

## Treasury Regulations 1.42

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## Federal Regulations

### **Reg § 1.42-1T. Limitation on low-income housing credit allowed with respect to qualified low-income buildings receiving housing credit allocations from a State or local housing credit agency (temporary).**

**Caution:** The Treasury has not yet amended Reg § 1.42-1T to reflect changes made by P.L. 106-554, P.L. 103-66, P.L. 101-508, P.L. 101-239, P.L. 100-647

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

*(1) Determination of amount of low-income housing credit.* Section 42 provides that, for purposes of section 38, a low-income housing credit is determined for a building in an amount equal to the applicable percentage of the qualified basis of the qualified low-income building. In general, the credit may be claimed annually for a 10-year credit period, beginning with the taxable year in which the building is placed in service or, at the election of the taxpayer, the succeeding taxable year. If, after the first year of the credit period, the qualified basis of a building is increased in excess of the qualified basis upon which the credit was initially determined, the allowable credit with respect to such additional qualified basis is determined using a credit percentage equal to two-thirds of the applicable percentage for the initial qualified basis. The credit for additions to qualified basis is generally allowable for the remaining years in the 15-year compliance period which begins with the first taxable year of the credit period for the building. In general, the low-income housing credit is available with respect to buildings placed in service after December 31, 1986, in taxable years ending after that date. See section 42 for the definitions of “qualified low-income building”, “applicable percentage”, “qualified basis”, “credit period”, “compliance period”, and for other rules relating to determination of the amount of the low-income housing credit.

*(2) Limitation on low-income housing credit allowed.* Generally, the low-income housing credit determined under section 42 is allowed and may be claimed for any taxable year if, and to the extent that, the owner of a qualified low-income building receives a housing credit allocation from a State or local housing credit agency. The aggregate amount of housing credit allocations that may be made in any calendar year by all housing credit agencies within a State is limited by a State housing credit ceiling, or volume cap, described in paragraph (b) of this section. The authority to make housing credit allocations within the State housing credit ceiling may be apportioned among the State and local housing credit agencies, under the rules prescribed in paragraph (c) of this section. Upon apportionment of the State housing credit volume cap, each State or local housing credit agency receives an aggregate housing credit dollar amount that may be used to make housing credit allocations among qualified low-

income buildings located within an agency's geographic jurisdiction. The rules governing the making of housing credit allocations by any state or local housing credit agency are provided in paragraph (d) of this section. Housing credit allocations are required to be taken into account by owners of qualified low-income buildings under the rules prescribed in paragraph (e) of this section. Exceptions to the requirement that a qualified low-income building receive a housing credit allocation from a State or local housing credit agency are provided in paragraph (f) of this section. Rules regarding termination of the authority of State and local housing credit agencies to make housing credit allocations after December 31, 1989, are specified in paragraph (g) of this section. Rules concerning information reporting by State and local housing credit agencies and owners of qualified low-income buildings are provided in paragraph (h) of this section. Special statutory transitional rules are incorporated into this section of the regulations as described in paragraph (i) of this section.

**(b) The State housing credit ceiling.** The aggregate amount of housing credit allocations that may be made in any calendar year by all State and local housing credit agencies within a State may not exceed the State's housing credit ceiling for such calendar year. The State housing credit ceiling for each State for any calendar year is equal to \$1.25 multiplied by the State's population. A State's population for any calendar year is determined by reference to the most recent census estimate (whether final or provisional) of the resident population of the State released by the Bureau of the Census before the beginning of the calendar year for which the State's housing credit ceiling is set. Unless otherwise prescribed by applicable revenue procedure, determinations of population are based on the most recent estimates of population contained in the Bureau of the Census publication, "Current Population Reports, Series P-25: Population Estimates and Projections, Estimates of the Population of States". For purposes of this section, the District of Columbia and United States possessions are treated as States.

**(c) Apportionment of State housing credit ceiling among State and local housing credit agencies.**

*(1) In general.* A State's housing credit ceiling for any calendar year is apportioned among the State and local housing credit agencies within such State under the rules prescribed in this paragraph. A "State housing credit agency" is any State agency specifically authorized by gubernatorial act or State statute to make housing credit allocations on behalf of the State and to carry out the provisions of section 42(h). A "local housing credit agency" is any agency of a political subdivision of the State that is specifically authorized by a State enabling act to make housing credit allocations on behalf of the State or political subdivision and to carry out the provisions of section 42(h). A "State enabling act" is any gubernatorial act, State statute, or State housing credit agency regulation (if authorized

by gubernatorial act or State statute). A State enabling act enacted on or before October 22, 1986, the date of enactment of the Tax Reform Act of 1986, shall be given effect for purposes of this paragraph if such State enabling act expressly carries out the provision of section 42(h).

(2) *Primary apportionment.* Except as otherwise provided in paragraphs (c)(3) and (4) of this section, a State's housing credit ceiling is apportioned in its entirety to the State housing credit agency. Such an apportionment is the “primary apportionment” of a State's housing credit ceiling. There shall be no primary apportionment of the State housing credit ceiling and no grants of housing credit allocations in such State until a State housing credit agency is authorized by gubernatorial act or State statute. If a State has more than one State housing credit agency, such agencies shall be treated as a single agency for purposes of the primary apportionment. In such a case, the State housing credit ceiling may be divided among the multiple State housing credit agencies pursuant to gubernatorial act or State statute.

(3) *States with 1 or more constitutional home rule cities.*

(i) In general. Notwithstanding paragraph (c)(2) of this section, in any State with 1 or more constitutional home rule cities, a portion of the State housing credit ceiling is apportioned to each constitutional home rule city. In such a State, except as provided in paragraph (c)(4) of this section, the remainder of the State housing credit ceiling is apportioned to the State housing credit agency under paragraph (c)(2) of this section. See paragraph (c)(3)(iii) of this section. The term “constitutional home rule city” means, with respect to any calendar year, any political subdivision of a State that, under a State constitution that was adopted in 1970 and effective on July 1, 1971, had home rule powers on the first day of the calendar year.

(ii) Amount of apportionment to a constitutional home rule city. The amount of the State housing credit ceiling apportioned to a constitutional home rule city for any calendar year is an amount that bears the same ratio to the State housing credit ceiling for that year as the population of the constitutional home rule city bears to the population of the entire State. The population of any constitutional home rule city for any calendar year is determined by reference to the most recent census estimate (whether final or provisional) of the resident population of the constitutional home rule city released by the Bureau of the Census before the beginning of the calendar year for which the State housing credit ceiling is apportioned. However, determinations of the population of a constitutional home rule city may not be based on Bureau of the

Census estimates that do not contain estimates for all of the constitutional home rule cities within the State. If no Bureau of the Census estimate is available for all such constitutional home rule cities, the most recent decennial census of population shall be relied on. Unless otherwise prescribed by applicable revenue procedure, determinations of population for constitutional home rule cities are based on estimates of population contained in the Bureau of the Census publication, "Current Population Reports, Series P-26: Local Population Estimates".

(iii) Effect of apportionments to constitutional home rule cities on apportionments to other housing credit agencies. The aggregate amounts of the State housing credit ceiling apportioned to constitutional home rule cities under this paragraph (c)(3) reduce the State housing credit ceiling available for apportionment under paragraph (c)(2) or (4) of this section. Unless otherwise provided in a State constitutional amendment or by law changing the home rule provisions adopted in a manner provided by the State constitution, the power of the governor or State legislature to apportion the State housing credit ceiling among local housing credit agencies under paragraph (c)(4) of this section shall not be construed as allowing any reduction of the portion of the State housing credit ceiling apportioned to a constitutional home rule city under this paragraph (c)(3). However, any constitutional home rule city may agree to a reduction in its apportionment of the State housing credit ceiling under this paragraph (c)(3), in which case the amount of the State housing credit ceiling not apportioned to the constitutional home rule city shall be available for apportionment under paragraph (c)(2) or (4) of this section.

(iv) Treatment of governmental authority within constitutional home rule city. For purposes of determining which agency within a constitutional home rule city receives the apportionment of the State housing credit ceiling under this paragraph (c)(3), the rules of this paragraph (c) shall be applied by treating the constitutional home rule city as a "State", the chief executive officer of a constitutional home rule city as a "governor", and a city council as a "State legislature". A constitutional home rule city is also treated as a "State" for purposes of the set-aside requirement for housing credit allocations to projects involving a qualified nonprofit organization. See paragraph (c)(5) of this section for rules governing set-aside requirements. In this connection, a constitutional home rule city may agree with the State housing credit agency to exchange an apportionment set aside for projects involving a qualified nonprofit organization for an apportionment that is not so restricted. In such a case, the authorizing

gubernatorial act, State statute, or State housing credit agency regulation (if authorized by gubernatorial act or State statute) must ensure that the set-aside apportionment transferred to the State housing credit agency be used for the purposes described in paragraph (c)(5) of this section.

*(4) Apportionment to local housing credit agencies.*

(i) In general. In lieu of the primary apportionment under paragraph (c)(2) of this section, all or a portion of the State housing credit ceiling may be apportioned among housing credit agencies of governmental subdivisions. Apportionments of the State housing credit ceiling to local housing credit agencies must be made pursuant to a State enabling act as defined in paragraph (c)(1) of this section. Apportionments of the State housing credit ceiling may be made to housing credit agencies of constitutional home rule cities under this paragraph (c)(4), in addition to apportionments made under paragraph (c)(3) of this section. Apportionments of the State housing credit ceiling under this paragraph (c)(4) need not be based on the population of political subdivisions and may, but are not required to, give balanced consideration to the low-income housing needs of the entire State.

(ii) Change in apportionments during a calendar year. The apportionment of the State housing credit ceiling among State and local housing credit agencies under this paragraph (c)(4) may be changed after the beginning of a calendar year, pursuant to a State enabling act. No change in apportionments shall retroactively reduce the housing credit allocations made by any agency during such year. Any change in the apportionment of the State housing credit ceiling under this paragraph (c)(4) that occurs during a calendar year is effective only to the extent housing credit agencies have not previously made housing credit allocations during such year from their original apportionments of the State housing credit ceiling for such year. To the extent apportionments of the State housing credit ceiling to local housing credit agencies made pursuant to this paragraph (c)(4) for any calendar year are not used by such local agencies before a certain date (e.g., November 1) to make housing credit allocations in such year, the amount of unused apportionments may revert back to the State housing credit agency for reapportionment. Such reversion must be specifically authorized by the State enabling act.

(iii) Exchanges of apportionments. Any State or local housing credit agency that receives an apportionment of the State housing credit ceiling for any calendar year under this paragraph (c)(4) may

exchange part or all of such apportionment with another State or local housing credit agency to the extent no housing credit allocations have been made in such year from the exchanged portions. Such exchanges must be made with another housing credit agency in the same State and must be consistent with the State enabling act. If an apportionment set aside for projects involving a qualified nonprofit organization is transferred or exchanged, the transferee housing credit agency shall be required to use the set-aside apportionment for the purposes described in paragraph (c)(5) of this section.

(iv) Written records of apportionments. All apportionments, exchanges of apportionments, and reapportionments of the State housing credit ceiling which are authorized by this paragraph (c)(4) must be evidenced in the written records maintained by each State and local housing credit agency.

*(5) Set-aside apportionments for projects involving a qualified nonprofit organization.*

(i) In general. Ten percent of the State housing credit ceiling for a calendar year must be set aside exclusively for projects involving a qualified nonprofit organization (as defined in paragraph (c)(5)(ii) of this section). Thus, at least 10 percent of apportionments of the State housing credit ceiling under paragraphs (c)(2) and (3) of this section must be used only to make housing credit allocations to buildings that are part of projects involving a qualified nonprofit organization. In the case of apportionments of the State housing credit ceiling under paragraph (c)(4) of this section, the State enabling act must ensure that the apportionment of at least 10 percent of the State housing credit ceiling be used exclusively to make housing credit allocations to buildings that are part of projects involving a qualified nonprofit organization. The State enabling act shall prescribe which housing credit agencies in the State receive apportionments that must be set aside for making housing credit allocations to buildings that are part of projects involving a qualified nonprofit organization. These set-aside apportionments may be distributed disproportionately among the State or local housing credit agencies receiving apportionments under paragraph (c)(4) of this section. The 10-percent set-aside requirement of this paragraph (c)(4) is a minimum requirement, and the State enabling act may set aside more than 10 percent of the State housing credit ceiling for apportionment to housing credit agencies for exclusive use in making housing credit allocations to buildings that are part of projects involving a qualified nonprofit organization.

(ii) Projects involving a qualified nonprofit organization. The term “projects involving a qualified nonprofit organization” means projects with respect to which a qualified nonprofit organization is to materially participate (within the meaning of section 469(h)) in the development and continuing operation of the project throughout the 15-year compliance period. The term “qualified nonprofit organization” means any organization that is described in section 501(c)(3) or (4), is exempt from tax under section 501(a), and includes as one of its exempt purposes the fostering of low-income housing.

(6) *Expiration of unused apportionments.* Apportionments of the State housing credit ceiling under this paragraph (c) for any calendar year may be used by housing credit agencies to make housing credit allocations only in such calendar year. Any part of an apportionment of the State housing credit ceiling for any calendar year that is not used for housing credit allocations in such year expires as of the end of such year and does not carry over to any other year. However, any part of an apportionment for 1989 that is not used to make a housing credit allocation in 1989 may be carried over to 1990 and used to make a housing credit allocation to a qualified low-income building described in section 42(n)(2)(B). See paragraph (g)(2) of this section.

**(d) Housing credit allocations made by State and local housing credit agencies.**

(1) *In general.* This paragraph governs State and local housing credit agencies in making housing credit allocations to qualified low-income buildings. The amount of the apportionment of the State housing credit ceiling for any calendar year received by any State or local housing credit agency under paragraph (c) of this section constitutes the agency's aggregate housing credit dollar amount for such year. The aggregate amount of housing credit allocations made in any calendar year by a State or local housing credit agency may not exceed such agency's aggregate housing credit dollar amount for such year. A State or local housing credit agency may make housing credit allocations only to qualified low-income buildings located within the agency's geographic jurisdiction.

(2) *Amount of a housing credit allocation.* In making a housing credit allocation, a State or local housing credit agency must specify a credit percentage, not to exceed the building's applicable percentage determined under section 42(b), and a qualified basis amount. The amount of the housing credit allocation for any building is the product of the specified credit percentage and the specified qualified basis amount. In specifying the credit percentage and qualified basis amount, the State or local housing credit agency shall not take account of the first-year conventions described

in section 42(f)(2)(A) and (3)(B). A State or local housing credit agency may adopt rules or regulations governing conditions for specification of less than the maximum credit percentage and qualified basis amount allowable under section 42(b) and (c), respectively. For example, an agency may specify a credit percentage and a qualified basis amount of less than the maximum credit percentage and qualified basis amount allowable under section 42(b) and (c), respectively, when the financing and rental assistance from all sources for the project of which the building is a part is sufficient to provide the continuing operation of the building without the maximum credit amount allowable under section 42.

*(3) Counting housing credit allocations against an agency's aggregate housing credit dollar amount.* The aggregate amount of housing credit allocations made in any calendar year by a State or local housing credit agency may not exceed such agency's aggregate housing credit dollar amount (i.e., the agency's apportionment of the State housing credit ceiling for such year). This limitation on the aggregate dollar amount of housing credit allocations shall be computed separately for set-aside apportionments received pursuant to paragraph (c)(5) of this section. Housing credit allocations count against an agency's aggregate housing credit dollar amount without regard to the amount of credit allowable to or claimed by an owner of a building in the taxable year in which the allocation is made or in any subsequent year. Thus, housing credit allocations (which are computed without regard to the first-year conventions as provided in paragraph (d)(2) of this section) count in full against an agency's aggregate housing credit dollar amount, even though the first-year conventions described in section 42(f)(2)(A) and (3)(B) may reduce the amount of credit claimed by a taxpayer in the first year in which a credit is allowable. See also paragraph (e)(2) of this section. Housing credit allocations count against an agency's aggregate housing credit dollar amount only in the calendar year in which made and not in subsequent taxable years in the credit period or compliance period during which a taxpayer may claim a credit based on the original housing credit allocation. Since the aggregate amount of housing credit allocations made in any calendar year by a State or local housing credit agency may not exceed such agency's aggregate housing credit dollar amount, an agency shall at all times during a calendar year maintain a record of its cumulative allocations made during such year and its remaining unused aggregate housing credit dollar amount.

*(4) Rules for when applications for housing credit allocations exceed an agency's aggregate housing credit dollar amount.* A State or local housing credit agency may adopt rules or regulations governing the awarding of housing credit allocations when an agency expects that applicants during a calendar year will seek aggregate allocations in excess of the agency's aggregate housing credit dollar amount. The State enabling act may

provide uniform standards for the awarding of housing credit allocations when there is actual or anticipated excess demand from applicants in any calendar year.

*(5) Reduced or additional housing credit allocations.*

(i) In general. A State or local housing credit agency may not reduce or rescind a housing credit allocation made to a qualified low-income building in the manner prescribed in paragraph (d)(8) of this section. Thus, a housing credit agency may not reduce or rescind a housing credit allocation made to a qualified low-income building which is acquired by a new owner who is entitled to a carryover of the allowable credit for such building under section 42(d)(7). A housing credit agency may make additional housing credit allocations to a building in any year in the building's compliance period, whether or not there are additions to qualified basis for which an increased credit is allowable under section 42(f)(3). Each additional housing credit allocation made to a building is treated as a separate allocation and is subject to the rules and requirements of this section. However, in the case of an additional housing credit allocation made with respect to additions to qualified basis for which an increased credit is allowable under section 42(f)(3), the amount of the allocation that counts against the agency's aggregate housing credit dollar amount shall be computed as if the specified credit percentage were unreduced in the manner prescribed in section 42(f)(3)(A) and the specified qualified basis amount were unreduced by the first-year convention prescribed in section 42(f)(3)(B).

(ii) Examples. The rules of paragraph (d)(5)(i) of this section may be illustrated by the following examples:

*Example (1).* For 1987, the County L Housing Credit Agency has an aggregate housing credit dollar amount of \$2 million. D, an individual, places in service on July 1, 1987, a new qualified low-income building. As of the close of each month in 1987 in which the building is in service, the building consists of 100 residential rental units, of which 20 units are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income. The total floor space of the residential rental units is 120,000 square feet, and the total floor space of the low-income units is 20,000 square feet. The building is not Federally subsidized within the meaning of section 42(i)(2). As of the end of 1987, the building has eligible basis under section 42(d) of \$1 million. Thus, the qualified basis of the building determined without regard to the first-year convention provided in section

42(f) is \$166,666.67 (i.e., \$1 million eligible basis times  $1/6$ , the floor space fraction which is required to be used instead of the larger unit fraction). However, the amount of the low-income housing credit determined for 1987 under section 42 reflects the first-year convention provided in section 42(f)(2). Since the building has the same floor space and unit fractions as of the close of each of the six months in 1987 during which it is in service, upon applying the first-year convention in section 42(f)(2), the qualified basis of the building in 1987 is \$83,333.33 (i.e., \$1 million eligible basis times  $1/12$ , the fraction determined under section 42(f)(2)(A)). Under paragraph (d)(2) of this section, the County L Housing Credit Agency may make a housing credit allocation by specifying a credit percentage, not to exceed 9 percent, and a qualified basis amount, which may be greater or less than the qualified basis of the building in 1987 as determined under section 42(c), without regard to the first-year convention provided in section 42(f)(2). If the County L Housing Credit Agency specifies a credit percentage of 8 percent and a qualified basis amount of \$100,000, the amount of the housing credit allocation is \$8,000. Under paragraph (d)(3) of this section, the County L Housing Credit Agency's aggregate housing credit dollar amount for 1987 is reduced by \$8,000, notwithstanding that D is entitled to claim less than \$8,000 of the credit in 1987 under the rules in paragraph (e) of this section. Under paragraph (e)(2) of this section, in 1987 D is entitled to claim only \$4,000 of the credit, determined by applying the first-year convention of  $6/12$  to the specified qualified basis amount contained in the housing credit allocation (i.e.,  $.08 \times \$100,000$ ).

*Example (2).* The facts are the same as in Example (1) except that on July 1, 1988, the number of occupied low-income units increases to 50 units and the floor space of the occupied low-income units increases to 48,000 square feet. These occupancy fractions remain unchanged as of the close of each month remaining in 1988. Under section 42(c), the qualified basis of the building in 1988, without regard to the first-year convention in section 42(f)(3)(B), is \$400,000 (i.e., \$1 million eligible basis times  $.4$ , the floor space fraction which is required to be used instead of the larger unit fraction). D's 1987 housing credit allocation from the County L Housing Credit Agency remains effective in 1988 and entitles D to a credit of \$8,000 (i.e.,  $.08$ , the specified credit percentage, times \$100,000, the specified qualified basis amount). With respect to the additional \$300,000 of qualified basis which the 1987 housing credit allocation does not cover, D must apply to the County L Housing Credit Agency for an additional housing credit allocation. Assume that the County L

Housing Credit Agency has a sufficient aggregate housing credit dollar amount for 1988 to make a housing credit allocation to D in 1988 by specifying a credit percentage of 9 percent and a qualified basis amount of \$300,000. The amount of the housing credit allocation that counts against the County L Housing Credit Agency's aggregate housing credit dollar amount is \$27,000 (i.e., the amount counted (.09 times \$300,000) is unreduced in the manner prescribed in section 42(f)(3)(A) and (B)). Since D's qualified basis in 1987 was \$166,666.67, D is entitled to claim a credit in 1988 with respect to such basis of \$14,000 (i.e.,  $.08 \times \$100,000$ , the 1987 credit allocation, +  $.09 \times \$66,666.67$ , the 1988 credit allocation). In addition, D is entitled to claim a credit in 1988 and subsequent years in the 15-year compliance period with respect to the additional \$233,333.33 of qualified basis covered by the 1988 housing credit allocation. However, the allowable credit for 1988 with respect to this amount of additional qualified basis is subject to reductions prescribed in section 42(f)(3)(A) and (B). Thus, D is entitled in 1988 to a credit at a 6-percent rate applied to \$116,666.67 of additional qualified basis, which is reduced to reflect the first-year convention. D's total allowable low-income housing credit in 1988 is \$21,000 (i.e., \$14,000 with respect to original qualified basis + \$7,000 with respect to 1988 additions to qualified basis). If the County L Housing Credit Agency had specified an 8-percent credit percentage in 1988 with respect to the qualified basis not covered by the 1987 housing credit allocation to D, D's allowable credit with respect to the \$233,333.33 of additions to qualified basis would not exceed, in 1988 and subsequent years, an amount determined by applying a specified credit percentage of 5.33 percent (i.e., two-thirds of 8 percent). In 1988, D's specified qualified basis amount would be adjusted for the first-year convention.

*(6) No carryover of unused aggregate housing credit dollar amount.* Any portion of a State or local housing credit agency's aggregate housing credit dollar amount for any calendar year that is not used to make a housing credit allocation in such year may not be carried over to any other year, except as provided in paragraph (g) of this section. An agency may not permit owners of qualified low-income buildings to transfer housing credit allocations to other buildings. However, an agency may provide a procedure whereby owners may return to the agency, prior to the end of the calendar year in which housing credit allocations are made, unusable portions of such allocations. In such a case, an owner's housing credit allocation is deemed reduced by the amount of the allocation returned to the agency, and the agency may reallocate such amount to other qualified low-income buildings prior to the end of the year.

*(7) Effect of housing credit allocations in excess of an agency's aggregate housing credit dollar amount.* In the event that a State or local housing credit agency makes housing credit allocations in excess of its aggregate housing credit dollar amount for any calendar year, the allocations shall be deemed reduced (to the extent of such excess) for buildings in the reverse order in which such allocations were made during such year.

*(8) Time and manner for making housing credit allocations.*

(i) Time. Housing credit allocations are effective for the calendar year in which made in the manner prescribed in paragraph (d)(8)(ii) of this section. A State or local housing credit agency may not make a housing credit allocation to a qualified low-income building prior to the calendar year in which such building is placed in service. An agency may adopt its own procedures for receiving applications for housing credit allocations from owners of qualified low-income buildings. An agency may provide a procedure for making, in advance of a building's being placed in service, a binding commitment (e.g., by contract, inducement resolution, or other means) to make a housing credit allocation in the calendar year in which a qualified low-income building is placed in service or in a subsequent calendar year. Any advance commitment shall constitute a housing credit allocation for purposes of this section.

(ii) Manner. Housing credit allocations are deemed made when Part I of IRS Form 8609, Low-Income Housing Credit Allocation Certification, is completed and signed by an authorized official of the housing credit agency and mailed to the owner of the qualified low-income building. A copy of all completed (as to Part I) Form 8609 allocations along with a single completed Form 8610, Annual Low-Income Housing Credit Agencies Report, must also be mailed to the Internal Revenue Service not later than the 28th day of the second calendar month after the close of the calendar year in which the housing credit was allocated to the qualified low-income building. Housing credit allocations to a qualified low-income building must be made on Form 8609 and must include—

(A) The address of the building;

(B) The name, address, and taxpayer identification number of the housing credit agency making housing credit allocation;

(C) The name, address, and taxpayer identification number of the owner of the qualified low-income building;

(D) The date of the allocation of housing credit;

(E) The housing credit dollar amount allocated to the building on such date;

(F) The specified maximum applicable credit percentage allocated to the building on such date;

(G) The specified maximum qualified basis amount;

(H) The percentage of the aggregate basis financed by tax-exempt bonds taken into account for purposes of the volume cap under section 146;

(I) A certification under penalties of perjury by an authorized State or local housing credit agency official that the allocation is made in compliance with the requirements of section 42(h); and

(J) Any additional information that may be required by Form 8609 or by an applicable revenue procedure.

See paragraph (h) of this section for additional rules concerning filing of forms.

(iii) Certification. The certifying official for the State or local housing credit agency need not perform an independent investigation of the qualified low-income building in order to certify on Part I of Form 8609 that the housing credit allocation meets the requirements of section 42(h). For example, the certifying official may rely on information contained in an application for a low-income housing credit allocation submitted by the building owner which sets forth facts necessary to determine that the building is eligible for the low-income housing credit under section 42.

(iv) Fee. A State or local housing credit agency may charge building owners applying for housing credit allocations a reasonable fee to cover the agency's administrative expenses for processing applications.

(v) No continuing agency responsibility. The State or local housing credit agency need not monitor or investigate the continued compliance of a qualified low-income building with the requirements of section 42 throughout the applicable compliance period.

**(e) Housing credit allocation taken into account by owner of a qualified low-income building.**

*(1) Time and manner for taking housing credit allocation into account.* An owner of a qualified low-income building may not claim a low-income housing credit determined under section 42 in any year in excess of an effective housing credit allocation received from a State or local housing credit agency. A housing credit allocation made to a qualified low-income building is effective with respect to any owner of the building beginning with the owner's taxable year in which the housing credit allocation is received. A housing credit allocation is deemed received in a taxable year, except as modified in the succeeding sentence, if that allocation is made (in the manner described in paragraph (d)(8) of this section) not later than the earlier of (i) the 60th day after the close of the taxable year, or (ii) the close of the calendar year in which such taxable year ends. A housing credit allocation is deemed received in a taxable year ending in 1987, if such allocation is made (in the manner described in paragraph (d)(8) of this section) on or before December 31, 1987. A housing credit allocation is not effective for any taxable year if received in a calendar year which ends prior to when the qualified low-income building is placed in service. A housing credit allocation made to a qualified low-income building remains effective for all taxable years in the compliance period. A taxpayer is required to complete the Form 8609 on which a housing credit agency made the applicable housing credit allocation and submit a copy of such Form 8609 with its Federal income tax return for each year in the compliance period. Failure to comply with the requirement of the preceding sentence with respect to any taxable year after the first taxable year in the credit period shall be treated as a mathematical or clerical error for purposes of the provisions of section 6213(b)(1) and (g)(2).

*(2) First-year convention limitation on housing credit allocation taken into account.* For purposes of the limitation that the allowable low-income housing credit may not exceed the effective housing credit allocation received from a State or local housing credit agency, as provided in paragraph (e)(1) of this section, the amount of the effective housing credit allocation shall be adjusted by applying the first-year convention provided in section 42(f)(2)(A) and (3)(B) and the percentage credit reduction provided in section 42(f)(3)(A). Under paragraphs (d)(2) and (5) of this section, the State or local housing credit agency must specify the credit percentage and qualified basis amount, the product of which is the amount of the housing credit allocation, without taking account of the first-year convention described in section 42(f)(2)(A) and (3)(B) or the percentage credit reduction prescribed in section 42(f)(3)(A). However, for purposes of the limitation on the amount of the allowable low-income housing credit, as provided in paragraph (e)(2) of this section, in a taxable year in which the first-year convention applies to the amount of credit determined

under section 42(a), the specified qualified basis amount shall be adjusted by the first-year convention fraction which is equal to the number of full months (during the first taxable year) in which the building was in service divided by 12. In addition, for purposes of the limitation on the amount of the allowable low-income housing credit, as provided in paragraph (e)(1) of this section, in a taxable year in which the reduction in credit percentage applies to additions to qualified basis, as prescribed in section 42(f)(3), the specified credit percentage shall be reduced by one-third. See examples in paragraphs (d)(5)(ii) and (e)(3)(ii) of this section.

*(3) Use of excess housing credit allocation for increases in qualified basis.*

(i) In general. If the housing credit allocation made to a qualified low-income building exceeds the amount of credit allowable with respect to such building in any taxable year (without regard to the first-year conventions under section 42(f)), such excess is not transferable to another qualified low-income building. However, if in a subsequent year there are increases in the qualified basis for which an increased credit is allowable under section 42(f)(3) at a reduced credit percentage, the original housing credit allocation (including the specified credit percentage and qualified basis amount) would be effective with respect to such increased credit.

(ii) Example. The provisions of this paragraph (e)(3) may be illustrated by the following example:

*Example* In 1987, a newly-constructed qualified low-income building receives a housing credit allocation of \$90,000 based on a specified credit percentage of 9 percent and a specified qualified basis amount of \$1,000,000. The building is placed in service in 1987, but the qualified basis in such year is only \$800,000, resulting in an allowable credit in 1987 (determined without regard to the first-year conventions) of \$72,000. In 1988, the qualified basis is increased to \$1,100,000, resulting in an additional credit allowable under section 42(f)(3) (without regard to the first-year conventions) of \$18,000 (i.e.,  $\$300,000 \times .06$  or  $2/3$  of .09). The unused portion of the 1987 housing credit allocation (\$18,000) is effective in 1988 and in each subsequent year in the compliance period only with respect to the specified qualified basis for the 1987 housing credit allocation (\$1,000,000). Thus, the owner is allowed to claim a credit in 1988 and in each subsequent year (without regard to the first-year conventions), based on the effective housing credit allocation from 1987, of \$84,000 (i.e.,  $\$72,000 + (\$200,000 \times .06)$ ). The owner of the qualified low-income building must obtain a new housing credit allocation in 1988 with respect to the additional \$100,000 of qualified basis in

order to claim a credit on such basis in 1988 and in each subsequent year. If the applicable first-year convention under section 42(f)(3)(B) entitled the owner in 1988 to only 1/2 of the otherwise applicable credit for the additions to qualified basis, under paragraph (e)(2) of this section the owner is allowed to claim a credit in 1988, based on the effective housing credit allocation from 1987, of \$78,000 (i.e., \$72,000)

*(4) Separate housing credit allocations for new buildings and increases in qualified basis.* Separate housing credit allocations must be received for each building with respect to which a housing credit may be claimed. Rehabilitation expenditures with respect to a qualified low-income building are treated as a separate new building under section 42(e) and must receive a separate housing credit allocation. Increases in qualified basis in a qualified low-income building are not generally treated as a new building for purposes of section 42. To the extent that a prior housing credit allocation received with respect to a qualified low-income building does not allow an increased credit with respect to an increase in the qualified basis of such building, an additional housing credit allocation must be received in order to claim a credit with respect to that portion of increase in qualified basis. See paragraph (e)(3) of this section. The amount of credit allowable with respect to an increase in qualified basis is subject to the credit percentage limitation of section 42(f)(3)(A) and the first-year convention of section 42(f)(3)(B). See paragraph (d)(5) of this section for a rule requiring that the State or local housing credit agency count a housing credit allocation made with respect to an increase in qualified basis as if the specified credit percentage were unreduced in the manner prescribed in section 42(f)(3) and the specified basis amount were unreduced by the first-year convention prescribed in section 42(f)(3)(B).

*(5) Acquisition of building for which a prior housing credit allocation has been made.* If a carryover credit would be allowable to an acquirer of a qualified low-income building under section 42(d)(7), such acquirer need not obtain a new housing credit allocation with respect to such building. Under section 42(d)(7), the acquirer would be entitled to claim only such credits as would have been allowable to the prior owner of the building.

*(6) Multiple housing credit allocations.* A qualified low-income building may receive multiple housing credit allocations from different housing credit agencies having overlapping jurisdictions. A qualified low-income building that receives a housing credit allocation set aside exclusively for projects involving a qualified nonprofit organization may also receive a housing credit allocation from a housing credit agency's aggregate housing credit dollar amount that is not so set aside.

**(f) Exception to housing credit allocation requirement.**

*(1) Tax-exempt bond financing.*

(i) In general. No housing credit allocation is required in order to claim a credit under section 42 with respect to that portion of the eligible basis (as defined in section 42(d)) of a qualified low-income building that is financed with the proceeds of an obligation described in section 103(a) (“tax-exempt bond”) which is taken into account for purposes of the volume cap under section 146. In addition, no housing credit allocation is required in order to claim a credit under section 42 with respect to the entire qualified basis (as defined in section 42(c)) of a qualified low-income building if 70 percent or more of the aggregate basis of the building and the land on which the building is located is financed with the proceeds of tax-exempt bonds which are taken into account for purposes of the volume cap under section 146. For purposes of this paragraph, “land on which the building is located” includes only land that is functionally related and subordinate to the qualified low-income building. See §1.103-8(b)(4)(iii) for the meaning of the term “functionally related and subordinate”. For purposes of this paragraph, the basis of the land shall be determined using principles that are consistent with the rules contained in section 42(d).

(ii) Determining use of bond proceeds. For purposes of determining the portion of proceeds of an issue of tax-exempt bonds used to finance (A) the eligible basis of a qualified low-income building, and (B) the aggregate basis of the building and the land on which the building is located, the proceeds of the issue must be allocated in the bond indenture or a related document (as defined in §1.103-13(b)(8)) in a manner consistent with the method used to allocate the net proceeds of the issue for purposes of determining whether 95 percent or more of the net proceeds of the issue are to be used for the exempt purpose of the issue. If the issuer is not consistent in making this allocation throughout the bond indenture and related documents, or if neither the bond indenture nor a related document provides an allocation, the proceeds of the issue will be allocated on a pro rata basis to all of the property financed by the issue, based on the relative cost of the property.

(iii) Example. The provisions of this paragraph may be illustrated by the following example:

*Example* In 1987, County K assigns \$500,000 of its volume cap for private activity bonds under section 146 to a \$500,000 issue of exempt facility bonds to provide a qualified residential rental

project to be owned by A, an individual. The aggregate basis of the building and the land on which the building is located is \$700,000. Under the terms of the bond indenture, the net proceeds of the issue are to be used to finance \$490,000 of the eligible basis of the building. More than 70 percent of the aggregate basis of the qualified low-income building and the land on which the building is located is financed with the proceeds of tax-exempt bonds to which a portion of the volume cap under section 146 was allocated. Accordingly, A may claim a credit under section 42 without regard to whether any housing credit dollar amount was allocated to that building. If, instead, the aggregate basis of the building and land were \$800,000, A would be able to claim the credit under section 42 without receiving a housing credit allocation for the building only to the extent that the credit was attributable to eligible basis of the building financed with tax-exempt bonds.

**(g) Termination of authority to make housing credit allocation.**

*(1) In general.* No State or local housing credit agency shall receive an apportionment of a State housing credit ceiling for calendar years after 1989. Consequently, no housing credit allocations may be made after 1989, except as provided in paragraph (g)(2) of this section. Housing credit allocations made prior to January 1, 1990, remain effective after such date.

*(2) Carryover of unused 1989 apportionment.* Any State or local housing credit agency that has an unused portion of its apportionment of the State housing credit ceiling for 1989 from which housing credit allocations have not been made in 1989 may carry over such unused portion into 1990. Such carryover portion of the 1989 apportionment shall be treated as the agency's apportionment for 1990. From this 1990 apportionment, the State or local housing credit agency may make housing credit allocations only to a qualified low-income building meeting the following requirements:

- (i) The building must be constructed, reconstructed, or rehabilitated by the taxpayer seeking the allocation;
- (ii) More than 10 percent of the reasonably anticipated cost of such construction, reconstruction, or rehabilitation must have been incurred as of January 1, 1989; and
- (iii) The building must be placed in service before January 1, 1991.

*(3) Expiration of exception for tax-exempt bond financed projects.* The exception to the requirement that a housing credit allocation be received with respect to any portion of the eligible basis of a qualified low-income

building, as provided in paragraph (f) of this section, shall not apply to any building placed in service after 1989, unless such building is described in paragraph (g)(2)(i), (ii), and (iii) of this section.

**(h) Filing of forms and special rules.**

*(1) Completed form.* For purposes of this section, a form shall be treated as completed if the State or local housing credit agency or the building owner has made a good faith effort to complete the form in accordance with the form and the instructions for the form.

*(2) Manner of filing.* A completed Form 8586, Low-Income Housing Credit, shall be filed with the owner's Federal income tax return for each taxable year the owner of a qualified low-income building is claiming the low-income housing credit during the 10-year credit period. A completed Form 8609 (or copy thereof) shall be filed with the owner's Federal income tax return for each of the 15 taxable years in the compliance period. If a housing credit allocation is not required to be received by an owner under paragraph (f) of this section, the owner shall obtain a blank copy of Form 8609 and fill in the address of the building and the name and address of the owner in Part I. Part II of Form 8609 shall be completed by the owner of the qualified low-income building only for the first year the low-income housing credit is claimed by the building owner. Part III of Form 8609 (Statement of Qualification) shall be completed by the owner of the qualified low-income building for each year of the 15-year compliance period.

*(3) Revised or renumbered forms.* If any form is revised or renumbered, any reference in this section to the form shall be treated as a reference to the revised or renumbered form.

**(i) Transitional rules.** The transitional rules contained in section 252(f)(1) of the Tax Reform Act of 1986 are incorporated into this section of the regulations for purposes of determining whether a qualified low-income building is entitled to receive a housing credit allocation or is excepted from the requirement that a housing credit allocation be received. Housing credit allocations made to qualified low-income buildings described in section 252(f)(1) shall not count against the State or local housing credit agency's aggregate housing credit dollar amount. The transitional rules contained in section 252(f)(2) of the Tax Reform Act of 1986 are incorporated into this section of the regulations for purposes of determining amounts available to certain State or local housing credit agencies for the making of housing credit allocations to certain qualified low-income housing projects. Amounts available to housing credit agencies under section 252(f)(2) shall be treated as special apportionments unavailable for housing credit allocations to qualified low-income buildings not described in section 252(f)(2). Housing credit allocations made from the special apportionments shall not count against the State

or local credit agency's aggregate housing credit dollar amount. The set-aside requirements shall not apply to these special apportionments. The transitional rules contained in section 252(f)(3) of the Tax Reform Act 1986 are incorporated in this section of the regulations for purposes of determining the amount of housing credit allocations received by certain qualified low-income buildings. Housing credit allocations deemed received under section 252(f)(3) shall not count against the State or local housing credit agency's aggregate housing credit dollar amount.

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T.D. 8144, 6/17/87.

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## Federal Regulations

### **Reg § 1.42-2. Waiver of requirement that an existing building eligible for the low-income housing credit was last placed in service more than 10 years prior to acquisition by the taxpayer.**

**(a) Low-income housing credit for existing building.** Section 42 provides that, for purposes of section 38, new and existing qualified low-income buildings are eligible for a low-income housing credit. The eligibility rules for new and existing buildings differ. Under section 42(d)(2), an existing building may be eligible for the low-income housing credit based upon the acquisition cost and amounts chargeable to capital account (to the extent properly included in eligible basis) if—

(1) The taxpayer acquires the building by purchase (as defined in section 179(d)(2), as applicable under section 42(d)(2)(D)(iii)(I)),

(2) 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 most recent nonqualified substantial improvement of the building, and

(3) The building was not previously placed in service by the taxpayer, or by a person who was a related person (as defined in section 42(d)(2)(D)(iii)(II)) with respect to the taxpayer as of the time the building was last previously placed in service.

**(b) Waiver of 10-year holding period requirement.** Section 42(d)(6) provides that a taxpayer may apply for a waiver of the 10-year holding period requirement specified in paragraph (a)(2) of this section. The Internal Revenue Service will grant a waiver only if—

(1) The existing building satisfies all of the requirements in paragraph (c) of this section, and

(2) The taxpayer makes an application in conformity with the requirements in paragraph (d) of this section.

**(c) Waiver requirements.**

(1) *Federally-assisted building.* To satisfy the requirement of this paragraph, a building must be a Federally-assisted building. The term “Federally assisted building” means any building which is substantially

assisted, financed, or operated under section 8 of the United States Housing Act of 1937, section 221(d)(3) or 236 of the National Housing Act, or section 515 of the Housing Act of 1949, as such acts were in effect on October 22, 1986.

*(2) Federal mortgage funds at risk.* To satisfy the requirement of this paragraph, Federal mortgage funds must be at risk with respect to a mortgage that is secured by the building or a project of which the building is a part. For purposes of this paragraph, Federal mortgage funds are at risk if, in the event of a default by the mortgagor on the mortgage secured by the building or the project of which the building is a part—

(i) The mortgage could be assigned to the Department of Housing and Urban Development or the Farmers' Home Administration, or

(ii) There could arise a claim against a Federal mortgage insurance fund (or such Department or Administration).

*(3) Statement by the Department of Housing and Urban Development or the Farmers' Home Administration.*

(i) To satisfy the requirement of this paragraph, a letter or other written statement must be made or received and approved by the national office of the Department of Housing and Urban Development or the Farmers Home Administration (“the Federal agency”). This letter or statement shall include the following:

(A) A statement that, as of the earlier of the time of the taxpayer's acquisition of the building or the taxpayer's application for a waiver, the building is a Federally-assisted building within the meaning of paragraph (c)(1) of this section and identifies the source of Federal assistance;

(B) A statement that a waiver of the 10-year holding period requirement is necessary to avert Federal mortgage funds being at risk within the meaning of paragraph (c)(2) of this section; and

(C) A statement that the Federal agency has taken a Federal agency action as described in paragraph (c)(3)(ii) of this section.

(ii) The following specified Federal agency actions shall be the only means of satisfying the requirement of this paragraph:

(A) The Federal agency intends to accept an assignment of a mortgage secured by the building or the project of which the building is a part, and such assignment requires payments by the agency or a mortgage insurance fund maintained by the agency to the prior mortgagee;

(B) The Federal agency or a mortgage insurance fund maintained by the agency intends to accept, as a consequence of foreclosure proceedings or otherwise, conveyance of the building or the project of which the building is a part;

(C) The Federal agency or a mortgage insurance fund maintained by the agency intends, as a consequence of default, to take possession of, hold title to, or otherwise assume ownership of the building or the project of which the building is a part; or

(D) The Federal agency has designated the building or the project of which the building is a part as a troubled building or project. A designation of a troubled building or project must satisfy the following requirements:

(1) Designation of troubled status must be based on a review by the Federal agency of the financial condition of the building or project and on a determination by the Federal agency of a history of financial distress or mortgage defaults;

(2) Designation of troubled status must be made or received and approved by the national office of the Federal agency; and

(3) Federal agency regulations or procedures must provide that, in the event of transfer of the ownership of a designated troubled building or project, the building or project may be subject to continued review by the Federal agency. Each Federal agency may prescribe its own standards and procedures for designating a troubled building or project so long as such standards are consistent with the requirements of this paragraph (c)(3)(ii)(D).

*(4) No prior credit allowed.* The requirement of this paragraph is satisfied only if no prior owner was allowed a low-income housing credit under section 42 for the building.

**(d) Application for waiver.**

*(1) Time and manner.* In order to receive a waiver of the 10-year holding period requirement specified in paragraph (a)(2) of this section, a taxpayer must file an application (including the applicable user fee) that complies with the requirements of this paragraph (d) and Rev. Proc. 90-1, 1990-1 I.R.B. 8 (or any subsequent applicable revenue procedure). The application must be filed by a taxpayer who has acquired the building by purchase or who has a binding contract to purchase the building. Such binding contract may be conditioned upon the granting of a waiver under this section. The application may be filed at any time after a binding contract has been entered into, but no later than 12 months after the taxpayer's acquisition of the building. An application for a waiver of the 10-year holding period requirement must not contain a request for a ruling on any other issue arising under section 42 or other sections of the Internal Revenue Code. An application for a waiver of the 10-year holding period requirement must be mailed or delivered to the address listed in section 3.01 of Rev. Proc. 90-1 (or any subsequent applicable revenue procedure).

*(2) Information required.* An application for a waiver of the 10-year holding period requirement must contain the following information:

- (i) The taxpayer's name, address and taxpayer identification number;
- (ii) The name (if any) and address of the acquired building and the project (if any) of which it is a part;
- (iii) The date of acquisition or the date of the binding contract for acquisition of the building by the taxpayer and the expected date of acquisition, the amount of consideration paid or to be paid for the acquisition (including the value of any liabilities assumed by the taxpayer), and the taxpayer's certification that such acquisition is by purchase (as defined in section 179(d)(2), as applicable under section 42(d)(2)(D)(iii)(I));
- (iv) The identity of the person from whom the building is acquired, and whether such person is a Federal agency, a mortgagee holding title to the building, or the mortgagor or prior owner;
- (v) The date the building was last placed in service and the date of the most recent (if any) nonqualified substantial improvement of the building (as defined in section 42(d)(2)(D)(i));
- (vi) The taxpayer's certification that the building was not previously placed in service by the taxpayer, or by a person who

was a related person (as defined in section 42(d)(2)(D)(iii)(II)) with respect to the taxpayer as of the time the building was last placed in service;

(vii) The amount and disposition (e.g., discharge, assignment, assumption, or refinance) of the outstanding mortgage at the time of acquisition and the identities of the mortgagee and mortgagor;

(viii) The taxpayer's certification that no prior owner was allowed a low-income housing credit under section 42 for the building (made to the best of the taxpayer's knowledge, with no documentation from other persons needed to be submitted); and

(ix) The statement from the Federal agency required by paragraph (c)(3)(i) of this section.

*(3) Other rules.*

(i) In the event that an acquired building will be owned by more than one taxpayer, a single application for waiver may be filed by one taxpayer on behalf of the co-owners if the application contains the names, addresses and taxpayer identification numbers of the other owners. A general partner or a designated limited partner may file an application for waiver on behalf of a partnership.

(ii) In the event that multiple Federally-assisted buildings in a project are being acquired by the taxpayer, a single application for waiver with respect to such buildings may be filed if the application contains the required information set out for the address of each Federally-assisted building involved.

(iii) In the event that specific Federally-assisted buildings are being acquired by the taxpayer in a project consisting of multiple buildings that may or may not be Federally-assisted, a single application for waiver with respect to the Federally-assisted buildings being acquired may be filed if the application contains the required information set out for the address of each Federally-assisted building being acquired.

*(4) Effective date of waiver.* A waiver will be effective when granted in writing by the Internal Revenue Service after submission of a completed application for waiver filed under this paragraph (d).

*(5) Attachment to return.* A waiver letter granted by the Internal Revenue Service shall be filed with the taxpayer's Federal income tax return for the

first taxable year the low-income housing credit is claimed by the taxpayer.

**(e) Effective date of regulations.** The provisions of §1.42-2 are effective for buildings placed in service by the taxpayer after December 31, 1986.

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T.D. 8302, 5/22/90.

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## Federal Regulations

### **Reg § 1.42-3. Treatment of buildings financed with proceeds from a loan under an Affordable Housing Program established pursuant to section 721 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).**

**(a) Treatment under sections 42(i) and 42(b).** A below market loan funded in whole or in part with funds from an Affordable Housing Program established under section 721 of FIRREA is not, solely by reason of the Affordable Housing Program funds, a below market Federal loan as defined in section 42(i)(2)(D). Thus, any building with respect to which the proceeds of the loan are used during the tax year is not, solely by reason of the Affordable Housing Program funds, treated as a federally subsidized building for that tax year and subsequent tax years for purposes of determining the applicable percentage for the building under section 42(b).

**(b) Effective date.** The rules set forth in paragraph (a) of this section are effective for loans made after August 8, 1989.

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T.D. 8368, 9/25/91.

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## Federal Regulations

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

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

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

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

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

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## Federal Regulations

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

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

#### **(a) Compliance monitoring requirement.**

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

*(2) Requirements for a monitoring procedure.*

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

(A) The recordkeeping and record retention provisions of paragraph (b) of this section;

(B) The certification and review provisions of paragraph (c) of this section;

(C) The inspection provision of paragraph (d) of this section; and

(D) The notification-of-noncompliance provisions of paragraph (e) of this section.

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

**(b) Recordkeeping and record retention provisions.**

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

- (i) The total number of residential rental units in the building (including the number of bedrooms and the size in square feet of each residential rental unit);
- (ii) The percentage of residential rental units in the building that are low-income units;
- (iii) The rent charged on each residential rental unit in the building (including any utility allowances);
- (iv) The number of occupants in each low-income unit, but only if rent is determined by the number of occupants in each unit under section 42(g)(2) (as in effect before the amendments made by the Omnibus Budget Reconciliation Act of 1989);
- (v) The low-income unit vacancies in the building and information that shows when, and to whom, the next available units were rented;
- (vi) The annual income certification of each low-income tenant per unit. For an exception to this requirement, see section 42(g)(8)(B) (which provides a special rule for a 100 percent low-income building);
- (vii) Documentation to support each low-income tenant's income certification (for example, a copy of the tenant's federal income tax return, Forms W-2, or verifications of income from third parties such as employers or state agencies paying unemployment compensation). For an exception to this requirement, see section 42(g)(8)(B) (which provides a special rule for a 100 percent low-income building). Tenant income is calculated in a manner consistent with the determination of annual income under section 8 of the United States Housing Act of 1937 (“Section 8”), not in accordance with the determination of gross income for federal income tax liability. In the case of a tenant receiving housing assistance payments under Section 8, the documentation requirement of this paragraph (b)(1)(vii) is satisfied if the public housing authority provides a statement to the building owner

declaring that the tenant's income does not exceed the applicable income limit under section 42(g);

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

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

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

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

**(c) Certification and review provisions.**

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

(i) The project met the requirements of:

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

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

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

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

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

(v) All units in the project were for use by the general public (as defined in Sec. 1.42-9), including the requirement that no finding of discrimination under the Fair Housing Act, 42 U.S.C. 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 governmental unit, the owner must attach a statement summarizing the violation report or notice or a copy of the violation report or notice to the annual certification submitted to the Agency under paragraph (c)(1) of this section. In addition, the owner must state whether the violation has been corrected;

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

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

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

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

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

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

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

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

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

(A) The Agency must conduct on-site inspections of all buildings in the project by the end of the second calendar year following the year the last building in the project is

placed in service and, for at least 20 percent of the project's low-income units, inspect the units and review the low-income certifications, the documentation supporting the certifications, and the rent records for the tenants in those units; and

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

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

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

*(4) Exception for certain buildings.*

(i) In general. The review requirements under paragraph (c)(2)(ii) of this section may provide that owners are not required to submit, and the Agency is not required to review, the tenant income certifications, supporting documentation, and rent records for buildings financed by the Rural Housing Service (RHS), formerly known as Farmers Home Administration, under the section 515 program, or buildings of which 50 percent or more of the aggregate basis (taking into account the building and the land) is financed

with the proceeds of obligations the interest on which is exempt from tax under section 103 (tax-exempt bonds). In order for a monitoring procedure to except these buildings, the Agency must meet the requirements of paragraph (c)(4)(ii) of this section.

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

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

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

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

**(d) Inspection provision.**

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

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

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

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

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

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

**(e) Notification-of-noncompliance provision.**

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

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

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

(3) *Notice to Internal Revenue Service.*

(i) In general. The Agency must be required to file Form 8823, "Low-Income Housing Credit Agencies Report of Noncompliance," with the Service no later than 45 days after the end of the correction period (as described in paragraph (e)(4) of this section, including extensions permitted under that paragraph) and no earlier than the end of the correction period, whether or not the noncompliance or failure to certify is corrected. The Agency must explain on Form 8823 the nature of the noncompliance or failure to certify and indicate whether the owner has corrected the noncompliance or failure to certify. Any change in either the applicable fraction or eligible basis under paragraph (c)(1)(ii) and (vii) of this section, respectively, that results in a decrease in the qualified basis of the project under section 42(c)(1)(A) is noncompliance that must be reported to the Service under this paragraph (e)(3). If an Agency reports on Form 8823 that a building is entirely out of compliance and will not be in compliance at any time in the future, the Agency need not file Form 8823 in subsequent years to report that building's noncompliance. If the noncompliance or failure to certify is corrected within 3 years after the end of the correction period, the Agency is required to file Form 8823 with the Service reporting the correction of the noncompliance or failure to certify.

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

(4) *Correction period.* The correction period shall be that period specified in the monitoring procedure during which an owner must supply any

missing certifications and bring the project into compliance with the provisions of section 42. The correction period is not to exceed 90 days from the date of the notice to the owner described in paragraph (e)(2) of this section. An Agency may extend the correction period for up to 6 months, but only if the Agency determines there is good cause for granting the extension.

**(f) Delegation of Authority.**

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

(i) In general. An Agency may retain an agent or other private contractor (“ Authorized Delegate”) to perform compliance monitoring. The Authorized Delegate must be unrelated to the owner of any building that the Authorized Delegate monitors. The Authorized Delegate may be delegated all of the functions of the Agency, except for the responsibility of notifying the Service under paragraphs (5) and (e)(3) of this section. For example, the Authorized Delegate may be delegated the responsibility of reviewing tenant certifications and documentation under paragraph (c)(1) and (2) of this section, the right to inspect buildings and records as described in paragraph (d) of this section, and the responsibility of notifying building owners of lack of certification or noncompliance under paragraph (e)(2) of this section. The Authorized Delegate must notify the Agency of any noncompliance or failure to certify.

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

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

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

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

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

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## Federal Regulations

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

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

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

**(b) Carryover-allocation basis.**

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

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

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

carryover-allocation basis if properly capitalizable into the basis of land or depreciable property that is reasonably expected to be part of a project.

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

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

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

(A) The fee is reasonable;

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

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

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

(E) If the fee is paid (or to be paid) by the taxpayer to a related person, and the taxpayer uses the cash method of accounting, the taxpayer could properly accrue the fee under the accrual method of accounting (considering, for example, the rules of section 461(h)). A person is a related person if the person bears a relationship to the taxpayer specified in sections 267(b) or 707(b)(1), or if the person and the taxpayer are engaged in trades or businesses under common control (within the meaning of subsections (a) and (b) of section 52).

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

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

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

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

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

*Example (2).* (i) *Facts.* D, an accrual-method taxpayer, receives a carryover allocation from Agency, the state housing credit agency, on September 11, 1993. As of that date, D has not begun construction of the low-income housing building D plans to build and D does not have basis in the land on which D plans to build the building. In 1993, D incurs some costs related to the planned building, including architects' fees. However,

at the close of 1993, these costs do not exceed 10 percent of D's reasonably expected basis in the project.

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

**(c) Verification of basis by agency.**

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

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

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

it had not been made and the carryover allocation document should not be filed with the Form 8610.

**(d) Requirements for making carryover allocations.**

*(1) In general.* Generally, an allocation is made when an Agency issues the Form 8609, Low-Income Housing Credit Allocation Certification, for a building. See §1.42-1T(d)(8)(ii). An Agency does not issue the Form 8609 for a building until the building is placed in service. However, in cases where allocations of credit are made pursuant to section 42(h)(1)(E) (relating to carryover allocations for buildings) or section 42(h)(1)(F) (relating to carryover allocations for multiple-building projects), Form 8609 is not used as the allocating document because the buildings are not yet in service. When an allocation is made pursuant to section 42(h)(1)(E) or (F), the allocating document is the document meeting the requirements of paragraph (d)(2) of this section. In addition, when an allocation is made pursuant to section 42(h)(1)(F), the requirements of paragraph (d)(3) of this section must be met for the allocation to be valid. An allocation pursuant to section 42(h)(1)(E) or (F) reduces the state housing credit ceiling for the year in which the allocation is made, whether or not the Form 8609 is also issued in that year.

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

- (i) The address of each building in the project, or if none exists, a specific description of the location of each building;
- (ii) The name, address, and taxpayer identification number of the taxpayer receiving the allocation;
- (iii) The name and address of the Agency;
- (iv) The taxpayer identification number of the Agency;
- (v) The date of the allocation;
- (vi) The housing credit dollar amount allocated to the building or project, as applicable;
- (vii) The taxpayer's reasonably expected basis in the project (land and depreciable basis) as of the close of the second calendar year following the calendar year in which the allocation is made;

(viii) The taxpayer's basis in the project (land and depreciable basis) as of the close of the calendar year in which the allocation is made and the percentage that basis bears to the reasonably expected basis in the project (land and depreciable basis) as of the close of the second following calendar year;

(ix) The date that each building in the project is expected to be placed in service; and

(x) The Building Identification Number (B.I.N.) to be assigned to each building in the project. The B.I.N. must reflect the year an allocation is first made to the building, regardless of the year that the building is placed in service. This B.I.N. must be used for all allocations of credit for the building. For example, rehabilitation expenditures treated as a separate new building under section 42(e) should not have a separate B.I.N. if the building to which the rehabilitation expenditures are made has a B.I.N. In this case, the B.I.N. used for the rehabilitation expenditures shall be the B.I.N. previously assigned to the building, although the rehabilitation expenditures must have a separate Form 8609 for the allocation. Similarly, a newly constructed building that receives an allocation of credit in different calendar years must have a separate Form 8609 for each allocation. The B.I.N. assigned to the building for the first allocation must be used for the subsequent allocation.

*(3) Special rules for project-based allocations.*

(i) In general. An allocation pursuant to section 42(h)(1)(F) (a project-based allocation) must meet the requirements of this section as well as the requirements of section 42(h)(1)(F), including the minimum basis requirement of section 42(h)(1)(E)(ii).

(ii) Requirement of section 42(h)(1)(F)(i)(III). An allocation satisfies the requirement of section 42(h)(1)(F)(i)(III) if the Form 8609 that is issued for each building that is placed in service in the project states the portion of the project-based allocation that is applied to that building.

*(4) Recordkeeping requirements.*

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

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

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

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

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

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

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

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## Federal Regulations

### Reg § 1.42-8. Election of appropriate percentage month.

#### (a) Election under section 42(b)(2)(A)(ii)(I) to use the appropriate percentage for the month of a binding agreement.

(1) *In general.* For purposes of section 42(b)(2)(A)(ii)(I), an agreement between a taxpayer and an Agency as to the housing credit dollar amount to be allocated to a building is considered binding if it—

(i) Is in writing;

(ii) Is binding under state law on the Agency, the taxpayer, and all successors in interest;

(iii) Specifies the type(s) of building(s) to which the housing credit dollar amount applies (i.e., a newly constructed or existing building, or substantial rehabilitation treated as a separate new building under section 42(e));

(iv) Specifies the housing credit dollar amount to be allocated to the building(s); and

(v) Is dated and signed by the taxpayer and the Agency during the month in which the requirements of paragraphs (a)(1)(i) through (iv) of this section are met.

(2) *Effect on state housing credit ceiling.* Generally, a binding agreement described in paragraph (a)(1) of this section is an agreement by the Agency to allocate credit to the taxpayer at a future date. The binding agreement may include a reservation of credit or a binding commitment (under section 42(h)(1)(C)) to allocate credit in a future taxable year. A reservation or a binding commitment to allocate credit in a future year has no effect on the state housing credit ceiling until the year the Agency actually makes an allocation. However, if the binding agreement is also a carryover allocation under section 42(h)(1)(E) or (F), the state housing credit ceiling is reduced by the amount allocated by the Agency to the taxpayer in the year the carryover allocation is made. For a binding agreement to be a valid carryover allocation, the requirements of paragraph (a)(1) of this section and §1.42-6 must be met.

(3) *Time and manner of making election.* An election under section 42(b)(2)(A)(ii)(I) may be made either as part of the binding agreement under paragraph (a)(1) of this section to allocate a specific housing credit

dollar amount or in a separate document that references the binding agreement. In either case, the election must—

- (i) Be in writing;
- (ii) Reference section 42(b)(2)(A)(ii)(I);
- (iii) Be signed by the taxpayer;
- (iv) If it is in a separate document, reference the binding agreement that meets the requirements of paragraph (a)(1) of this section; and
- (v) Be notarized by the 5th day following the end of the month in which the binding agreement was made.

*(4) Multiple agreements.*

(i) Rescinded agreements. A taxpayer may not make an election under section 42(b)(2)(A)(ii)(I) for a building if an election has previously been made for the building for a different month. For example, assume a taxpayer entered into a binding agreement for allocation of a specific housing credit dollar amount to a building and made the election under section 42(b)(2)(A)(ii)(I) to apply the appropriate percentage for the month of the binding agreement. If the binding agreement subsequently is rescinded under state law, and the taxpayer enters into a new binding agreement for allocation of a specific housing credit dollar amount to the building, the taxpayer must apply to the building the appropriate percentage for the elected month of the rescinded binding agreement. However, if no prior election was made with respect to the rescinded binding agreement, the taxpayer may elect the appropriate percentage for the month of the new binding agreement.

(ii) Increases in credit. The election under section 42(b)(2)(A)(ii)(I), once made, applies to any increase in the credit amount allocated for a building, whether the increase occurs in the same or in a subsequent year. However, in the case of a binding agreement (or carryover allocation that is treated as a binding agreement) to allocate a credit amount under section 42(e)(1) for substantial rehabilitation treated as a separate new building, a taxpayer may make the election under section 42(b)(2)(A)(ii)(I) notwithstanding that a prior election under section 42(b)(2)(A)(ii)(I) is in effect for a prior allocation of credit for a substantial rehabilitation that was previously placed in service under section 42(e).

*(5) Amount allocated.* The housing credit dollar amount eventually allocated to a building may be more or less than the amount specified in the binding agreement. Depending on the Agency's determination pursuant to section 42(m)(2) as to the financial feasibility of the building (or project), the Agency may allocate a greater housing credit dollar amount to the building (provided that the Agency has additional housing credit dollar amounts available to allocate for the calendar year of the allocation) or the Agency may allocate a lesser housing credit dollar amount. Under section 42(h)(7)(D), in allocating a housing credit dollar amount, the Agency must specify the applicable percentage and maximum qualified basis of the building. The applicable percentage may be less, but not greater than, the appropriate percentage for the month the building is placed in service, or the month elected by the taxpayer under section 42(b)(2)(A)(ii)(I). Whether the appropriate percentage is the appropriate percentage for the 70-percent present value credit or the 30-percent present value credit is determined under section 42(i)(2) when the building is placed in service.

*(6) Procedures.*

(i) Taxpayer. The taxpayer must give the original notarized election statement to the Agency before the close of the 5th calendar day following the end of the month in which the binding agreement is made. The taxpayer must retain a copy of the binding agreement and the election statement and must file an additional copy of each with the taxpayer's Form 8609, Low-Income Housing Credit Allocation Certification, for the first taxable year in which credit is claimed for the building.

(ii) Agency. The Agency must file with the Internal Revenue Service the original of the binding agreement and the election statement with the Agency's Form 8610, Annual Low-Income Housing Credit Agencies Report, that accounts for the year the allocation is actually made. The Agency must also retain a copy of the binding agreement and the election statement.

*(7) Examples.* The following examples illustrate the provisions of this section. In each example, X is the taxpayer, Agency is the state housing credit agency, and the carryover allocations meet the requirements of §1.42-6 and are otherwise valid.

*Example (1).* (i) In August 1993, X and Agency enter into an agreement that Agency will allocate \$100,000 of housing credit dollar amount for the low-income housing building X is constructing. The agreement is binding and meets all the requirements of paragraph (a)(1) of this section. The agreement is a reservation of credit, not an allocation, and therefore, has

no effect on the state housing credit ceiling. On or before September 5, 1993, X signs and has notarized a written election statement that meets the requirements of paragraph (a)(3) of this section. The applicable percentage for the building is the appropriate percentage for the month of August 1993.

(ii) Agency makes a carryover allocation of \$100,000 of housing credit dollar amount for the building on October 2, 1993. The carryover allocation reduces Agency's state housing credit ceiling for 1993. Due to unexpectedly high construction costs, when X places the building in service in July 1994, the product of the building's qualified basis and the applicable percentage for the building (the appropriate percentage for the month of August 1993) is \$150,000, rather than \$100,000.

Notwithstanding that only \$100,000 of credit was allocated for the building in 1993, Agency may allocate an additional \$50,000 of housing credit dollar amount for the building from its state housing credit ceiling for 1994. The appropriate percentage for the month of August 1993 is the applicable percentage for the building for the entire \$150,000 of credit allocated for the building, even though separate allocations were made in 1993 and 1994. Because allocations were made for the building in two separate calendar years, Agency must issue two Forms 8609 to X. One Form 8609 must reflect the \$100,000 allocation made in 1993, and the other Form 8609 must reflect the \$50,000 allocation made in 1994.

(iii) X gives the original notarized statement to Agency on or before September 5, 1993, and retains a copy of the binding agreement, election statement, and carryover allocation document. X files a copy of the binding agreement, election statement, and carryover allocation document with X's Form 8609 for the first taxable year in which X claims credit for the building.

(iv) Agency files the original of the binding agreement, election statement, and 1993 carryover allocation document with its 1993 Form 8610. Agency retains a copy of the binding agreement, election statement, and carryover allocation document. After the building is placed in service in 1994, Agency issues to X a copy of the Form 8609 reflecting the 1993 carryover allocation of \$100,000 and files the original of that form with its 1994 Form 8610. Agency also files the original of the 1994 Form 8609 reflecting the \$50,000 allocation with its 1994 Form 8610 and issues to X a copy of the 1994 Form 8609. Agency retains copies of the Forms 8609 that are issued to X.

*Example (2).* (i) In September 1993, X and Agency enter into an agreement that Agency will allocate \$70,000 of housing credit dollar amount for rehabilitation expenditures that X is incurring and that X will treat as a new low-income housing building under section 42(e)(1). The

agreement is binding and meets all the requirements of paragraph (a)(1) of this section. The agreement is a reservation of credit, not an allocation, and therefore, has no effect on Agency's state housing credit ceiling. On or before October 5, 1993, X signs and has notarized a written election statement that meets the requirements of paragraph (a)(3) of this section. The applicable percentage for the building is the appropriate percentage for the month of September 1993. Agency makes a carryover allocation of \$70,000 of housing credit dollar amount for the building on November 15, 1993. The carryover allocation reduces by \$70,000 Agency's state housing credit ceiling for 1993.

(ii) In October 1994, X and Agency enter into another binding agreement meeting the requirements of paragraph (a)(1) of this section. Under the agreement, Agency will allocate \$50,000 of housing credit dollar amount for additional rehabilitation expenditures by X that qualify as a second separate new building under section 42(e)(1). On or before November 5, 1994, X signs and has notarized a written election statement meeting the requirements of paragraph (a)(3) of this section. On December 1, 1994, X receives a carryover allocation under section 42(h)(1)(E) for \$50,000. The carryover allocation reduces by \$50,000 Agency's state housing credit ceiling for 1994. The applicable percentage for the rehabilitation expenditures treated as the second separate new building is the appropriate percentage for the month of October 1994, not September 1993. The appropriate percentage for the month of September 1993 still applies to the allocation of \$70,000 for the rehabilitation expenditures treated as the first separate new building. Because allocations were made for the building in two separate calendar years, Agency must issue two Forms 8609 to X. One Form 8609 must reflect the \$70,000 allocation made in 1993, and the other Form 8609 must reflect the \$50,000 allocation made in 1994.

(iii) X gives the first original notarized statement to Agency on or before October 5, 1993, and retains a copy of the first binding agreement, election statement, and carryover allocation document issued in 1993. X gives the second original notarized statement to Agency on or before November 5, 1994, and retains a copy of the second binding agreement, election statement, and carryover allocation document issued in 1994. X files a copy of the binding agreements, election statements, and carryover allocation documents with X's Forms 8609 for the first taxable year in which X claims credit for the buildings.

(iv) Agency retains a copy of the binding agreements, election statements, and carryover allocation documents. Agency files the original of the first binding agreement, election statement, and 1993 carryover allocation document with its 1993 Form 8610. Agency files the original of the second binding agreement, election statement, and 1994 carryover

allocation document with its 1994 Form 8610. After X notifies Agency of the date each building is placed in service, the Agency will issue copies of the respective Forms 8609 to X, and file the originals of those forms with the Agency's Form 8610 that reflects the year each form is issued. The Agency also retains copies of the Forms 8609.

**(b) Election under section 42(b)(2)(A)(ii)(II) to use the appropriate percentage for the month tax-exempt bonds are issued.**

*(1) Time and manner of making election.* In the case of any building to which section 42(h)(4)(B) applies, an election under section 42(b)(2)(A)(ii)(II) to use the appropriate percentage for the month tax-exempt bonds are issued must—

(i) Be in writing;

(ii) Reference section 42(b)(2)(A)(ii)(II);

(iii) Specify the percentage of the aggregate basis of the building and the land on which the building is located that is financed with the proceeds of obligations described in section 42(h)(4)(A) (tax-exempt bonds);

(iv) State the month in which the tax-exempt bonds are issued;

(v) State that the month in which the tax-exempt bonds are issued is the month elected for the appropriate percentage to be used for the building;

(vi) Be signed by the taxpayer; and

(vii) Be notarized by the 5th day following the end of the month in which the bonds are issued.

*(2) Bonds issued in more than one month.* If a building described in section 42(h)(4)(B) (substantially bond-financed building) is financed with tax-exempt bonds issued in more than one month, the taxpayer may elect the appropriate percentage for any month in which the bonds are issued. Once the election is made, the appropriate percentage elected applies for the building even if all bonds are not issued in that month. The requirements of this paragraph (b), including the time limitation contained in paragraph (b)(1)(vii) of this section, must also be met.

*(3) Limitations on appropriate percentage.* Under section 42(m)(2)(D), the credit allowable for a substantially bond-financed building is limited to the amount necessary to assure the project's feasibility. Accordingly, in

making the determination under section 42(m)(2), an Agency may use an applicable percentage that is less, but not greater than, the appropriate percentage for the month the building is placed in service, or the month elected by the taxpayer under section 42(b)(2)(A)(ii)(II).

*(4) Procedures.*

(i) Taxpayer. The taxpayer must provide the original notarized election statement to the Agency before the close of the 5th calendar day following the end of the month in which the bonds are issued. If an authority other than the Agency issues the tax-exempt bonds, the taxpayer must also give the Agency a signed statement from the issuing authority that certifies the information described in paragraphs (b)(1)(iii) and (iv) of this section. The taxpayer must file a copy of the election statement with the taxpayer's Form 8609 for the first taxable year in which credit is claimed for the building. The taxpayer must also retain a copy of the election statement.

(ii) Agency. The Agency must file with the Internal Revenue Service the original of the election statement and the corresponding Form 8609 for the building with the Agency's Form 8610 that reflects the year the Form 8609 is issued. The Agency must also retain a copy of the election statement and the Form 8609.

## Federal Regulations

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

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

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

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

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

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§ 1.42-10 Utility allowances.

(a) Inclusion of utility allowances in gross rent. If the cost of any utility (other than telephone, cable television, or Internet) for a residential rental unit is paid directly by the tenant(s), and not by or through the owner of the building, the gross rent for that unit includes the applicable utility allowance determined under this section. This section only applies for purposes of determining gross rent under section 42(g)(2)(B)(ii) as to rent-restricted units.

(b) Applicable utility allowances —(1) Buildings assisted by the Rural Housing Service. If a building receives assistance from the Rural Housing Service (RHS-assisted building), the applicable utility allowance for all rent-restricted units in the building is the utility allowance determined under the method prescribed by the Rural Housing Service (RHS) for the building (whether or not the building or its tenants also receive other state or federal assistance).

(2) Buildings with Rural Housing Service assisted tenants. If any tenant in a building receives RHS rental assistance payments (RHS tenant assistance), the applicable utility allowance for all rent-restricted units in the building (including any units occupied by tenants receiving rental assistance payments from the Department of Housing and Urban Development (HUD)) is the applicable RHS utility allowance.

(3) Buildings regulated by the Department of Housing and Urban Development. If neither a building nor any tenant in the building receives RHS housing assistance, and the rents and utility allowances of the building are reviewed by HUD on an annual basis (HUD-regulated building), the applicable utility allowance for all rent-restricted units in the building is the applicable HUD utility allowance.

(4) Other buildings. If a building is neither an RHS-assisted nor a HUD-regulated building, and no tenant in the building receives RHS tenant assistance, the applicable utility allowance for rent-restricted units in the building is determined under the following methods.

(i) Tenants receiving HUD rental assistance. The applicable utility allowance for any rent-restricted units occupied by tenants receiving HUD rental assistance payments (HUD tenant assistance) is the applicable Public Housing Authority (PHA) utility allowance established for the Section 8 Existing Housing Program.

(ii) Other tenants —(A) General rule. If none of the rules of paragraphs (b)(1), (2), (3), and (4)(i) of this section apply to any rent-restricted units in a building, the appropriate utility allowance for the units is the applicable PHA utility allowance. However, if a local utility company estimate is obtained for any unit in the building in accordance with paragraph (b)(4)(ii)(B) of this section, that estimate becomes the appropriate utility allowance for all rent-restricted units of similar size and construction in the building. This local utility company estimate procedure is not available for and does not apply to units to which the rules of paragraphs (b) (1), (2), (3), or (4)(i) of this section apply. However, if a local utility company estimate is obtained for any unit in the building under

paragraph (b)(4)(ii)(B) of this section, a State or local housing credit agency (Agency) provides a building owner with an estimate for any unit in a building under paragraph (b)(4)(ii)(C) of this section, a cost estimate is calculated using the HUD Utility Schedule Model under paragraph (b)(4)(ii)(D) of this section, or a cost estimate is calculated by an energy consumption model under paragraph (b)(4)(ii)(E) of this section, then the estimate under paragraph (b)(4)(ii)(B), (C), (D), or (E) becomes the applicable utility allowance for all rent-restricted units of similar size and construction in the building. Paragraphs (b)(4)(ii)(B), (C), (D), and (E) of this section do not apply to units to which the rules of paragraphs (b)(1), (2), (3), or (4)(i) of this section apply.

(B) Utility company estimate. Any interested party (including a low-income tenant, a building owner, or an Agency) may obtain a local utility company estimate for a unit. The estimate is obtained when the interested party receives, in writing, information from a local utility company providing the estimated cost of that utility for a unit of similar size and construction for the geographic area in which the building containing the unit is located. In the case of deregulated utility services, the interested party is required to obtain an estimate only from one utility company even if multiple companies can provide the same utility service to a unit. However, the utility company must offer utility services to the building in order for that utility company's rates to be used in calculating utility allowances. The estimate should include all component deregulated charges for providing the utility service. The local utility company estimate may be obtained by an interested party at any time during the building's extended use period (see section 42(h)(6)(D)) or, if the building does not have an extended use period, during the building's compliance period (see section 42(i)(1)). Unless the parties agree otherwise, costs incurred in obtaining the estimate are borne by the initiating party. The interested party that obtains the local utility company estimate (the initiating party) must retain the original of the utility company estimate and must furnish a copy of the local utility company estimate to the owner of the building (where the initiating party is not the owner), and the Agency that allocated credit to the building (where the initiating party is not the Agency). The owner of the building must make available copies of the utility company estimate to the tenants in the building.

(C) Agency estimate. A building owner may obtain a utility estimate for each unit in the building from the Agency that has jurisdiction over the building provided the Agency agrees to provide the estimate. The estimate is obtained when the building owner receives, in writing, information from the Agency providing the estimated per-unit cost of the utilities for units of similar size and construction for the geographic area in which the building containing the units is located. The Agency estimate may be obtained by a building owner at any time during the building's extended use period (see section 42(h)(6)(D)). Costs incurred in obtaining the estimate are borne by the building owner. In establishing an accurate utility allowance estimate for a particular building, an Agency (or an agent or other private contractor of the Agency that is a qualified professional within the meaning of paragraph (b)(4)(ii)(E) of this section) must take into account, among other things, local utility rates, property type, climate and degree-day variables by region in the State, taxes and fees on utility charges, building materials, and mechanical systems. If the Agency uses an agent or other private contractor to calculate the utility

estimates, the agent or contractor and the owner must not be related within the meaning of section 267(b) or 707(b). An Agency may also use actual utility company usage data and rates for the building. However, use of the Agency estimate is limited to the building's consumption data for the twelve-month period ending no earlier than 60 days prior to the beginning of the 90-day period under paragraph (c)(1) of this section and utility rates used for the Agency estimate must be no older than the rates in place 60 days prior to the beginning of the 90-day period under paragraph (c)(1) of this section. In the case of newly constructed or renovated buildings with less than 12 months of consumption data, the Agency (or an agent or other private contractor of the Agency that is a qualified professional within the meaning of paragraph (b)(4)(ii)(E) of this section) may use consumption data for the 12-month period of units of similar size and construction in the geographic area in which the building containing the units is located.

(D) HUD Utility Schedule Model. A building owner may calculate a utility estimate using the “HUD Utility Schedule Model” that can be found on the Low-Income Housing Tax Credits page at <http://www.huduser.org/datasets/lihtc.html> (or successor URL). Utility rates used for the HUD Utility Schedule Model must be no older than the rates in place 60 days prior to the beginning of the 90-day period under paragraph (c)(1) of this section.

(E) Energy consumption model. A building owner may calculate utility estimates using an energy and water and sewage consumption and analysis model (energy consumption model). The energy consumption model must, at a minimum, take into account specific factors including, but not limited to, unit size, building orientation, design and materials, mechanical systems, appliances, and characteristics of the building location. The utility consumption estimates must be calculated by either a properly licensed engineer or a qualified professional approved by the Agency that has jurisdiction over the building (together, qualified professional), and the qualified professional and the building owner must not be related within the meaning of section 267(b) or 707(b). Use of the energy consumption model is limited to the building's consumption data for the twelve-month period ending no earlier than 60 days prior to the beginning of the 90-day period under paragraph (c)(1) of this section, and utility rates used for the energy consumption model must be no older than the rates in place 60 days prior to the beginning of the 90-day period under paragraph (c)(1) of this section. In the case of newly constructed or renovated buildings with less than 12 months of consumption data, the qualified professional may use consumption data for the 12-month period of units of similar size and construction in the geographic area in which the building containing the units is located.

(c) Changes in applicable utility allowance —(1) In general. If, at any time during the building's extended use period (as defined in section 42(h)(6)(D)), the applicable utility allowance for units changes, the new utility allowance must be used to compute gross rents of the units due 90 days after the change (the 90-day period). For example, if rent must be lowered because a local utility company estimate is obtained that shows a higher utility cost than the otherwise applicable PHA utility allowance, the lower rent must be in effect for rent due at the end of the 90-day period. A building owner using a utility

company estimate under paragraph (b)(4)(ii)(B) of this section, the HUD Utility Schedule Model under paragraph (b)(4)(ii)(D) of this section, or an energy consumption model under paragraph (b)(4)(ii)(E) of this section must submit copies of the utility estimates to the Agency that has jurisdiction over the building and make the estimates available to all tenants in the building at the beginning of the 90-day period before the utility allowances can be used in determining the gross rent of rent-restricted units. An Agency may require additional information from the owner during the 90-day period. Any utility estimates obtained under the Agency estimate under paragraph (b)(4)(ii)(C) of this section must also be made available to all tenants in the building at the beginning of the 90-day period. The building owner must pay for all costs incurred in obtaining the estimates under paragraphs (b)(4)(ii)(B), (C), (D), and (E) of this section and providing the estimates to the Agency and the tenants. The building owner is not required to review the utility allowances, or implement new utility allowances, until the building has achieved 90 percent occupancy for a period of 90 consecutive days or the end of the first year of the credit period, whichever is earlier.

(2) Annual review. A building owner must review at least once during each calendar year the basis on which utility allowances have been established and must update the applicable utility allowance in accordance with paragraph (c)(1) of this section. The review must take into account any changes to the building such as any energy conservation measures that affect energy consumption and changes in utility rates.

(d) Record retention. The building owner must retain any utility consumption estimates and supporting data as part of the taxpayer's records for purposes of §1.6001-1(a).

[T.D. 8520, 59 FR 10073, Mar. 3, 1994, as amended by T.D. 9420, 73 FR 43867, July 29, 2008]

## Federal Regulations

### Reg § 1.42-11. Provision of services.

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

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

**(b) Services that are optional.**

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

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

*(3) Required services.*

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

(ii) Exceptions.

(A) Supportive services. Section 42(g)(2)(B)(iii) provides an exception for certain fees paid for supportive services. For purposes of section 42(g)(2)(B)(iii), a supportive service is any service provided under a planned program of services designed to enable residents of a residential rental property to remain independent and avoid placement in a

hospital, nursing home, or intermediate care facility for the mentally or physically handicapped. For a building described in section 42(i)(3)(B)(iii) (relating to transitional housing for the homeless) or section 42(i)(3)(B)(iv) (relating to transitional housing for the homeless), a supportive service includes any service provided to assist tenants in locating and retaining permanent housing.

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

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

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## Federal Regulations

### Reg § 1.42-12. Effective dates and transitional rules.

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

**(a) Effective date.** The rules set forth in §§1.42-6 and 1.42-8 through 1.42-12 are effective May 2, 1994. However, binding agreements, election statements, and carryover allocation documents entered into before May 2, 1994, that follow the guidance set forth in Notice 89-1, 1989-1 C.B. 620 (see §601.601(d)(2)(ii)(b) of this chapter) need not be changed to conform to the rules set forth in §§1.42-6 and 1.42-8 through 1.42-12.

**(b) Prior periods.** Notice 89-1, 1989-1 C.B. 620 and Notice 89-6, 1989-1 C.B. 625 (see §601.601(d)(2)(ii)(b) of this chapter) may be applied for periods prior to May 2, 1994.

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

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## Federal Regulations

### **Reg § 1.42-13. Rules necessary and appropriate; housing credit agencies' correction of administrative errors and omissions.**

**(a) Publication of guidance.** Under section 42(n), the Secretary has authority to prescribe regulations as may be necessary or appropriate to carry out the purposes of section 42. The Secretary may also provide guidance through various publications in the Internal Revenue Bulletin. (See §601.601(d)(2)(ii)(b) of this chapter.)

#### **(b) Correcting administrative errors and omissions.**

*(1) In general.* An Agency may correct an administrative error or omission with respect to allocations and recordkeeping, as described in paragraph (b)(2) of this section, within a reasonable period after the Agency discovers the administrative error or omission. Whether a correction is made within a reasonable period depends on the facts and circumstances of each situation. Except as provided in paragraph (b)(3)(iii) of this section, an Agency need not obtain the prior approval of the Secretary to correct an administrative error or omission, if the correction is made in accordance with paragraph (b)(3)(i) of this section. The administrative errors and omissions to which this paragraph (b) applies are strictly limited to those described in paragraph (b)(2) of this section, and, thus, do not include, for example, any misinterpretation of the applicable rules and regulations under section 42. Accordingly, an Agency's allocation of a particular calendar year's low-income housing credit dollar amount made after the close of that calendar year, or the use of an incorrect population amount in calculating a State's housing credit ceiling for a calendar year are not administrative errors that can be corrected under this paragraph (b).

*(2) Administrative errors and omissions described.* An administrative error or omission is a mistake that results in a document that inaccurately reflects the intent of the Agency at the time the document is originally completed or, if the mistake affects a taxpayer, a document that inaccurately reflects the intent of the Agency and the affected taxpayer at the time the document is originally completed. Administrative errors and omissions described in this paragraph (b)(2) include the following—

(i) A mathematical error;

(ii) An entry on a document that is inconsistent with another entry on the same or another document regarding the same property, or taxpayer;

(iii) A failure in tracking the housing credit dollar amount an Agency has allocated (or that remains to be allocated) in the current calendar year (e.g., a failure to include in its State housing credit ceiling a previously allocated credit dollar amount that has been returned by a taxpayer);

(iv) An omission of information that is required on a document; and

(v) Any other type of error or omission identified by guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter) as an administrative error or omission covered by this paragraph (b).

*(3) Procedures for correcting administrative errors or omissions.*

(i) In general. An Agency's correction of an administrative error or omission, as described in paragraph (b)(2) of this section, must amend the document so that the corrected document reflects the original intent of the Agency, or the Agency and the affected taxpayer, and complies with applicable rules and regulations under section 42.

(ii) Specific procedures. If a document corrects a document containing an administrative error or omission that has not yet been filed with the Internal Revenue Service, the Agency, or the Agency and the affected taxpayer, should complete and file the corrected document as the original. When a document containing an administrative error or omission has already been filed with the Service, the Agency, or the Agency and the affected taxpayer, should refile a copy of the document containing the administrative error or omission, and prominently and clearly note the correction thereon or on an attached new document. The Agency should indicate at the top of the document(s) that the correction is being made under §1.42-13 of the Income Tax Regulations.

(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—

(A) Is a numerical change to the housing credit dollar amount allocated for the building or project;

(B) Affects the determination of any component of the State's housing credit ceiling under section 42(h)(3)(C); or

(C) Affects the State's unused housing credit carryover that is assigned to the Secretary under section 42(h)(3)(D).

(iv) Requesting the Secretary's approval. To obtain the Secretary's approval under paragraph (b)(3)(iii) of this section, an Agency must submit a request for the Secretary's approval within a reasonable period after discovering the administrative error or omission, and must agree to any conditions that may be required by the Secretary under paragraph (b)(3)(v) of this section. When requesting the Secretary's approval, the Agency, or the Agency and the affected taxpayer, must file an application that complies with the requirements of this paragraph (b)(3)(iv). For further information on the application procedure see Rev. Proc. 93-1, 1993-1 I.R.B. 10 (or any subsequent applicable revenue procedure). (See §601.601(d)(2)(ii)(b) of this chapter.) The application requesting the Secretary's approval must contain the following information—

(A) The name, address, and identification number of each affected taxpayer;

(B) The Building Identification Number (B.I.N.) and address of each building or project affected by the administrative error or omission;

(C) A statement explaining the administrative error or omission and the intent of the Agency, or of the Agency and the affected taxpayer, when the document was originally completed;

(D) Copies of any supporting documentation;

(E) A statement explaining the effect, if any, that a correction of the administrative error or omission would have on the housing credit dollar amount allocated for any building or project; and

(F) A statement explaining the effect, if any, that a correction of the administrative error or omission would have on the determination of the components of the State's housing credit ceiling under section 42(h)(3)(C) or on the State's unused housing credit carryover that is assigned to the Secretary under section 42(h)(3)(D).

(v) Agreement to conditions. To obtain the Secretary's approval under paragraph (b)(3)(iii) of this section, an Agency, or the Agency and the affected taxpayer, must agree to the conditions the Secretary considers appropriate.

(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 references 8 buildings instead of 10 buildings), or the correct 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 Agencies 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 before 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).

**(c) Examples.** The following examples illustrate the scope of this section:

*Example (1).* Individual B applied to Agency X for a reservation of a low-income housing credit dollar amount for a building that is part of a low-income housing project. When applying for the low-income housing credit dollar amount, B informed Agency X that B intended to form Partnership Y to finance the project. After receiving the reservation letter and prior to receiving an allocation, B formed Partnership Y and sold partnership interests to a number of limited partners. B contributed the low-income housing project to Partnership Y in exchange for a partnership interest. B and Partnership Y informed Agency X of the ownership change. When actually allocating the housing credit dollar amount, Agency X sent Partnership Y a document listing B, rather than Partnership Y, as the building's owner. Partnership Y promptly notified Agency X of the error. After reviewing related documents, Agency X determined that it had incorrectly listed B as the building's owner on the allocation document. Since the parties

originally intended that Partnership Y would receive the allocation as the owner of the building, Agency X may correct the error without obtaining the Secretary's approval, and insert Partnership Y as the building's owner on the allocation document.

*Example (2).* Agency Y allocated a lower low-income housing credit dollar amount for a low-income housing building than Agency Y originally intended. After the close of the calendar year of the allocation, B, the building's owner, discovered the error and promptly notified Agency Y. Agency Y reviewed relevant documents and agreed that an error had occurred. Agency Y and B must apply, as provided in paragraph (b)(3)(iv) of this section, for the Secretary's approval before Agency Y may correct the error.

**(d) Effective date.** This section is effective February 24, 1994. However, an Agency may elect to apply these regulations to administrative errors or omissions that occurred before the publication of these regulations. Any reasonable method used by a State or local housing credit agency to correct an administrative error or omission prior to February 24, 1994, will be considered proper, provided that the method is consistent with the rules of section 42. Paragraphs (b)(3)(vi), (vii), and (viii) of this section are effective January 14, 2000.

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T.D. 8521, 2/23/94, amend T.D. 8859, 1/13/2000.

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## Federal Regulations

### Reg § 1.42-14. Allocation rules for post-1989 State housing credit ceiling amounts.

**Caution:** The Treasury has not yet amended Reg § 1.42-14 to reflect changes made by P.L. 106-554

**(a) In general.** The State housing credit ceiling for a State for any calendar year after 1989 is comprised of four components. The four components are—

- (1) \$1.25 multiplied by the State population (the population component);
- (2) The unused State housing credit ceiling, if any, of the State for the preceding calendar year (the unused carryforward component);
- (3) The amount of State housing credit ceiling returned in the calendar year (the returned credit component); plus
- (4) The amount, if any, allocated to the State by the Secretary under section 42(h)(3)(D) from a national pool of unused credit (the national pool component).

**(b) The population component.** The population component of the State housing credit ceiling of a State for any calendar year is determined pursuant to section 146(j). Thus, a State's population for any calendar year is determined by reference to the most recent census estimate, whether final or provisional, of the resident population of the State released by the Bureau of the Census before the beginning of the calendar year for which the State's housing credit ceiling is set. Unless otherwise prescribed by applicable revenue procedure, determinations of population are based on the most recent estimates of population contained in the Bureau of the Census publication, *Current Population Report, Series P-25; Population Estimates and Projections, Estimates of the Population of States*. For convenience, the Internal Revenue Service publishes the population estimates annually in the Internal Revenue Bulletin. (See §601.601(d)(2)(ii)(b)).

**(c) The unused carryforward component.** The unused carryforward component of the State housing credit ceiling of a State for any calendar year is the excess, if any, of the sum of the population and returned credit components, over the aggregate housing credit dollar amount allocated for the year. Any credit amounts attributable to the national pool component of the State housing credit ceiling that remain unallocated at the close of a calendar year are not carried forward to the succeeding calendar year; instead, the credit expires and cannot be reallocated by any Agency.

**(d) The returned credit component.**

*(1) In general.* The returned credit component of the State housing credit ceiling of a State for any calendar year equals the housing credit dollar amount returned during the calendar year that was validly allocated within the State in a prior calendar year to any project that does not become a qualified low-income housing project within the period required by section 42, or as required by the terms of the allocation. The returned credit component also includes credit allocated in a prior calendar year that is returned as a result of the cancellation of an allocation by mutual consent or by an Agency's determination that the amount allocated is not necessary for the financial feasibility of the project. For purposes of this section, credit is allocated within a State if it is allocated from the State's housing credit ceiling by an Agency of the State or of a constitutional home rule city in the State.

*(2) Limitations and special rules.* The following limitations and special rules apply for purposes of this paragraph (d).

(i) General limitations. Notwithstanding any other provision of this paragraph (d), returned credit does not include any credit that was—

(A) Allocated prior to calendar year 1990;

(B) Allowable under section 42(h)(4) (relating to the portion of credit attributable to eligible basis financed by certain tax-exempt bonds under section 103); or

(C) Allocated during the same calendar year that it is received back by the Agency.

(ii) Credit period limitation. Notwithstanding any other provision of this paragraph (d), an allocation of credit may not be returned any later than 180 days following the close of the first taxable year of the credit period for the building that received the allocation. After this date, credit that might otherwise be returned expires, and cannot be returned to or reallocated by any Agency.

(iii) Three-month rule for returned credit. An Agency may, in its discretion, treat any portion of credit that is returned from a project after September 30 of a calendar year and that is not reallocated by the close of the calendar year as returned on January 1 of the succeeding calendar year. In this case, the returned credit becomes part of the returned credit component of the State housing credit ceiling for the succeeding calendar year. Any portion of credit that is returned from a project after September 30 of a calendar year that is reallocated by the close of the calendar year is treated as

part of the returned credit component of the State housing credit ceiling for the calendar year that the credit was returned.

(iv) Returns of credit. Subject to the limitations of paragraphs (d)(2)(i) and (ii) of this section, credit is returned to the Agency in the following instances in the manner described in paragraph (d)(3) of this section.

(A) Building not qualified within required time period. If a building is not a qualified building within the time period required by section 42, it loses its credit allocation and the credit is returned. For example, a building is not qualified within the required time period if it is not placed in service within the period required by section 42 or if the project of which the building is a part fails to meet the minimum set-aside requirements of section 42(g)(1) by the close of the first year of the credit period.

(B) Noncompliance with terms of the allocation. If a building does not comply with the terms of its allocation, it loses the credit allocation and the credit is returned. The terms of an allocation are the written conditions agreed to by the Agency and the allocation recipient in the allocation document.

(C) Mutual consent. If the Agency and the allocation recipient cancel an allocation of an amount of credit by mutual consent, that amount of credit is returned.

(D) Amount not necessary for financial feasibility. If an Agency determines under section 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, that amount of credit is returned.

*(3) Manner of returning credit.*

(i) Taxpayer notification. After an Agency determines that a building or project no longer qualifies under paragraph (d)(2)(iv)(A), (B), or (D) of this section for all or part of the allocation it received, the 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 to the Agency. If

an allocation is cancelled by mutual consent under paragraph (d)(2)(iv)(C) of this section, there must be a written agreement signed by the Agency, and the allocation recipient, or its successor in interest, indicating the amount of the allocation that is returned to the Agency. The effective date of the agreement is the date the credit is returned to the Agency.

(ii) Internal Revenue Service notification. 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 paragraph (d)(2)(ii) of this section, and a Form 8609, *Low-Income Housing Credit Allocation Certification*, has been issued for the building, the 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 Agency attaches to an amended Form 8610, *Annual Low-Income Housing Credit Agencies Report*, the original of an amended Form 8609 reflecting the correct amount of credit attributed to the building together with an explanation for the filing of the amended Forms. The Agency must send a copy of the amended Form 8609 to the taxpayer that owns 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 in §1.42-5(e)(3) for filing a Form 8823, *Low-Income Housing Credit Agencies Report of Noncompliance*.

**(e) The national pool component.** The national pool component of the State housing credit ceiling of a State for any calendar year is the portion of the National Pool allocated to the State by the Secretary for the calendar year. The national pool component for any calendar year is zero unless a State is a qualified State. (See paragraph (i) of this section for rules regarding the National Pool and the description of a qualified State.) Credit from the national pool component of a State housing credit ceiling must be allocated prior to the close of the calendar year or the credit expires and cannot be reallocated by any Agency. A national pool component credit that is allocated during a calendar year and returned after the close of the calendar year may qualify as part of the returned credit component of the State housing credit ceiling for the calendar year that the credit is returned.

**(f) When the State housing credit ceiling is determined.** For purposes of accounting for the State housing credit ceiling on Form 8610 and for purposes of determining the set-aside apportionment for projects involving qualified nonprofit organizations described in section 42(h)(5) and §1.42-1T(c)(5), the State housing credit ceiling for any calendar year is determined at the close of the calendar year.

**(g) Stacking order.** Under section 42(h)(3)(C), credit is treated as allocated from the various components of the State housing credit ceiling in the following order. The first credit allocated for any calendar year is treated as credit from the sum of the population and returned credit components of the State housing credit ceiling. Once all of the credit in these components has been allocated, the next credit allocated is treated as credit from the unused carryforward component of the State housing credit ceiling. Finally, after all of the credit from the population component, returned credit component, and unused carryforward component has been allocated, any further credit allocated is treated as credit from the national pool component.

**(h) Nonprofit set-aside.**

*(1) Determination of set-aside.* Under section 42(h)(5) and §1.42-1T(c)(5), at least 10 percent of a State housing credit ceiling in any calendar year must be set aside exclusively for projects involving qualified nonprofit organizations (the nonprofit set-aside). However, credit allocated from the nonprofit set-aside in a calendar year and returned in a subsequent calendar year does not retain its nonprofit set-aside character. The credit becomes part of the returned credit component of the State housing credit ceiling for the calendar year that the credit is returned and must be included in determining the nonprofit set-aside of the State housing credit ceiling for that calendar year. Similarly, credit amounts that are not allocated from the nonprofit set-aside in a calendar year and are returned in a subsequent calendar year become part of the returned credit component of the State housing credit ceiling for that year and are also included in determining the set-aside for that year.

*(2) Allocation rules.* An Agency may allocate credit from any component of the State housing credit ceiling as part of the nonprofit set-aside and need not reserve 10 percent of each component for the nonprofit set-aside. Thus, an Agency may satisfy the nonprofit set-aside requirement of section 42(h)(5) and §1.42-1T(c)(5) in any calendar year by setting aside for allocation an amount equal to at least 10 percent of the total State housing credit ceiling for the calendar year.

**(i) National Pool.**

*(1) In general.* The unused housing credit carryover of a State for any calendar year is assigned to the Secretary for inclusion in a national pool of unused housing credit carryovers (National Pool) that is reallocated among qualified States the succeeding calendar year. The assignment to the Secretary is made on Form 8610.

*(2) Unused housing credit carryover.* The unused housing credit carryover of a State for any calendar year is the excess, if any, of the unused

carryforward component of the State housing credit ceiling for the calendar year over the excess, if any, of—

(i) The total housing credit dollar amount allocated for the year; over

(ii) The sum of the population and returned credit components of the State housing credit ceiling for the year.

*(3) Qualified State.*

(i) In general. The term qualified State means, with respect to any calendar year, any State that has allocated its entire State housing credit ceiling for the preceding calendar year and for which a request is made by the State, not later than May 1 of the calendar year, to receive an allocation of credit from the National Pool for that calendar year. Except as provided in paragraph (i)(3)(ii) of this section, a State is not a qualified State in a calendar year if there remains any unallocated credit in its State housing credit ceiling at the close of the preceding calendar year that was apportioned to any Agency within the State for the calendar year.

(ii) Exceptions.

(A) De minimis amount. If the amount remaining unallocated at the close of a calendar year is only a de minimis amount of credit, the State is a qualified State eligible to participate in the National Pool. For that purpose, a credit amount is de minimis if it does not exceed 1 percent of the aggregate State housing credit ceiling of the State for the calendar year.

(B) Other circumstances. Pursuant to the authority under section 42(n), the Internal Revenue Service may determine that a State is a qualified State eligible to participate in the National Pool even though the State's unallocated credit is in excess of the 1 percent safe harbor set forth in paragraph (A) of this section. The Internal Revenue Service will make this determination based on all the facts and circumstances, weighing heavily the interests of the States who would otherwise qualify for the National Pool. The Internal Revenue Service will generally grant relief under this paragraph only where a State's unallocated credit is not substantial.

(iii) Time and manner for making request. For further guidance as to the time and manner for making a request of housing credit dollar amounts from the National Pool by a qualified State, see Rev. Proc. 92-31, 1992-1 C.B. 775. (See 601.601(d)(2)(ii)(b)).

(4) *Formula for determining the National Pool.* The amount allocated to a qualified State in any calendar year is an amount that bears the same ratio to the aggregate unused housing credit carryovers of all States for the preceding calendar year as that State's population for the calendar year bears to the population of all qualified States for the calendar year.

**(j) Coordination between Agencies.** The Agency responsible for filing Form 8610 on behalf of all Agencies within a State and making any request on behalf of the State for credit from the National Pool (the Filing Agency) must coordinate with each Agency within the State to ensure that the various requirements of this section are complied with. For example, the Filing Agency of a State must ensure that all Agencies within the State that were apportioned a credit amount for the calendar year have allocated all of their respective credit amounts for the calendar year before the Filing Agency can make a request on behalf of the State for a distribution of credit from the National Pool.

**(k) Examples.**

(1) The operation of the rules of this section may be illustrated by the following examples. Unless otherwise stated in an example, Agency A is the sole Agency authorized to make allocations of housing credit dollar amounts in State M, all of Agency A's allocations are valid, and for calendar year 1994 Agency A has available for allocation a State housing credit ceiling consisting of the following housing credit dollar amounts:

A. population component:	\$ 100
B. unused carryforward component	\$ 50
C. returned credit component	\$ 10
D. national pool component	\$ 0
Total	<hr/> \$ 160

(2) In addition, the \$10 of returned credit component was returned before October 1, 1994.

*Example (1).* (i) Additional facts. By the close of 1994, Agency A had allocated \$80 of the State M housing credit ceiling. Of the \$80 allocated, \$16 was allocated to projects involving qualified nonprofit organizations.

(ii) Application of stacking rules. The first credit allocated is treated as allocated from the population and returned credit components of the State housing credit ceiling, to the extent of those components. In this case, the \$80 of credit allocated is less than the sum of the population and returned credit components. The excess of the sum of the population and returned credit components over the total amount allocated for the calendar year ( $\$110 - 80 = \$30$ ) becomes the unused carryforward component of State M's 1995 State housing credit ceiling. Because Agency A did not allocate credit in excess of the sum of the population and returned credit components, no credit is treated as allocated from State M's \$50 unused carryforward component in 1994. Because none of this component may be carried forward, all \$50 is assigned to the Secretary for inclusion in the National Pool. Under paragraph (i)(3) of this section, State M does not qualify for credit from the National Pool for the 1995 calendar year.

(iii) Nonprofit set-aside. Agency A allocated exactly the amount of credit to projects involving qualified nonprofit organizations as necessary to meet the nonprofit set-aside requirement (\$16, 10% of the \$160 ceiling).

*Example (2).* (i) Additional facts. By the close of 1994, Agency A had allocated \$130 of the State M housing credit ceiling. Of the \$130 allocated, \$20 was allocated to projects involving qualified nonprofit organizations.

(ii) Application of stacking rules. The first \$110 of credit allocated is treated as allocated from the population and returned credit components. In this case, because all of the population and returned credit components are allocated, no amount is included in State M's 1995 State housing credit ceiling as an unused carryforward component. The next \$20 of credit allocated is treated as allocated from the \$50 unused carryforward component. The \$30 remaining in the unused carryforward component is assigned to the Secretary for inclusion in the National Pool for the 1995 calendar year. Under paragraph (i)(3) of this section, State M does not qualify for credit from the National Pool for the 1995 calendar year.

(iii) Nonprofit set-aside. Agency A allocated \$4 more credit to projects involving qualified nonprofit organizations than necessary to meet the nonprofit set-aside requirement. This does not reduce the application of the 10% nonprofit set-aside requirement to the State M housing credit ceiling for the succeeding year.

*Example (3).* (i) Additional fact. None of the applications for credit that Agency A received for 1994 are for projects involving qualified nonprofit organizations.

(ii) Nonprofit set-aside. Because at least 10% of the State housing credit ceiling must be set aside for projects involving a qualified nonprofit organization, Agency A can allocate only \$144 of the \$160 State housing credit ceiling for calendar year 1994 ( $\$160 - 16 = \$144$ ). If Agency A allocates \$144 of credit, the credit is treated as allocated \$110 from the population and returned credit components and \$34 from the unused carryforward component. The \$16 of unallocated credit that is set aside for projects involving qualified nonprofit organizations is treated as the balance of the unused carryforward component, and is assigned to the Secretary for inclusion in the National Pool. Under paragraph (i)(3) of this section, State M does not qualify for credit from the National Pool for the 1995 calendar year.

*Example (4).* (i) Additional facts. The \$10 of returned credit component was returned prior to October 1, 1994. However, a \$40 credit that had been allocated in calendar year 1993 to a project involving a qualified nonprofit organization was returned to the Agency by a mutual consent agreement dated November 15, 1994. By the close of 1994, Agency A had allocated \$160 of the State M housing credit ceiling, including \$16 of credit to projects involving qualified nonprofit organizations.

(ii) Effect of three-month rule. Under the three-month rule of paragraph (d)(2)(iii) of this section, Agency A may treat all or part of the \$40 of previously allocated credit as returned on January 1, 1995. If Agency A treats all of the \$40 amount as having been returned in calendar year 1995, the State M housing credit ceiling for 1994 is \$160. This entire amount, including the \$16 nonprofit set-aside, has been allocated in 1994. Under paragraph (i)(3) of this section, State M qualifies for the National Pool for the 1995 calendar year.

(iii) If three-month rule not used. If Agency A treats all of the \$40 of previously allocated credit as returned in calendar year 1994, the State housing credit ceiling for the 1994 calendar year will be \$200 of which \$50 will be attributable to the returned credit component ( $\$10 + \$40 = \$50$ ). Because credit amounts allocated in a prior calendar year that are returned in a subsequent calendar year do not retain their nonprofit character, the nonprofit set-aside for calendar year 1994 is \$20 (10% of \$200). The \$160 that Agency A allocated during 1994 is first treated as allocated from the population and returned credit components, which total \$150. The next \$10 of credit allocated is treated as allocated from the unused carryforward component. The \$40 of unallocated credit from the unused carryforward component includes the \$4 of unallocated nonprofit set-aside. The entire \$40 of credit from the carryforward component is assigned to the Secretary for inclusion in the National Pool for the 1995 calendar year. State M does not qualify for credit from the National Pool for the 1995 calendar year.

*Example (5).* (i)(A) Additional facts. For calendar year 1994, Agency A has a State housing credit ceiling that consists of the following housing credit dollar amounts:

A. population component:	\$ 100
B. unused carryforward component:	\$ 0
C. returned credit component:	\$ 20
D. national pool component:	\$ 10
Total	\$ 130
Minimum nonprofit set-aside	\$ 13
Ceiling amount not set-aside	\$ 117

(B) In addition, the \$20 of returned credit component was returned before October 1, 1994. By the close of 1994, Agency A had allocated \$100 of the State housing credit ceiling.

(ii) Application of stacking rules. The \$20 excess of the sum of the population component and the returned credit component over the total amount allocated for the calendar year ( $\$120 - 100 = \$20$ ) becomes the unused carryforward component of the State housing credit ceiling for the 1995 calendar year. The \$10 of unallocated credit from the national pool component expires and cannot be reallocated. This amount is neither carried over to 1995 by State M nor assigned to the Secretary for inclusion in the National Pool. Under paragraph (i)(3) of this section, State M does not qualify for credit from the National Pool for the 1995 calendar year.

**(l) Effective date.** The rules set forth in §1.42-14 are effective January 1, 1994.

## Federal Regulations

### Reg § 1.42-15. Available unit rule.

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

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

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

**(c) Exception.** A unit ceases to be treated as a low-income unit if it becomes an over-income unit and a nonqualified resident occupies any comparable unit that is available or that subsequently becomes available in the same low-income building. In other words, the owner of a low-income building must rent to qualified residents all comparable units that are available or that subsequently become available in the same building to continue treating the over-income unit as a low-income unit. Once the percentage of low-income units in a building (excluding the over-income units) equals the percentage of low-income units on

which the credit is based, failure to maintain the over-income units as low-income units has no immediate significance. The failure to maintain the over-income units as low-income units, however, may affect the decision of whether or not to rent a particular available unit at market rate at a later time. A unit is not available for purposes of the available unit rule when the unit is no longer available for rent due to contractual arrangements that are binding under local law (for example, a unit is not available if it is subject to a preliminary reservation that is binding on the owner under local law prior to the date a lease is signed or the unit is occupied).

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

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

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

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

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

*Example (1).* This example illustrates noncompliance with the available unit rule in a low-income building containing three over-income units. On January 1, 1998, a qualified low-income housing project, consisting of one building containing ten identically sized residential units, received a housing credit dollar amount allocation from a state housing credit agency for five low-income units. By the close of 1998, the first year of the credit period, the project satisfied the minimum set-aside requirement of section 42(g)(1)(B). Units 1, 2, 3, 4, and 5 were occupied by individuals whose incomes did not exceed the income limitation applicable under section 42(g)(1) and were otherwise low-income residents under section 42. Units 6, 7, 8, and 9 were occupied by market-rate tenants. Unit 10 was vacant. To

avoid recapture of credit, the project owner must maintain five of the units as low-income units. On November 1, 1999, the certificates of annual income state that annual incomes of the individuals in Units 1, 2, and 3 increased above 140 percent of the income limitation applicable under section 42(g)(1), causing those units to become over-income units. On November 30, 1999, Units 8 and 9 became vacant. On December 1, 1999, the project owner rented Units 8 and 9 to qualified residents who were not current residents at rates meeting the rent restriction requirements of section 42(g)(2). On December 31, 1999, the project owner rented Unit 10 to a market-rate tenant. Because Unit 10, an available comparable unit, was leased to a market-rate tenant, Units 1, 2, and 3 ceased to be treated as low-income units. On that date, Units 4, 5, 8, and 9 were the only remaining low-income units. Because the project owner did not maintain five of the residential units as low-income units, the qualified basis in the building is reduced, and credit must be recaptured. If the project owner had rented Unit 10 to a qualified resident who was not a current resident, eight of the units would be low-income units. At that time, Units 1, 2, and 3, the over-income units, could be rented to market-rate tenants because the building would still contain five low-income units.

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

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

## Federal Regulations

### Reg § 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;

(2) A qualifying program of rental assistance administered under section 9 of the United States Housing Act of 1937; 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.

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T.D. 8731, 9/25/97.

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## Federal Regulations

### Reg § 1.42-17. Qualified allocation plan.

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

#### (a) Requirements.

(1) *In general.* [Reserved]

(2) *Selection criteria.* [Reserved]

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

(i) The sources and uses of funds and the total financing planned for the project. The taxpayer must certify to the Agency the full extent of all federal, state, and local subsidies that apply (or which the taxpayer expects to apply) to the project. The taxpayer must also certify to the Agency all other sources of funds and all development costs for the project. The taxpayer's certification should be sufficiently detailed to enable the Agency to ascertain the nature of the costs that will make up the total financing package, including subsidies and the anticipated syndication or placement proceeds to be raised. Development cost information, whether or not includible in eligible basis under section 42(d), that should be provided to the Agency includes, but is not limited to, site acquisition costs, construction contingency, general contractor's overhead and profit, architect's and engineer's fees, permit and survey fees, insurance premiums, real estate taxes during construction, title and recording fees, construction period interest, financing fees, organizational costs, rent-up and marketing costs, accounting and auditing costs, working capital and operating deficit reserves, syndication and legal fees, and developer fees;

(ii) Any proceeds or receipts expected to be generated by reason of tax benefits;

(iii) The percentage of the housing credit dollar amount used for project costs other than the costs of intermediaries. This requirement should not be applied so as to impede the development of projects in hard-to-develop areas under section 42(d)(5)(C); and

(iv) The reasonableness of the developmental and operational costs of the project.

*(4) Timing of Agency evaluation.*

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

(A) The time of the application for the housing credit dollar amount;

(B) The time of the allocation of the housing credit dollar amount; and

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

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

*(5) Special rule for final determinations and certifications.* For the Agency's evaluation under paragraph (a)(4)(i)(C) of this section, the taxpayer must submit a schedule of project costs. Such schedule is to be prepared on the method of accounting used by the taxpayer for federal income tax purposes, and must detail the project's total costs as well as those costs that may qualify for inclusion in eligible basis under section 42(d). For projects with more than 10 units, the schedule of project costs must be accompanied by a Certified Public Accountant's audit report on the schedule (an Agency may require an audited schedule of project costs for projects with fewer than 11 units). The CPA's audit must be conducted in accordance with generally accepted auditing standards. The auditor's report must be unqualified.

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

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

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

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