility allowances for the rent-restricted units in the building based upon an average of the actual use of similarly constructed and sized units *in the building* using actual utility usage data and rates, provided that the taxpayer has written approval from the state agency.

If an owner computes the utility allowance estimates based on the expected or historical use by the LIHC buildings/units, the estimate must be calculated in a reasonable manner and *contemporaneously* documented<sup>3</sup> to show how the estimate was determined. State agencies should review the methodology used to calculate the estimate for reasonableness, and ensure that the estimate is computed accurately.

### **Updating Utility Allowances**

If the applicable utility allowance for a unit changes, the new utility allowance must be used to compute gross rents of LIHC units due 90 days after the change. As a practical matter, utility allowances are usually reviewed when HUD updates the Area Median Gross Income (AMGI) for the location (which may change the allowable gross rent). If the applicable utility allowance for a unit changes, the new allowance must be used to compute gross rents due 90 days after the change.

## **In Compliance**

Low-income housing projects are in compliance when the appropriate utility allowance is used, the utility allowance is properly calculated, and rents are reduced for a utility allowance when utilities are paid directly by the tenant.

### **Example 1: Utility Allowance Increases**

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<sup>2</sup> Chief Counsel has opened a regulation project. See Federal Register/Vol. 70, No. 209. The regulation number is 1545-BC22 and the sequence number is 2597. This chapter will be updated when the regulation is revised.

<sup>3</sup> IRC §6001 requires all taxpayers to keep adequate records to support the items represented on their tax returns, including utility allowances.

The maximum gross rent is \$500. The owner charged rent of \$450, which reflected a \$50 utility allowance; i.e., \$450 rent + \$50 utility allowance = \$500 gross rent. The annual utility allowance estimate increases to \$75. The owner reduces the rent to \$425 based upon the increased utility allowance of \$75; for a gross rent of \$500 (\$425 + \$75 = \$500).

#### Example 2: Local Utility Company No Longer Provides Estimates

The owner used estimates of utility use as provided by the local utility company to determine the utility allowance. The owner asked the local utility company for an updated estimate of use by similar units in the local area. The utility company informed the owner that they no longer provide estimates. With the state agency's approval, the owner begins using the current PHA allowance.

#### Example 3: Public Housing Authority's (PHA) Utility Allowance is Outdated

The owner used estimated utility use as provided by the local utility company to determine the utility allowance. The owner reviewed the allowance and asked the local utility company for an updated estimate of use by similar units in the local area. The utility company informed the owner that it no longer provides estimates. The owner and state agency agree that the PHA's utility allowance did not reflect current costs. With the state agency's approval, the owner begins using a utility allowance based on the actual utility use for the LIHC building. The owner may continue to use actual utility costs to compute the utility allowance until further guidance is provided through administrative ruling or regulation.

#### Example 4: Increased Utility Allowance Does Not Cause Rent to Exceed Limit

The maximum gross rent limit is \$500, but the owner charged \$415 rent and a \$50 utility allowance for a total of \$465. The utility allowance increases to \$60 the next year. The owner makes no adjustment to the rent. The owner is in compliance. The owner is charging \$415 rent and a \$60 utility allowance for a total of \$475, which continues to be below the gross rent limit of \$500.

## Out of Compliance

Low income housing projects are considered out of compliance when the appropriate utility allowance is not used, the utility allowance is not properly calculated, or rents are not reduced for a utility allowance when utilities are paid directly by the tenant. Lack of annual written documentation of utility allowances is considered noncompliance; without proof of the amount of the allowance, there is no way to correctly compute the rent.

## **Back in Compliance**

A unit is considered back in compliance when the rent charged is reduced and correctly reflects the utility allowance. The date of correction is date that the rents correctly reflect the utility allowance.

Example 1: The maximum gross rent is \$500. Beginning on March 1, 2003, the owner charged \$450 rent and a \$75 utility allowance; the total rent is \$525. The rent is \$25 over the ceiling. The error was discovered during a state agency's review on April 13, 2004.

The owner immediately reduces the rent charged to \$425 for rents due beginning on May 1, 2004. The effective date of the new rent, or May 1, 2004, is the date the units are back in compliance.

## **References**

1. Notice 89-6, 1989-1 C.B. 625.
2. Treas. Reg. 1.42-10.

**Chapter 19**  
**Category 11n**  
**Owner has Failed to Respond to Agency**  
**Requests for Monitoring Reviews**

**Definition**

This category is used to report owners of low-income properties that failed to respond to agency requests for monitoring reviews. Under the inspection provision Treas. Reg. §1.42-5, the state agencies must have the right to perform an on-site inspection of any low-income housing project at least through the end of the 15-year compliance period for the buildings in the project. State agencies (or their representatives) must conduct on-site inspections, inspect units, and review income (re)certifications, supporting documentation, and rent records for the tenants in those units, and otherwise meet the provisions listed in Treas. Reg. §1.42-5(a)(2)(i)(A), (B), (C), and (D).

The review of tenant records may be undertaken wherever the owner maintains or stores the records. A state 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). However, 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.

**In Compliance**

An owner is in compliance when requests for site visitations and access to tenants' records are honored without unreasonable postponements.

**Example 1: Reasonable Request for Postponement**

A state agency notified an owner that a property was to be inspected and requested that the inspection be conducted in 30 days. The owner requested that the inspection be postponed for two weeks because the permanent on-site manager had scheduled training during that time period.

This is a reasonable request. Although the owner arranged for a temporary manager, the permanent manager is more knowledgeable regarding the day-to-day operations, procedures, and tenant files.

**Out of Compliance**

An owner is out of compliance when requests for site visitations or tenant file inspections are denied or unreasonably postponed. A state agency should accommodate the owner's valid needs to reschedule a site visit or tenant file review, but should not allow owners to

delay or circumvent compliance monitoring reviews.<sup>1</sup> The date of noncompliance is the earlier of the date (1) the owner refused to allow a site visitation or access to tenants' records or (2) first postponed the site visit or access to tenant's records.

#### Example 1: Repetitive Delays

A state agency notified an owner on April 21, 2004, that a property was to be inspected and requested that the inspection be conducted on May 20, 2004. On May 2, 2004, the owner requested that the inspection be postponed until June 16, 2004, to give them time to get the records together. Then, the day before the inspection, the owner called to say that the property manager would not be available. The inspection was rescheduled for June 28, 2004, but the owner called again on June 27 to say that not all the records were available at the site and it would be more convenient to work at his office during the week of July 12, 2004.

The owner's repeated requests for postponements are not reasonable. The property is out of compliance on May 2, 2004.

State agencies may remove a LIHC property from the program if the owner fails to respond to repeated notices for monitoring reviews. See chapter 21 for complete discussion.

## Back in Compliance

The owner is back in compliance when the agency performs the site visit and/or reviews the tenants' files.

#### Example 1: Site Visit Performed Late

A state agency filed form 8823 noting noncompliance because the owner refused to allow the state agency's representatives on the property to perform the physical inspection. The date of noncompliance was August 15, 2004. The taxpayer received the IRS' notice identifying the noncompliance, after which the site inspection was completed on December 15, 2004, when state agency resources were available.

The property is back in compliance on December 15, 2004 and a Form 8823 should be filed noting the correction date.

## References

1. IRC §42(i).
2. TD 8430, 1992-2 C.B. 14

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<sup>1</sup> The IRS recommends that if the site visit/file review can be rescheduled within 45 days of the initial date, the appointment should be reschedule; longer postponements should be discouraged except under unusual circumstances. There is no legal authority for allowing this time period: it is similar to IRS policy for rescheduling audit appointments during an audit. See Internal Revenue Manual 4.10.2.8.3(4).

**Chapter 20**  
**Category 11o**  
**Low-Income Units**  
**Used on a Transient Basis**

**Definition**

This category is used to report noncompliance when units have been used on a transient basis. Generally, the length of the initial lease agreement determines whether use is transient. A unit is nontransient if the initial lease term is six months or more.<sup>1</sup>

There are two exceptions to the general rule that the initial lease term must be 6 months or longer.

**Buildings  
Used for  
Transitional  
Housing for  
the Homeless  
Under IRC  
§42(i)(3)(B)(iii)**

Certain transitional housing for the homeless may be considered used other than on a transient basis provided the residential rental unit contains sleeping accommodations and kitchen and bathroom facilities and is located in a building-

1. which is used exclusively to facilitate the transition of homeless individuals<sup>2</sup> to independent living within 24 months, and
2. in which a government entity or qualified nonprofit organization<sup>3</sup> provided such individuals with temporary housing and supportive services designed to assist such individuals in locating and retaining permanent housing.

**Single-Room  
Occupancy  
(SRO) Units  
Under IRC  
§42(i)(3)(B)(iv)**

SRO units which permit the sharing of kitchen, bathroom, and dining facilities, shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis.

**In Compliance**

A unit is in compliance with this requirement if the *initial lease term for each tenant* is at least six months. The presence of a six month initial lease is the customary evidence used to document the owner and tenant's intent to enter into a nontransient rental agreement.

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<sup>1</sup> H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-89 (1986), 1986-3 (Vol. 4) C.B. 89.) Residential units must be for use by the general public and all of the units in a project must be used on a nontransient basis. ...Generally, a unit is considered to be used on a nontransient basis if the initial lease term is six months or greater. Additionally, no hospital, nursing home, sanitarium, life care facility, retirement home providing significant services other than housing, dormitory, or trailer park may be a qualified low-income project....certain single room occupancy housing used on a nontransient basis may qualify for the credit, even though such housing may provide eating, cooking, and sanitation facilities on a shared basis.

<sup>2</sup> Within the meaning of section 103 of the Stewart M. McKinney Homeless Act (42 U.S.C. 11302) , as in effect on the date of the enactment of this clause.

<sup>3</sup> As defined in IRC §42(h)(5).

#### Example 1: Tenant Vacates Before End of the Lease

A couple vacates their unit before fulfilling their initial six-month lease because the husband accepted a job in another state. Because the couple was subject to a valid six-month lease and vacated the unit for a valid reason, the low-income unit was not used on a transient basis.

### **Out of Compliance**

Other than the two exceptions for certain transitional housing and single room occupancy units, a unit is out of compliance if the unit is rented on a transient basis. The out of compliance date is the effective date of the initial tenant income certification. A unit is out of compliance if:

1. no lease is on file for the tenant, or
2. the tenant's initial lease term is not at least six months.

#### Example 1: Month-to-Month Initial Leases

A state agency discovers that an owner of a 100 unit LIHC property (not a SRO or transitional housing) established a policy of signing month-to-month leases at the time of initial occupancy.

At the time of the review, 84 units are occupied by households with initial month-to-month leases. All 84 units are out of compliance based on the effective date of the initial tenant income certification.

### **Back in Compliance**

Noncompliance is corrected when a lease with a term of at least six months is executed. The correction date is the effective date of the new lease.

**Chapter 21**  
**Category 11p**  
**Project is No Longer in Compliance**  
**Nor Participating in the Program**

**Definition**

This category should be used to notify the Internal Revenue Service that a building is entirely out of compliance and is no longer participating in the program.

1. The determination that an LIHC building is entirely out of compliance and will not be in compliance at any time in the future is a recapture event under IRC §42(j).
2. The filing of a Form 8823 for this category also puts the IRS on notice that the state agency is no longer performing monitoring activities with respect to the property.<sup>1</sup>
3. The building is no longer considered a qualified low-income building under IRC §42(c)(2)(A).<sup>2</sup> No credit is allowable in the remaining years of the credit period, even if the building complies with all the requirements of IRC §42.

**Out of Compliance**

A state agency may find that a building is no longer in compliance with the LIHC program requirements, and thus, is no longer participating in the program. The following discussion provides a broad overview of issues that may justify terminating an owner's participation in the program. It is not an exhaustive list; state agencies should consider each case individually based on the specific facts and circumstances.

**Return of Credits to State Agency**

Under certain circumstances, a state agency may obtain return of previously allocated low-income housing credits. In accordance with Treas. Reg. 1.42-14(d)(2)(ii), these credits may be returned up to 180 days following the close of the first tax year of the credit period for the building that received the allocation. If a credit is returned within 180 days following the close of the first taxable year of a building's credit period as provided in Treas. Reg. §1.42-14(d)(2)(ii), and a Form 8609, low-income Housing Credit Allocation and Certification, has been issued for the building, the state agency must notify the Internal Revenue Service that the credit has been returned.

If only part of the credit has been returned, this notification requirement is satisfied when the state agency attaches to an amended Form 8610, Annual Low-Income Housing Credit Agencies Report, the original of an amended Form 8609 reflecting

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<sup>1</sup> Treas. Reg. §1.42-5(e)(3).

<sup>2</sup> IRC §42(c)(2) states that the term "qualified low-income building" means any building which is part of a qualified low-income housing project at all times during the period beginning on the 1<sup>st</sup> day in the compliance period on which such building part of such a project, and ending on the last day of the compliance period with respect to such building.

the correct amount of credit attributed to the building together with an explanation for filing of the amended forms. The state agency must send a copy of the amended Form 8609 to the owner of the building.

If the building is not issued an amended Form 8609 because all of the credit allocated to the building is returned, notification to the Internal Revenue Service is satisfied by following the requirements prescribed by Treas. Reg. 1.42-5(e)(3) for filing Form 8823.

Treas. Reg. §1.42-14(d)(2)(iv) specifies the reasons for the return of the entire amount of allocated credit:

1. The building is not placed in service within the required time period or fails to meet the minimum set-aside requirements of IRC §42(g)(1) by the close of the first year of the credit period.
2. The building does not comply with the terms of its credit allocation. The terms of an allocation are the written conditions agreed to by the state agency and the allocation recipient in the allocation document.
3. The owner and state agency mutually agree to cancel an allocation of credit by mutual consent.
4. The state agency determines, under IRC §42(m)(2), that an amount of credit allocated to a project is not necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period.

#### IRS Notification

An attachment should be used to explain that the credits are being returned under the authority of Treas. Reg. 1.42-14(d)(2)(ii) and why the property did not qualify.

#### Owner Notification

As provided in section 1.42-14(d)(3)(i), after a state agency determines that building or project is not in compliance for the reasons 1, 2 or 4 above, the state agency must provide written notification to the allocation recipient, or its successor in interest, that all or part of the allocation is no longer valid. The notification must also state the amount of the allocation that is no longer valid. The date of the notification is the date the credit is returned by the state agency.

If an allocation is cancelled by mutual consent as noted in number 3 above, there must be a written agreement signed by the state agency and the allocation recipient, or its successor in interest, indicating the amount of the allocation that is returned to the state agency. The effective date of the agreement is the date the credit is returned to the state agency.

### **Egregious Noncompliance with Program Requirements**

Egregious noncompliance is conspicuous, flagrant, and systemic in nature and includes the failure to make reasonable attempts to comply with the requirements of the program, or careless, reckless, or intentional disregard of program requirements.

### Example 1: Failure to Make Reasonable Attempts to Comply with Program Requirements

The owner did not allow physical inspections or tenant file reviews after the end of the 10-year credit period.

Explanations from the owner should be solicited and analyzed for reasonableness. It is important that the owner be given an opportunity to respond and provide explanations. The reasonableness of the explanations should be evaluated for credibility, presence of corroborative or contradictory evidence, and collateral evidence from third party sources. Refer to chapter 3 for additional guidance.

An attachment to Form 8823 should be used to explain the extent of noncompliance.

#### **The Owner has Voluntarily and Permanently Withdrawn From the Program and is No Longer Claiming Credits**

An owner, during the 15-year compliance period, may voluntarily withdraw a property from the low-income housing credit program, but retain ownership. The building still exists physically, but is not being operated as an LIHC property. For example, the owner may have converted the entire building to a use other than as an LIHC housing project or 100% of the units may be vacant (and the owner has no intention of renting any of the units in the future).

An attachment to the Form 8823 should be used to explain why the property was withdrawn and identify the last year the property was in service. This information is needed for the IRS to determine whether the owner properly recaptured accelerated credits.

#### **Failure to Respond to Repeated Requests for Reports, Certifications, Reviews, or Other Essential Communication**

State agencies may remove an LIHC property from the program if the owner fails to respond to *repeated* notices for monitoring reviews<sup>3</sup>, or annual reports and owner certifications are not submitted, *and* Forms 8823 identifying the noncompliance were previously submitted to the IRS.

1. Under the inspection provisions of Treas. Reg. §1.42-5(d)(1), the state 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.
2. Under the certification provisions of Treas. Reg. §1.42-5(c), state agencies may remove a property from the program if annual reports and owner certifications are not submitted

A state agency should send follow-up notices clearly stating that failure to respond will result in the agency notifying the IRS that the property is no longer in compliance and is no longer participating in the LIHC program. See Treas. Reg. §1.42-5(e)(2), which requires the state agency to provide prompt notification to the owner if the project is not in compliance with the provisions of IRC §42.

The date of noncompliance is the first day of *the first year* that the owner failed to provide annual reports or certifications or did not respond to a request for the physical inspection of the property.

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<sup>3</sup> See Treas. Reg. § 1.42-5(c)(2).

## **Building No Longer Participating in the Low-Income Housing Program**

When a building is no longer in compliance nor participating in the Low-Income Housing Credit Program, state agencies need to address two issues, as discussed below.

### **Extended Low-Income Housing Commitment**

IRC §42(h)(6)(D) requires a property owner to commit to the low-income housing program for a minimum of 30 years. The commitment is documented as a restrictive covenant against the property and is recorded against the property as a deed restriction governed by state law. Commonly known as “extended use agreements”, these covenants are agreements *between the owner and state agency*. Consideration should be given to enforcing the agreement through a civil court proceeding. However, when a building or project is removed from the program, state agencies have discretionary authority to release the extended use agreement and remove the deed restriction.

### **Protection of Tenants Rights**

Under IRC §42(h)(6)(E)(ii), there are two requirements that must be met when an extended use agreement is terminated:

1. No eviction or termination of tenancy (other than for good cause) of an existing tenant of any low-income unit before the close of the 3-year period following the termination of the extended use agreement, and
2. No increase in the gross rent of any unit occupied by an existing tenant before the close of the 3-year period following the termination of the extended use agreement, not otherwise permitted under IRC §42. In other words, units occupied by income-qualified tenants continue to be rent restricted for three years, or until the tenants vacate the units.

**Chapter 22**  
**Category 11q**  
**Other Noncompliance**  
**Qualified Nonprofit Organization Failed to Materially Participate**

**Definition**

IRC §42(h)(5) requires that each state set aside at least 10% of its state housing credit ceiling for allocations to projects in which qualified nonprofit organizations own an interest, and materially participate in the development and operation of the projects. “Qualified nonprofit organization” is defined as an IRC §501(c)(3) or 501(c)(4) organization exempt from tax under IRC §501(a) that is determined by the state agency as not being affiliated with or controlled by a for-profit organization, and one of the exempt purposes of the organization includes the fostering of low-income housing.

For purposes of this allocation, a nonprofit organization must have an ownership interest in the low-income housing project throughout the 15-year compliance period and materially participate in the *development* and *operation* of the project. Whether a nonprofit sponsor materially participates will depend on the application of IRC §469(h) to the facts and circumstances of a given project.

Under IRC §469(h)(1), the nonprofit must participate on a *regular, continuous, and substantial* basis in the development and operation of the project.<sup>1</sup> Although this standard is vague, the legislative history suggests the following guidelines in defining material participation in a business activity:

1. Material participation is most likely to be established in an activity that constitutes the principal business/activity of the taxpayer,
2. Involvement in the actual operations of the activity should occur. That is, the services provided must be integral to the operations of the activity. Simply consenting to someone else’s decisions or periodic consultation with respect to general management decisions is not sufficient.
3. Participation must be maintained throughout the year. Periodic consultation is not sufficient.
4. Regular on-site presence at operations is indicative of material participation.
5. Providing services as an independent contractor is not sufficient.

Accordingly, a nonprofit entity will be considered to materially participate where it is regularly, continuously, and substantially involved in providing services integral to

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<sup>1</sup> Treas. Reg. §1.469-5T provides rules for determining the material participation for individuals. IRC §469(h)(4) and Treas. Reg. §1.469-5T(g)(3) provide rules for determining the material participation of certain corporations. Because neither of these provisions applies to nonprofit organizations, they should be reviewed for illustrative purposes only. The general facts and circumstances test of IRC §469(h)(1) is the test applicable to nonprofit organizations.

the development and operations of a project.

Pursuant to IRC §42(h)(5)(D), the ownership and material participation test can be met by the organization if it owns stock in a qualified corporation that satisfies the ownership and material participation test. A qualified corporation must be a corporation that is 100 percent owned at all times during its existence by one or more qualified nonprofit organizations.

## In Compliance

For purposes of reviewing properties for compliance with the requirements of IRC §42(h)(5) during the 15-year compliance period, the state agencies' responsibility is limited to consideration of whether the qualified nonprofit entity is *materially participating* in the *operation* of the project; i.e., both management decision making and the day-to-day operations. In order to materially participate, the qualified nonprofit must be engaged in the activities on a basis that is regular, continuous, and substantial.

### Example 1: Qualified Nonprofit Organization Materially Participates

A for-profit organization and a qualified nonprofit organization are general partners for an LIHC project. The state agency sent the review notification letter to the nonprofit and the nonprofit's executive director was on site at the time of the review to answer questions and participate in the physical inspection. The nonprofit received the compliance report, corrected a noncompliance issue and report back to the state agency.

The owner has demonstrated management involvement.

### Example 2: Property Managed by Nonprofit Representatives

A qualified nonprofit organization owns an LIHC project. Not having the expertise to operate an LIHC property on a day-to-day basis, the nonprofit hires an affordable housing management company. The management company reports to, and is paid by, the qualified nonprofit organization.

The application of the material participation rules under IRC § 469 should be flexible. In this case, the owner has demonstrated both management decision making and control of the day-to-day operations through their oversight of the management company.

## Out of Compliance

A taxpayer is out of compliance if:

1. The qualified nonprofit organization does not materially participate (as determined under IRC §469(h)(1)), or

2. The qualified nonprofit organization does not materially participate in both the *development and operation* of the project; i.e., both management decisions and day-to-day activities.

A property is out of compliance for any taxable year where the entity does not participate on a basis that is regular, continuous and substantial within the meaning of IRC §469(h)(1) for that year. Noncompliance can be identified by interviewing the qualified nonprofit organization's management representatives and observation while at the property site.

#### Example 1: Qualified Nonprofit Does Not Participate in Management Decisions

A for-profit organization and qualified nonprofit organization are general partners for an LIHC project. The nonprofit organization fully participated in the development of the project, but has not participated in (directly or through a representative) any monthly management meetings in year 3 of the compliance period and does not otherwise participate on a regular, continuous, or substantial basis.

The property is out of compliance for year 3 of the compliance period.

#### Example 2: Management Company Employee Provides Volunteer Services

A for-profit organization and qualified nonprofit organization are general partners for an LIHC project. The third party management company operating the property reports to the for-profit general partner. The management company employs a property manager who signed an agreement to be a "volunteer" for the non-profit and provide services for the nonprofit organization.

The property is not in compliance because the property manager's agreement to be a volunteer is part of its employment responsibilities to the for-profit organization.

Should a state agency become aware of noncompliance with other requirements imposed under IRC §42(h)(5), Form 8823 should be filed noting the issue. Areas of noncompliance may include:

1. The qualified nonprofit organization loses its exempt status. As part of the preparation for a review of an LIHC property owned by a qualified nonprofit organization under IRC §42(h)(5), state agencies may confirm that the nonprofit is a qualified tax-exempt organization by using the IRS website ([www.irs.gov](http://www.irs.gov)). Enter "78" into the "Search IRS site for" feature; the response will be "Chances are you are looking for Publication 78, Search for Exempt Organizations"; clicking on the underline portion will provide an alphabetical listing of exempt organizations. The state agency should request documentation of tax-exempt status if the organization is not included on the list.
2. The qualified nonprofit organization does not have an ownership interest in the low-income housing project.

## Back in Compliance

LIHC projects are considered back in compliance in a taxable year when a qualified nonprofit organization owns an interest in the project and satisfies the material participation test set forth in IRC §469(h)(1) for that taxable year.

### Example 1: Qualifying Nonprofit Organization Begins Attending Management Meetings

A for-profit organization and a qualified nonprofit organization are general partners for an LIHC project. The nonprofit organization materially participated in the on-going operation of the project in years 2, 3, and 4. They did not materially participate in year 5. It was determined that in year 7 of the compliance period, the nonprofit organization materially participated.

The property is out of compliance as of December 31<sup>st</sup> of year 5 and back in compliance as of December 31<sup>st</sup> of year 7.

## Reference

1. IRC §42(h)(5)
2. Senate Report. 99-313, 99<sup>th</sup> Cong. 2<sup>nd</sup> Session, 1986-3 C.B. (Vol. 3) 732

## Chapter 23 Category 11q Other Noncompliance Issues

### Definition

This category should be used to report noncompliance only when the noncompliance cannot be associated with any other category. The discussion presented here is not intended to be all inclusive.

### Nonreportable Compliance Issues

#### Nonperformance of Extended Use Agreement

Under IRC §42(h)(6), taxpayers receiving credits must execute an extended use agreement, which is recorded as a restrictive covenant against the property, as provided by state law. The extended use period ends on the later of the date specified in the agreement or 15 years after the close of the compliance period. At a minimum, the property must be maintained as low-income housing property for 30 years beginning with the first day of the compliance period. The required content of the extended use agreement is outlined in IRC §42(h)(6)(B).

In addition, state agencies may add additional terms or restrictions to reflect the terms of the credit allocation. Under IRC §42(m), state agencies are required to develop qualified allocation plans with criteria for determining housing needs in their location and selecting appropriate projects. These terms and conditions will be reflected in the extended use agreement; e.g., the targeting of special needs groups, income restrictions, rent skewing, housing types, etc. State agencies are expected to enforce the agreement. Nonperformance of the terms of the extended use agreement should *not* be reported to the IRS. See chapter 16 for reportable noncompliance associated with extended use agreements.

#### Example 1: Special Set-Asides Not Reported

The owner elected the 40/60 minimum set-aside on Form 8609. The state agency required 20/50 targeting, as evidenced in the extended use agreement. The maximum 50% gross rent is \$400, but the maximum 60% gross rent is \$500. The owner charges \$450 rent and a \$50 utility allowance, for a total of \$500. The rent charged is above the limit agreed upon in the extended use agreement, but equals the rent limit for the 60 percent minimum set aside election.

The owner has violated the state's requirements. However, according to the imputed income limitation applicable to the unit, the rent is in compliance within federal regulation. The state agency should *not* file a Form 8823.

#### Example 2: Elected Minimum Set-Aside Inconsistent with Extended Use Agreement

An owner, at the time of application and subsequent submission of final cost certifications when the LIHC project was completed, represented to the state agency that the 20/50 minimum set-aside would be elected. The 20/50 minimum set-aside is also identified in the extended use agreement. When making the election on Form 8609 for IRS purposes, the taxpayer selected the 40/60 set-aside.

The taxpayer is in compliance with the requirements of IRC §42. Noncompliance with the terms of the extended use agreement is *not* reportable to the IRS on Form 8823.

## Chapter 24 Line 13 Building Disposition

### Definition

Recapture of the accelerated portion of credits may be caused not only by noncompliance with the LIHC program, but by either the sale or other disposition of an LIHC building or the sale of an ownership interest in such a building. It is important to report all dispositions so that the IRS can determine whether the taxpayer has complied with the requirements of IRC §42(j); i.e., the credits have been appropriately recaptured or bonds posted.<sup>1</sup>

### Types of Building Dispositions

Line 13a on Form 8823 identifies four categories of building dispositions.

1. **SALE** - Types of activities that would constitute a “sale” (which does not necessarily involve the seller receiving money) include:
  - a. **Fee Title Sale of Building** - Fee title passes from the seller to a whole new entity (buyer)
  - b. **Termination of Partnership**
2. **FORECLOSURE** - Foreclosure is the legal process reserved by a lender to terminate the borrower's interest in a property after a loan has been defaulted. On foreclosure, the *owner* is deemed to have made a sale of the property for the outstanding amount of the mortgage debt. In some foreclosures, the new “owner” is an entity not eligible to claim tax credits (i.e. HUD, State Housing Finance Agency, etc.) or the new “owner” is not claiming tax credits (i.e., mortgagee, bank, etc.).
  - a. **Deed of Property in Lieu of Foreclosure** - the owner voluntarily conveys the property to the mortgage holder to avoid foreclosure proceedings.
3. **DESTRUCTION** - Destruction is related to a building's *physical structure*, and not to the ownership interest in the building. The destruction affects the building *in its entirety*, i.e., the eligible basis of the property is reduced to \$0. The destruction is *permanent* and the building is not expected to operate as a tax credit project again. Violations of the physical inspection standards, or casualty losses that are temporary in nature should not be reported as destruction, which is permanent.
4. **OTHER (Attach Explanation)** – Any event, not listed above, which results in the disposition of a low-income housing credit unit, building, or property.

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<sup>1</sup> See Exhibit 24-1 for an explanation of the recapture requirements

**State Agency  
Responsibility  
for Reporting  
Property  
Dispositions**

The owner of a low-income housing building is the entity identified on the Form 8609. State agencies should confirm that the ownership has not changed as part of their monitoring and inspection responsibilities.

**Example 1: Owners Sells Property**

ABC, a limited partnership, owns and operates an LIHC building, and is identified as the owner on Form 8609. Mr. Jones is the general partner. There are two limited partners, Mr. Smith and the XYZ investment fund. On September 17, 2004, ABC sells the building to E&F, a limited partnership. As included in the extended use agreement, the state agency approved the sale. The state agency should report the disposition on Form 8823.

LIHC buildings are generally owned by partnerships and identifying changes in the composition of the ownership entities is not required. However, if a state agency becomes aware of a change in the composition of the ownership entity, the disposition should be reported.

**Example 2: State Agency Reviews Owners' Annual Certification**

ABC, a limited partnership, owns and operates an LIHC building, and is identified as the owner on Form 8609. Mr. Jones is the general partner. There are two limited partners, Mr. Smith and the XYZ investment fund. As part of the regular monitoring procedures, the state agency reviews the owner's annual certification to confirm that ownership has not changed. The state agency is not required to ask whether Mr. Jones, Mr. Smith, or XYZ has disposed of their interest (or a portion of their interest).

**Example 3: General Partner Changes**

ABC, a limited partnership, owns and operates an LIHC building, and is identified as the owner on Form 8609. Mr. Jones is the general partner. There are two limited partners, Mr. Smith and the XYZ investment fund. Mr. Jones decides to retire and sells his interest to Ms. White, who will continue as the general partner. The change is not identified in the owner's annual certification. However, a letter sent to Mr. Jones is returned to the state agency as undeliverable. The state agency notifies the limited partners that the general partner cannot be located. Mr. Smith calls Ms. White, who contacts the state agency to explain the change in ownership of the partnership. The state agency should file Form 8823 noting the disposition category as "other"; i.e., Mr. Smith is no longer a partner.

**References**

1. IRC §42(f)(4)

**Exhibit 24-1**  
**Explanation of**  
**Credit Recapture Requirements**  
**Under IRC §42(j)**

As explained in the legislative history, the disposition of an LIHC building (or interest therein) is a recapture event.<sup>1</sup> The amount of the recapture is 1/3 of the allowable credit for each year if the building is disposed of through year 11 of the compliance period plus interest. The interest is computed at the overpayment rate established under IRC §6621 on the recaptured credit for each taxable year for the period beginning on the due date for filing the return for the prior taxable year involved. The amount of the recapture declines if the disposition occurs after year 11 of the credit period.

Taxpayers must file Form 8611, Recapture of Low-Income Housing Credit, with their tax return for the year of sale to recapture the LIHC.

**Large Partnership Recapture**

In the case of a large partnership (a partnership of 35 or more partners), the partnership is treated as the taxpayer to which the credit is allowable for purposes of recapture. The tax benefit rule under IRC §42(j)(4)(A) does not apply and the increase in tax because of the recapture amount is allocated among the partners in the same manner as the partnership's taxable income for the year is allocated among the partners.

The legislative history<sup>2</sup> also indicates that no change in ownership is deemed to occur on the disposition of a partner's interest provided that within a 12-month period at least 50 percent (in value) of the original ownership is unchanged. These conditions apply unless the partnership elects out of such under IRC §42(j)(5).

**Other Partnerships and Recapture**

For partnerships with fewer than 35 partners, and those electing out of the large partnership provisions of IRC §42(j)(5), a partner (taxpayer) may elect to avoid or defer recapture until the taxpayer has, in the aggregate, disposed of more than 33 1/3 percent of the taxpayer's greatest total interest in the qualified low-income building through the partnership at any time. Once dispositions aggregate more than 33 1/3 percent, further deferral is possible only if a surety bond or alternative collateral is provided. The taxpayer that defers recapture by reason of the 33 1/3 percent rule will remain subject to recapture with respect to that interest. See Rev. Rul. 90-60, 1990-2 C.B. 35.

**Surety Bonds and Subsequent Owners**

Recapturing the accelerated portion of the credit can be avoided if the owner selling the building, or interest therein, posts a bond equal to the amount specified on Form 8693, Low-Income Housing Credit Disposition Bond. The IRS approves the bond when it is determined that the amount of the bond is correct and that the project is expected to remain in compliance for the balance of the initial compliance period; i.e., the new owner intends to maintain the building as low-income housing throughout the 15-year compliance period. The bond must remain in effect until 58 months after the end of the 15-year compliance period.

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<sup>1</sup> H.R. Conf. Rep. No. 481, 99<sup>th</sup> Cong., 2<sup>nd</sup> Sess. II-96 (1986)

<sup>2</sup> H.R. Conf. Rep. No. 481, 99<sup>th</sup> Cong., 2<sup>nd</sup> Sess. II-96 (1986)

As a practical matter, surety bonds may be difficult and costly to obtain. Because of the amount of the bond needed and the inability of the seller to assure that the property will continue to comply (such power effectively being with the new owner), sureties are likely to require either full collateral or very high creditworthiness from the bonded party. IRS Revenue Procedure 99-11 establishes a collateral program as an alternative to providing a surety bond to avoid or defer recapture of low-income housing tax credits. Under this program, taxpayers pledge certain United States Treasury securities to the IRS as collateral.

The IRS will “call a bond” to recapture credit if it subsequently determined that the new owner did not continue to operate the building as a qualified low-income building for the remainder of the compliance period.

## References

1. IRS Form 8609 instructions - Line 10(b) - Partnerships with 35 or more partners are treated as the taxpayer for purposes of recapture unless an election is made not to treat the partnership as the taxpayer. Check the “Yes” box if you do not want the partnership to be treated as the taxpayer for purposes of recapture.
2. IRC §42(j)(5).
3. IRC §42(j)(6).
4. Rev. Rul. 90-60, 1990-2 C.B. 3.
5. Rev. Proc. 99-11, 1999-2 I.R.B 14.

## Chapter 25 Miscellaneous Noncompliance Topics

The chapter includes noncompliance topics not discussed elsewhere.

### **Tenant Misrepresentation or Fraud**

LIHC property owners should demonstrate due diligence to prevent tenant fraud. Fraud includes *deliberate* misrepresentation of fact in order to induce someone else to part with something of value or surrender a legal right. In this case, the outcome of deliberate misrepresentation by a tenant can result in the property owner renting a residential unit to an ineligible tenant at a below market rate.

If misrepresentation is suspected, additional steps should be taken to verify the accuracy of information provided by the tenant. See chapter 4. Regulation 1.42-5 gives examples of how an income certification may be documented, including the submission of federal tax returns. If necessary, tenants can be asked to complete Form 8821, Tax Information Authorization, which will allow the owner to confirm the accuracy of the tenant's tax returns with the IRS.

If an owner discovers that a tenant has *deliberately* misrepresented their income level, student status, household size, or any other item used to determine eligibility, the owner should consult state or local landlord-tenant laws to determine whether the tenant can be asked to vacate the LIHC unit or the rent raised to the market rate. The owner is not expected to complete the annual recertification if a tenant is asked to leave or an eviction proceeding is in process.

Report any suspected or known deliberate misrepresentation of income to the Internal Revenue Service's Suspected Tax Fraud Hotline at 1-800-829-0433. When calling the Hotline, the following information should be provided:

1. tenant's name,
2. tenant's social security number if possible,
3. explain association with LIHC program,
4. what the tenant did that misrepresented their income or documentation (the owner may be asked to provide evidence of the tenant's fraudulent acts),
5. amount of tenant income as reported by the tenant and the amount actually verified, and
6. the difference between the market rate and restricted rent for the unit, and how long the tenant was in the unit. This is the amount of economic benefit the tenant may be deemed to have received as taxable income.

**Reporting Tenant Misrepresentation or Fraud to the IRS**

So that possible loss of low-income housing credit might be avoided if it is determined upon later review by the state agency that a tenant is not qualified for low-income housing, the state agency should encourage owners to immediately report any suspected deliberate misrepresentation of fraud by a tenant to the state agency.<sup>1</sup>

The Low-Income Housing Program will not consider there to have been reportable noncompliance if tenant fraud is discovered and addressed by the owner prior to a state agency review or an IRS audit, and the owner satisfies the state agency that: (1) the tenant provided false information; (2) the owner did everything a prudent person would do to avoid fraudulent tenants (due diligence) and has implemented any needed changes to avoid future problems; (3) the tenant has vacated the unit (if possible); and (4) there is no pattern of accepting fraudulent tenants. In such cases, the owner need not reduce the applicable fraction for determining the credit amount and the state agency need not report the noncompliance arising because of the tenant's fraud on Form 8823.

This administrative procedure applies only when the owner notifies the state agency before notice is given by the state agency that a review of the tenant records or a site inspection is to be conducted. As a general rule, the Internal Revenue Service does not want to disturb the credit when the owner has demonstrated due diligence to avoid fraudulent tenants, timely removes fraudulent tenants when identified, and timely notifies the state agency of their actions.

**Identification of Tenant Misrepresentation or Fraud During State Agency Reviews or IRS Audits**

An owner's opportunity to identify and self-correct misrepresentations or fraud by a tenant for purposes of the low-income housing credit terminates upon notification of a state agency's intended review/inspection of the LIHC project. Any noncompliance arising from such a misrepresentation or fraud discovered during a state agency's review/inspection should be reported to the IRS on Form 8823 under the appropriate category of noncompliance, regardless of the cause. As noted in Treas. Reg. §1.42-5(a), state agencies are required to report any noncompliance of which the agency becomes aware. Agencies should report all noncompliance, without regard to whether the identified outstanding noncompliance is subsequently corrected. See chapter 3 for full discussion.

**Owner/Taxpayer Fraud**

If a state agency becomes aware of an apparent fraudulent act by the owner, management company, or other party associated with the low-income housing property, or a party responsible for providing income/asset verification for tenants, the state agency should report the alleged acts to the Internal Revenue Service's Criminal Investigation Department (CID) by calling 1-800-829-0433.

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<sup>1</sup> The IRS wants to provide an incentive for owners to identify, and remove (if possible) fraudulent tenants. By working with the state agency up front, we can provide an opportunity to resolve the problem without harming the owner and not waiting for a state agency review, yet retaining involvement in the determination of a "fraudulent" tenant.

## Chapter 26 Tenant Good Cause Eviction and Rent Increase Protection

### Definition

Under IRC §42(h)(6), buildings are eligible for the low-income housing credit only if the owner has entered into an extended low-income housing commitment. The commitment is commonly known as the “extended use agreement.” The extended use agreement must be recorded pursuant to state law as a restrictive covenant. See Chapter 16 for additional detail.

### 3-Year Good Cause Eviction and Rent Increase Protection for Tenants

The term of the agreement is at least 30 years, beginning on the first day of the compliance period and ends on the later of the date specified by the state agency or 15 years after the close of the 15-year compliance period under IRC §42(i)(1). Under IRC §42(h)(6)(E)(i), the extended use agreement can be terminated under two circumstances:

1. the building is acquired through foreclosure, or
2. the state agency fails to present a qualified contract for the acquisition of the LIHC building (or part thereof) by a party who will continue to operate the building (or part thereof) as low-income housing.

In the event that the extended use agreement is terminated, IRC §42(h)(6)(E)(ii) provides existing low-income tenants protection against two events for three years following the termination. These events are:

1. the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or
2. any increase in the gross rent with respect to such unit no otherwise permitted under IRC §42.

### Revenue Ruling 2004-82: Prohibitions Under IRC §42(h)(6)(B)(i) Apply throughout Extend Use Period

Under section C of Rev. Rul. 2004-82<sup>1</sup>, Q&A #5 provides further guidance regarding extending use agreements. Question 5 states, “Must the extended low-income housing commitment prohibit the actions described in subclauses (I) and (II) of IRC §42(h)(6)(E)(ii) (i.e., eviction or the termination of tenancy (other than for good cause) only for the 3-year period described in IRC §42(h)(6)(E)(ii)?”

The answer is “no”. IRC §42(h)(6)(B)(i) requires that an extended low-income housing commitment include a prohibition during the entire 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 IRC §42.

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<sup>1</sup> Rev. Rul. 2004-82, 2004-2 C.B. 350.

The revenue ruling includes the following explanation. When Congress amended IRC §42(h)(6)(B)(i) to add the requirement that the extended use agreement must *prohibit the actions described in subclauses (i) and (II) of subparagraph (E)(ii)*, IRC §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.

The revenue ruling also provided guidance for updating extended use agreements to explicitly provide tenants with protection against evictions without good cause and increases in rent not allowable under IRC §42. The revenue ruling provided that if it is determined by the end of a taxable year that a taxpayer's extended use agreement does not meet the requirements for an extended use agreement under IRC §42(h)(6)(B) (for example, it does not provide no-cause eviction protection for 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 use agreement is in effect is corrected within 1 year of the date of the determination, the determination will not apply to the current year of the credit period or any prior year.

The revenue ruling also requires the state agencies to review its extended low-income housing commitments for compliance with the interpretation of §42(h)(6)(B)(i) 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 Revenue Ruling 2004-82, the 1-year period described under §42(h)(6)(J) will commence on the date of that determination.

**Revenue  
Procedure  
2005-37**

Effective June 21, 2005, the IRS issued Rev. Proc. 2005-37<sup>2</sup> to provide the state agencies guidance for satisfying the review requirements under Rev. Rul. 2004-82, Q&A #5.

Extended Use Agreements Entered into Before January 1, 2006.

If the extended use agreement contain general language requiring building owners to comply with the requirements of IRC §42 (catch-all language), the requirements of Rev. Ruling 2004-82, Q&A-5, are satisfied if:

1. Agencies notify building owners in writing on or before December 31, 2005, that consistent with the interpretation in Q&A #5, the catch-all language prohibits the owner from evicting or terminating the tenancy of an existing tenant of any low-income unit (other than for good cause) throughout the entire commitment period. Further, state agencies must notify building owners that the catch-all language prohibits the owner from making an increase in the gross rent with respect to a low-income unit not otherwise permitted by IRC §42 throughout the entire commitment

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<sup>2</sup> Rev. Proc. 2005-37, 2005-28 I.R.B. 79.

period;

2. The owner must, as part of its certification under Treas. Reg. 1.42-5(c)(1)(xi), certify annually that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under IRC §42;

Finally, if the extended use agreement is amended for any reason after December 31, 2005, it must also be amended to clearly provide for the prohibition against the eviction or termination of tenancy other than for good cause and any increase in the gross rent not otherwise permitted under IRC §42.

Commitments entered into before January 1, 2006, that do not contain specific language on the IRC §42(h)(6)(B)(i) prohibitions or catch-all language do not satisfy the requirements of Rev. Rul. 2004-82, Q&A #5 and must be amended by December 31, 2005 to clearly provide for the IRC §42(h)(6)(B)(i) prohibitions against the eviction or termination of tenancy of an existing tenant of any low-income unit (other than for good cause) and the increase in the gross rent with respect to a low-income unit not otherwise permitted by IRC §42.

#### Extended Use Agreements Entered into After December 31, 2005

1. Extended use agreements executed after December 31, 2005, must clearly provide for the prohibition against the eviction or termination of tenancy other than for good cause and any increase in the gross rent not otherwise permitted under IRC §42.
2. The owner must also, as part of its certifications under Treas. Reg. 1.42-5(c)(1)(xi), certify annually that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under IRC §42.

## **In Compliance**

Owners are in compliance with the prohibitions against evictions or terminations of tenancy for other than good cause and increases in the gross rent not permitted under IRC §42 when all of the following four requirements are met.

1. The extended use agreement includes the prohibitions.
  - a. For agreements entered into before January 1, 2006, the agreement must contain general language requiring building owners to comply with the requirements of IRC §42 (catch-all language) and the state agency must notify the owner in writing on or before December 31, 2005, that the catch-all language prohibits the owner from evicting or terminating the tenancy of an existing tenant of any low-income unit (other than for good cause) or increases the gross rent not otherwise permitted by IRC §42 throughout the entire commitment period.

- b. For extended use agreements executed after December 31, 2005, the agreement must clearly provide for the prohibition against the eviction or termination of tenancy other than for good cause and any increase in the gross rent not otherwise permitted under IRC §42.
2. The owner must, as part of its annual certification under Treas. Reg. §1.42-5(c)(1)(xi), certify annually that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under IRC §42.
  3. The owner must not evict or terminate the tenancy of an existing tenant of any low-income unit for other than for good cause.
  4. The owner must not increase the gross rent unless permitted by IRC §42.

## Out of Compliance

Owners are out of compliance with the prohibitions against evictions or terminations of tenancy for other than good cause and increases in the gross rent not permitted under IRC §42 if any of the following four requirements is not met.

### Extended Use Agreement

Generally, no credit is allowable for a building in a year unless an extended use agreement is in effect at the end of the year. The extended use agreement is not in effect and the owner is out of compliance if (1) the extended use agreement does not include the prohibitions, or (2) does not contain the general catch-all language requiring compliance with IRC §42 if the agreement was entered into before January 1, 2006.

Noncompliance is reported under category 11k, Owner Failed to Execute and Record Extended Use Agreement Within Time Prescribed by Section 42(h)(6)(J). See chapter 16 for additional discussion.

### Annual Certification

Owners are out of compliance if they fail to certify annually, or certify incompletely or inaccurately, under the penalty of perjury, that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under IRC §42.

Noncompliance is reported under category 11d, Owner Failed to Provide Annual Certifications or Provided Incomplete or Inaccurate Certification. See chapter 7 for additional discussion.

### Increased Gross Rent

The owner is out of compliance if the gross rent in a manner not permitted by IRC §42. A unit qualifies as an LIHC unit when the gross rent does not exceed 30 percent of the imputed income limitation applicable to such unit under IRC §42(g)(2)(C). The income limit for a low-income housing unit is based on the minimum set-aside election made by the owner under IRC §42(g)(1).

Noncompliance is reported under category 11g, Gross Rent(s) Exceed Tax Credit Limits. See chapter 11 for additional discussion.

## **Back in Compliance**

Owners are back in compliance with the prohibitions against evictions or terminations of tenancy for other than good cause and increases in the gross rent not permitted under IRC §42 if:

### **Extended Use Agreement**

The extended use agreement is in effect and the owner is back in compliance when the extended use agreement is amended to clearly provide for the prohibition against the eviction or termination of tenancy other than for good cause and any increase in the gross rent not otherwise permitted under IRC §42.

Corrected noncompliance is reported under category 11k, Owner Failed to Execute and Record Extended Use Agreement Within Time Prescribed by Section 42(h)(6)(J). See chapter 16 for additional discussion.

### **Annual Certification**

The noncompliance is corrected when the owner certifies that for the preceding 12-month period no tenants in low-income units were evicted or had their tenancies terminated other than for good cause and that no tenants had an increase in the gross rent with respect to a low-income unit not otherwise permitted under IRC § 42. In the event that tenant(s) in low-income units were evicted or had their tenancies terminated other than for good cause, or that tenant(s) had an increase in the gross rent with respect to a low-income unit not otherwise permitted under IRC § 42, the annual certification must disclose the violations.

Corrected noncompliance is reported under category 11k, Owner Failed to Provide Annual Certifications or Provided Incomplete or Inaccurate Certification. See chapter 7 for additional discussion.

### **Increased Gross Rent**

A unit is back in compliance when the rent charged does not exceed the limit. An owner cannot avoid the disallowance of the LIHC by rebating excess rent to the affected tenants. Corrected noncompliance is reported under category 11g, Gross Rent(s) Exceed Tax Credit Limits. See chapter 11 for additional discussion.

## **Reference**

1. IRC §42(h)(6).
2. Rev. Rul. 2004-82, 2004-35, I.R.B. 1.
3. Rev. Proc. 2005-27, 2005-28 I.R.B. 1.